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Hard line adopted on Greek debt loss

By Peter Spiegel in Brussels, Gerrit Wiesmann in Berlin and Hugh Carnegy in Paris

European negotiators have asked Greek debt holders to accept a 60 per cent cut in the face value of their bonds, a hardline stance that far exceeds losses agreed in a deal between private investors and eurozone authorities three months ago.

The stance, delivered to a consortium of international banks at the weekend by Vittorio Grilli, Italian treasury chief and lead eurozone negotiator, is a victory for German-led northern creditor countries who have been pushing for Greek bondholders to accept far more of the burden for a second bail-out.

According to officials briefed on the talks, France, the European Central Bank and the International Monetary Fund remain concerned the tough stance could trigger bondholder insurance policies known as credit default swaps, sparking investor panic because of uncertainty over which financial institutions face CDS losses.

“The CDS market is not very transparent,” said Jacques Cailloux, European economist at RBS. “You don’t know where the exposures are.”

But Paris, the ECB and IMF went along with the hardline negotiating position. Officials said Christine Lagarde, IMF chief, Nicolas Sarkozy, French president, and Jean-Claude Trichet, ECB president, met Mr Grilli on Saturday night to give him the mandate.

Mr Sarkozy’s backing was a significant breakthrough, officials said. France had initially resisted but Mr Sarkozy accepted the need for a big writedown on the condition it be voluntary. “The French president has moved, very much so,” said a person familiar with the talks.

Officials said some countries, including Germany, were less concerned about a so-called credit event – an explicit default that would trigger CDS contracts. But others, including the IMF, feared consequences similar to the collapse of Lehman Brothers in 2008.

“You don’t need to be paranoid to be terrified,” said the person familiar with the talks. “They need to find a fine line where they don’t create a credit event but where the effect is significant enough so the [Greek] debt is sustainable over the long term.”

A senior German official said: “We are trying to avoid a credit event.”

Steven Kennedy, a spokesman for the International Swaps and Derivatives Association, said the group's determination committees only rule on credit events after they are asked to intervene, but the determining factor is whether debt holders agreed to take losses.

"There are limits, however, to what could be considered voluntary," said Charles Dallara, managing director and chief negotiator for the Institute of International Finance, representing bondholders.

The 60 per cent cut is a significant shift both in magnitude and in kind. The July deal did not force cuts in the face value of Greek debt; instead, bondholders would have been given new bonds that only delayed repayment for 30 years.

The IIF estimated the deal amounted to a 21 per cent reduction in net present value. A person close to bondholders said a 60 per cent cut in face value would be equivalent to a 75-80 per cent reduction in net present value.

According to officials, IIF negotiators have offered a 40 per cent cut in net present value rather than a face value reduction. In addition, the IIF has asked new bonds used in a proposed swap transaction be backed by €55bn in collateral, a €20bn increase on the July deal.

Private investors, mostly European banks and in particular Greek and Cypriot ones, hold about €206bn in Greek bonds. Shares of National Bank of Greece fell 21 per cent on Monday; Alpha Bank shares were off 19 per cent; and Eurobank EFG fell 20 per cent amid fears the banking sector would be nationalised.

Additional reporting by Richard Milne in London and Kerin Hope in Athens