BRADY BOND CONCEPT SUMMARY[1]

"Brady Bond" is the name of a financial device used to resolve severe debt problems of certain countries in the 1980's. The situations were is some important ways parallel to that of the energy sector in Georgia. Thus, a similar device might help resolve the problem here. About 15 nations eventually used Brady Bonds, each with its own variation on the pattern based on the specific facts of the country and the interests being negotiated. The Brady Bonds of at least 6 countries are still trading (see web references at the end of this note). .

The typical condition which a Brady Bond resolved was as follows. Many commercial loans had been made to diverse borrowers in a country, by foreign commercial banks, usually denominated in dollars. As a result of domestic policy of the Government, perhaps funding their budget by inflation instead of taxation, the currency suffered severe devaluation. This left the private commercial borrowers in the country unable to pay their debt in dollars. Even if the creditors had wished to foreclose on the debtors and take or sell their assets there were simply insufficient assets to cover the debts. And, with the concurrent currency crisis, the national Government also quickly risked insolvency. Thus it was necessary to restructure the debts in some credible form, while also making the government solvent and its own bond ratings acceptable.

This is not an exact parallel to the condition of Georgian energy sector, but many of the elements are present: large current debts, insufficient security to cover them in foreclosure, it is highly improbable to sell the companies in their financial condition, and there is belief that government policies had to some large degree caused the problem.

The Brady Bond resolved these situations. The following are typical elements of the restructure leading to issue of a Brady Bond. The creditors together with the Government and the debtors, agreed to write down the face amounts of the debts, to some fraction of their original value; say, 50%. Second, it was agreed that these debts, whatever their original terms or current status, would be repaid over a fixed longer term, say 15 or 20 years, at some agreed manageable interest rate and principal repayment schedule. Third, the bonds became Government instruments; that is, while payments might be made on them by the original debtors, the instrument called the "Brady Bond" traded as a Government issued security. The original creditors then received these Brady Bonds, as full payment of and in proportion to their original claims, and were free to trade them on ordinary bond markets.

The payments of the Brandy Bond were secured by three concurrent devices. First, the creditors made payments against the renegotiated amounts due as agreed in the restructure. Second, the Government guaranteed those payments. But, third, the subtle part: as assurance of those payments, the Government also purchased a security which was deposited in escrow, assuring payment. Typically that security was a zero-coupon bond issued by the US treasury, for the specific purpose, and purchased by the local Government. Thus, rather than the local Government itself paying on the bonds (thus making them a current obligation from their budget) the Government bought an asset, the zero coupon bond, and pledged that as assurance of payment of the tradable Brady Bonds. Thus, if at term of the zero coupon bond, there was no default, the local Government received its asset, the full value of the zero coupon bond at its term.

Lets put this into a package. Assume the original debt were $200, which was written down to $100, then spread over a payment term of 20 years at x interest rate. Thus the terms of the Brady Bond are to pay $100 over 20 years at x percent. This is a Government of Georgia bond that trades on the normal securities markets. Assume that this Brady Bond says the Government of Georgia will secure the full face amount of that Bond with an escrow deposit of a zero coupon bond. The purchase price for a zero coupon bond that pays $100 at term, in 20 years, as say 7 percent is about $25. Thus, using this device, the Government of Georgia eliminates $200 of current debt of

[1] Note created by Paul Ballonoff, Chief of Party for CORE International, on Request of Minister of Energy Nika Gilauri.

enterprises, but pays nothing to the creditors; instead, the Government of Georgia actually buys an asset, the aero coupon security, whose full value is paid to the Government of Georgia at its term, if the conditions of payment on the Brady Bond are met. Also, no foreign government pay the loans from its budget either; the zero coupon security was actually a loan from the Government of Georgia to that of the issuing central bank (say, the US Treasury).

Clearly, part of this structure was the willingness of the US Treasury to issue (sell) the zero coupon security on sufficiently favorable terms. To achieve this, since part of the cause of the crisis was typically government over spending, the US Treasury, or whatever was the issuer, sought "conditionalities" typically on fiscal on policy changes by the local Government.

In the case of Georgia, the underlying repayment of the bond would probably be by the soon to be privatized distribution company(ies). Then very probably, the conditions that would be sought to issue (sell) the zero coupon security would be assurances on the process of sale and quality of eventual buyer, and perhaps others, such as to assure ability of the companies to collect from customers. The negotiation process in Georgia might be somewhat simpler than in many earlier countries, since most of the creditors are Georgian government or Government owned entities. When necessary in other countries, legal devices (new laws) were used to give incentives to both creditors and debtors to negotiate in the fixed term allowed to complete the restructure.

The above outlines the general structure. In each situation all of the parameters of the above structure would be subject to negotiation in the process of creating the Brady Bonds.

As well, in Georgia, the willingness of a major Central Bank to issue the zero coupon securities, (and the conditionalities they sought in that process) would probably be a very strong factor in securing the confidence of credible buyers for the companies being privatized.

See also for example:
Brady Bond Definition: http://www.investorwords.com/567/Brady_bond.html
Brady Bond Primer: http://www.emgmkts.com/research/bradydef.htm
Some Current Trading Prices: http://www.emgmkts.com/pricing/latinbradys.htm