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No insurance pay-out on Greek debt

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Billions of dollars in credit default insurance on Greek sovereign bonds will not yet be paid out despite next week's restructuring of €186bn of the country's debt, an industry body has ruled in a move that raised complaints from some investors.

The International Swaps and Derivatives Association decided that the bonds had not suffered a so-called credit event, industry jargon for a default on debt or a signficant negative change in its terms.

Under Greece's planned restructuring, some £186bn of bonds will next week be swapped for new, longer-maturing debt with lower coupon payments. A further €20bn is expected to be swapped next month as part of a second round of restructuring.

The body's determinations committee rejected two requests to declare a credit event. One was based on grounds that the European Central Bank was being given de facto seniority in a controversial debt swap and the other cited the introduction by Greece of legislation that would require any recalcitrant bondholders to take part in the swap should support for the deal pass a certain level.

Many traders and investors expect a credit event still to be declared as soon as next week. However, the effectiveness of credit defaults swaps has still been called into question following the ISDA ruling.

Bill Gross, who runs the world's biggest private bond fund at Pimco, said on CNBC television that the decision not declare a credit event on the writedown of Greek sovereign debt set a dangerous precedent.

He said Isda's decision should be seen as a disappointment to buyers of CDS. However, Pimco is one of the voting members of the Isda determinations committee that decided against a pay-out.

Paul Griffiths, global head of fixed income at Aberdeen Asset Managers, said: "This may be bad news for the CDS market. In the longer-term, there is an almost metaphysical question. Why is CDS there? Why does it exist? "

Michael Hampden-Turner, credit strategist at Citi, said: "The credit derivative market could be undermined by a failure of the CDS settlement process, because it would mean that prudent bond holders who used CDS to hedge their exposure might not be able to able to satisfy the requirements for settlement and end up getting back less money."

However, one senior risk manager at a US bank said: "I don't think this decision makes any difference. We all know that CDS is not perfect. It is still a useful instrument."

The complicated nature of Greece's debt swap has sparked an intense debate over whether sovereign CDS, used by many banks and other investors to reduce their exposure to countries such as Italy, are worth less than had previously been thought.

Isda itself has eft the door open to future claims if bond holders are forced to take losses as part of next week's bond swap

However, in a quirk of the CDS process, the amount of money investors will be able to recover from the derivatives will depend on what market price the new bonds will trade it.