

Bond holders edging closer to haircut

The sale of a €14bn savings book and the collapse of a little known Danish bank may be first signs of bondholders getting burned, writes Louise McBride

THE move by Moody's to downgrade the senior debt of the Irish banks last Friday is probably the clearest indication yet that a haircut is on the cards for some senior bondholders.

The downgrade came a few days after the auction of Anglo Irish Bank and Irish Nationwide's €14bn deposit book. The auction, which is expected to be completed in about a week, could make it easier for a new government to force some senior bondholders -- particularly the €3.1bn of unguaranteed senior Anglo bonds -- to share the banks' losses, rather than having the taxpayer foot most of the bill.

"Deposits and senior debt rank equal in creditor status, so you can't haircut senior debt without haircutting depositors," explains Donal O'Mahony, global strategist for Davy. "However, if a bank's balance sheet is restructured so that depositors and senior debt holders are separated, such as through a deposit book disposal, then senior debt is left on its own at the top of the balance sheet -- and is vulnerable to politicians' errant ways."

Taking the €14bn in deposits off the books of Anglo and Irish Nationwide may effectively shield savers from any case that could be made that they too should be forced to share the banks' losses. Both banks are now being wound down.

Another recent development which could trigger a bondholder haircut was across the North Sea in a little known Danish bank called Amagerbanken.

Last Sunday, the Danish government seized Amagerbanken after the bank -- which had run up massive losses on loans to property developers and investors in commercial real estate -- went bust. Bondholders in Amagerbanken face losses of about 41 per cent following the seizure. About 700 savers face a similar fate as they have more than €100,000 on deposit -- more savings than the Danish government was willing to protect.

The action taken by the Danish government "starts the ball rolling on the issue of [bank] bonds," says Dermot O'Leary, chief economist with Goodbody Stockbrokers. "It is a precedent we have not seen before".

It is the bondholders in Anglo Irish Bank who have most to fear from any repercussions of the Amagerbanken collapse, according to Simon Adamson, a senior analyst with British research firm, CreditSights.

"It is very difficult to write down the senior debt of a bank that continues in business," says Adamson. "But Amagerbanken is being taken over and will be either wound down or sold. Although Anglo is a much bigger bank than Amagerbanken, there are some parallels between Anglo and the Danish bank. Anglo is also being wound down so the treatment of bondholders in Amagerbanken is more relevant to Anglo than the other Irish banks."

Senior debt is debt which is usually paid back before other debts and liabilities should the bank (or company) that issued that debt go bust. Senior bondholders have up to now been untouchable -- indeed, it was a condition of the IMF-EU bailout that they would not be forced to share the losses of the Irish banks.

There is about €6.4bn of senior debt in Anglo Irish Bank -- of which €3.3bn is senior guaranteed debt, and another €3.1bn is senior unsecured debt, according to O'Mahony. Irish Nationwide has about €632m of senior unsecured debt, says O'Mahony.

It is the senior unsecured debt which is the most vulnerable of the senior debt to a haircut as it does not have the protection of a guarantee. It was the unguaranteed senior unsecured debt which Moody's downgraded last week.

It is unlikely that any new government will accept that senior bondholders should continue to be sheltered from bank losses -- particularly in light of Amagerbanken. The outgoing Minister for

Finance Brian Lenihan even admitted this last week, when he said that his government "put the €20bn [of senior debt outside of the government guarantee] on the table in the EU/IMF negotiations, but the European Central Bank ruled it out. But it's still there in debate and we're pressing for a substantial discount and for burden sharing".

Burning senior bondholders, however, would be "an unpopular move", says Kevin O'Doherty, director of the regulatory consultants, Compliance Ireland. "You could make a lot of enemies," says O'Doherty. "Senior bondholders include insurance companies, banks and so on, so any haircut would be very disruptive."

In a report published last week, Goodbody Stockbrokers said that our banks, businesses and government would find it tough to raise money over the next few years should senior bondholders be forced to share Irish bank losses. However, the report added, "it is clear that the Irish State cannot continue to cover the liabilities of the Irish banks".

Although EU governments are currently reluctant to impose losses on senior bondholders because it could destabilise banks and stock markets, there are moves afoot to do so. A new bank restructuring law in Germany gives the authorities power to impose bank losses on a bank's creditors -- which in theory could include senior bondholders.

"We are gradually moving towards senior debt being written down," says Adamson. "The mechanisms (for senior bondholder losses) are starting to be put into legislation in EU countries."

With a big chunk of bonds due to be paid off later this year, the clock is ticking.

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