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U.S. Treasury gives green light to Russian default insurance payouts

Caitlin Webber

The U.S. Treasury issued a special waiver on Friday to allow investors with insurance against a Russian default, known as Credit Default Swaps, to receive their payouts.

The normally straightforward process of CDS payouts was thrown into chaos in June when Washington said its sanctions on Russia represented a total ban on buying Moscow's debt.

An investor who buys a CDS contract usually hands over the underlying bond to the bank or fund that sold them the CDS when a default happens.It traditionally involves an auction to determine the price, but under the sanctions that exchange effectively became illegal.

The license authorizes U.S. persons to purchase or receive Russian bonds starting two days before the announced date of the auction, and up to eight business days after the auction takes place.

The committee that sets the auction date has a scheduled meeting on Monday at 1300 GMT after having met three times this week.

"OFAC has issued two General Licenses (waivers) to help U.S. and other global investors more cleanly exit their exposures to Russia," a Treasury spokesperson said, referring to the Office of Foreign Assets Control which enforces U.S. sanctions.

The move also authorizes financial institutions "to facilitate, clear, and settle" the newly-authorized transactions, the Treasury's website added.

Analysts had estimated that roughly $2.5 billion worth of Russia sovereign debt CDS had been held up by the problems.

"This is an example of the fine tuning of a sanctions apparatus that the United States has had significant experience with through the years," said Jamal El-Hindi, a counsel at law firm Clifford Chance.

"Specific licenses, general licenses, are used to make sure that the overall impact of the sanctions is doing what they want it to do, and not blocking things that they don't want it to block," he said.

Russia was declared in default last month although it had already tripped in May by failing to pay an additional $1.9 million of interest that had built up on an earlier overdue payment as Western sanctions shut off payment channels.

The confusion had seen investors lobby Washington to make Friday's allowance, which came alongside another 'license' that authorises, through to October 19, wind-down transactions involving securities issued by Russia-based entities under agreements that were entered into before June 6.

"The Treasury granting the license was sensible and helps to fulfill the purposes of a CDS and the reason that the CDS investment exists," said Jay Auslander, a partner at law firm Wilk Auslander.

"From a financial point of view it is good news and what we would have hoped to see."

Still, a holder of Russian CDS said those contracts could have been settled without bonds changing hands, and that the waiver could end up favoring sellers of protection insurance like U.S. investment firm PIMCO, which holds a large chunk of those contracts.

The Treasury's license effectively allows U.S. entities to buy Russian debt if that purchase is necessary to settle the insurance payout, meaning firms such as PIMCO could be left holding a long position in the country's bonds which are currently trading at huge discounts.

"(That) seems counter to what the sanctions are trying to do," the CDS holder said, speaking on condition of anonymity.

PIMCO declined to comment.

(Reporting by Caitlin Webber in Washington, Marc Jones in London, and Rodrigo Campos and Davide Barbuscia in New York; Reuters News)

---- Index References ----

Company: CDS Co.,Ltd.; CLIFFORD CHANCE LLP; Office of Foreign Assets Control; WILK TECHNOLOGIES LTD; PIMCO ENERGY AND TACTICAL CREDIT OPPORTUNITIES FUND; US TREASURY (CATS)

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