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Argentine Cross-Border Structured Market Still Waging Uphill Battle

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Nine months after Argentina defaulted on its public debt, setting off a chain reaction of sweeping austerity measures, the resonance of this sovereign catastrophe and lack of clear rules in the financial system continue to perpetuate an unfavorable economic environment for business—including the securitization market.

Securitization has been a popular investment vehicle in Argentina during the last decade. But after Argentina imposed reforms to shore up its markets in the wake of the default, those involved in the structured finance market have been closely studying the performance of securitizations in that country. The reforms included devaluation of the Argentine currency, imposing restrictions on hard currency transfers, and pesifying most contracts. ("Pesification" is the compulsory conversion of certain dollar debt into pesos at a one-to-one exchange rate.)

Since the default, it became apparent that export future flow transactions are the best performing because their revenues are in hard currency and captured offshore. Those particular future flow transactions best shield against the risks of transferability, convertibility, and devaluation relative to other types of structured debt. On the other end of the spectrum are mortgage-backed securities and those structures that rely on single obligors. These are local currency generators, like utilities, which have emerged as Argentina's worst-performing securitizations.

Monitoring a Fluid Situation

Standard & Poor's has been closely following the fluid situation in Argentina and providing commentary and notification of its ratings actions in respect to that market. In January 2002, in the midst of key economic and political events in Argentina, Standard & Poor's published a first review of the status of those Argentine structured transactions that were issued in the global markets and rated by Standard & Poor's (see table 1). This article provides an update on how these transactions have been performing; all were affected by changes in laws and regulations. Many of the transactions were affected by the creditworthiness of their underlying corporate obligors. However, different structural features present in some of these transactions have allowed them to continue performing successfully.

Transaction Issuer	Underlying Obligor(s)	Transaction Rating
BHN II Mortgage Trust	Residential mortgagors	D
BHN III Mortgage Trust	Residential mortgagors	D
Gain Trust Notes	Edenor S.A.	CC

Oil Enterprises Ltd.	YPF S.A.	AAA
Oil Trading Corp.	YPF S.A.	AAA
Salta Hydrocarbon Royalty Trust	Private hydrocarbon concessionaires operating in the province of Salta	CCC+/CW Negative
TGN CRIBs Class I Financial Trust	TGN S.A.	CC
TGN IFC Trust I	TGN S.A.	D
TGN IFC Trust II	TGN S.A.	D
TGS S.A. (IADB B loan)	TGS S.A.	CC
TGS S.A. (IADB B loan)	TGS S.A.	CC

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Pesification Adversely Affects Mortgage-Backed Securities

In February, almost five years after the issuance of one of the finest examples of secondary mortgage market development in Latin America, Standard & Poor's lowered the ratings on the senior classes of BHN II and III Mortgage Trusts to 'D' from 'CC'. This rating action was based on the government's requirement of the "pesification" of the monthly U.S. dollar-denominated payments due on the bonds at a one-to-one rate. Standard & Poor's viewed this provision as a material change in the original terms of the BHN Mortgage Trusts' debt obligations, as it mandated a change of currency and interest rate payable to investors. Although funds continue to flow to investors, they are not in an amount and denomination needed to satisfy the original terms of the trusts' obligations.

Since the pesification in February, investors have suffered considerable losses. For example, losses in U.S. dollars for interest payments on the mortgage bonds on BHN II have reached US\$428,683, which represents 64% of the US\$672,897 originally owed for the respective period (see table 2). Similarly, losses on principal payments with respect to the original amortization schedule have reached 68%, totalizing US\$7,015,425 over the scheduled US\$10,281,332.

Date	Payments made in Argentine Peso since Feb. 2002		Exchange Rate	Payments made since Feb. 2002 converted to US\$		Credit losses to investors (in US\$)	
	Principal	Interest		Principal	Interest	Principal	Interest
2-Feb	--	112,943	2.05	-	55,094	-	57,849
2-Mar	--	115,509	2.23	-	51,802	-	63,707
2-Apr	4,405,349	128,695	2.88	1,530,882	44,722	2,874,467	83,973
2-May	2,293,445	110,277	3.17	723,807	34,803	1,569,638	75,474
2-Jun	2,325,529	105,113	3.51	662,336	29,937	1,663,192	75,176
2-Jul	1,257,010	100,360	3.6	348,882	27,855	908,128	72,504
	10,281,332	672,897		3,265,907	244,213	7,015,425	428,683

In May, the Argentine government created an indexing mechanism for these

pesified mortgages; the mechanism is related to variations in wages. The new wage index has not been fully defined, and it is unclear how it will be periodically adjusted. Indexation will likely begin in October.

