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Hedge Funds Sue to Freeze Puerto Rico Bank's Assets.

A group of hedge funds asked a federal court in San Juan on Monday to freeze the assets of Puerto Rico's powerful Government Development Bank, claiming it was insolvent and appeared to be spending what cash it had left to prop up other parts of the island's troubled government.

The bank had failed to provide financial information that creditors were entitled to under federal law, the hedge funds said in a lawsuit. They asked the United States District Court in San Juan to bar further cash transfers by the bank, other than those essential to the safety and well-being of the island's residents.

"Once G.D.B. spends its last remaining funds — and it is only a matter of time — many essential services in Puerto Rico may come to a halt," the hedge funds said in their complaint. By then, they said, there would be nothing left for the bank's creditors, who "will suffer substantial losses."

The bank plays a critical role in Puerto Rico's financial affairs, and if it stumbles, the effects would be widely felt.

The Government Development Bank has a debt payment of about \$422 million due on May 1, and credit analysts doubt it has enough cash to make it.

The president of the bank, Melba Acosta Febo, said on Monday that the lawsuit's accusations were "erroneous" and that the bank was acting within the bounds of the relevant laws.

"The central claim of G.D.B.'s creditors, that G.D.B. has knowingly withheld financial information in order to prefer certain depositors over its bondholders, is wholly false and without basis in fact," she said, adding that the bank "will respond to the complaint in full through proper legal means."

The federal bankruptcy code bars Puerto Rico from Chapter 9 municipal bankruptcy. So, Congress is working on a law that would allow Puerto Rico to restructure debts under the watch of a federal oversight board. The draft bill would shield the government from creditor lawsuits in the case of a major default.

But the legislation raises constitutional issues. Congress is not expected to enact a law in time for the bank's May 1 debt payment due date — or perhaps not even by July 1, when an even bigger payment from Puerto Rico is due.

The hedge funds, which own Puerto Rico bonds, based part of their lawsuit on a confidential report by Puerto Rico's Commissioner of Financial Institutions, which in November found the Government Development Bank insolvent.

In March, a federal judge quoted prominently from the commissioner's confidential report in deciding a tax case, though the commissioner's office would not release a copy.

In that tax case, Walmart accused Puerto Rico of unlawfully hitting the retailer with a higher tax rate last year than any other business on the island. Walmart argued that the island's lawmakers had

enacted the tax because they were desperate to fill a \$125 million budget gap.

Judge José Antonio Fusté not only drew on the confidential finding that the bank was insolvent, but also wrote that the bank had not had a required examination since 2007.

After a struggle for information, the examiners had determined, he wrote, that the bank's liquidity level was "critically deficient," that it was failing to account properly for at least \$2.3 billion of "off-balance sheet items," and that its liquidity would be "negative \$1.348 billion in June 2016," which was less than the required reserve levels. The examiners found that the bank might be put into receivership.

As Judge Fusté's opinion has gained attention, rumors have swirled on the island about a possible receivership for the bank, or other drastic steps. Ms. Acosta issued a statement on Friday calling such rumors irresponsible.

"The G.D.B. will neither shut down nor be privatized," she said. She said the bank was still trying to negotiate with creditors and was considering other steps, "such as declaring a temporary moratorium on payments, and amending the G.D.B. charter."

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By MARY WILLIAMS WALSH

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