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## **Puerto Rico's Fight on Utility Deal Raises Risk for Bond Insurers.**

- MBIA, Assured Guaranty shares fall amid push for concessions
- Conflict marks prelude to restructuring of entire debt load

When Puerto Rico struck a deal more than a year ago to cut the government electric company's \$9 billion debt, one group was spared the hit: bond insurers, whose guarantees the island needed to win back the faith of investors.

That agreement and the precedent it set are now at risk as Governor Ricardo Rossello threatens to use the bankruptcy-like powers the U.S. has since given the territory to seek additional concessions from MBIA Inc. and Assured Guaranty Ltd. That's triggered a decline in bond insurers' shares over speculation about the scale of the losses they face as Puerto Rico moves toward the bigger effort to slash its entire \$70 billion debt.

"For an outsider coming in, like the governor, it probably doesn't seem to him like the people of Puerto Rico got the best deal here," said Chas Tyson, an analyst with Keefe, Bruyette & Woods.

The push to reopen the Puerto Rico Electric Power Authority's December 2015 agreement — the only one the island has reached — marks an opening salvo in Rossello's effort to pull the government out of a crisis that's promising to impose deep losses on bondholders, who snapped up the territory's high-yielding debt for years even as the economy contracted. Puerto Rico has already defaulted on a major swath of its debt and the fiscal recovery plan approved this month by U.S. financial overseers would cover less than a quarter of what it owes between 2018 and 2026, assuming the government can accomplish its goals of cutting spending and raising revenue.

Analysts say bond insurers have enough cash to weather their exposure to Puerto Rico and that's reflected in the price of guaranteed commonwealth bonds, some of which trade for over 100 cents on the dollar.

But insurers' shares have slid amid speculation the resolution will be more costly than previously anticipated. Since the end of January, MBIA has fallen 18 percent and Assured 5 percent, while Ambac Financial Group Inc., which also insures Puerto Rico debt, has declined 11 percent. The S&P 500 Index has gained nearly 4 percent over the same time.

The companies that insured the debt of the utility, known as Prepa, were set to avoid paying out claims under the deal. Owners of uninsured bonds, including Franklin Advisers Inc. and OppenheimerFunds Inc., agreed to accept 85 cents on the dollar by exchanging their securities for new debt backed by a share of residents' electricity bills.

Instead of covering payments on the other debt they guaranteed, the insurers agreed to fund a \$462 million surety bond that would backstop the securities — providing investors with protection against a default. Assured and MBIA also purchased bonds from Prepa to provide the utility with cash needed to cover debt payments.

Prepa's uninsured debt is trading around 60 cents, indicating creditors got a good deal relative to the market, said Tyson. "Every dollar that you don't spend on debt service can be passed on to utility customers in the form of lower prices," he said.

Rossello's push has riled insurers and bondholders, who said it cast doubt on his ability to negotiate with other creditors and jeopardizes the government's ability to return to the capital markets. If his administration can't strike an agreement, Puerto Rico and the federal oversight board may turn to the courts to reduce what is owed, thanks to a provision included in a U.S. law passed last year to give the island tools to deal with its debt.

Puerto Rico is facing a deadline to reach out-of-court settlements with creditors by May 1, when a legal stay that's sheltered it from the consequences of most lawsuits is set to lapse. The Prepa deal could also expire on Friday if it's not extended, as insurers and bondholders have previously agreed to do.

The gulf between Rossello and Prepa's creditors was on public display at a March 22 congressional hearing in Washington, where Adam Bergonzi, chief risk officer of MBIA's National Public Finance Guarantee unit, said the governor has done little to reach out to creditors. An adviser to Franklin and Oppenheimer also questioned Rossello's failure to close the deal. On Tuesday, U.S. Representative Doug LaMalfa, who heads the House panel that held the hearing, urged Rossello to complete the Prepa agreement by Friday's deadline.

MBIA's National insures \$8.6 billion of principal and interest payments, including \$1.8 billion of Prepa debt, and had \$4.6 billion of claims-paying resources at the end of 2016, according to the company's disclosures. Assured guarantees \$8.1 billion of principal and interest payments, including \$1.1 billion from the utility, and had \$11.7 billion to meet claims as of Dec. 31.

Syncora Guarantee Inc., which is also a party to the Prepa deal, had only about \$461 million of exposure to Puerto Rico as of Sept. 30. Ambac insures \$9.7 billion of principal and interest, \$7.3 billion of which comes due from 2047 to 2054, according to a filing. The company reported \$8.8 billion of claims-paying resources as of Dec. 31. It doesn't guarantee Prepa securities.

MBIA spokesman Greg Diamond, Assured Guaranty spokeswoman Ashweeta Durani and Syncora spokeswoman R. Sharon Smith declined to comment. An e-mail and phone message seeking comment from Ambac weren't returned.

Puerto Rico's move to extract concessions from the insurance companies may be short-sighted, said Mark Palmer, managing director at BTIG LLC. He said the island may need the companies to guarantee its bonds whenever it wants to resume borrowing for public works, given that investors may be worried that it would default again if the economy doesn't turn around.

"It makes sense to use insurance where the investors are really taking risks on the insurer and not the municipality," he said.

The conflict between Puerto Rico and the utility creditors is unlikely to be resolved outside a broad agreement to restructure all of the island's debts, said Tyson, the analyst with Keefe, Bruyette.

"There's a pretty wide distance between the governor, the oversight board and the major creditors of Prepa," he said.

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by Martin Z Braun and Jordyn Holman

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