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Greek Sovereign CDS Credit Event Frequently Asked Questions (FAQ)
March 9, 2012

Why did the ISDA EMEA Determinations Committee rule that a credit event occurred?
The Determinations Committee determined that the invoking of the collective action clauses by Greece to force all holders to accept the exchange offer for existing Greek debt constituted a credit event under the 2003 ISDA Credit Derivatives Definitions.

Those Definitions state that the Restructuring Credit Event is triggered if one of a defined list of events occurs, with respect to a debt obligation such as a bond or a loan, as a result of a decline in creditworthiness or financial condition of the reference entity.

The listed events are: reduction in the rate of interest or amount of principal payable (which would include a "haircut"); deferral of payment of interest or principal (which would include an extension of maturity of an outstanding obligation); subordination of the obligation; and change in the currency of payment to a currency that is not legal tender in a G7 country or a AAA-rated OECD country.

An important element of the definition of Restructuring is that the event has to occur in a form that binds all holders of the "restructured" debt.

The DC found that the Greek debt restructuring plan involves a “haircut” and is binding on all holders of Greek debt.

Why did it take so long for the Determinations Committee to declare a credit event?
A CDS is a legal contract between two counterparties. As such, it contains legal terms that are defined in the 2003 ISDA CDS Definitions. Those Definitions explain how the contracts work and the events that qualify as Credit Events. The Determinations Committee is required to use these Definitions and publicly available information in its deliberations.

The DCs do not determine on a prospective basis if and whether a credit event might occur. That is why they sometimes reject questions submitted to them for consideration, and it is why sometimes they find that a credit event has not yet occurred.

A few months ago ISDA said that a credit event would not occur. Did the DC change its mind on whether a credit event occurred?
No. When the Greek debt restructuring plan was first announced, there was no mention of using collective action clauses (CACs) and the plan was proposed to be voluntary. Based on this, ISDA stated that, subject to the ultimate decision by the Determinations Committee, the restructuring plan at that time did not appear likely to constitute a credit event.

Less than two weeks ago, the ISDA EMEA Determinations Committee ruled that no credit event had occurred. What changed?
At the time the previous question was submitted to the DC, Greece had not yet invoked the CACs.

Now that a credit event has occurred, what happens next?
Market participants conduct an auction through which the recovery value of Greek debt is determined. This recovery value determines the net payouts made under CDS contracts when a credit event occurs. The DC determined that an auction will be held in respect of outstanding Greek sovereign CDS transactions on March 19.

How much will be paid out now that a CDS credit event has been triggered?
According to the Depository Trust & Clearing Corporation's CDS data warehouse, the total net exposure of market participants who have sold CDS credit protection on Greek sovereign debt is approximately $3.2bn as of March 2, 2012.

The net cash payout on CDS when a credit event occurs is the face amount of the CDS contract less the recovery value of the underlying obligations as determined at a CDS auction. For example, if the CDS auction showed the recovery value of debt to be (hypothetically) 25%, the aggregate amount payable would, in Greece's case, be 75% of $3.2bn: $2.4bn.

Furthermore, statistics indicate that, on average, 70% of derivatives exposure is collateralized and the level of CDS collateralization is likely to be even higher as over 90% of CDS transactions (by numbers of trades) are collateralized.

The data regarding CDS exposures on Greek sovereign debt, and for the top 1,000 reference entities, are public. They are available here:
www.dtcc.com/products/derivserv/data_table_i.php?tbid=5

How can an auction be held if there are no "old bonds" because they have been exchanged for new bonds?
The EMEA Determinations Committee will ultimately decide which of the obligations are deliverable under the Credit Derivatives Definitions for purposes of the Greek CDS settlement auction. It is important to note that Greece has outstanding a wide variety of obligations. Not all existing bonds are covered by the use of CACs. In addition, new bonds are being issued that might satisfy the requirements for deliverable obligations.

ISDA published a preliminary list of obligations issued or guaranteed by the Hellenic Republic. The preliminary list can be accessed here: http://www2.isda.org/preliminary-greek-obligations/

Who are the members of the DCs?
Each DC consists of ten voting dealers and five voting non-dealers, plus two consultative (non-voting) dealers and one consultative non-dealer. The dealers are selected annually according to (and only to) their CDS trading volume over the past year and their compliance with certain requirements, notably to participate in CDS auctions, whilst the non-dealers are selected annually at random from a pool of buyside market participants meeting certain specified size criteria. Non-dealer members' one-year terms are staggered so that they do not all finish their terms at once. A list of the firms that are members of the DCs is available at:
http://www.isda.org/dc/committees.html

ISDA is not a voting member of any Determinations Committee.

What is the process for determining a Credit Event?
All firms entering into CDS transactions using the standard ISDA documentation (described above) have agreed to be bound by the decisions reached through the process for determining a Credit Event set out in the CDS Definitions. This process is fair, transparent and well tested, and was developed working closely with global regulators. Credit Events are determined by one of five regional ISDA Credit Derivatives Determinations Committees (DCs). An event with respect to Greece is dealt with by the EMEA DC.

The process begins when a market participant puts a question to the DC for the relevant region. Any market participant (who need not be an ISDA member) with one or more CDS transactions can raise a question. A question is raised by submitting it, along with publicly-available information evidencing the event, using an online form on the ISDA website.

After a question is submitted, it must be accepted by one of the members of the appropriate DC (or by two members, if it is a general interest question that is submitted anonymously). This step is included in order to filter out frivolous questions. Once a question is accepted, the DC will meet within a defined timeframe to consider it. The DC will weigh the publicly-available evidence and vote on whether a Credit Event has occurred within the terms of the CDS Definitions. It should be noted that the DC simply applies the Definitions to the public facts; it is not empowered to decide whether, as a matter of policy, a Credit Event should or should not occur in particular circumstances.

As soon as a vote has occurred, the determination is posted on the ISDA website. Each DC member's vote is made public. Requests to the DCs and updates following meetings of the DCs are posted promptly on the ISDA website on the Credit Derivatives page at http://www.isda.org/credit.