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Should High-Risk Speculators in Puerto Rico Bonds Have a Seat at the Restructuring Table?

Summary

- Puerto Rico announced a five-year bond restructuring proposal.
- Bondholders will be forced to make concessions.
- U.S. House Democrats claim it's "unjust" for speculators to have restructuring input.

Puerto Rico last week said it had laid out a five-year plan for broadly restructuring its mammoth debt.

A significant question facing the politicians and bankers in charge of the debt reorganization is whether hedge fund investors, who recently bought the highly speculative bonds, should be treated the same as mom-and-pop retail investors. Those investors believed that they were investing in long term, safe and secure municipal bonds that their financial advisors at UBS (NYSE:UBS) and other firms recommended.

First, the plan.

"The new plan calls for restructuring about \$47 billion of Puerto Rico's \$72 billion in bond debt and carrying out an ambitious package of economic changes under the eyes of an independent financial control board," reported Mary Williams Walsh of the New York Times. "Virtually every element of the plan requires either concessions negotiated from creditors or legislation enacted in San Juan or Washington, suggesting a long and difficult road ahead."

"Among the most striking aspects of the plan - and likely to be one of the most contentious - is the proposal to restructure Puerto Rico's general obligation bonds, which were sold to investors with an explicit constitutional promise that timely repayment would take priority over all other expenditures on the island," according to the Times report.

"For decades, general obligation bonds have been marketed as virtually default-proof, and a major restructuring of them now by Puerto Rico would raise unwelcome questions about the credibility of the time-honored "full faith and credit" pledge that stands behind such bonds," according to the Times. "Puerto Rico is not proposing to walk away from its bonds completely, but to pay its investors less."

Remember, Puerto Rico defaulted for the first time in August when it paid just \$628,000 of \$58 million due from one of its agencies. Unlike U.S. municipalities, Puerto Rico cannot seek federal bankruptcy protection.

The five-year restructuring plan will entail significant concessions from bondholders and will likely spawn much litigation over general obligation bond guarantees, according to the Times.

It's a dire situation. Puerto Rico and its agencies only have \$5 billion to repay \$18 billion of principal and interest over the next five years.

How will investors fare under the plan? That is one of the key questions raised by a policy paper called "Profit at Any Cost" prepared recently by U.S. House Democrats. The paper argues that it is "unjust and unrealistic" for hedge fund managers and other institutional investors to demand full repayment on what they knew to be junk bonds, according to an article by Billy House of Bloomberg.

The policy paper criticizes these investors' opposition to proposed legislation that would allow Puerto Rico to file for Chapter 9 bankruptcy to restructure its \$70 billion debt that the governor claimed could not be paid.

According to Bloomberg, the policy paper states that hedge fund managers are "now pushing teacher layoffs, pension cuts and other quality-of-life reductions for Puerto Ricans as the 'solution' to the crisis in a self-serving attempt to enlarge their profits."

It seems clear that Puerto Rico bonds are heading for a massive default or restructuring that will result in pain for bondholders. While Puerto Rico is a mess and blood will flow, it seems unfair to treat all investors the same here.

We agree with the policy paper. All investors are not created equal. The little guy who bought Puerto Rico bonds as long-term investments deserves fair treatment while the institutions, hedge funds and other such big boys should take a seat at the back of the room during these negotiations.

Zamansky LLC are securities and investment fraud attorneys representing investors in federal and state litigation against financial institutions. For more information about Zamansky LLC, please visit [here](#).

Additional Disclosure: Zamansky LLC represents investors in arbitration cases against UBS regarding Puerto Rico bonds and UBS closed end bond funds, Lehman structured products and other investments.

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