European Credit Views

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Greek international law bonds

Two types of vintages

In addition to the Greek law bonds, there are EUR18bn worth of international law bonds outstanding

The current round of PSI talks seems to be making only slow progress despite nearly daily announcements that an agreement is supposedly imminent. However, even a very high participation by the private sector would seem to be insufficient to put Greece onto a sustainable debt path. As a consequence, public sector participation is being discussed and new austerity measures are being demanded by the European core.

For public sector participation to be politically acceptable, a high level of private sector participation seems very important. One way of enforcing this would be for the public sector to threaten the introduction and potential use of Collective Auction Clauses (CAC) in Greek law bonds.

Since there are EUR18bn worth of international law bonds that already have CACs, it seems likely that some private sector investors might have built minority blocking stakes that would prevent CACs from being activated in these bonds. It therefore is important to observe that there seem to be two vintages of Greek international law bonds[1], the newer ones issued after 2004, which contain a threshold of 75% for material bondholder decisions to become binding on all holders, and a second vintage, issued before 2004, whose threshold only is 66%[2]. All things being equal, it therefore is probably easier for a private investor to build such a blocking stake in one of the newer vintage type bonds, which we thus find more attractive.

We expect international law bonds to trade at a premium to Greek law government bonds. We think that there is a higher chance that, at the single bond level, some of the former would not participate in a restructuring that could be enforced following the retroactive introduction of CACs into the latter since minority blocking stakes by the private sector might already be in place.

However, if CACs were introduced into Greek law bonds and minority blocking stakes in international law bonds prevented a full participation by all holders, we would expect that the higher the proportion of private sector hold-outs, the higher the chance of a hard CDS Credit Event would become.

Furthermore, if the Greek authorities decide to take the route of a hard default, for example, a failure to pay, there is a good chance that the international law bonds would be subject to that as well. We suspect that the use of English law might in the end not prove much recourse given Greece's financial condition. A minority blocking stake is hence no hedge against a hard credit event, in our view – it merely minimizes the risk of taking a loss on a bond without the CDS triggering.

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1 The terms "Prospectus" and "Offering Circular" are, for most purposes, interchangeable. Both are the disclosure document intended to provide information to prospective note holders. Since prospectuses are not readily available we have extracted our information from the offering circulars of the respective bonds which are available on Bloomberg.

2 While other provisions require a two thirds majority, the CACs in the older vintage type bonds specifically mention a 66% threshold according to the offering circulars.

€18bn of International law bonds

According to Bloomberg, there are 27 Greek international law bonds outstanding with a total euro equivalent notional of EUR18bn. We list these in Exhibit 1 below, sorted by EUR equivalent notional outstanding. As can be seen from the non-availability of prices in some cases, we think that it is unlikely that all of these are traded in the market and that overall liquidity is probably quite poor with only a few exceptions. In particular, the third bond from the top, which is an index linker, and the last one, which is part of a medium-term note program, have special features that make them less comparable to the remaining bonds.

All of these are Hellenic Republic Government International bonds, senior unsecured and issued in EUR or JPY, except for the CHF 2.125% 2013 and USD 4.625% 2013 bonds.

Governing law and jurisdiction

We analysed 16 bonds out of the 27[3] for which the governing law is English law and the courts of England have jurisdiction.

Exhibit 1: Summary of Greek international law bonds

Sorted by euro equivalent amount outstanding. Bond prices as of 7 February 2012. N/As in the CAC threshold column mean that documentation was not available for the respective bond on Bloomberg

