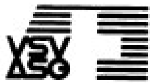
Corriere del Ticino 2010/06/17



LET'S TALK ABOUT...
FINANCIAL LEXICON EDITED BY THE SWISS ASSOCIATION OF ASSET MANAGERS

Debt Restructuring

(Part One) We are not going to consider corporate stream linings and reorganization processes, aimed at cutting costs and stimulate operations, but rather those financial acts which are carried on by issuers of bonds and similar instruments in the public financial markets, such issuers then happening to face difficult conditions. In that sense restructuring means a sudden change of the rules which are at the very base of the borrowing-lending contract, in terms of payment of periodical interests (coupons) and final repayment of principal. So restructuring, when decided by a corporate or government/sovereign issuer, is a relevant and consequence bearing event. Many see a debt restructuring as a minor episode if compared with an actual default, but restructuring itself is a default, in that it breaks the compliance with the legal obligations and contractual terms which were agreed upon when the debt instrument was set and issued. Just recently, for the possible – or likely – restructuring of the Greek sovereign debt, the term “soft restructuring” has been used, but the definition is pretty vague and meaningless, because any restructuring is indeed an insolvency *tout court,* and places the involved issuer in an extremely negative position face the international capital markets. Of course the reasons why for debt restructuring are liquidity problems, financial unbalances, bad management and so on. Financial history is rich of such events, for both corporate and government issuers, and some of those cases will be reviewed in the coming articles about defaults.
Restructuring in most cases means re-negotiating the debt terms, so to release the pressure on the issuer’s cash flow and let him continue to operate. And such terms are more pressing for private corporations, which face the ghost of bankruptcy, whilst governments, that are not subject to failure for definition, tend to use the restructuring tool in more elastic and often more free and even impudent ways, as negative consequences are usually more limited for them.
In practice restructuring often means refinancing: the old debt which has come to expiration and can not be repaid is switched into a new one, with different terms, usually longer maturities, higher yields so to appease investors and/or newly set terms and conditions, so to temporarily releave the issuer’s financial pressure. This is one solution, but harder ones may be decided, which will be discussed next. *(to be continued) - GLT*

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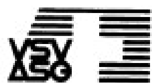
Corriere del Ticino 2010/06/24



LET'S TALK ABOUT...
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Debt Restructuring

(Part Two) We just discussed the case – or better said, the many actual cases – of those bond issuers, both government and corporate, which can not comply with their financial obligations in paying periodical interests (coupons) and/or in reimbursing the principal at maturity, due to their distressed financial conditions. Instead of fully defaulting, the issuer can then opt for a debt restructuring, which is all the same a default, as contractual terms are infringed anyway, although it is seen by many as a softer and less traumatic event. Debt restructuring is often implemented through e renegotiation of terms: expirations may be postponed, yields changed and new terms added in order to make the switching attractive for the investor, also lowering the pressure on the issuer's cash flows. But debt restructuring may take other forms, as in the case of an "haircut", that is offering investors a straight cut of the amount to be repaid: a sort of "take it or nothing" which may be indeed unsatisfactory for the investor, also placing the issuer in an unfavourable position, but offers no alternatives, except a full default with even gloomier outcomes. Such cases are very frequent too. Otherwise the restructuring may take the form of a full or partial transformation of the debt into equity. Bonds or notes are then switched into shares and the investor's legal status changes drastically: the periodical interests in the form of coupons are replaced by variable and erratic dividends (if any), with no fixed guarantee for the repayment of principal. One more restructuring type is the one related to many hedge funds and funds of funds, after they have been dramatically affected by the deep crisis linked to subprime debts, the related instruments, and all that came out from that. We will discuss it in the next article. *(to be continued) - GLT*

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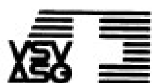
Corriere del Ticino 2010/07/01



LET'S TALK ABOUT...
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Debt Restructuring

(Part Three) The hedge funds and funds of funds, when confronted with the deep crisis initially stemmed by the subprime sector, then spread to most property securities and credit-related instruments in general, have carried out a particular form of debt restructuring. Their participants, in view of the dramatic conditions of the financial markets in general and the alternative areas in particular, had suddenly and widely asked for the redemptions of their investments, and such massive requests could not be satisfied by the scarce liquidity that the funds' managers were holding. The funds' problems were also exacerbated by their high level of leverage, in that they had invested much larger amounts than the capitals actually received, then borrowing heavily, also thanks to the extremely easy access to credit in those days
Most of them have been then compelled to liquidate their holdings in the middle of real market storms and, in order to avoid rush sell-offs, they have decided to block (gate) redemptions, while promising partial reimbursements, much diluted in time, according to more of less defined schedules. The declared reason was a strategy in favour of their clients themselves, as it would have been bad to sell their assets at the extremely cheap prices of those moments. But the major feature of their restructuring has been the splitting of portfolios into two different sections, which have actually become two different products. One portion, the liquidation series, was to include those components which looked better priced and more easily negotiable within a reasonable time perspective, despite all the kinds of uncertainties and difficulties they carried with them. Besides this series another one was created, the so called "side pocked", to include, alas, the more problematic portfolio components, the toxic securities, being those instruments with no real market price (*de facto* valueless) and not able to be traded, for which better times were to be expected or further more "creative" restructuring strategies, if any. Of course the involved participants suffer several damages thanks to this strategy: firstly, the block of redemptions; secondly the reimbursements of their participations (often with heavy losses attached) according to long lasting schedules, possibly going through many months and even years, and, last and not least, the perspective of definitely loosing a part of their investment. But one of the most emblematic and complex case of debt restructuring in modern financial history is likely the one of the Argentina debt, which will be considered next. *(to be continued) - GLT*

