Athens weighs drastic debt plan

LONDON

Group of bankers wants country to repurchase bonds at steep discount

BY LANDON THOMAS JR.

As Greece's creditors bicker over the terms of bailouts, the government is examining a more radical approach that could reduce the country's escalating debt in one fell swoop.

Taking a page from the playbook used this year that forced private-sector investors to suffer an unprecedented loss on their bonds, bankers close to the Greek Finance Ministry are proposing that the country deploy a controversial legal mechanism that could force institutions to sell their bonds back to the government at a price favorable to Greece.

Having narrowly secured parliamentary approval for yet another round of spending cuts and tax increases, Greece is on the verge of receiving €31 billion, or $39.5 billion, in bailout loans. The euro zone is also weighing a series of other measures, like extending loan maturities and paring interest rates.

But none of these steps address the question at the heart of the dispute between the International Monetary Fund and Greece's creditors in Europe: How to reduce Greece's increasing sovereign debt burden, which is approaching 200 percent of gross domestic product.

That is why a small circle of lawyers and bankers suggest that Greece offer to buy back its deeply discounted debt at 27 cents and 33 cents per euro above where it trades on the secondary market.

And if investors hold out for a higher price, the government would trigger collective action clauses, or C.A.C.'s, in the bond contracts that, in theory, would prevent a bidding war, allowing the country to retire as much as €40 billion of its €340 billion in debt.

For example: the €62 billion worth of new bonds that Greece issued as part of the debt restructuring deal with private bondholders in March are now valued at about €15 billion — trading at around 25 cents to the euro. If Greece borrowed the money to buy back this debt, it could retire €30 billion to €40 billion worth of its obligations, depending on the ultimate price it paid.

Of course, Greece would need to borrow more money from its creditors to make such a deal work. And while that would be a challenge, Germany — the biggest contributor to the Greek bailout — could take the view that this was a better way to reduce Greek debt than to ask taxpayers to swallow a loss via a write-down of bailout loans.

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Unlike the last time, when banks, hedge funds and other investors were forced to take a big cut on their bonds, this time they would not be asked to suffer a large loss. However, depending on the price, they may have to forego some additional potential profit if the bonds continue rallying after the buyback.

Creditors are discussing many different strategies about how to address Greece's debt, with the buyback option just one possibility. While the most pressing need is getting Greece the €31 billion it needs to survive, arriving at a long-term solution on debt is seen as crucial, given that the economy continues to shrink. Greece's economy contracted by 7 percent in the third quarter, which makes the size of the sovereign debt relative to economic output all the more onerous.

If successful, the debt buyback could bring Greece's debt down to a more sustainable level and afford the country a chance of meeting the target of a debt ratio of 120 percent of G.D.P. by the year 2020, which is a level the I.M.F. has set for it to lend the country more money. European leaders have said that this benchmark needs to be relaxed.

But the idea has infuriated the many hedge funds that in the past months have scooped up more than €22 billion worth of Greek bonds at cheap prices. With many sitting on big profits after the recent market rally, they are in no mood to sell cheaply, especially if Greece resorts to wielding a legal cudgel to get a deal done.

"It's really the dumbest thing that Greece can do right now," said Hans Humes of Greylock Capital, who has been one of the more aggressive investors in discounted Greek bonds.

Collective action clauses are legal riders in bond contracts that can make it easier for a debtor country to restructure its loans by forcing holdouts to accept the sovereign's proposal for a bond swap if a certain proportion of creditors agree to it. They were used to great effect during the restructuring of Greece's private sector debt earlier this year.

With Greece needing to sell more than €50 billion worth of state-owned assets in the coming years, it doesn't want to alienate foreign investors who are just now getting over their fear that the country will be forced to leave the euro. For example, one of the larger holders of Greek debt is Third Point, the New York-based hedge fund, which has also shown interest in bidding for OPAP, the state-owned betting company. The government hopes the sale of OPAP would jump-start its moribund privatization efforts.

To date, Europe and the European Central Bank have rejected suggestions from the I.M.F. that they write down their share of Greece's debt — about 63 percent, in total. The only other way to secure an immediate reduction in the debt stock is to look again to private sector institutions, even though they hold just 18 percent of Greece's debt and have already gone through a painful restructuring.

Wolfgang Schäuble, Germany's powerful finance minister, and Jörg Asmussen, who sits on the executive board of the E.C.B., have spoken favorably about a buyback option, although they have not addressed the possibility of using collective action clauses to secure the best possible outcome.

Still, sovereign debt experts point out that for the C.A.C.'s on the restructured bonds to be triggered, 75 percent of the holders must accept the government's offer. There is little chance of that if Greece hits them with a low bid. If,

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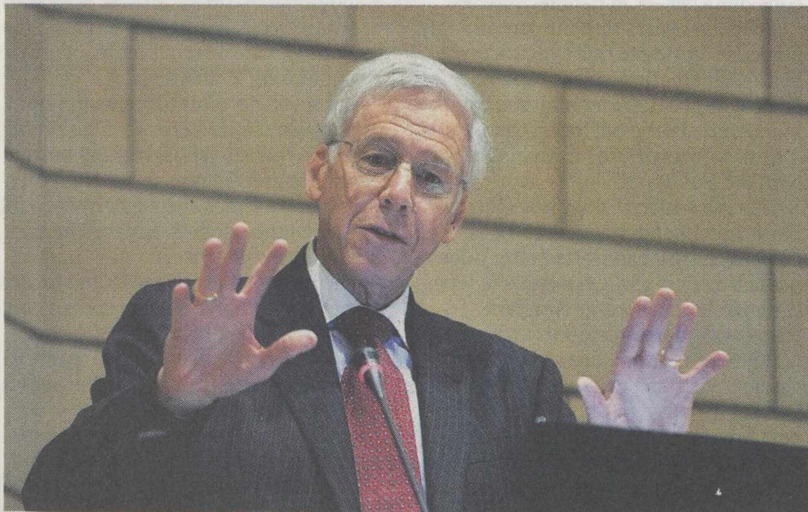

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Charles Dallara, who represented major banks during the Greek debt restructuring talks this year, opposes the plan for Greece to reduce debt by buying back its bonds cheaply.

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however, Greece offered a premium to today's market price of around 25 cents on the euro, then there is a strong possibility that investors might bite — although in such a case the cost to Greece would be higher and the debt reduction lower.

The government need not bother making an offer of 25 cents to 30 cents, said one hedge fund investor who owns Greek bonds. "But 35 cents would attract interest and you may not find many people who want to hold at that level," said this person, who requested anonymity because he was not authorized to speak publicly.

Such an attitude illustrates one of the main criticisms of debt-buyback strategies, which were frequently used during the Latin American debt crisis in the 1980s: Once investors realize a buyback is being considered, they start accumulating the once-scorned bonds, thus forcing the government to spend — or in the case of Greece, borrow — an even larger sum of money to retire a smaller portion of its debt.

The winners are vulture and distressed-debt investors, as well as opportunistic hedge funds like Third Point in the United States and Brevan Howard in Britain that hold out for the highest price possible and then walk away with a rich return.

"It is a boondoggle," said Gabriel Sterne, a sovereign debt expert at Exotix, a London-based investment bank.

Charles Dallara, who as head of the Institute of International Finance represented the major banks during the debt restructuring talks this year, opposes the concept.

It is not the debt itself that is the issue, he argues. Rather, it is Greece's inability to dig itself out of a near-depression.

"We have already seen a massive reduction in debt," he said. "It has nothing to do with the debt dynamic, it is the lack of a growth dynamic that is the problem."