Coupon	Maturity	Amount outst.(m)	Amount outst. (€m)	CAC threshold	Bid price	Currency	Coupon frequency	Coupon type	Series	Issue date	Interest due (€)	Interest due (€m)	Bloomberg ID
FLOAT	04/11/16	5,600,000	5,600,000	75.0%	30.00	EUR	SEMI ANN.	FLOAT		04/11/08	41,552	41,552	EH294205
FLOAT	07/05/18	2,100,000	2,100,000	75.0%	26.00	EUR	SEMI ANN.	FLOAT		07/05/06	15,740	15,740	EF520448
2.085	07/25/57	1,600,000	1,600,000	75.0%	N/A	EUR	ANNUAL	FIXED	HICP	03/30/07	136,019	136,019	EG235555
4.625	06/25/13	1,500,000	1,145,038	75.0%	35.38	USD	ANNUAL	FIXED		06/25/08	69,375	52,958	EH427982
FLOAT	05/10/34	1,000,000	1,000,000	75.0%	7.88	EUR	SEMI ANN.	FLOAT		05/10/04	8,045	8,045	ED495774
5.2	07/17/34	1,000,000	1,000,000	75.0%	23.88	EUR	ANNUAL	FIXED		04/30/04	52,000	52,000	ED448927
2.125	07/05/13	650,000	541,667	N/A	38.75	CHF	ANNUAL	FIXED		07/05/05	13,813	11,511	ED974699
3.8	08/08/17	50,000,000	500,000	N/A	N/A	JPY	SEMI ANN.	FIXED	EMTN	08/08/97	950,000	9,500	MM126294
FLOAT	05/15/12	450,000	450,000	66.0%	74.63	EUR	QUARTERLY	FLOAT		05/15/02	1,344	1,344	EC560207
4.59	04/08/16	400,000	400,000	66.0%	15.00	EUR	ANNUAL	FIXED	REGS	04/08/03	18,360	18,360	EC939194
5	08/22/16	40,000,000	400,000	Japanese	N/A	JPY	SEMI ANN.	FIXED	15BR	08/22/96	1,000,000	10,000	TT329938
4.5	11/08/16	40,000,000	400,000	N/A	N/A	JPY	SEMI ANN.	FIXED	EMTN	11/08/96	900,000	9,000	MM124960
VAR	07/06/25	400,000	400,000	75.0%	N/A	EUR	SEMI ANN.	VAR		07/06/05	1,074	1,074	ED988431
5.25	02/01/16	30,000,000	300,000	Japanese	N/A	JPY	SEMI ANN.	FIXED	12BR	01/31/96	787,500	7,875	TT326604
4.5	07/03/17	30,000,000	300,000	N/A	N/A	JPY	SEMI ANN.	FIXED	EMTN	07/03/97	675,000	6,750	MM126189
3	04/30/19	25,000,000	250,000	N/A	N/A	JPY	SEMI ANN.	FIXED	EMTN	04/30/99	375,000	3,750	EC142995
VAR	07/13/20	250,000	250,000	75.0%	N/A	EUR	ANNUAL	VAR	GRC	07/13/05	1,343	1,343	EF008526
VAR	04/19/21	250,000	250,000	75.0%	N/A	EUR	SEMI ANN.	VAR	EMTN	04/19/06		-	EF363835
VAR	07/07/24	250,000	250,000	75.0%	N/A	EUR	ANNUAL	VAR	EMTN	07/07/05	6,863	6,863	EF003362
5.8	07/14/15	20,000,000	200,000	N/A	N/A	JPY	SEMI ANN.	FIXED	9BR	07/14/95	580,000	5,800	TT322060
5	03/11/19	200,000	200,000	N/A	27.75	EUR	ANNUAL	FIXED		03/11/99	10,000	10,000	EC101144
6.14	04/14/28	200,000	200,000	66.0%	19.13	EUR	ANNUAL	FIXED		04/14/00	12,280	12,280	EC261675
VAR	06/09/21	150,000	150,000	75.0%	N/A	EUR	SEMI ANN.	VAR		06/09/06	1,282	1,282	EF469737
VAR	07/10/26	130,000	130,000	75.0%	N/A	EUR	ANNUAL	VAR		07/10/06		-	EG332134
VAR	06/03/19	110,000	110,000	N/A	N/A	EUR	ANNUAL	VAR	EMTN	06/03/99	4,620	4,620	EC151645
VAR	05/31/21	100,000	100,000	75.0%	N/A	EUR	ANNUAL	VAR		05/31/06		-	EF433370
VAR	05/21/14	70,000	70,000	N/A	N/A	EUR	ANNUAL	VAR	EMTN	05/21/99	2,800	2,800	EC151275

Source: the BLOOMBERG PROFESSIONAL™ service, Credit Suisse

[3] For nine bonds there was no prospectus or offering circular available on Bloomberg and two are in Japanese, so we excluded them from the analysis.

