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ECB avoids forced losses on Greek bonds

By Ralph Atkins in Frankfurt

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The European Central Bank has secured protection against forced losses on its Greek government bonds in a move that should make it easier for profits on its holdings to be put towards Greece's second bail-out.

The ECB's Greek bonds, bought for an estimated €40bn, will be exchanged for new bonds exempt from any legal action by Athens to impose losses, according to people familiar with the transaction. Such protection was seen by the ECB as essential if it was to co-operate with the complex choreography behind the eurozone's official rescue plan for Greece.

However, the deal secured by the ECB for its Greek holdings could undermine its intervention in other eurozone government bond markets, by raising fears among private sector bondholders that it would also receive preferential treatment in any future bail-out. It could also trigger legal action by other Greek bondholders arguing the ECB has received unfair treatment.

The ECB has come under pressure from the International Monetary Fund and private investors to contribute towards Greece's bail-out. But the Frankfurt-based institution has been determined not to violate the spirit of the European Union ban on "monetary financing", or central bank funding of governments.

The ECB acquired its Greek bonds under an emergency bond-buying programme launched in May 2010 by Jean-Claude Trichet, ECB president. If held to maturity, the ECB would reap the difference between the price it paid for the bonds and their estimated face value of about €55bn, plus interest.

Mario Draghi, who became ECB president in November, has said the bank could distribute those profits to eurozone governments via national central banks. The maturity of the bonds means income would be booked over the next three years – but could be taken into account in financing plans currently being drawn up for Greece.

However, the ECB has always insisted it could not be part of the so-called "private sector involvement" in Greece's bail out – the plan to impose substantial "voluntary" losses on bondholders.

The risk the ECB faced was that, to ensure sufficient participation in the PSI, Athens would insert "collective action clauses" retroactively into Greek bonds. These would allow a recalcitrant minority to be brought into line. That risk of CACs being imposed has increased considerably in recent days as terms of the PSI have become clearer.

Under the exchange deal struck by the ECB, its new Greek bonds will be excluded from the PSI operation and any insertion of CACs. Otherwise, the terms of the bonds will be similar to those of its existing holdings.

The ECB had no comment on Thursday on the exchange, which is expected to be settled shortly. Its policymakers will argue the deal has avoided losses that could have run into tens of billions of euros.

The decision was controversial within the ECB, however. Germany's Bundesbank argued against seeking exemption from CACs because of the legal risks and the precedent it would set. But Mr Draghi may be unconcerned about the signals the Greek deal will send to investors in other bond markets where the ECB has intervened. Since taking office, he has sought to run down the ECB's bond purchasing programme, which he fears proved ineffective.

The exchange deal does not cover Greek government bonds held by eurozone national central banks as part of their own investment portfolios.

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