Risk managers on default probability for prime sovereigns: Moderator's introduction

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Thank you, Stephen. I'll be quite brief in my introduction, thus leaving the work to the invited speakers and specialists, the real specialists in this field.

Throughout this workshop we have been reminded that even prime sovereigns have defaulted on occasion. Yet the main risk we take, or that investors take, by holding prime sovereign debt may not be hard default. That is an extremely rare event, at least among OECD countries. The risk is rather value loss of different kinds, resulting from what we can call "soft defaults", which may entail unexpected inflation or the depreciation of the currency in which the debt is denominated. And we all know that, historically, debt has been reduced or evaporated in just this way. And there are other forms of soft default too. We have just learned about the complexities around restructuring and about the imposition of seniority rules by supranationals. We have recently seen both these forms of soft default during the euro crisis.

Value losses on sovereign debt often occur when the investors collectively increase their subjective probability estimates of a hard or soft default. The high yields resulting from that implicit downgrading is one important form of mark-to-market loss incurred on a bond portfolio.

So the question is: how we can measure this risk and how we can control this kind of default risk on sovereign debt? The speakers will consider different ways: ratings, models, internal models (quantitative or qualitative), or measures based on market indicators.

We have three very qualified speakers, comprising a practitioner, a policymaker and an academic. I leave the floor first to Tom Wilson from Allianz. Tom, the floor is yours.

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