

ThePost.ie

Burning the bondholders: the options

07 March 2010 By Cliff Taylor

Burn the bondholders! As it becomes clear how much taxpayers' money will be needed to recapitalise the banks in the months ahead, another topic - discussed on and off over the past year - will come back into focus. What losses can be imposed on bondholders in the banks?

Banks get money from various sources. At one end of the line - the risky one - are the shareholders.

Bank shareholders who have held shares since before the crash have lost most of their investment; in the case of Anglo Irish Bank they lost it all. At the other end of the line, the secure one, are depositors, and most commentators believe that depositors must be protected in all cases for the credibility of our banking system.

In the middle - with investments more risky than depositors but not as risky as shareholders - are the bondholders.

These are largely financial institutions who invested money, often for fixed periods for various rates of return.

Some bondholders, the so called senior debt holders, are seen as being almost akin to depositors.

Others, generally referred to as subordinated bondholders, are more akin to shareholders, taking a higher return in return for accepting more risk.

In the event of losses, it is meant to be shareholders who lose first and subordinated bondholders, the other class of risk investors, who are next in line. Some of this subordinated debt is covered by the state guarantee and some is not.

A major issue in debate is whether losses should be imposed in some way on these bondholders and particularly on those holding subordinated debt. Many analysts say they should be - particularly in the case of the obviously bust Anglo Irish Bank - where there is more than €2 billion in outstanding subordinated debt.

The government has argued that being too aggressive with bondholders could cause problems for the government, and could lead investors to demand a higher return. So far some banks have "bought back" debt.

This voluntary process does impose some costs on bondholders by paying them less than full value for their bonds, but is not as aggressive as the critics of the government approach would like.

A recent analysis by Glas Securities estimated that there was close to €13 billion in outstanding subordinated debt in the six institutions covered by the government guarantee, though subsequent buy-backs will have reduced this figure somewhat.

It estimated potential capital gains of between €3 billion and €4 billion could be raised from buyback programmes similar to those already started.

Critics, including Fine Gael, believe that bondholders should be hit for more. In the case of Anglo and Irish Nationwide in particular, this is set to be a big issue for debate.

There are suggestions that restructuring Anglo into a good and a bad bank could provide a mechanism for impairing some losses on bondholders.

© Thomas Crosbie Media 2010.