

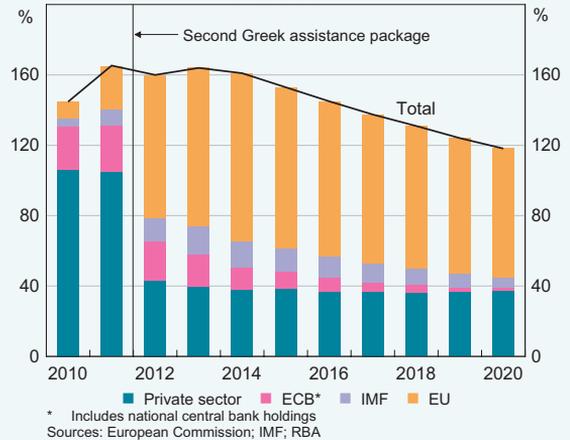
Box B

The Greek Private Sector Debt Swap

A key element of the second Greek assistance package of €130 billion was private sector involvement (PSI) in a Greek government debt exchange. Nearly 97 per cent of private sector bondholders participated in the exchange of their Greek government bonds for short-term European Financial Stability Facility (EFSF) notes and new long-term Greek government bonds, which equated to a reduction of 53.5 per cent in nominal terms and around 75 per cent in net present value terms. The majority of bondholders voluntarily participated in the exchange and the Greek Government activated collective action clauses (CACs) to compel most remaining holders to participate. The International Swaps and Derivatives Association (ISDA) subsequently ruled that the activation of CACs constituted a 'credit event' for credit default swaps (CDS) referencing Greek sovereign debt.

The debt swap reduced the amount of Greek government debt outstanding by around €100 billion, although Greece's debt-to-GDP ratio is expected to be little changed in the near term given the additional public support provided under the second package (Graph B1). The composition of outstanding Greek government debt has, however, changed significantly. The private sector now holds 25 per cent of Greek debt, equivalent to around 45 per cent of GDP, compared with 105 per cent of GDP in 2011. Official sector creditors (including the European Union (EU), European Central Bank (ECB) and International Monetary Fund (IMF)) have increased their claims to around 115 per cent of GDP. Greek government debt is projected by the IMF to fall to around 120 per cent of GDP by 2020.

Graph B1
Greek Government Debt Outstanding
Per cent of GDP



The Debt Swap Deal

Of the €356 billion of Greek government debt outstanding prior to the bond swap, €206 billion was eligible for the PSI (Table B1). This included €177 billion of bonds governed by Greek law and €29 billion of foreign-law bonds and government-guaranteed securities. The remaining €150 billion of outstanding Greek debt comprised short-term bills, official sector loans, and the ECB's holdings of Greek bonds, all of which were exempt from the swap. After lengthy negotiations, private holders of Greek government bonds were able to swap their existing bonds for a package of new bonds. For every €100 of bonds swapped, holders received:

- New long-term Greek government bonds with a face value of €31.5 and maturities ranging from 11 to 30 years. These bonds have coupon payments that will increase from 2 per cent initially to a maximum of 4.3 per cent in 2022 and beyond.

Table B1: Greek Government Debt Holdings
As at end 2011

	€ billion	Share of total Per cent
Total	356	–
<i>of which:</i>		
PSI eligible	206	58
– Greek law bonds	177	50
– Foreign-law bonds and government-guaranteed securities	29	8
Other	150	42
– ECB bond holdings	57	16
– EU loans	53	16
– IMF loans	21	6
– Bills and other	19	5

Sources: European Commission; RBA

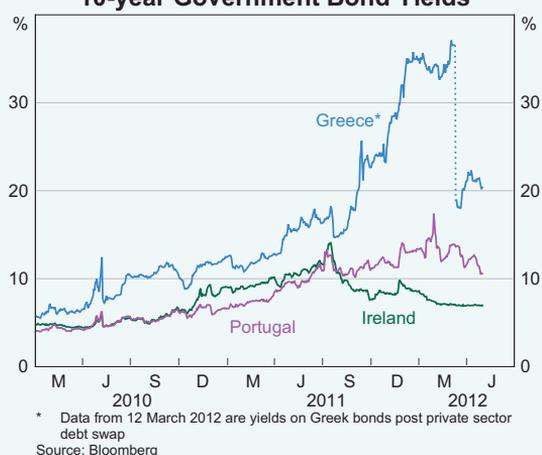
- €15 in short-term EFSF notes.
- Detachable GDP-linked securities, which provide an additional coupon payment should future Greek GDP exceed current projections.

Around 85 per cent of eligible holders of bonds governed by Greek law agreed to participate in the debt swap. The Greek Government then activated CACs that had been retroactively inserted into the contracts for these bonds, compelling the remaining Greek law bondholders also to participate. In addition, more than 70 per cent of foreign-law bondholders have taken part, increasing the overall participation rate in the bond swap to 97 per cent. The participation rate was at the upper end of market expectations, and alleviated earlier concerns that the PSI may not be successful and that Greece would therefore not receive the additional official assistance.

The net present value loss accepted by private sector bondholders was around 75 per cent based on market pricing immediately following the bond exchange, although the losses will have varied

according to the exact bond that investors held prior to the exchange. New Greek government bonds began trading in mid March at yields of around 18 per cent and have since risen to around 20 per cent, noticeably above yields on bonds issued by other euro area governments that have received EU/IMF assistance packages (Graph B2).

Graph B2
10-year Government Bond Yields



Greek Sovereign CDS Credit Event Auction

As noted above, the activation of CACs constituted a 'credit event' for CDS referencing the Greek sovereign. Credit event auctions are the standard mechanism used in the settlement of CDS contracts after a credit event has been declared. The auction process establishes a uniform recovery value of the defaulted debt, which is then used to determine the payment from sellers of CDS to buyers. The recovery value is akin to a secondary market price of a claim on the defaulted entity.

Market participants conducted the Greek auction on 19 March but as the old Greek law bonds had already been exchanged, the securities used in the auction included the newly issued bonds. The payout rate was determined to be 78.5 per cent; that is, the buyer of a US\$10 million CDS contract would have received a payment of US\$7.85 million from the protection seller. In the event, CDS payouts were broadly sufficient to cover the losses that bondholders who had purchased CDS incurred in the private sector debt swap and the result was in line with market expectations.

Despite earlier fears, the market response to the auction was muted. This reflects the fact that Greece's debt restructuring was widely anticipated and that the net value of Greek sovereign CDS outstanding was relatively small. Although the gross value of outstanding CDS contracts referencing the Greek sovereign was around US\$80 billion at the time of the auction, actual (net) exposures were much smaller, at around US\$3 billion, once the value of offsetting transactions between counterparties was taken into account (Graph B3). Payments on Greek sovereign CDS were completed in late March. ↗

Graph B3
Greek Sovereign CDS Outstanding
Notional value

