Greece and its Dr Evil Trade

ByDino Sola

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The record book of manipulations in the Treasury bond markets has some eminent entries: from the Mozer Affair in 1991, which led to the resignation of John Meriwether from Salomon and sowed the seeds for the formation of LTCM, to Citigroup's Dr Evil trade in 2004, in which some Citigroup traders used a "pump and dump" tactic to make money for their firm, roiling the Euro bond and derivatives markets.

Now Greece has its own Dr Evil trade, which the Financial Times covered in its Analysis page on February 16.

By way of background, recall a shocking January 13, Financial Times front page article title Fake Greek Data Criticised (see picture below) describing a report by Eurostat (the European Statistical Office) which accused Greece of "falsifying data about its public finances and allowing political pressures to obstruct the collection of accurate statistics." The report went on to say that Eurostat couldn't cope with "deliberate misreporting and fraud" (!) on the part of Greece, and that it was unable to validate the Greek government's deficit and debt figures even after repeated restatements.

"The report listed categories in which, it said, Greece had deliberately misreported financial data last year, including revenues from extra-budgetary accounts, swaps write-offs, …"


Fake Greek data criticised

It now appears that Eurostat has zeroed in on some dodgy transactions, except it might very well be Eurostat the one who is foggy about what is legal and what is not (read on).

According to the February 16 FT article, the controversial trade has two components. The first one is a massive currency swap that Goldman Sachs (who else?) arranged for the Greek government in 2002, while the second leg is a special purpose vehicle (SPV) that Goldman (again) set up in 2008 to securities the Greek government liabilities under the 2002 currency swap.

The SPV (are you thinking about Enron too?) serves the purpose of securitizing Greece's liabilities under the currency swap agreement, transforming them into a 20-year bond. The SPV is called Titlos PLC, and you can read its prospectus here (highly recommended if you suffer from insomnia).

The surprising thing is that Eurostat doesn't seem to have a problem with the SPV; it is concerned by the 2002 currency swap. Why, you say, a currency swap is something straightforward, what can be the problem? The problem is that this currency swap is a very special one. Details of this special swap have been reported by Risk Magazine, who had even commented on the strange swaps in 2003 (these article are highly recommended, especially if you work at Eurostat).

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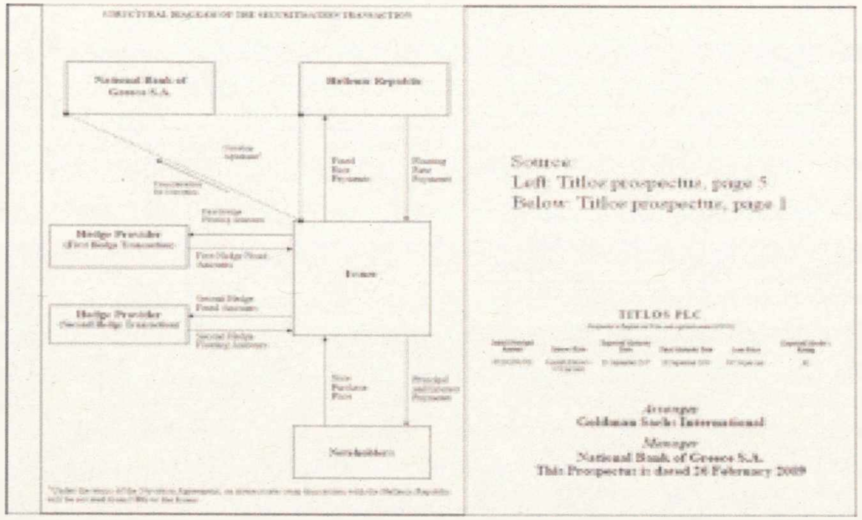

Funny swaps

This is how these fishy swaps work: suppose a government – say, Greece – issues some debt denominated in euros; it then enters into a currency swap with a counterparty – say, Goldman Sachs – under which it would receive payments in euros and make payments in another currency, like US dollars or Japanese yens. However – and here is the catch – these foreign currency payments would not be at the going market rate, like for everybody else, but an artificially low rate. And why would Goldman accept such a deal? Because down the line the coupon payments grow bigger, to compensate for the artificially low rate. So this is really like a loan (by Goldman to Greece) on top of a currency swap, and curiously this is how the transaction should be accounted for **now**.

Now, but not in 2002. Back then, all that Greece had to disclose were the (low) foreign currency payments. Satyajit Das, an expert on derivatives and author of the informative and humorous book **Traders, Guns & Money: Knowns and Unknowns in the Dazzling World of Derivatives**, explains in a Financial Times **article**, that these fishy swaps were quite common in the 90s and early 00s, and were openly used by countries to understate their indebtedness and therefore window-dress their books so that they looked in compliance with EU requirements such as the **Maastricht criteria**.

For example, explains Das, in December 1996 Italy structured a swap under which it had to "pay" US dollar LIBOR minus 16.77% (cool!), and was able to record cash inflows under the agreement. These negative payments were used by Italy to reduce its (stated) deficit, and show that it was within the 3%-of-GDP limit set by Maastricht.

Still according to Das, the 2002 Greek swap allowed the country to reduce its debt-to-GDP ratio from 107% in 2001 to 104.9 in 2002, and lowered its interest payments from 7.4% in 2001 to 6.4% in 2002. Note that Greece joined the EU in 2002.

Where was Eurostat?

If this seems crazy to you, you're not alone (with me): after all, Risk Magazine was very critical of these transactions in its **July 2003 article**:

"With the help of Goldman Sachs, Greece has been using giant swaps deals to ensure its national debt ratios meet EU targets. But these deals are likely to prove controversial."

Right!! Risk Mag said, at the time, that an academic, **Gustavo Piga**, had written a paper in 2001 and made quite noise about this, accuding several countries of using "window dressing" in their public accounts. According to the 2003 Risk Mag article:

"But why did the large negative market value of the swaps not appear on the liability side of Greece's balance sheet?

The answer can be found in ESA95, a 243-page manual on government deficit and debt accounting, published by the European Commission and Eurostat in 2002. As revealed by Piga, the drafting of ESA95's section on derivatives was the subject of