Two types of vintages

There seem to be two types of vintages of bond documentation[4], separated into the ones issued before and after 2004. The language used differs in a couple of key characteristics, for our purposes most importantly in the definition of collective auction clauses and the events of default.

We paraphrase and summarise the actual documents rather than copying them. Furthermore, we would stress we are not providing legal advice. For the exact and complete wording, we refer the reader to the original documents.

Collective Auction Clauses (CAC)

We analysed 16 bonds, 13 of which are of the newer vintage type and three of which are of the older type. We suspect that classification into two vintages also holds true for the bonds for which we did not find any documentation. The top six by EUR equivalent notional, which account for €12.4bn, all are of the newer vintage type.

The key difference between the two vintages is the percentage of note holders that need to agree to make a CAC binding on all holders. In the case of the new vintage, this threshold is **75%**, and in the case of the old vintage it is only **66%**. Since the devil is in the detail, we below quote the text from a typical offering circular of the newer vintage[5]. After that, we highlight the differences between that and the older vintage. Note that we have added the bolding in the following texts.

The Agency Agreement contains provisions for convening meetings of Note holders to consider matters affecting their interests, including modification by Extraordinary Resolution of the Terms and Conditions of the Notes or the provisions of the Agency Agreement. Such a meeting may be convened by the Republic and shall be convened by the Republic at any time upon the request in writing of the holder or holders of 10% or more in principal amount of the Notes for the time being outstanding. The quorum for any meeting convened to consider an Extraordinary Resolution shall be one or more persons holding or representing not less than 66 2/3 % of the aggregate principal amount of the Notes. However for so called ***reserved matters****, the necessary quorum will be one or more persons holding or representing not less than* ***75%*** *of the aggregate principal amount of the Notes*[6]*.*

Reserved matters are to

(i) *change the due date for the payment of the principal, premium (if any) or any instalment of interest on the Notes;*

(ii) *reduce or cancel the principal amount or redemption price or premium (if any) of the Notes;*

(iii) *reduce the portion of the principal amount which is payable upon acceleration of the maturity of the Notes;*

(iv) *reduce the interest rate on the Notes or any premium payable upon redemption of the Notes;*

(v) *change the currency in which interest, premium (if any) or principal will be paid or the places at which interest, premium (if any) or principal of Notes is payable;*

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4 While a prospectus contains all the details of a bond, an offering circular only provides the "important highlights". Since prospectuses are not readily available we have extracted our information from the offering circulars of the respective bonds which are available on Bloomberg.

5 With small omissions and highlighted bold font where we find it useful for emphasis.

6 Or not less than 50% of the aggregate principal amount of the Notes for the time being outstanding at any adjourned meeting.

(vi) shorten the period during which the Republic is not permitted to redeem Notes, or permit the Republic to redeem Notes if, prior to such action, the Republic is not permitted to do so;

(vii) reduce the proportion of the principal amount of the Notes whose vote or consent is necessary to modify, amend or supplement the Agency Agreement or the Terms and Conditions of the Notes;

(viii) reduce the proportion of the principal amount of the Notes whose vote or consent is necessary to make, take or give any request, demand, authorisation, direction, notice, consent, waiver or other action provided to be made in the Agency Agreement or the Terms and Conditions of the Notes;

(ix) change the obligation of the Republic to pay additional amounts with respect to the Notes;

(x) change this definition, the definition of "outstanding" contained in the Agency Agreement or the definition of "Written Resolution" set out below;

(xi) change the governing law provision of the Notes;

(xii) change the courts to the jurisdiction of which the Republic has submitted, its obligation under the Agency Agreement or the Terms and Conditions of the Notes to appoint and maintain an agent for service of process or the waiver of immunity in respect of actions or proceedings brought by any holder based upon a Note; or

(xiii) appoint a committee to represent Note holders after an event of default occurs.

