
A Stumble May Lead Puerto Rico Forward.

When an amorphous problem drags on without a solution anywhere near the horizon, it can be refreshing when something concrete happens, even if it's not particularly positive.This seems to be the case with Puerto Rico, which just had its biggest default ever by missing $911 million of payments due on July 1. While the move couldn't exactly be called good — defaults and insolvencies rarely are — it carried some kernels of optimism, especially for bond traders and insurers, if not for the commonwealth's residents.

For one, the default could be seen as a starting gun for the aforementioned elusive solution and a defining moment after antagonistic negotiations between Puerto Rico and its creditors. Also, it was smaller than it could have been. The island was on the hook for $2 billion of bond payments, which it was ill-equipped to pay. The fact that it paid any surprised some.

Puerto Rico made it clear last year that it has no intention of paying off its $70 billion debt load in full. Moreover, it dragged its heels about disclosing its true finances. Congress wasn't providing much assistance. And talks between Puerto Rico and creditors kept breaking down.

The hard July 1 debt payment deadline appeared to focus everyone's efforts. U.S. lawmakers expedited a bill giving the commonwealth tools to restructure its debt, passing it on June 29, just days before the payment came due. The island opted to disclose its 2014 finances right afterward.

The legislation didn't prevent a default or even map out specifically how Puerto Rico's debt would be restructured. But it started to clear a path forward and created a fiscal control board to oversee the island's finances, a move that has been welcomed by many investors.

By the time the default actually came to pass, investors took the missed payments in stride, or even as a good sign. Just take a look at prices on the bonds. They've largely risen, with some notes gaining considerably, as investors became more optimistic about their recoveries.As it became clearer that Congress would pass legislation to give restructuring tools to Puerto Rico, traders grew more confident and started transacting more frequently. Trading volumes have picked up in Puerto Rico bonds from the lackluster levels of March and April, when there was less certainty about anything having to do with the island's finances.

And at least one group of players is benefiting, at least for now: bond insurers. Check out the share prices of MBIA, Assured Guaranty and Ambac. They've hung in there despite the fact that they are on the hook to compensate investors for losses on billions of dollars of Puerto Rico debt.

These debt-insurance firms are getting a chance to prove their effectiveness. Two subsidiaries of Assured Guaranty paid an estimated $184 million in net claims in the wake of the default, albeit decrying the island's lack of payment as a violation of its constitution.

Assured Guaranty is capitalized well enough to cover these payments, given its $12 billion on hand to cover all claims, according to Mark Palmer, a BTIG analyst who covers the company. Its net insured exposure to Puerto Rico amounts to about $5 billion, he said.

"There's such a thing as a good loss for a municipal guarantor," Palmer said. "It underlines the value proposition associated with bond insurance." An orderly restructuring of Puerto Rico's debt is probably too much to ask for at this point, and in fact the turbulence is probably just shifting into a new phase.

Creditor squabbles and government recriminations are a given. But that blip way out there on the horizon might not be a mirage.

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