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The sovereign CDS market is broken [1]

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Or so some will tell you these days. The reason given is that ISDA (the committee that decides such things) has just decided that Greece has not in fact defaulted on its bonds and therefore the CDS protection that was bought on those bonds does not need to pay out.

Cue consternation among those who don't quite understand what is going on. Look, we can see that Greece is defaulting, CDS was intended to pay out on default, no payout, that's the end of the CDS market, right? Well, umm, no, as two very [3] different [4] people have independently pointed out.

It is true that we expect Greece to default any time now. Indeed, it's entirely possible to argue that Greece is planning to default. That that swap of bonds, where the ECB gets to have new bonds, everyone else has to take a 70% haircut on their old bonds, that this is a default because of the subordination and the different treatment of two holders of the same bonds.

But, here's the thing. This all hasn't happened yet. The prices of a CDS on Greek soverign debt has been closely tracking the value of the bonds, tracking that price all the way down in fact. So that part of the market has been working just fine. But what about that final trigger, the declaration of default so that not just collateral moves but that money gets signed, not just handed, over?

Well, yes, we all think that Greece is about to default, yes, we all think that the deal announced and about to get underway meets the definition of a default. But that's the point: it's all just about to get underway. This is all still in the future. So the default hasn't happened yet meaning that the CDS does not pay out *yet*. When the default does happen then they almost certainly will. And the Greek events won't be the end of the sovereign CDS market, they'll be a vindication of it. Those who bought the insurance will get paid out. Those who didn't won't.

Likely to encourage a few more people to buy the insurance, isn't it?

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