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Preferred-Creditor Transactions

Standard & Poor's currently rates four Argentine transactions that benefit from the preferred creditor status of a multilateral agency. The transactions, issued by two utility companies, Transportadora de Gas del Sur (TGS) and Transportadora de Gas del Norte (TGN), are: TGS S.A. \$176 million IADB B loan; TGS S.A. \$75 million IADB B loan; TGN IFC Trust I trust certificates; and TGN IFC Trust II trust certificates.

These transactions are dollar-denominated and involve loans from either the Inter-American Development Bank (IADB) or the International Finance Corp. (IFC). Since these institutions are preferred creditors, dollar obligations owed to them are rated at the local currency rating of the corporate obligor, in this case, TGS and TGN. Despite widespread restrictions on payment transfers, Argentina's central bank has allowed private companies to make foreign currency-denominated debt payments to the preferred creditors without previous authorization from the central bank. This policy is consistent with the treatment of private-sector debt to multilaterals in previous episodes of financial stress in Argentina, and elsewhere. Because the TGN transactions originally had letters of credit to provide liquidity, they were able to withstand any temporary currency transfer restrictions imposed by the Argentine government. However, the ability and willingness of companies, particularly utility companies, to continue making payments to preferred creditors have been affected by the devaluation, a freeze on tariffs, and illiquidity throughout the financial system.

Specifically, in February 2002, Standard & Poor's lowered its ratings on both TGS structured deals to 'CC' from 'CCC-', following the downgrade of the local currency rating of TGS. Since February, the Argentine government and most of the utility companies have been trying to reach an agreement on the renegotiation of the tariff system. Meanwhile, the utilities' credit structures continue to deteriorate and are directly impacting the companies' ability to generate healthy cash flows. Due to this financial stress, TGS' ability to make the payments on the IADB loans is uncertain.

Standard & Poor's downgraded the TGN IFC Trust certificates to 'D' from 'CC' in February, after the nonpayment by TGN that month of the monthly principal due to the IFC on loans backing the certificates. From February to May 2002, TGN only made interest payments on its obligations and in June it stopped payments due on the IFC loans altogether, and hence the certificates.

Additionally, in July, Standard & Poor's withdrew the 'D' rating on Aguas Argentinas S.A.'s \$140 million fixed-rate IADB B loan, at the company's request.

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Transactions Insured for Political Risk

Standard & Poor's rates three transactions that use political risk insurance to protect against currency transfer and convertibility restrictions currently being imposed by the Argentine government. These transactions are issued by: TGN CRIBs Financial Trust I (TGN); Gain Financial Trust (Edenor); and Salta Hydrocarbon Royalty Trust (Salta).

The Overseas Private Investment Corp. (OPIC) provides the political risk insurance for the TGN transaction. The insurance may be used to meet dollar debt payments if TGN satisfies its requirement to make peso payments into an Argentine account. The policy has a maximum aggregate compensation amount of US\$87.5 million. The transaction is currently rated 'CC'. Unlike the TGN IFC Trusts I and II, it is not in default as the interest due on the CRIBs bonds on June 28 was paid by TGN. Nevertheless, since TGN has not replenished the reserve fund of the transaction since December 2001, and considering that it has several issuances in default, TGN will likely find it difficult to continue making timely interest payments on this transaction in the medium term. A cross-default to TGN's other debt could result in an acceleration of the structured debt, which is not covered by OPIC's policy. Since principal amortization does not begin until 2008, the political risk insurance amount of US\$87.5 million could cover interest payments for the next three-and-a-half years, assuming TGN can deposit sufficient pesos locally.

The Edenor transaction, rated 'CC', is insured for political risk by OPIC. However, the insurance only covers principal payments; it does not cover interest payments. For that reason, Standard & Poor's rating on the transaction has always reflected the foreign-currency rating of Edenor S.A. In January, the rating of Edenor S.A. was downgraded to 'SD'. However, the 'CC' rating of the structured transaction was maintained, because the transaction is still complying with its debt obligations in a timely manner. The ability of the transaction to make the next payment, due in December, will depend on Edenor's ability and willingness to meet the dollar payments to pay interest on the debt. So far, Edenor has been receiving authorization from the central bank to make the dollar payments but there is no certainty that the central bank will continue granting this authorization in the near future.

