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Greek yields up as CDS trading put on hold

By David Oakley, Capital Markets Correspondent MARCH 25 2012

Yields on new Greek bonds have jumped sharply in the past week amid worries over a shutdown of the market in insurance-like products used to hedge the risk of holding Athens' debt.

Banks have stopped offering prices on Greek sovereign credit default swaps because a payout on new instruments could be forced immediately due to technical problems with the documentation used to settle contracts.

Yields, which have an inverse relationship with prices, have leapt more than 3 percentage points to 16.93 per cent on the new 2042 Greek bond – which is issued under a debt exchange with private sector bondholders and used to set the final payout on CDS contracts – since March 12, its first day of trading.

The market's concern centres on a so-called 60-day look-back clause in standard CDS contracts, which could be used to activate a payout on new contracts in the wake of a "credit event" that was declared on March 9, when Greece secured private sector participation for its debt restructuring.

Bankers fear the rising yields on Greek debt, and uncertainty surrounding the CDS trigger process, could hit sentiment in other eurozone bond markets, where borrowing costs for indebted governments have fallen from recent peaks.

"This is yet another problem that will deter investors and banks from buying Greek bonds," said a senior CDS trader at one European bank. "If you can't use CDS to hedge the risk of buying Greek bonds, then you may decide not to buy Greek bonds."

Critics have questioned the timing of the credit event declared by the International Swaps and Derivatives Association, which triggered a net €2.5bn payout to institutions holding sovereign default protection, and the auction process used to set the final figure that was paid out.

The credit event was triggered after private investors were forced to accept a €100bn writedown on Greece's debt, equivalent to losses of about 70 per cent for Greek bondholders.

Bankers want the ISDA to make a swift ruling that look-back clauses in CDS contracts cannot be used to activate fresh payouts on any new protection.

"There is not a great deal of demand for Greek CDS at the moment," said one government bondtrader at a US bank, "but the fact the market is not trading is bad for sentiment."

Some traders say Greek yields, already trading at distressed levels, may have risen because of wider worries about eurozone growth, which also saw a jump in Spanish and Italian bond yields last week.

However, the Portuguese and Irish bond markets have traded steadily, suggesting to others that worries over CDS and expectations of another default in Athens are a factor in forcing Greek yields higher. Greek CDS prices were last quoted on March 9, when a buyer of protection would have had to pay $7.8m up front to insure $10m of debt against default.

There has been criticism that the credit event should have been activated much earlier to provide more certainty over CDS payouts.

It would also have enabled holders of Greek debt to deliver old bonds rather than new bonds in return for payments in the auction. Although the process eventually paid out what was deemed a "fair price" by many market participants, this was considered to be more down to luck than design.

Markit, the data provider, said it needed at least three global banks to give it prices for Greek CDS before it could continue to quote them.