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News Analysis

Documentation issues

Voluntary debt exchanges scrutinised

Greek CDS contracts appear unlikely to be triggered under current proposals for a Greek debt restructuring. Indeed, a proposal from a consortium of French banks put forward earlier this week specifically underlines the necessity of preventing a credit event on Greek CDS. However, events in Athens over the past few months have put the spotlight on credit event definitions and could provide a catalyst for a revaluation of standard market documents.

"Even though CDS credit event definitions are well established, they can't cover every conceivable scenario," says Assia Damianova, special counsel at Cadwalader, Wickersham & Taft. "Crises come in different shapes and forms, sometimes revealing scope for improvement of standard market documents. The evolving situation in to Greece may turn out to be one of those instances."

The restructuring of Greek debt and its implications for CDS has been a hot topic in recent weeks, despite its relatively small volume of outstanding contracts (see SCI 21 June). Analysts have played down fears that regulators would be able to restructure Greece's debt while avoiding a credit event, noting that a 'voluntary' restructuring would not trigger the contracts.

A proposal brought forward by a consortium of French banks earlier this week - in broad terms - calls for a 'voluntary roll-over' of Greek debt into new 30-year bonds. But in instances such as this, the word 'voluntary' may not be as clear-cut as it seems.

Damianova asks whether an exchange done because of coercive economic reasons can be said to be truly 'voluntary'. "If one looks at the economic substance of the exchange, one may argue that if a refinancing restructuring with an adverse credit effect has been achieved, it should be irrelevant whether it was carried through an exchange," she says.

"Restructuring has proved to be the most problematic of the credit events with its difficulties of defining what is adverse for bondholders and of interpreting the circumstances that led to the adverse effect," she continues. "For example, if debt is restructured through an exchange, one will have to consider whether the definition of restructuring is wide enough to capture an exchange, if on the facts all holders have the power to accept or decline the exchange offer and if the offer has been accepted and become 'binding on all holders'. One would also have to consider the issues both under the public law of the jurisdiction of the sovereign and the proper law of the debt obligation that has been restructured."

Damianova observes that documentation pertaining to credit events for sovereign CDS probably hasn't been evaluated through real life scenarios since the debt restructuring of Uruguay in 2003. "If market events show that restructuring doesn't capture the risk that market participants expect to be captured, then the industry may have to reconsider its standard documents," she suggests. "For example, one can consider adding terms to safeguard against the manipulation of an exchange offer in a way that formally avoids a 'restructuringr credit event, whilst substantively impacting the credit quality of the sovereign debt."

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