*Resolutions may be duly passed as an Extraordinary Resolution at any meeting of the Note holders or by Written Resolution and **will be binding on all the Note holders** (whether or not they are present at such meeting and whether or not they may sign the Written Resolution) and on all Coupon holders.*

*An "**Extraordinary Resolution**" means a resolution passed at a meeting of the Note holders duly convened and held in accordance with the provisions above by or on behalf of the holders of: (i) in the case of a Reserved Matter, at least **75%** of the aggregate principal amount of the Notes for the time being outstanding[7], or (ii) in the case of a matter other than a Reserved Matter, at least 66 2/3% of the aggregate principal amount of the Notes for the time being outstanding[8].*

*A "**Written Resolution**" means a resolution in writing signed by or on behalf of the holders of: (i) in the case of a Reserved Matter, at least 75% of the aggregate principal amount of the Notes for the time being outstanding, or (ii) in the case of a matter other than a Reserved Matter, at least 66 2/3% of the aggregate principal amount of the Notes for the time being outstanding.*

7 Or at least 50% at any adjourned meeting of aggregate principal amount of the Notes for the time being outstanding.

8 Or at least 25% at any adjourned meeting of the aggregate principal amount of the Notes for the time being outstanding.

Difference from old vintage

While the **reserved matters** in the old vintage are not explicitly named that way, there also is a higher majority required for a quorum in case of some special business of a Note holder meeting. Such business would include, inter alia,

(i) *modification of the Maturity Date or reduction or cancellation of the nominal amount payable upon maturity or otherwise, or variation of the method of calculating the amount of principal payable on maturity or otherwise,*

(ii) *reduction of the amount payable or modification of the payment date in respect of any interest in respect of the Notes or variation of the method of calculating the rate of interest in respect of the Notes,*

(iii) *modification of the currency in which payments under the Notes and/or the Coupons appertaining thereto are to be made,*

(iv) *modification of the majority required to pass an Extraordinary Resolution or*

(v) *modification of the provisions of the Agency Agreement*

While some of these seem to be "just" worded differently, some of the newer vintage items were not included at that time, for example, items (xi) and (xii) on the newer vintage which deal with a potential change of law or jurisdiction.

However, we believe the most important difference is that for the **older vintage bonds** only a majority of **66%**[9] of the nominal amount of the notes outstanding at the time are necessary for a quorum to pass an Extraordinary Resolution relating to the aforementioned matters.

Changes to the bond documentation in favour of the note holders:

If the changes to the bond documentation are in favour of the bond holders, the issuer or its agent may actually proceed **without** the note holders' consent[10]:

The Republic and the Agent may, without the vote or consent of any holder of the Notes, amend the Agency Agreement or the Notes for the purpose of:

(i) *adding to Republic's covenants for the benefit of the holders of the Notes; or*

(ii) *surrendering any right or power conferred upon the Republic; or*

(iii) *securing the Notes; or*

(iv) *curing any ambiguity or curing, correcting or supplementing any defective provision in the Notes or the Agency Agreement; or*

(v) *amending the Agency Agreement or any of the Notes in any manner which the Republic and the Agent may determine and which is not inconsistent with the Notes and* ***does not in the opinion of the Republic adversely affect the interest of any holder of the Notes****; or*

(vi) *correcting in the opinion of the Republic a manifest error of a formal, minor or technical nature; or*

(vii) *complying with mandatory provisions of law or any other modification provided that such modification is not* ***in the opinion of the Republic materially prejudicial to the interests of the Holders****.*

9 Or at any adjourned such meeting not less than 33%.

10 The wording below is taken from one of the newer vintage type bonds.

Any such modification, waiver or authorisation shall be binding on the Note holders and any such modification unless the Agent otherwise requires, shall be notified by the Agent to the Note holders as soon as practicable thereafter.

We highlight two sections under points (v) and (vii) as the wording specifically mentions **"the opinion of the Republic"**. Point (vii) is probably less relevant as these bonds are issued under English rather than Greek law. Furthermore, we do not expect the Greek Republic to try to make this a 'loophole' as it would be very damaging for its reputation, probably resulting in a much longer inability to issue new bonds and with negative implications for other sovereigns using similar wording in their bond documentation. However, at least it highlights the fact that we are dealing with a sovereign and not an ordinary corporate.

