Silver lining for Europe's banks in financial bailout of Greece

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No bank likes to take a loss, especially those in Europe that already suffer from a toxic mix of thin capital, financing problems and weak loan books.

But in the case of the second bailout for Greece, the one that is supposed to make private investors feel the pain as well as taxpayers, the biggest banks in Europe are on the road now actually [illegible]ching the concept.

That is because the first major bond restructuring of Europe's long-festering debt crisis appears to be a better deal for the banks than it is for Greece.

This week, bankers representing the Greek government — from Deutsche Bank, BNP Paribas and HSBC — are explaining to investors, ranging from large European banks to smaller fund managers and insurance companies, why it is in their interest to trade in their decimated Greek bonds for a new package of longer-dated securities with triple-A backing.

The bond exchange is a crucial component — worth about a quarter — of the rescue package that Europe and the

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International Monetary Fund put together to support the near-bankrupt Greek economy through 2014. Chancellor Angela Merkel of Germany and others insisted that banks make such a contribution to give them some political cover at home.

If investors balk at the 21 percent write-down that is the price for getting a deal done, the whole package could collapse, because European governments, which must secure approvals from their parliaments this month, will be hard pressed to come up with the extra funds themselves.

But with the price of Greek debt now trading, in some cases, at 50 cents on the dollar, that 21 percent hit that banks are being asked to take seems quite the bargain.

As a bonus, the new bonds will be governed by international law rather than Greek law, a significant alteration that will strengthen the negotiating hand of the banks if Greece ever does decide to default.

The Institute of International Finance, the advocacy group for global banks that is also the chief architect of the deal, says that 60 percent to 70 percent of the financial institutions holding Greek bonds have agreed to the swap so far. That comes close to the 90 percent threshold that the Greek government has said must be reached for the exchange to take place.

"This is an attractive offer," said Hung Q. Tran, a senior executive at the institute. "We are making the case that if this deal is implemented it will restore stability to Greece."

Since Greece's official offer will not be made to investors until October, it is hard to gauge whether enough banks and investors will accept the offer to reach 90 percent. Nevertheless, the institute says that 40 financial institutions, including all of the largest European banks, have already agreed to the terms.

All of which raises the question of whether the banks that financed the country's debt spree have gotten off too easy — and whether the Greek government should have pushed for a larger write-down to ease its debt onus.

In particular, analysts point to the diminution of Greece's bargaining power in future debt negotiations with its bankers. In past debt negotiations involving countries like Argentina, Uruguay and Russia, the bulk of the debt was governed by either U.S. or English law. That gave bondholders the upper hand in negotiating terms, as they could either hold out for a better deal because of super majority provisions or challenge the governments in foreign courts.

More than 90 percent of Greece's debt is governed by Greek law, however, a holdover from before the introduction of the euro. That, legal experts say, gives the government the flexibility, if it so chooses, to alter bond contracts and secure a more beneficial restructuring deal over the objections of its foreign creditors.

MICHELE TANTUSSI/BLOOMBERG

Chancellor Angela Merkel has insisted that banks contribute to a Greek rescue.

Parliament, for example, could pass a law that would allow it to push through a restructuring deal with the support of a simple 51 percent majority from creditors, as opposed to the 75 percent level that most international contracts require. More drastic, it could simply refuse to pay and leave it to creditors to do their best in seeking redress in Greek courts.

Debt experts have long argued that this legal quirk represented an unprecedented bargaining advantage for Greece as it seeks to whittle away its debt mountain.

"No other debtor country in modern history has been in a position significantly to affect outcome of a sovereign debt restructuring by changing some feature of the law by which the vast majority of the instruments are governed," wrote Lee C. Buchheit, a veteran debt lawyer at Cleary Gottleib Steen & Hamilton, in a paper he co-wrote in 2010 about how Greece might restructure its debt.

If the exchange goes through, though the old bonds will be replaced by ones governed by international law. That will tilt the negotiating scales in favor of Greece's international creditors.

Mr. Buchheit is now advising the Greek government on its debt exchange offer. Neither he nor the Greek government would comment on whether Greece was giving up too much in losing the local law advantage.

There is no doubt that as a member of the euro zone, Greece, unlike Argentina or Russia before it, has limited ability to act in a more proactive manner or threaten to default outright, as it still holds out the hope of re-entering bond markets in the distant future. But if it cannot, the loss of such a bargaining chip will be keenly felt.

"This was a big concession, but because Greece was not willing to default it had little choice," said Anna Gelpern, an expert in sovereign debt law at American University in Washington. "But if in another two years their debt stock is still unsustainable and they are willing to walk away from their debt and Europe, then they will be exposed to a higher threat of litigation."

The jury is still out as to whether Greece will reach that point of no return.

But late Wednesday, a Greek parliamentary committee issued a report saying that Greece's debt dynamics were "out of control" and that given the depth of the recession — the economy is expected to shrink more than 5 percent this year — Greece's ratio of debt to gross domestic product for 2012 is likely to exceed the official forecast of 172 percent.

The government disputed the committee's findings. But what cannot be disputed is that this year and next, Greece's debt to G.D.P. burden will increase, not decrease.