Bloomberg BRIEF

Bankruptcy

04.21.15
TUESDAY

VOICES Claims Trading Is Next U.S. Export to Europe, Says Schulte Roth's Karp

Claims trading investors are increasingly seeking opportunities in Europe, according to attorney **David Karp**, partner at **Schulte Roth & Zabel LLP** and head of its distressed debt and claims trading practice group. He spoke with Bloomberg Brief reporter Hema Parmar. His comments have been edited and condensed.

Q: Has claims trading drawn in more distressed investors?

A: Lehman and the Icelandic banks put claims into the market that were available in a more liquid way than claims had been previously. What we've seen since 2008 is a significant amount of new players — private equity and hedge fund players — come into claims trading and have some success on the back of those two names. What they then did was they went out and raised additional capital on the back of the success that they had with the Icelandics and Lehman. What you have right now is a very crowded space with a lot of capital and hedge funds and private equity funds looking for paper. It's difficult to source. It is long term to settle. And, there can be costs involved in settling. While the space has matured significantly and the market is much more educated about claims since 2008, it has also become a much more competitive space.

Q: There's more activity in the space but it's more competitive. Do you see that trend continuing?

A: Parties are pushing harder to source more international situations, more messy situations because they have better experience and by necessity because they need to put capital to work. What we've seen since 2008 is really continued development of the European market, funds pushing deep into Europe, not just England, France, Germany, but into other countries. There's a lot of risk inherent in the legal process of those countries. Europe has 27 different bankruptcy regimes. The way to perfect security and the way to take ownership of a claim can be very different in different countries. You have to deal with counterparty risk, potentially of individuals or small corporates in those countries. So it's very hard to manage those risks in a settlement process.

Q: Do you need a minimal amount in terms of assets and liabilities in order to make a claims trade worthwhile as an investor?

A: What really hurts you in claims trading is having too much capital to put to work. There are a number of small boutique claims trading investors looking at claims anywhere from $25,000 to $100,000. An interesting statistic I saw last year is that approximately 90 percent of Chapter 11 business filings in the U.S. do not trade. The reason they do not trade is because the size of the claims are not big enough to garner interest from financial institutions. So there are a number of boutique investors that are taking advantage of some of those smaller cases. What really brings out the name brand institutional funds is larger filings, like with Madoff, Lehman, the Icelandics. That's what those players are looking for.

Q: Are there more people getting involved with the marketing and selling of claims?

A: If you look at a five-year trend, absolutely. But you've had a number of dealers fail. Dealers that were not able to put their own balance sheet to work have had a very tough time making a market as riskless principles. It's a tough business. It's tough to source. It's tough to match and it's tough to get size. You have some bulge-bracket banks and a couple of boutiques that have been in this for the long term that are very savvy with structures and how to match flow trades. But you've definitely seen an uptick of dealers that are involved in the space.

Whether they're going to survive long term is very hard to tell because it is a tough business.

Q: Why is it difficult to source?

A: There's only so much paper out there. While there's paper for names like Madoff and for the Icelandic banks and for different boxes of Lehman where you have smaller capital structures, where you have a number of distressed investors interested, there may not be a lot of trade credit available. What becomes difficult is a claim generally has unique credit risk based on the seller of the claim. If you have a bond, you've been indentured. If you have a loan, you have a credit agreement. When you have a claim you have that financial counterparty, you have the plumber, whatever agreement they signed up to with the debtor. What happens is the portfolio manager is analyzing the class of those trade creditors and how they're recovering. They're not necessarily wanting to take risk on the unique risk the plumber or that financial creditor has.

Q: What's your outlook in this space for the next five years?

A: The space has garnered a lot of attention. It has garnered a lot of capital. The issue right now is source and opportunity for that capital. You're going to see over the next five years continued international claims trading. You're going to see some creative structures to help put that capital to work relating to claims trading. I don't think that those parties that are invested in the space are going anywhere. They're going to continue to be opportunistic distressed investors, looking at opportunities to put capital to work.

AT A GLANCE

Age: 41

Based in: New York, London

Education: Fordham University School of Law (J.D.), Cornell University (B.S.)

Memberships: American Bankruptcy Institute, Asia Pacific Loan Market Association, Emerging Markets Trade Association, International Swaps and Derivatives Association, INSOL Europe, Loan Market Association, Loan Syndications and Trading Association.