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The Greek debt exchange transaction (private sector involvement)

One of the key events in the 'Greek crisis' which has been unfolding over the last three years, was the debt exchange of February and March 2012, which resulted in a 'haircut' of more than 50 per cent in the nominal amount of Greek government bonds (GGBs) held by private investors. This unprecedented sovereign debt restructuring, the largest ever, obviously had various interesting legal aspects.

Background

Doubts about the viability of the Greek debt first appeared in late 2009, following the elections of October of that year and a new party coming into government. The political class as a whole either ignored or was totally incapable of dealing with such an issue. As a consequence, following a brief foray into the possibility of market abuse in the GGB market – government officials strongly criticised market moves as being caused by credit default swap exposure and related manipulation activities – the inevitability of a complete market shut-out was accepted in early 2010.

To avoid the repercussions of a default, financial assistance via a newly created EU/ECB/IMF mechanism ('troika') was granted in May 2010 in an amount of €106bn. During the ensuing period, any bonds falling due were re-paid with funds provided through this mechanism, until in the course of 2011 it gradually became apparent that the total debt level – already exceeding 100 per cent of GDP and due to rise exponentially – was entirely unsustainable despite any measures taken at the budgetary front. A solution therefore had to be found that would involve direct debt reduction: this was the debt exchange transaction, which came to be known as private sector involvement (PSI).

While a purely voluntary exchange is always possible under the basic freedom of contract rule, neither the terms of the bonds nor Greek law at the time of issuance, allowed for the possibility of any adverse decision of the majority of bondholders being imposed on a dissenting minority (actually this was possible in relation to corporate bonds, by operation of the law on corporate bond issuance 3156/2003, but not for GGBs). However, as pointed out originally by Buchheit and Gulati in their groundbreaking 2010 article, Greek law was obviously capable of being amended by proper action of the Greek state – quite conveniently also the debtor of the bonds in question.

Legislation

In February 2012, following EU decisions on the introduction of Collective Action Clauses (CACs) in all new EU States' bond issues, Law 4050/2012 was approved by the Greek Parliament (the 'Greek Bond Act'). Its subject was 'Rules for amending bonds issued or guaranteed by the Hellenic Republic with Bondholders agreement' and its purpose was to create a framework for allowing the terms of GGBs in circulation to be amended by introducing CACs. Such framework consisted of the following:

(a) launch of the procedure by decision of the Government Council (a body comprising of all Ministers) designating the bonds eligible to participate in the term amending exercise;

(b) authorisation for the PDMA (Public Debt Management Authority) to issue invitations to bondholders to agree to the amendment and at the same time exchange their securities for new ones, including the specific terms of the proposal;

(c) appointment of the Bank of Greece as the entity managing the process;

(d) decision of the bondholders on the proposal, for which participation of at least half of the total outstanding amount of each issue and consent of at least a two-thirds majority of participating capital is required; and

(e) issuance of new bonds and concurrent cancellation of the previous ones, including any rights deriving from such securities.

All this sounds procedural and more or less expected, but the Bond Act included some further interesting provisions. A crucial element was defining – for all purposes of this law – as 'bondholders' the entities participating in the Bank of Greece Electronic System through which GGBs are held, that is, the institutions acting as registered holders of the accounts through which the bonds were held. For reasons of legal clarity and for ringfencing the procedure from any outer challenge, the offer was addressed to these persons only and not to the ultimate beneficiaries. Such bondholders were further deemed as always acting according to the guidance and with the approval of end-investors and were to incur no liability, even if acting without – 'or even contrary to' – explicit instructions of investors. The Bond Act also contained wording to the effect that:

> 'the provisions of [this] law aim to safeguard the highest public interest, are mandatory legal rules with immediate effect and supersede any contrary, general or special provision of law, legislative act or contract, including those of law 3156/2003, and their exercise does not create nor activate any contractual or legal right of any Bondholder or investor, nor any contractual or legal obligation of the issuer or the guarantor of the notes, except as specifically provided in the present law.'

With this rather unusual and quite serious wording, the intention was made clear to protect to the largest extent possible the eventual transaction from any future legal challenge. The political decision was quite strong both at the local and at the European level to safeguard the legal integrity of the PSI exercise by any means available, and the legislative text was anything but laconic in this respect.

Offer

Following the introduction of the Bond Act and of additional rules of tax nature – which aimed at countering any adverse tax repercussions for legal entities participating in the exchange – the offer was launched in 24 February 2012. The Hellenic Republic via the PDMA issued an invitation to holders of GGBs and Greek state guaranteed corporate bonds, which comprised an exchange offer and a consent solicitation. The offer was for receiving new bonds and certain additional securities of a nominal amount significantly lower than that of the bonds that were due to be exchanged and the solicitation for consenting to the adoption of proposed amendments to the terms of their bonds. At the same time an Act of the Government Council designated the eligible bonds and authorised the terms of the proposed exchange. The decisions of bondholders – reached via fully electronic 'meetings' and subsequent voting – broadly accepted the proposals, in early March, with very limited exceptions. An additional Act of the Government Council Act then approved the bondholders' decision for amending the terms. The amendments took the form of a decision of the Ministry of Finance, the authority entrusted with issuing bonds on behalf of the Greek Government.

The result of all these actions, which satisfied legal requirements, including those of the specific rules of the Greek Bond Act, was the successful completion of the bond

exchange. Holders of approximately €172bn in various types of bonds issued or guaranteed by the Hellenic Republic tendered their securities for exchange and at the same time consented to the proposed amendments of the terms of these bonds. This resulted in the activation of the newly introduced CACs, and consents reached about €198bn or 95.7 per cent of the overall outstanding amount of all PSI-eligible debt, with only certain foreign law governed issues remaining. These were exchanged for €92bn of newly issued debt with lower interest, resulting in an amount of net debt reduction in the area of €109bn.

Challenges

The PSI, given the retroactively introduced collective action clauses, as well as certain aspects of the procedure believed to be involving a certain element of coercion, received criticism both in Greece and abroad. Many individual investors complained and attempted to challenge the exchange on various legal grounds. In fact, it has been reported that almost 10,000 persons have filed more than 150 petitions before the Council of State, the Highest Greek Administrative Court against the legal acts that implemented the exchange. These include mainly individuals, but also social security funds and certain corporate entities. The main arguments are that the enabling legislation and subsequent exchange of non-consenting investors' holdings have breached constitutional rules, namely on protection of private property and equality, as well as Article 1 of the ECHR Protocol 1. However, it is rather doubtful that it was the actual exchange that caused the damage in the property of claimants, as GGBs had suffered a significant drop in value prior to that, and not as a result of the offer. A pilot case has already been heard by the Court in March 2013. While a full decision is expected within the next few months, published reports indicate that the petitions are due to be rejected and the constitutionality of the relevant rules upheld. If this is confirmed, the PSI will maintain on the legal front the success it also clearly had from the operational and financial aspects. While much will depend on numerous other factors, decisions and events, the PSI may in the future be considered as a defining step leading to a broader positive outcome, one that unfortunately still eludes the country.