

Report on the EU bailout proposal for Greece – November 2011

Introduction by Stuart Agnew MEP

There is apparently nothing stopping a non-European institution from buying Greek debt now and then subsequently demanding full payment (instead of accepting the well publicised 'hair cut'). If there is a preventive condition within the bailout terms, this condition should be made obvious.

However there is a very big risk that free profit can be made by non-jurisdiction (i.e. non-European banks) at the expense of those banks participating in the bail out. The tabled 'solution' could prove to be a taxpayer bailout with the sole beneficiaries being private U.S. or other foreign private parties and this is being made possible purely to fashion a deal that saves face, rather than addressing the substance of the problem. If the bailout goes ahead, it may contain a rather large hidden cost implication for the UK, even if it is not an explicit transfer of funds.

Preamble

Reports are emerging that US hedge funds have been buying up Greek bonds at a knock down price in recent weeks, potentially to take advantage of any agreement that involves voluntary 'hair cuts' on bonds. Apparently, there are Greek bonds issued which may allow holders to refuse to take a haircut and demand payment in full. Having made such a demand for full payment, if refused they could 'call a default event' (which the politicians appear desperate to avoid). If this happens, it means some creditors may get better treatment at the expense of others, just to avoid the 'D' word. Furthermore, it means that banks (and as a result taxpayers who back them) may be taking a hit in favour of independent hedge funds and others just to retain the facade of liquidity.

We should also not be fooled or scared by the concept of a Greek default causing a catastrophe a la Lehman Bros. It won't, for very obvious and transparent reasons, as follows:

1. Greek default has been virtually priced into every economic scenario that the markets envisage.
2. The haircut of 50% means the banks are already taking the effect of a default and hence a legal default would just be a term, not an effect.
3. The scare stories about CDS (Credit Default Swap) are untrue. These days, unlike in subprime CDO (Collateralized Debt Obligation) & CDS days), nearly all CDSs are already marked to market and collateralised each night by cash. Hence there will be no massive and unforeseen shocks as the default is already priced in.

4. The effect of a Greek default is not opaque, it has been considered for years and priced accordingly, it is also a zero sum issue, for every loser there is a winner.

5. The difference with the subprime debacle was the opaque nature of pricing and valuation. It was possible for both sides to believe that they were making money.

The Government should state whether RBS and Lloyds will be allowed to refuse the 'haircut' until ALL bond holders share the pain.

Conclusion

The fine print of the bailout conditions should be made public, so that the taxpayer can see that they are not being set up to provide a windfall profit for late investors in Greek debt.

The ISDA (International Swaps and Derivatives Association) believe, based on what information is available to them from news reports, that the eurozone proposal involves a voluntary exchange that would not be binding on all holders. As such, it does not appear to be likely that the eurozone proposal will trigger payments under existing CDS contracts. However, whether or not it does so will be decided by the DC (Determinations Committee) on the basis of the specific facts, if a request is made to them.

The reason the bailout has been structured as voluntary is to avoid the ISDA calling a credit event (default). This means holders of debt who don't come under EU pressure, i.e. non-EU regulated firms and those willing to stand up to the EU, are perfectly entitled to ask for all their money back without a haircut when the debt becomes due, (this may be over the next couple of years). Greece must then pay these 'hold outs' or they will call a default event on Greece thus scuppering the plans to avoid default.

By initially avoiding a default, the EU must either accept that default is inevitable when these debts are due or accept that some bond holders must be paid in full to avoid the default.

Either way, those who are able to avoid pressure from the EU (US Hedge funds don't fear anyone, their banks or their governments (most may be domiciled in places like Cayman Islands etc), will be getting a much sweetened deal at the expense of those banks who are pressured into letting Greece off.

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It should be noted that these banks are being sweetened to accept the deal with euro money (and given we subsidise the whole party) by us.

In the longer term, the bailout will almost certainly lead to further EU funds (not just eurozone funds) being diverted to support banks for whom this haircut is substantial enough to place at risk.

References

ISDA (International Swaps and Derivatives Association)

UKIP Constituent