

ISDA determines Credit Event occurred in Greece

12 March 2012

Authors: Georgia M. Quenby, Brett Hillis, Rosanne M. Kay

The EMEA Determinations Committee of the International Swaps and Derivatives Association (ISDA) met on Friday last week (9 March) to discuss the Greek debt swap deal and to determine whether the deal amounts to a “Restructuring Credit Event”, thus triggering settlement under credit default swaps (CDS) referencing the Greek sovereign. The Determinations Committee decided that a “Restructuring Credit Event” has occurred. The decision was based on the invoking by Greece of collective action clauses (“CACs”) to force all holders to accept the exchange offer for existing Greek bonds. The invoking of the clauses means that the “haircut” suffered by bondholders is not voluntary and falls within the definition of “Restructuring” in the 2003 ISDA Credit Derivatives Definitions.

The vast majority of CDS are documented using standard terms developed by ISDA. Since the introduction of new standard terms in 2009, these have provided for regional ISDA Determination Committees to make binding decisions on whether a Credit Event has occurred.

Earlier this year, the EMEA Determinations Committee was asked to decide whether the passage of a law in Greece inserting CACs in bonds issued by Greece and subject to Greek law had constituted a Restructuring Credit Event. The Determinations Committee determined unanimously on 1 March that the passing of the law did not constitute a Credit Event.

Since then, it has been announced that Greece won 85.8% (out of a required 90%) support from its private-sector bondholders for the proposed debt swap. To overcome the shortfall, Greece announced that it is activating CACs in bond contracts to force holdouts into the deal thus bringing the total support to 95.7%, a move which is bound to result in litigation.

Market participants will now conduct an auction through which the recovery value of Greek debt is determined. This will determine the net payouts made under CDS contracts when a credit event occurs. An auction will be held in respect of outstanding Greek sovereign CDS transactions on 19 March.

In credit default swaps subject to physical settlement the protection buyer is required to deliver bonds (“Deliverable Obligations”) to the protection seller. A long-standing theoretical issue for the sovereign CDS market has been what bonds can be delivered if the use of CACs means that all of the old bonds have been exchanged for new bonds. Not all bonds issued by Greece are subject to CACs. Also, the relevant ISDA terms set a special definition of Deliverable Obligations for sovereign restructuring and, as a result, at least some new bonds may be Deliverable Obligations. The Determinations Committee will ultimately decide what obligations can be delivered.

We have a dedicated Eurozone response group, with expertise in insolvency, financing, litigation, financial markets and commodities trading, advising clients with assets, positions and other issues connected with the Greek bond swap and the Eurozone economic crisis generally. If you have exposures relevant to the Greek bond swap and/or the Eurozone economic crisis and would like help with the evolving situation, please contact Georgia Quenby, Brett Hillis or Rosanne Kay in London, Anthony Pouloupoulos in Athens, or any other member of the Eurozone response group.

About Reed Smith

Reed Smith is a global relationship law firm with more than 1,600 lawyers in 23 offices throughout the United States, Europe, Asia and the Middle East.

The information contained herein is intended to be a general guide only and not to be comprehensive, nor to provide legal advice. You should not rely on the information contained herein as if it were legal or other professional advice.

Reed Smith LLP is a limited liability partnership registered in England and Wales with registered number OC303620 and its registered office at The Broadgate Tower, 20 Primrose Street, London EC2A 2RS. Reed Smith LLP is regulated by the Solicitors Regulation Authority. Any reference to the term ‘partner’ in connection to Reed Smith LLP is a reference to a member of it or an employee of equivalent status.

This Client Alert was compiled up to and including March 2012.

The business carried on from offices in the United States and Germany is carried on by Reed Smith LLP of Delaware, USA; from the other offices is carried on by Reed Smith LLP of England; but in Hong Kong, the business is carried on by Reed Smith Richards Butler. A list of all Partners and employed attorneys as well as their court admissions can be inspected at the website <http://www.reedsmith.com/>.

© Reed Smith LLP 2012. All rights reserved.