Has Greece Caused a Credit Event?

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The recent financial travails of Greece raise three interesting questions: First, has the country's conduct so far constituted a credit event and, in particular, will any of the steps Greece has taken in response to the demands of the situation be found to constitute a credit event? Second, even if no credit event has occurred yet, will Greece be able to avoid restructuring its debt if it fails to satisfy the conditions precedent to its receipt of EU and IMF support? (Whatever waivers the political process might provide to Greece, it seems unlikely that those who bought protection will be satisfied with politically desired social peace.) Lastly, will the decline of Greece's financial rating to junk status create rights for protection buyers even if such a decline is not a credit event?

As a basic proposition, we are assuming that significant numbers of Greek sovereign risk credit default swaps (CDS) or indices including Greek sovereign risk have ISDA 'failure to pay', 'restructuring' and 'repudiation/moratorium' credit event definitions. It appears that every effort has been made by Greece to avoid triggering these credit events, at least based on its public statements.

And yet one must be concerned that promises made by Greece to the European Central Bank, the IMF or its fellow EU countries, or public announcements by Greek politicians urging the protection of entitlements over payment of state external debts, verge on repudiation. All that remains for a credit event to occur is a minimal failure to pay or de minimis change in terms. One will be able to argue that those politicians did not represent the sovereign at the time of their speeches, but the risk is there, especially if there is a change in government.

Even if Greece's financial problems are for the time being, liquidity, as opposed to solvency, problems, one must assume that they will become solvency problems leading to a failure to pay or a restructuring if fiscal reform and economic growth are insufficient. Under extreme stress one must assume that Greek external debt will have its essential terms changed.

Protection buyers and sellers will need to review their own transactions to determine the agreed credit event definitions and assess when and if a credit event may occur or may have occurred. Determining whether a restructuring credit event has occurred as a result of a sovereign's actions is not always easy. For example, under the 1999 ISDA Definitions, the restructuring credit event definition included an obligation exchange, that is, the so-called mandatory transfer of one set of obligations for another. In *Eternity Global Master Fund v Morgan Guaranty Trust Co. of New York*, the Second Circuit ruled that the Argentina government's self-described voluntary debt exchange in late 2001 may have constituted a mandatory transfer, and remanded the case back to the district court for further proceedings.

The 2003 ISDA Definitions, however, do not include an obligation exchange within its restructuring credit event definition. Courts have also wrestled with the precise meaning of other credit event definitions relating to sovereigns, such as a sovereign event. In *Aon Financial Products v Société Générale* the judge overturned the district court's determination that a sovereign event had occurred, strictly construing that defined term. The credit event definitions found in particular sovereign risk CDSs will, therefore, need to be carefully analysed.

Finally, protection buyers need to be vigilant in protecting their rights even in the face of market custom. The developing law arising out of the Lehman bankruptcy shows that an ignored credit event may be a waived credit event if the protection buyer does not take timely action (e.g., promptly terminating a CDS when a credit event occurs).

Disclosure: Pillsbury Winthrop Shaw Pittman acted as counsel for Société Générale in the Aon case referenced above.