

## THE BRADY PLAN

The Brady Plan, the principles of which were first articulated by U.S. Treasury Secretary Nicholas F. Brady in March 1989, was designed to address the so-called LDC debt crisis of the 1980's. The debt crisis began in 1982, when a number of countries, primarily in Latin America, confronted by high interest rates and low commodities prices, admitted their inability to service hundreds of billions of dollars of their commercial bank loans. Because many of these countries' economies were then dependent on commercial bank financing, continued debt reschedulings and the resulting perception of uncreditworthiness led to a "lost decade" of economic stagnation, during which voluntary international credit and capital flows to these nations and their private sectors all but halted.

From 1982 through 1988, debtor nations and their commercial bank creditors engaged in repeated rounds of rescheduling and restructuring sovereign and private sector debt, in the belief that the difficulty these nations experienced in meeting their debt obligations was a temporary phenomenon that would end as the debtor nations' economies rebounded. However, by the time the Brady Plan was announced, it was widely believed that most debtor nations were no closer to financial health than they had been in 1982, that many loans would never be entirely repaid, and that some form of substantial debt relief was necessary for these nations and their fragile economies to resume growth and to regain access to the global capital markets.

The basic tenets of the Brady Plan were relatively simple and were derived from common practices in domestic U.S. corporate work-out transactions: (1) bank creditors would grant debt relief in exchange for greater assurance of collectability in the form of principal and interest collateral; (2) debt relief needed to be linked to some assurance of economic reform and (3) the resulting debt should be more highly tradable, to allow creditors to diversify risk more widely throughout the financial and investment community.

Because the rescheduling process evolved on a case-by-case basis, each Brady issue is unique, but most Brady restructurings included at least two basic options for debt holders: the exchange of loans for either Par Bonds or Discount Bonds. Par Bonds represent an exchange of loans for bonds of equal face amount, with a fixed, below-market rate of interest, allowing for long-term debt service reduction by means of concessionary interest terms. Discount Bonds represent an exchange of loans for a lesser amount of face value in bonds (generally a 30-50% discount), allowing for immediate debt reduction, with a market-based floating rate of interest. The principal of both Par and Discount Bonds was secured at final maturity by a pledge of zero-coupon instruments which, in the case of Par and Discount Bonds denominated in U.S. dollars, are U.S. Treasury securities. A portion of the interest payable on Par and Discount Bonds (generally from 12 to 24 months coverage) was also secured by the pledge of high-grade investment securities.

While both Par and Discount Bonds are 30-year collateralized bonds, a number of nations also issued uncollateralized bonds with shorter tenors (e.g., "Floating Rate Bonds" and "Front Loaded Interest Reduction Bonds"). Some nations also issued bonds in exchange for unpaid interest on defaulted loans (e.g., "Past Due Interest Bonds" or "Interest Arrears Bonds"). Each Brady country negotiated the specific terms and details of its Brady restructuring during discussions with its commercial bank creditors, who were offered a 'Menu of Options' for their exchange of eligible debt.

Mexico, the first nation to begin negotiating with its commercial bank creditors (August 1982), was also the first nation to restructure under the Brady Plan (1989-90). Since then, a total of more than U.S. \$160 billion face amount of Brady bonds have been issued. In addition to Mexico, Brady bonds have been issued by Argentina, Brazil, Bulgaria, Costa Rica, the Dominican Republic, Ecuador, Ivory Coast (Cote d'Ivoire), Jordan, Nigeria, Panama, Peru, the Philippines, Poland, Russia, Uruguay, Venezuela and Vietnam. The large issue size of many Brady bond issuances has substantially contributed to providing the Brady bond market with substantially greater liquidity than is found in many other financial marketplaces.

The Brady Plan was very successful in several important respects. First, it allowed the participating countries to negotiate substantial reductions in their overall levels of debt and debt service. Second, it succeeded in diversifying sovereign risk away from commercial bank portfolios more widely throughout the financial and investment communities. Third, it encouraged many Emerging Markets countries to adopt and pursue ambitious economic reform programs. Finally, the Brady Plan has enabled many Emerging Market countries to regain access to the international capital markets for their financing needs.

This is not to say, of course, that the Brady Plan has succeeded in solving all economic problems throughout the Emerging Markets. The road to greater economic development and democratization has been a bumpy one for some countries. But the Brady Plan has facilitated a return from the rescheduling mode of the LDC debt crisis to a more normalized, market-oriented relationship between Emerging Markets countries and their creditors.

With these successes and the subsequent re-access to international capital markets by Emerging Markets countries, the dominance of Brady bonds in the Emerging Markets debt markets has been gradually eroded. There is no longer a pipeline of Brady restructurings to increase the debt stock available for trading, and much Brady debt has been exchanged or bought back by debtor nations in public or private secondary market transactions. While Brady bond trading accounted for 61% of total Emerging Markets debt trading in 1994 (U.S. \$1.68 trillion), EMTA's Debt Trading Volume Surveys show that Brady bond market share had declined to approximately 25% of total trading in 2000 (U.S. \$712 billion).

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