



Ajax, the suicidal bonds

Tracy Alloway on Dec 10 12:54.

Ajax was a Greek hero who committed suicide post- *Iliad*. Ajax bonds are the worst performing *catastrophe* bonds this year.

Sold by Ajax Re Ltd., they were one of four of the so-called cat bonds which used Lehman Brothers Special Financing as their total return swap counterparty. Not surprisingly, the issuers of the bonds had to **terminate** their swaps after Lehman went under in September — et voila, catastrophe for investors, so to speak.

From a [Bloomberg article](#) on the subject out today:

The \$100 million Ajax Re bonds, sold last year by Bermuda- based Aspen Insurance Holdings Ltd., promise to pay back principal and interest of 625 basis points more than the Libor interbank rate unless an earthquake increases claims in California...

There were no major earthquakes in California this year, but investors still lost out. And it gets worse:

Ajax Re's collateral, which was guaranteed by Lehman, was worth "substantially less" last month than \$100 million, Aspen Insurance said in a Nov. 10 regulatory filing. Ajax invested in bonds sold by another insurance company, called Ballantyne Re Plc, which were offered by Bermuda-based Scottish Re Group Ltd...

Ballantyne Re bonds have been cut to as low as C by Moody's Investors Service, the firm's lowest grade, because it invested in mortgage-backed securities, including subprime debt. Moody's said Aug. 25 there is a "high probability" that losses on the mortgage bonds will cause some Ballantyne Re bonds to default.

There's a lot of irony here. Catastrophe bonds are meant to act as insurance against cataclysmic events — the "tail risk" described in Michael Lewis's 2007

piece on the subject - "In Nature's Casino." That meant that until recently they were a relative safe haven for investors, as described in the Bloomberg article: *The bonds promise investors as much as 10 percentage points more than benchmark interest rates unless insurers reclaim money to pay disaster claims. That happened only once before, and so-called cat bonds were posting annualized returns of as much as 8.3 percent as recently as August, even as the credit crunch left investors in bonds of companies with similar ratings nursing losses of 14.9 cents on the dollar*

But that's not the case any longer. Cat bond sales will probably fall to something like \$2.7bn this year from a record \$7bn in 2007, according to estimates quoted by Bloomberg. Setting aside the issue of redemptions (it's true that hedge funds have been liquidating some of their bond holdings, which can still fetch a decent price in the secondary market) there's still the wider problem of counterparty risk. From [Reactions Magazine](#):

"If cat bonds are not underwritten properly, as happened with four bonds underwritten by Lehman Brothers, then investors are exposed to credit risk," said John Brynjolfsson, managing director and chief investment officer at hedge fund Armored Wolf. "It was a complete disaster, I think, of risk management going on. The representations that were made were not followed through."

Investors demanded that the collateral structures of cat bonds are tightened and made more transparent. They said they wanted to avoid credit risk in deals.

"We would rather have treasuries in the account than any credit risk," said Urs Ramseier, head of insurance-linked securities at Swiss investment manager Horizon 21.

In other words, cat bonds need to find a way of protecting investors from financial catastrophe — not just insurers from the natural. A tough job in today's market, we would think.

Related links:

[Cat bonds survive earthquakes, decline after Lehman's collapse - Bloomberg](#)

Cat bond market reflects on a difficult year - Reactions Magazine
In Nature's Casino - New York Times, by Michael Lewis

<http://ftalphaville.ft.com/blog/2008/12/10/50269/ajax-the-suicidal-bonds/>