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Greek Restructuring: Why Isn't It (Yet) a Credit Event?

Recent developments arising out of the Greek sovereign debt crisis have required the ISDA Determinations Committee to determine whether a "Credit Event" has occurred under credit default swaps ("CDS") referencing Greek sovereign debt. The Determinations Committee concluded on 1 March 2012 that a Credit Event has not yet occurred. We explain below why this is the case.

Standard Sovereign CDS incorporates the 2003 ISDA Credit Derivatives Definitions (as amended). These definitions set out what will constitute Credit Events and the Determinations Committee will then decide (on request) whether a relevant Credit Event has occurred and, broadly, the market has agreed to live with the result.

The Credit Event in question is "Restructuring". Many different things might constitute "Restructuring", but those in play at the moment are: (1) reduction in principal or interest, and (2) change in ranking in priority of payment, causing Subordination. These must occur in a form that binds all holders of the relevant Obligation and must result from deterioration in creditworthiness or financial condition of the debtor.

The events that give rise to the question as to whether a Restructuring Credit Event has occurred are these:

- Greece has just passed legislation imposing Collective Action Clauses ("CACs") on Greek law sovereign bonds. This would, in the future, allow a certain percentage of the holders to agree, for example, a debt write off on the bonds and bind all the holders to the same write off.
- Greece has just swapped various Greek law bonds held by the European Central Bank ("ECB") for new Greek law bonds which will not be affected by the imposition of CACs. These new ECB holdings will not be capable of being forced into any future debt write off and so appear to have some superior or higher ranking status than the Greek law bonds held by others which will be subject to those CACs.
- Greece is going through a "voluntary" debt exchange offer which would result in bond holders accepting a significant value write down and the Greek Ministry of Finance appears to have made a rather obvious statement that the CACs could be used to achieve participation in the debt write down.

The Determinations Committee took the unusual step of publishing an explanation of the decision and, while not shedding much light on the matter, it appears that their reasoning may be on the following lines:

- The mere imposition of CACs does not satisfy any limb of the definition of Restructuring. The use of CACs to force non-consenting bondholders to accept a debt write-down would (all other requirements being satisfied) be a Restructuring Credit Event, but there is no current evidence that CACs are being used.
- The new ECB bonds enjoy senior ranking, as do the remaining bonds which are subject to the exchange offer. This does not satisfy the definition of Subordination, which looks exclusively at whether (i) there is pari passu treatment on liquidation, dissolution, reorganisation or winding up (arguably none of which is relevant to Greece) or (ii) payments can be made and retained on the subordinated instrument when there are payment arrears on the senior instrument.

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What we have here is a situation where the ECB bonds will have claims for par repayment and the other bonds (after the exchange and any possible use of CACs) will have pari passu claims for a smaller amount. Both claims will rank at the same level.

- The Ministry of Finance statement appears just to be a statement that CACs could be applied. There are two points here: they are clearly not being applied now (the statement effectively admits as much); and they will only apply if the requisite majority of bondholders vote in favour (so they may not apply anyway). In effect, any application of the CACs to bind non-consenting bondholders is away in the future and so cannot have created a Restructuring Credit Event now.

However, all interested parties will have noted the Determinations Committee's final parting shot that the Greek situation is still evolving and so there may be developments in the future making it appropriate to ask again whether a Restructuring Credit Event has occurred.

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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