Bond holdings by the Greek official sector

For the purposes described above, any bonds held directly by the Republic will **not** form part of the calculation of notional outstanding. Importantly, **bonds held by** the **Greek central bank** or any of the Republic's local authorities for this purpose **will not count as being held by the Republic**[11]:

For the purposes of (i) ascertaining the right to attend and vote at any meeting of Note holders, (ii) Condition 10 (Meetings of Note holders and Modification) of the Offering Circular and Schedule 3 of the Agency Agreement (Provisions for Meetings of Note holders) and (iii) Condition 7 (Events of Default) and for purposes of determining whether the required percentage of holders of the Notes are present at a meeting for quorum purposes, or has consented to or voted in favour of any request, demand, authorisation, direction, notice, consent, waiver, amendment, modification or supplement to the Notes or the Agency Agreement, or whether the required percentage of holders has delivered a notice of acceleration of the Notes, any ***Notes that the Republic owns or controls directly or indirectly will be disregarded and deemed not to be outstanding****. For this purpose,* ***Notes owned, directly or indirectly, by the Bank of Greece*** *or any of the Republic's local authorities and other local authorities' entities* ***will not be regarded as, or deemed to be, owned or controlled, directly or indirectly by the Republic****.*

The interesting question that arises from this is, what are the shares of the Greek Republic and its central bank in these international law bonds? There is already a discussion under way about whether or not the ECB and the public sector should take part in any loss sharing. Hence, there is a chance that the ECB could forgo any gains on its Greek government bond holdings by selling these at the price at which they were purchased. The question then becomes, who would be the buyer? One of the options mentioned is the EFSF. However, if the Greek Republic bought them with the funds received from the new bailout program, it would probably have the undesired effect of decreasing the notional outstanding of these notes[12], making it easier for the private sector to build a minority blocking stake. In contrast, if the Republic held some of these notes already, it would have an incentive to sell them in order to increase the notional outstanding, thereby making it slightly more difficult to build a minority blocking stake.

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[11] The wording below is taken from one of the newer vintage type bonds.

[12] Unless they find a way how to swap them out to some other official institution like the Bank of Greece. However we think the ECB would be uncomfortable with that, to say the least.

Events of default

For the newer vintage bonds, there are five types of events whose occurrence allows the holders of 25% of the aggregate principal amount of outstanding notes to give notice that the notes are immediately due and payable or decide that litigation be instituted. These five events are[13]:

(a) *the Republic defaults in any payment of interest in respect of any of the Notes or Coupons and such default is not cured by payment thereof within 30 days from the due date for such payment; or*

(b) *the Republic is in default in the performance of any other covenant, condition or provision set out in the Notes and continues to be in default for 30 days after written notice thereof shall have been given to the Republic by the holder of any Note; or*

(c) *in respect of any other External Indebtedness in an amount equal to or exceeding U.S.$25,000,000 (or its equivalent), (i) such indebtedness is accelerated so that it becomes due and payable prior to the stated maturity thereof as a result of a default thereunder and such acceleration has not been rescinded or annulled or (ii) any payment obligation under such indebtedness is not paid as and when due and the applicable grace period, if any, has lapsed and such non-payment has not been cured; or*

(d) *general moratorium is declared by the Republic or the Bank of Greece in respect of its External Indebtedness or the Republic or the Bank of Greece announces its inability to pay its External Indebtedness as it matures; or*

(e) *any government order, decree or enactment shall be made whereby the Republic is prevented from observing and performing in full its obligations contained in the Notes,*

If the event(s) of default has been cured or waived, the holders of at least 66.67% of the aggregate principal amount of the notes may rescind such a notice of acceleration or decision of litigation.

Difference from older vintage

For the older vintage, the wording regarding who is allowed to give notice – and in particular how large a proportion of the principal of the outstanding notes is required – can be different. For example, for the floaters maturing in 2012 it is stated that *the holder of any Note may give notice that such Note is immediately due and payable […], unless prior to such a time all events of default in respect of the Notes shall have been cured.*

In addition, for some bonds only a subset of the aforementioned potential default events are listed. For example, for the 4.625% 2013 bonds, events (c) and (d) are not mentioned.

[13] The below wording is taken from one of the newer vintage type bonds.

