

Sovereign risk manager of the year

IGCP

When Portugal exited its bailout last May, it declined to take an official credit line, against the advice of many. It was a bold move for a country emerging from its deepest recession in 40 years, but was taken on the back of the country's first debt auction in three years, signalling to the country's government that Portugal could stand alone again.

The €750 million auction of 10-year bonds at a 3.58% yield, completed successfully in April, was the culmination of more than two years of work by the Portuguese debt office, the Agência de Gestão da Tesouraria e da Dívida Pública (IGCP) to rebuild trust with investors. It did so against a domestic backdrop of political tensions and intense public scrutiny.

"The reintroduction of bond auctions was the litmus test of Portugal's ability to fund itself through the markets. It proved we had returned successfully to full market access," says Cristina Casalinho, who was appointed chairman of the IGCP in October last year. Casalinho has served on the IGCP board since 2012.

The IGCP started building up to that auction in 2012, by extending maturities on some existing debt to spread out its refinancing needs, followed by syndicated debt issuance in 2013. After last year's bailout exit, the debt office quickly went through the gears, completing in July the biggest issuance of 10-year US dollar-denominated bonds by a European sovereign since Germany in 2005 – via syndication. That was followed by another milestone in September with the country's first 15-year syndication since 2008, despite wobbly markets and returning eurozone concerns.

Throughout, the debt office was under intense scrutiny from banks and investors overseas and the public and politicians at home. Portugal's



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crisis experience was – and remains – a painful one, and the IGCP was making its return while unemployment levels were still around 15% and GDP growth was weak. The finance ministry met with IGCP staff regularly, at times as often as every month.

"We felt that responsibility – that a weak transaction could not happen. The first transactions we did were a validation that the country was recovering its reputation, and the quality of market access was an indication of that," says Paulo Ribeiro, head of the issuing

and markets division, who has been at IGCP since 2009.

Bankers applaud the IGCP's focus and strength of will: "Not nearly enough credit is given to the force of personality and conviction that was needed to pursue these strategies – even though they might seem textbook – at a time when people were saying it can't be done. In a way it's not a spectacular new innovation, but it's the context," says Lee Cumbes, London-based head of sovereign, supranational and agency debt at Barclays.

Markets tested the IGCP in September – turbulence that saw Greek yields leap back to crisis highs, while Spain missed auction targets. In Lisbon, the debt office had already signalled its intent to issue €3.5 billion of 15-year debt.

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But it's still not quite predictable enough for Ribeiro: "We comment between ourselves that when our auctions stop being news, that's the moment where everything is 100% back to normal. Public debt is supposed to be boring," he says.

To support an orderly primary market, the IGCP has also tried to boost diversity and liquidity in the secondary market – not an easy task when investors are still smarting

from the haircuts that followed the downgrade of Portuguese debt to junk status in 2011. To do this, the IGCP revamped its rating system for primary dealers during 2013 and 2014, putting more weight on criteria such as turnover with end-investors, the number of meetings promoted between the IGCP and investors, and a qualitative score for limiting volatility when trading in the interdealer market. Those points, which are disclosed to the dealers, add up to a ranking that determines how often the bank will get called on for IGCP issuance.

"To be a successful primary dealer in the appraisal system we have, banks soon understood they needed to be good liquidity providers to end investors. That has been our focus during the past two years, to gear the primary dealership model to providing a better functioning market to investors," says Ribeiro.

In addition, senior IGCP staff have hit the road to win back investors the old-fashioned way in meetings and roadshows, travelling for as much as a week each month—a process that also helped the debt office assess the strength of demand for Portuguese debt. Emphasis was put on getting to investors outside of the continent, especially in the UK and US, which had been less impacted by downgrades to Portuguese debt following the crisis.

A January 2014 syndication suggested those efforts were paying off, with 38% of the debt bought by UK investors and more than 7% by US investors. Appetite from North America for

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Portuguese debt helped support the \$4.5 billion 10-year US dollar issue in July.

Liquidity improved too, with over-the-counter and platform turnover building steadily over 2014. Combined daily turnover started at roughly €500 million at the end of 2013 and reached a peak of around €1.4 billion in March, which was maintained through to the end of the third quarter.



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"We have almost all the big names involved in our debt at the moment, and this is probably the strongest statement that our liquidity has improved dramatically. They want to execute hundreds of millions of euros in orders, so if it were difficult for them to buy Portuguese bonds, they would see this as a significant limitation," says Ribeiro. "We will never have a debt market as liquid as Italy, for example, but if you compare the liquidity of our bonds with other countries of similar size, the improvement is enormous."

While the debt team worked to win back investors and ensure support from the banks, another team was busy negotiating with the same primary dealers on a different topic – the mis-selling of derivatives to state-owned enterprises (SOEs) in Portugal, the source of a domestic political scandal in 2013 (*Risk* May 2014, www.risk.net/2341988). Around 69 trades meant to hedge SOE interest rate exposure were challenged by the government as overly complex.

So far, all banks but one have settled with the government; Santander is still involved in litigation. The IGCP led the 2013 negotiations that resulted in the majority of the trades being unwound at a fair value of negative €1.03

billion, rather than negative €1.5 billion, reducing losses by around €470 million. A large part of those savings was derived from credit and funding valuation adjustment provisions banks had already accounted for, which the IGCP says was recognised as a basis of the negotiations.

"Since the risks for which the banks had built up cash buffers didn't materialise, it made sense for them to share that with the SOEs in unwinding the transactions," says Casalinho.

The negotiations put the IGCP in an awkward position – wrestling with the very dealers it was relying on to support the government debt market. However, Casalinho credits both the IGCP and the banks with keeping the two issues separate.

"We had a negotiation team talking with the banks, that in some cases were also road-showing and meeting investors with us. We are appreciative of how investment banks took their role," says Casalinho. Even in the cases where banks' team members overlapped, "they could distance themselves. When it was a debt capital markets issue, it was treated as such, and then when it was unwinding swaps sold to SOEs, it was another. Both parties were able to separate the issues." **R**