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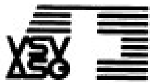
Corriere del Ticino 2010/07/08



LET'S TALK ABOUT...
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Debt Restructuring

(Part Four) Argentine debt restructuring undoubtedly is one of the most crooked, longest (as not yet currently settled), anomalous, as well as rich of consequences, and morals for all the parties involved in it. The crisis which took to the default of the government in Buenos Aires comes from far away, due to the huge economic troubles Argentina had faced along the years, and reached its climax in the 1990's, then fuelling recession and instability, along a worsening path that still continues so far, despite some slight improvements since the year 2003. The state of insolvency, although being latent long before, was officially declared in 2002, together with huge outflows of capitals from the country (a situation which was to take place in Venezuela some later), and the giving up of the currency peg, an actually fictitious and foolish measure which was - and still is - so common for many Latin American countries (including Cuba), the terms of which was a 1 to 1 ratio with the US dollar. Due to such dramatic events the rate of exchange was floated and that was to fuel high inflation, being this another common plague of South American scenarios. The government of Buenos Aires, being unable to repay expiring debits, opted for a debt restructuring, but was soon confronted with strong oppositions by private and corporate investors, mainly from Europe, Italy in particular, and Japan, who harshly criticized the operation's terms. Many legal actions were taken, and in several cases the Argentine government succumbed and was sentenced to fully and immediately repay defaulted investments.
The default was huge, actually the biggest in the financial history, amounting to some 93 billion US dollars, as the result of irresponsible economic policies which had been carried on. Currency reserves were almost dried up and the few left were just essential in avoiding further dramatic devaluations of the *peso*. It was indeed to result the mother of all defaults and, since then, Argentina was to be excluded from the international financial community and from borrowing via the institutional capital markets, with the exception of few eccentric initiatives, more or less propagandistic, as the purchase of Argentine bonds by the Venezuelan government of colonel Chavez. International markets reproved political and economic authorities of Buenos Aires about many terms and features of their restructuring, as we are going to discuss further down. (*to be continued) - GLT*

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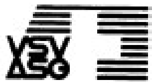

LET'S TALK ABOUT...
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Debt Restructuring

(Part Five) The hugest, longest and most crooked restructuring of any time (at least so far) has been the one concerning the Argentine debt; it began in 2002 after a long period of economic and financial troubles, not yet fully gone. It has been widely disputed by private and institutional investors (pension funds) involved as well as financial actors in general, due to the terms it adopted, which also took to many legal suits and the exclusion of the country from the international capital markets till now. By the way the restructuring itself is still to be completely defined. The initial operation's amount was USD 93 billion, which were to hugely increase once the plan began its course of implementation, after a lot of uncertainties and delays: it was a "take it or nothing" option according to which about two thirds of the expired and unrepaid bonds were switched into new instruments with lower face values (so causing an immediate loss of about 30% to investors). The newly issued instruments of lower values carried much longer maturities (also multi-decennial) and were partially indicized to the country's long-term GDP.

Besides those technical features and terms, the main reasons which fuelled opposition and fury by many investors and institutions were the arrogant attitude of the Argentinean government, the slowness in defining and implementing solutions and the ambiguous stance towards the International Monetary Fund: as soon as that institution criticized the restructuring's plan it was immediately repaid in a parallel way, in prejudice of the other creditors, with the aim of saving the government's face and to leaving at least one door open just in case other emergency interventions should be needed. The whole story is thus marked by unclear and unfair outlines, and some important harsh morals can be drawn from it. (*to be continued) - GLT*

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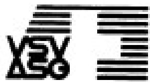

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Debt Restructuring

(Part Five) Argentine debt restructuring, one among the many default cases that have marked the entire financial history (while reminding that restructuring is a default itself in both formal and practical terms), whether allowing investors to recover portions of their investments or not, in long or reasonable times, however inspires some reflections and morals for all involved parties.
For debt issuers the moral may be not to abuse the reliance – or poor caution – of operators and investors and, should a crisis arise and make it impossible to comply with the fixed repayment terms, to however show respect for bondholders and set fair solutions in a short time and in line with the markets' expectations, so not to clash with them, however heavy the financial pressures. For investors the major moral is to assess and select investment instruments with great wisdom and rationality, always considering that much higher expected or promised yields than market averages always take high risk levels with them, whatever the type of risk. The common idea that rich coupons however cover and dilute risks, whatever the sort of debt principal, is questionable at least. Perhaps the most important morals concern financial institutions: they are often pretty unconstrained (not to say impudent) in offering high-risk (or low-transparence) instruments and products, without adequately inform and evaluate the acceptability of such risks by their clients. A question arise about the types of financial actors, in that large banks and other major financial institutions may be taken in a conflict of interests with some kinds of "particular" securities: they may happen to be part of underwriting pools or directly involved in promoting or placing those issues; moreover, as holding them in their own books, they may be interested in spreading them in their clients' portfolios, according to more or less transparent patterns. In such sense the role of an independent asset manager may make the difference thanks to its neutral and unconstrained position, which may be more favourable for the client. The independent manager normally has no interest in "promoting" a specific bond or other product and can assess risk-reward ratios in more balanced and fair terms, so protecting his/her clients against too hazardous or incautious choices, except the case the client himself/herself accepts such risk and and opts for that investment explicitly. In such case a disclaimer in witting, with the client's signature, may be recommended. *(end) - GLT*

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