In February, Standard & Poor's lowered its rating on Salta Hydrocarbon Royalty Trust bonds to 'CCC+' from 'B-'. The rating remains on CreditWatch with negative implications, where it was placed in July 2001, following Standard & Poor's reassessment of the Province of Salta's oil and gas industry risk, on which the transaction's cash flow is dependent. To date, all payments have been honored in U.S. dollars. In December 2001, the Argentine Central Bank passed regulations exempting several types of export and public-related financing from repatriation and transferability controls, even though some of these deals, including public-related transactions, still require central bank authorization to continue making payments abroad. Specifically, in the case of the Salta Hydrocarbon Royalty transaction, these regulations have allowed the paying agent and the Province of Salta, which has been receiving central bank authorization on each payment date, to continue transferring the respective royalty flows to the U.S. trustee to service the structured debt. The transaction has a 31-month transfer and convertibility insurance policy and a six-month liquidity reserve fund, which is held in the U.S. Cash flow for debt service payments comes from royalty payments made by private concessionaires operating in the province of Salta. During 2001 these payments were over two times the debt service requirements, and during the first seven months of 2002 have been 1.35x on average, with a minimum of 1.21x in June 2002. In February 2002, the Province of Salta announced the pesification of royalty payments. Nevertheless, since that date the trustee has continued to transfer the collected pesos from the royalties, converted into U.S. dollars at the free-flotation exchange rate, to the U.S. account, and this has been sufficient to cover the original debt service. According to the partial collection information received to date, and due to the good coverage ratios, it is expected that the flows derived from the underlying royalties during the last three months will be sufficient to cover the September debt payment without the need of a draw on reserve funds.

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Export-Backed Transactions Best Deflector of Risks

As a consequence of the Argentine crisis, future flow export-backed transactions emerged as the structure that best shielded against the risks of transferability, convertibility, and devaluation relative to other types of structured debt. Standard & Poor's currently rates four global transactions backed by oil exports of YPF Sociedad Anonima (YPF). They are: YPF Sociedad Anonima (SPE) 7.50% structured export notes ("SEN II"); YPF Sociedad Anonima (SPE) 7.00% medium-term notes ("SEN III"); Oil Enterprises Ltd. 6.239% notes ("Oil Enterprises"); and Oil Trading Corp. 6.467% notes ("Oil Trading").

In April 2002, Standard & Poor's affirmed its 'BB+' rating on YPF's structured export notes (SENs) and removed them from CreditWatch where they were placed in January. The rating action followed the affirmation of the 'BB+' local currency and 'B+' foreign currency corporate credit rating on the underlying company. The 'BB+' foreign currency rating on the SENs remains three notches above the foreign currency rating of YPF, reflecting Standard & Poor's opinion that the government will continue to grant the SENs exclusions from any repatriation requirements. The rating affirmation was based on the release of financial statements that confirmed Standard & Poor's expectations of a significant debt reduction, thereby lowering immediate refinancing risks. Payments on these deals are based on YPF shipping daily barrels of oil through a dedicated pipeline to the Chilean government-owned oil company ENAP ('A-'). To date, oil shipments are being made by YPF. The deals also benefit from debt service reserves equal to the next three debt payments. In May 2002, the first series of the SEN transaction was fully repaid. The remaining two outstanding series are expected to mature in October 2002.

Oil Enterprises and Oil Trading also have YPF as the underlying obligor. Payments on those transactions are insured by MBIA Insurance Corp. and Capital Markets Assurance Corp., respectively. Therefore, the insurer will make payments to investors if the company is unable to export or must repatriate the export proceeds due to government restrictions.

Standard & Poor's will continue to follow and monitor the performance of all of these transactions and the effect that financial events, changes to regulations and legislation, and other relevant factors could have on their performance. For specific information on any of these transactions please contact the analysts listed above. Surveillance reports are also available upon request for each of these transactions. For additional information on these topics, please see the most recent commentary articles on Standard & Poor's Web-based credit analysis system, at www.ratingsdirect.com. It is also available on Standard & Poor's Web site at www.standardandpoors.com in Standard & Poor's special section on the Argentine Crisis, in the Forum section, under Market Analysis.

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