Debt buyback and the myth of creditor power

Author: Yesha Yadav, Vanderbilt Law School

Discussant: Anjali Sharma, Finance Research Group
Presented at the Emerging Markets Finance Conference, 2019

13^{th} December, 2019

The paper

Bondholders and buybacks

Need for better regulatory protection for bondholders in the context of debt buybacks for the following reasons:

1. Borrower information $>$ bondholder information. Allows borrowers to under-price buybacks.
2. Dispersed creditors $+$ tight procedural timelines $\rightarrow$ coordination and negotiation challenges $\rightarrow$ strategic under-pricing.
3. Large creditors with greater power may extract value from bondholders.

Why care?

The problems with inadequate bondholder protection:

1. Lower levels of bondholder welfare.
2. Reduced levels of bondholder led governance (activist bondholders).
3. In the long run, an increase in firms' cost of capital.

Suggestions for policy

1. More research, of the empirical kind.
2. Better pre and post buyback disclosures – substance and timeliness.
3. Discrete fiduciary protection for buybacks.

Comments

- Substance
- Positioning
- Relevance to the Indian context

Substance

Do bondholders care?

- The paper fails to make the case that bondholders really care about this issue.
- Is this a one off problem or a general problem? If it is a general problem then:
  - Does it show up as longer, protracted debt negotiations?

    A timeline of 20 days is generally sufficient to secure threshold consent.
  - Why the big shift towards cov-light debt?
- Perhaps:
  - Creditors are generally comfortable with the information they have.
  - They are "on the same page" as management. Narrow disagreements, minimal need for control.
  - Where is the problem?

Mis-pricing in buyback transactions

- No clear evidence that money is being left at the table systematically and consistently.
- Borrowing is a repeat game. In general, borrowers are incentivised to not step on lenders' toes.
- Lenders would have caught on to it made suitable adjustments.

Redistribution of power amongst creditors

- Is this overstating the influence of banks?
- Banks may benefit, but do they dictate?
- Is large creditor power (in normal times) not offset by shareholder governance mechanisms?

Even if bondholders did care...

- They appear to be making rational choices w.r.t coordination, information collection.
- Objective of securities regulation – only investor protection or a balance between issuer and investor rights?
- This paper documents the rights that bondholders could have, but don't have now.
- The key question: should they have these rights?
- The paper needs to show that the balance has currently been struck in the wrong place.
- CBA to show that shifting line will
  Benefit creditors/ecosystem $>$ Cost debtors/ecosystem

Benefits/costs to the ecosystem

- Creditors deliver governance value.
- But Bondholders $\subset$ Creditors.
- Does bondholders governance delivers net value to the ecosystem beyond what other creditors deliver?

What about distressed firms?

- Incentives of parties vary across normal vs distressed.
- Lenders may only care about recovery.

Policy suggestions

- More research – undoubtedly. But what prevents it today?
- More disclosure – in general this is a good thing. But why are these not being demanded under the current law?
- Fiduciary protection – is this needed? Why can't contracting solve the problem?

There is no right answer on the balance of rights between debtors and creditors. That the current system is disadvantageous to creditors need not be a call to action.

Positioning

The contribution of the paper:

- Highlights the paucity of research in this area.
- Provides a long list of possible research questions.
- Suggestion: recast the paper as an identification of a potential problem which needs to be examined.

Relevance for the Indian context

- Not much evidence on the nature and impact of creditor led governance – a possible area of research, empirical and legal.
- The question of balance – we see this struggle in the IBC context.
- Will be interesting to see how this evolves!

www.ifrogs.org