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FINANCIAL TIMES

February 28, 2012 10:55 pm

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CDS payouts on Greek bond deal on agenda

By Michael Mackenzie in New York

A group of banks and investors in the credit derivatives market will meet on Thursday to determine whether Greece's planned debt swap deal should trigger payments on its default insurance.

The question facing the International Swaps and Derivatives Association is whether the deal constitutes a "credit event" because it creates two classes of bond holders – the European Central Bank, which is spared losses, and private investors, who are being forced to take losses of up to 75 per cent on their Greek bond holdings.

If the 10 banks and five investors on the ISDA determinations committee decide a credit event has occurred, payments would be made on $3.2bn in net outstanding credit derivative contracts.

ISDA's move comes after Standard & Poor's on Monday downgraded Greece to "Selective Default", providing the latest sign that the country may have defaulted.

Greece wants nearly all holders of some €206bn of its debt to participate in a debt swap known as private sector involvement so that the country can start receiving the €130bn of rescue funds from the European Union. Bondholders have until March 12 to agree to the PSI, which could lead to a reduction of up to 75 per cent in the value of their holdings.

The prospect that existing bondholders would face a "haircut" has long been expected and has led some investors to buy credit protection in recent years from banks and other investors to insure their bonds against a default. But the issue of a "voluntary" restructuring of Greece's debt, as the PSI has been termed, has muddied the waters as to whether it constitutes an actual credit event.

Last week, the Greek parliament approved the retroactive insertion of a collective action clause, which would force all bondholders to accept the terms of the deal put forward by the Greek government. This comes after the Greek government recently agreed to replace €55bn in bonds held by the European Central Bank with new bonds that are immune from a default.

Usually ISDA's determination committee is asked to make a ruling on a credit event once bondholders have incurred actual losses. It has accepted a question from an investor ahead of next month's bond swap as to whether Greece has triggered a credit event because of the exclusion of the ECB from losses.

"A question relating to a potential credit event with respect to the Hellenic Republic has been submitted to, and subsequently accepted for consideration," ISDA said in a statement on Tuesday.

As it stands, the net $3.2bn of outstanding Greek CDS is a relatively small market and bankers say their exposures have been hedged. But some in the bond market say that if the committee does not rule a credit event has occurred, then the creditability of the sovereign CDS market will be damaged.

A ruling that a credit event has occurred must be passed by at least 12 members.

Among the banks involved are: Bank of America Merrill Lynch, Barclays, BNP Paribas, Credit Suisse, Deutsche Bank, Goldman Sachs, JPMorgan, Morgan Stanley, Societe Generale and UBS. Investment firms include: BlueMountain Capital, Citadel, DE Shaw, Elliott Management and Pacific Investment .