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Puerto Rico Default Won't Derail Market, Bond Insurer Says.

A bond default by Puerto Rico won't derail the $3.7 trillion municipal-bond market as the investor base for the commonwealth's securities has shifted to hedge funds from individuals and mutual funds, according to Tom Metzold, a managing director at National Public Finance Guarantee, which insures some of the debt.

"Is Puerto Rico the first domino?" Metzold said Wednesday at a forum sponsored by Standard & Poor's at the Harvard Club in New York. "The answer is no."

Negotiations between commonwealth officials and holders of some of Puerto Rico's $73 billion of bonds fell apart last week. The administration of Governor Alejandro Garcia Padilla has said it may run out of cash next month. Puerto Rico has about $720 million of bond payments due in December and January.

"We're obviously hoping very much that they don't want to go nuclear and not pay that," Metzold said. "We can assist, but we're looking for a little give and take here so that potentially this can extend for a longer period of time."

Puerto Rico's Government Development Bank, which oversees the island's borrowing, is facing a Dec. 1 debt payment of $354 million. The GDB said Wednesday that it had net liquidity of $875 million as of Sept. 30. If the GDB doesn't make the payment, it would be a violation of the commonwealth's constitution, Metzold said.

Bond Insurers

MBIA Inc., the parent of National Public Financial, has been in talks with Puerto Rico Electric Power Authority and other insurance companies that guarantee repayment on some of utility's bonds to delay payments to free up cash and and help restructure $8.3 billion of debt, two people with knowledge of the matter said last week. Assured Guaranty Ltd. and Syncora Guarantee Inc., along with MBIA, back about $2.5 billion of the bonds.

Tim Ryan, a portfolio manager at Nuveen Asset Management, said he expected the price spreads to widen between how much bonds are offered and how much buyers are willing to bid if there's a default. Bid-offer spreads have increased on other news, such as when the Obama administration proposed giving Puerto Rico a form of bankruptcy protection, he said.

"There will be an adjustment in prices," Ryan said. "There are individuals on the island that own direct debt. If there's a default and temporary suspension in payments, their game has changed." Some investors may sell Puerto Rico debt, driving prices down, if there's a default, Ryan said, adding that it's difficult to quantify the risks to bondholders given the uncertainty of the political and legal process.

Commonwealth general obligations with an 8 percent coupon that mature in July 2035 traded Thursday at an average price of 73.1 cents on the dollar, according to data compiled by Bloomberg.

The bonds yield 11.5 percent.

Giving Puerto Rico the ability to file bankruptcy “is a slippery slope,” Metzold said, because it could result in more litigation. Congress isn’t likely to approve the Obama plan, both Metzold and Ryan said.

“Negotiation means a give and take, not I want, I want, I want,” Metzold said. “There are realistic solutions if people are willing to be realistic in their expectations.”

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