Puerto Rico Risks Dangerous Precedent by Protecting Pensions.

A suggestion from a U.S. Treasury official to protect Puerto Rico's pension payments while also seeking cuts from all bondholders may be viewed as the latest sign that politicians favor retirees over investors in cases of municipal distress.

Treasury Counselor Antonio Weiss said in prepared testimony Thursday that a failure to ensure payments from Puerto Rico's pension system, which has more than 330,000 beneficiaries and is underfunded by $44 billion, would harm the commonwealth's residents and damage its economy. Meanwhile, "all creditors must be at the table" to restructure the island's liabilities to an affordable level, he said.

It could "set a dangerous precedent," said Peter Hayes, head of munis at BlackRock Inc., which oversees $110 billion of the debt. "Pensions are clearly down the capital structure in terms of hierarchy and repayment. So the political side of it is boosting them higher than bondholders."

Weiss said in Washington that there was a difference between protecting pensions and saying that they "should be prioritized above everything else." He said all stakeholders should receive fair and equitable treatment.

Political Priorities

The suggestion to shield Puerto Rico's pensions, combined with bankruptcies in Detroit and Stockton, California, show that the politics around retiree benefits can often muddy the outlook for repayment assumed by bond investors. Constitutionally protected general obligations would recover about 72 percent under a plan from the commonwealth released earlier this month. Other securities would get less.

In Stockton, the California Public Employees' Retirement System was protected from cuts while some bondholders received cents on the dollar. In Detroit, the city's pensions got more than twice what creditors who loaned the city money for those funds received. General obligation bondholders settled for less than full value, even though the $3.7 trillion municipal market has long believed that such debt is sacrosanct.

Moody's Investors Service said Thursday in a report that recovery rates for bondholders have generally been lower than for retirees in municipal bankruptcies. Of the six large bankruptcies cited in the report, four of them paid pensioners 100 percent of what they were owed.

Generally, to fund a pension plan, "you raise taxes and you pay for it, or you have to make cuts if you don't want to raise taxes," Hayes said in an interview at BlackRock's New York headquarters. "We're seeing this political will to make pensioners whole and ignore the other two options."

Ryan Deadline

Puerto Rico's benchmark general obligations with an 8 percent coupon and maturing in 2035 traded at an average 71 cents on the dollar, the highest price since Feb. 5, data compiled by Bloomberg show. They've been little changed in 2016 as many investors are entrenched in their positions ahead of a restructuring.

Republican Representative Mick Mulvaney from South Carolina also brought up the risk of a "dangerous precedent" in potentially favoring pensioners at the expense of bondholders during a Thursday hearing of the House Financial Services Committee's oversight and investigations group.

"That doesn't strike me as fair," he said.

Congress is considering whether to inject the federal government into a more central role in a crisis that's escalated since Governor Alejandro Garcia Padilla in June said the government can't afford to pay its debt.

Puerto Rico has already defaulted on some securities and has warned that it may halt payments as soon as May without a solution. House Speaker Paul Ryan directed Republican committee chiefs to come up with a plan by the end of March.

Bloomberg Business

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February 25, 2016 — 10:42 AM PST Updated on February 25, 2016 — 1:52 PM PST