

# **Bond Case Briefs**

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## **As Puerto Rico Nears Record Default, Insured Investors Rest Easy.**

The mutual-fund company with the biggest stake in Puerto Rico bonds that are almost certain to default on July 1 isn't worried.

That's because Wells Capital Management's \$23 million position in the island's general-obligation debt is entirely backed by units of bond insurers Assured Guaranty Ltd. and MBIA Inc., which agreed to pay investors if Puerto Rico doesn't. That guarantee has distanced Wells Capital and other bondholders from a crisis that's been rapidly unfolding over the past nine months and reached a new pitch last week, when Puerto Rico's governor signed a law authorizing him to halt payments on much of its \$70 billion of debt.

"I haven't even really thought about them not making a payment," said Lyle Fitterer, head of tax-exempt debt in Menomonee Falls, Wisconsin, at Wells Capital, which oversees \$39 billion of the securities. "We haven't been involved in any of the negotiations. It's really seamless for us."

As Puerto Rico veers toward a record-setting default, the insurers have created a haven for mutual funds and individuals who sold off much of the island's uninsured bonds when their ratings were cut to junk, leaving hedge funds and distressed-debt buyers bearing the brunt of the impact. Assured, MBIA's National Public Finance Guarantee Corp. and Ambac Financial Group Inc. guarantee \$27 billion of the U.S. territory's payments, a pledge that's kept those bonds holding steady even as the prices of others tumbled.

The longest-maturing Puerto Rico general obligations backed by Assured, which mature in 2037, traded at an average price of about 100 cents on the dollar on April 7. By contrast, the commonwealth's benchmark bonds due in 2035 last week dropped to as little as 63 cents, the lowest since they were first sold to investors in March 2014.

The insurance companies acted as a similar bulwark following the record bankruptcy of Detroit in 2013, when they stepped in to argue on behalf of bondholders.

With more debt than any state but California and New York, the scale of Puerto Rico's crisis is unprecedented in the \$3.7 trillion municipal market. It has borrowed nearly nine times as much as Detroit had by the time it turned to court to cut its debt. Puerto Rico Governor Alejandro Garcia Padilla called the commonwealth "insolvent" last week as he signed the law that gives him the power to declare a moratorium on debt payments.

That step, if taken, could last through January 2017 and would likely lead to defaults on general obligations, sales-tax debt and, potentially, its highway securities, according to Standard & Poor's. Puerto Rico Treasury Secretary Juan Zaragoza last week said there's "absolutely" no way the government will have funds needed to cover debt bills that come due in July. On Monday, the commonwealth released a revised restructuring proposal that seeks to slash its \$49.3 billion tax-supported debt to as little as \$32.6 billion, a smaller reduction than the cut to \$26.5 billion originally proposed.

S&P, which gives an AA rating to Assured's units and an AA- to National, has said those ranks are consistent with the companies being able to withstand a wave of Puerto Rico defaults. It doesn't rate Ambac.

All three companies say they have sufficient funds.

The potential losses from Puerto Rico "are manageable" given Assured's \$12 billion in claims-paying resources, Robert Tucker, senior managing director at the company, said in a statement. Holders of bonds it insures "can be certain they will continue to receive full payment of scheduled debt service when due," he said.

Bill Fallon, the chief executive of National, said the company's \$4.7 billion available to pay claims at the end of 2015 has left it with enough to pay bondholders in full.

"We're fully capable and liquid to make the payments as required under our policies," Ambac President Nader Tavakoli said. "If there are defaults on our policies, we will pay them."

The anticipated losses have been a drag on the companies' stock prices. Assured shares, which traded as high as \$29.52 in June before Garcia Padilla declared that the island's debt couldn't be paid, finished Friday at \$24.01. MBIA has dropped 18 percent since that time to \$7.70, while Ambac declined 37 percent to \$15.15.

Investors can count on insurers to pay them back, but some could struggle with larger-than-expected losses from the commonwealth, said Matt Dalton at Belle Haven Investments. He owns some general obligations that mature July 1 guaranteed by Assured, the only company he relies on for backing.

"It's like wearing suntan lotion in the hot sun: You just have a safer, more comfortable feeling, because you have the insurance between you and a potential disaster," said Dalton, chief executive officer of Rye Brook, New York-based Belle Haven, which oversees \$4.2 billion of municipal bonds. "You can still get burned if you stay out in the sun too long, even with UV 50 on, but it won't send you to the hospital."

Fitterer at Wells Capital said he's not only buying insured bonds, but also sticking to shorter-dated debt because of uncertainty around the losses that may be imposed on insurers.

That bet is paying off. Assured-backed general obligations coming due on July 1 traded last week above 100 cents on the dollar, signaling full confidence that both principal and interest will be paid on the maturity date. Those bonds due July 1 without insurance changed hands at 63 cents, which would amount to a yield close to 300 percent.

For Fitterer, Dalton and others holding insured obligations, as the securities come due in the next few months, they can say something with near-certainty that uninsured bondholders can't. "Yes, they will pay," Fitterer said.

"We're going to get paid on those with insurance, for sure," Dalton said.

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