THE INTRODUCTION OF COLLECTIVE ACTION CLAUSES IN UMS’S BONDS
## Agenda

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Mexico’s Collective Action Clauses

Introduction

Mexico’s adoption of CACs has added practical experience to theoretical debate over reforms of the international financial architecture.

Goal of this presentation:

- To share Mexico’s experience to shed light on debate over financial reform
- To highlight important practical considerations Mexico confronted
- To contrast evolution of Mexican CAC bonds vs Non-CAC bonds

Practical considerations encouraged us to proceed cautiously.
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Why did Mexico decide to include CACs?

Mexico is better off if the sovereign bond market works well.

Since late 1990’s, market participants have had serious concerns about the sovereign bond market

– How would a restructuring unfold?
– What role would official creditors play?

Even though Mexico’s creditworthiness is strong, lack of confidence in the sovereign bond market harms Mexico indirectly
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Why did Mexico decide to include CACs?

Confidence would not be restored by an SDRM

− Design and ratification of SDRM would take a long time
− Investors would have doubts about role of supernational authority

“Contractual” approach does not create such concerns

− A large set of bonds already includes CACs
− Many examples of corporate bond restructurings with CACs
− Fundamental legal framework preserved

Mexico has an interest in seeing market evolve in the direction of the contractual approach
Mexico’s Collective Action Clauses
Why did Mexico move first?

Risk that no other sovereign issuer would move
  − Uncertainties would linger

Risk that another sovereign issuer would set a precedent
  − By moving first, we could design clauses most appropriate for Mexico

Little risk that Mexico would pay a premium for CACs
  − Mexico’s investment-grade status
  − Our CACs, on balance, left investors no worse and, perhaps, better off
Mexico’s Collective Action Clauses
What clauses to include?

A 75% threshold for changing most important bond terms appropriate
– Especially as threshold applies bond-by-bond rather than across all bonds

A higher threshold for important non-payment terms
– Threshold raised from 2/3rds to 75% to amend important non-payment terms
– Address bondholder concerns about “coercive” exchange

A wider definition of excluded bonds
– Bonds owned or controlled, directly or indirectly, by UMS are excluded from voting
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What clauses to exclude?

No aggregation mechanism

- We support the principle that material changes to bonds should require super-majority consent of holders of all affected bonds
- Prefer simpler approach.
- Misgivings about principle of aggregation, especially across different classes of creditors (e.g., bondholders, commercial bank lenders, official creditors)

No contractual obligation to provide economic/financial information

- Mexico is committed to transparency, and supplies information according to IMF’s SDDS
- But we believe market works better when issuers can choose whether or not to be transparent
- Do not want to preclude providing better information that might not conform to SDDS
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How Did Mexico Introduce the CACs?

The new changes were presented as part of new documentation.

Mexico was sensitive to complaints that we were acting unilaterally:

- Public deliberations over CACs would have taken time to complete, with no guarantee of a balanced package of clauses.
- Private negotiations with a small number of investors would have furnished some investors with material non-public information.
- Investor groups had already made their positions known, with considerable precision.
- We relied on the advice of our legal counsel and our underwriters.
Mexico’s Collective Action Clauses

How Did Mexico Market the New Bond?

Marketing goals

− Place the bond as efficiently as possible, minimizing Mexico’s cost of funds

12-year maturity

− Appealed to heart of high-grade investor community, an important constituency for Mexico

− Did not compete directly with recently issued 10-year bond

Extended marketing period

− Mexico endeavored to provide investors with enough time to study CACs

− But did not want to take too much market risk, given bond-market volatility

− We formally launched and priced once we received a critical mass of positive feedback
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The composition of UMS’s investor base was not affected by the introduction of CACs

**UMS bonds with Collective Action Clauses - Distribution by investor type**

- **UMS ’08 (Issued 4/8/03)**
  - Asset Manager: 67%
  - Insurance: 10%
  - Hedge Fund: 11%
  - Bank: 11%
  - Pension Fund: 1%
  - Source: JPMorgan

- **UMS ’15 (Issued 2/26/03)**
  - Asset Manager: 53%
  - Insurance: 21%
  - Hedge Fund: 9%
  - Bank/Retail: 12%
  - Pension Fund: 5%
  - Source: JPMorgan

- **UMS ’33 (Issued 4/8/03)**
  - Asset Manager: 58%
  - Insurance: 20%
  - Hedge Fund: 10%
  - Bank: 10%
  - Pension Fund: 2%
  - Source: JPMorgan

**UMS bonds without Collective Action Clauses - Distribution by investor type**

- **UMS ’11 (Issued 1/8/01)**
  - Asset Manager: 59%
  - Insurance: 18%
  - Hedge Fund: 9%
  - Bank/Retial: 11%
  - Pension Fund: 3%
  - Source: JPMorgan

- **UMS ’13 (Issued 1/9/03)**
  - Asset Manager: 47%
  - Insurance: 25%
  - Hedge Fund: 8%
  - Bank/Retail: 16%
  - Pension Fund: 4%
  - Source: JPMorgan

- **UMS ’22 (Issued 9/17/02)**
  - Asset Manager: 40%
  - Insurance: 38%
  - Bank/Retail: 10%
  - Pension Fund: 3%
  - Hedge Fund: 9%
  - Source: JPMorgan

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The over-subscription of the new bonds with CACs was in line with previous issues.

Source: JPMorgan
The UMS 2015 was priced tight relative to UMS’s existing curve
The UMS 2008 and 2033 were priced tight relative to UMS’s existing curve.
The UMS benchmark bonds with CACs trade in line or slightly through UMS’s yield curve.

Source: JPMorgan
The UMS 2015 pricing looks tight to the curve also when regressing only the bonds in that sector of the curve.

Source: JPMorgan
Pricing of the UMS ‘08 was in line with the short/middle sector of the curve
Pricing of the UMS ‘33 was in line with the long sector of the curve
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Performance of the new UMS 15

Spread Evolution - Feb 26 = 100

Price Evolution, Feb 26 = 100

Source: JPMorgan
Dotted lines denote bond with CACs

Source: JPMorgan
Dotted lines denote bonds with CACs
Performance of the new UMS 08

Spread Evolution - Apr 8 = 100

Price Evolution, Apr 8 = 100

Source: JPMorgan
Dotted lines denote bond with CACs

Source: JPMorgan
Dotted lines denote bonds with CACs
Performance of the new UMS 33

Spread Evolution - Apr 8 = 100

Price Evolution, Apr 8 = 100

Source: JPMorgan
Dotted lines denote bond with CACs
On a relative basis, the UMS bonds with CACs have outperformed the other bonds since February 26.
On a relative basis, the UMS bonds with CACs have outperformed the other bonds on the curve since April 8.

Spread Change Since the Date of pricing of the UMS 2008 and 2033 (April 8) - (bps)

- Source: JPMorgan
- Dotted line denotes average spread change of UMS bonds without CACs
- As of June 3, 2003