Conclusion

Based on the above analysis, we expect Greek international law bonds to trade at a premium to Greek law government bonds. We think there is a higher chance that, at the single bond level, some of the holders of the former would not participate in a restructuring that could be enforced by the retroactive introduction of CACs into the latter since minority blocking stakes by the private sector might already be in place.

Furthermore, due to their higher CAC threshold it is probably easier[14] for a private investor to build a blocking stake in one of the newer vintage type bonds, which we thus find more attractive.

In addition, if CACs were introduced retroactively for Greek law bonds, we believe there is a good chance that the threshold would need to be set at 66% (or lower) rather than 75%, since the banks have probably sold a large share of their holdings to either the public sector or to investors who do not need to participate in a voluntary PSI. The international law bonds with the 75% threshold should thus benefit on a relative basis.

However, if CACs were introduced into Greek law bonds and minority blocking stakes in international law bonds prevented a full participation by all holders, we would expect that the higher the proportion of private sector hold-outs, the higher the chance of a hard credit event would become.

Furthermore, if the Greek authorities decided to take the route of a hard default, for example, a failure to pay, we believe there is a good chance that the international law bonds would be subject to that as well. We suspect that English law may in the end not prove much recourse given Greece's financial condition. A minority blocking stake is hence no hedge against a hard credit event, in our view – it merely minimizes the risk of taking a loss in a bond without the CDS triggering.

We do not know if the ECB holding of circa EUR45bn of GGBs includes international law bonds. Given the ECB's unwillingness to participate in the PSI, we would expect it to sell its stake to participating (private or public) parties if there were a chance of preventing a minority blocking stake.

There is an interesting additional conclusion with regards to the tactic that we highlighted in our latest *Flash*, which could be designed to ensure a nearly universal take-up in a bond exchange as described by Mitu Gulati and Jeromin Zettelmeyer. In our opinion, this tactic only works if it turns out to be a true prisoners' dilemma, in the sense that the parties that can decide to participate or not know that they will lose if the other parties choose to participate and one stands more or less alone as a single hold-out. However, the potential existence of blocking stakes and, importantly, the fact that the respective players might be aware of them, reduces the likelihood of anyone choosing to participate out of pure fear that the other players might do so. As a consequence, we believe a voluntary take up can only work if the result from participating becomes more lucrative – in other words, if what the private sector could receive in exchange for its bonds was somehow enhanced in value. Among other things, that could include seniority, legal and jurisdictional considerations. We also think that, as the private sector involvement becomes increasingly punitive, the risk of a non-cooperative strategy decreases, reducing the chance of a voluntary outcome.

Finally, we would like to point out that our *Game Theory* would suggest that the environment we currently observe, namely a low stress environment, is exactly the type where one would expect "aggressive" behaviour by any player. Therefore, we would not be surprised if a hard default by Greece (i.e., a default where relations with the core break down, endangering the ECB's considerable additional exposure) is being contemplated a lot more than it was just a few months ago.

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14 Ignoring the actual size and liquidity of that particular issue.

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Disclosure Appendix

Analyst Certification

Christian Schwarz, William Porter, Chiraag Somaia, Joachim Edery and Jessica Orts each certify, with respect to the companies or securities that he or she analyzes, that (1) the views expressed in this report accurately reflect his or her personal views about all of the subject companies and securities and (2) no part of his or her compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

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Buy: Indicates a recommended buy on our expectation that the issue will deliver a return higher than the risk-free rate.
Sell: Indicates a recommended sell on our expectation that the issue will deliver a return lower than the risk-free rate.

Corporate Bond Fundamental Recommendation Definitions

Buy: Indicates a recommended buy on our expectation that the issue will be a top performer in its sector.
Outperform: Indicates an above-average total return performer within its sector. Bonds in this category have stable or improving credit profiles and are undervalued, or they may be weaker credits that, we believe, are cheap relative to the sector and are expected to outperform on a total-return basis. These bonds may possess price risk in a volatile environment.
Market Perform: Indicates a bond that is expected to return average performance in its sector.
Underperform: Indicates a below-average total-return performer within its sector. Bonds in this category have weak or worsening credit trends, or they may be stable credits that, we believe, are overvalued or rich relative to the sector.
Sell: Indicates a recommended sell on the expectation that the issue will be among the poor performers in its sector.
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