



LET'S TALK ABOUT...

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Selective Default

As we have already explained in previous articles, default means insolvency, that is missed payments by an issuer of financial instruments – usually bonds – of recurrent interests and principal in full and at the due maturity dates. Any events which do not comply with such terms determine a state of default. In the case of Greece, the latest rescue plan include, among several measures, the voluntary conversion by holders – which are mainly banks and insurance companies – of expiring securities that the sovereign issuer is unable to repay, with other ones carrying different features and much longer durations. Such restructuring does not apply to all instruments but just a part of them. Thus a condition of so called “selective default” arises: the issuer regularly repays some bonds or is supposed to go on regularly paying coupons and reimburse principal at due expirations, but is currently unable to repay other ones, which actually are the object of the restructuring. Standard&Poor’s, one of the leading international rating agencies, marks such issuer’s state as SD, a sort of Limbo just a step before the fateful D mark, the sign of full insolvency which places the involved issuer out of the international capital markets.

However, after putting the issuer under watch, the assigned rating may be raised or lowered, so that the condition of “selective default” too may be temporary, if the outcomes of restructuring result in making the issuer able to fully and duly repay all other instruments still held by investors. An awkward question is whether such “selectively defaulted” instruments may be accepted as collateral, that is guarantee, by financial institution for granting credit. Technically speaking such bonds are valueless, at least temporarily, so that the answer should be negative but, as in the case of Greece, choices and decisions are more determined by politic than strictly financial arguments, which however often fail to consider unexpected market reactions. - *GLT*

The views expressed are not necessarily those of the Swiss Association of Asset Managers