



## Merrill rejected UBS' \$1.2b PNG deal

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Bank of America Merrill Lynch sought to refinance a contentious US\$1.2 billion loan provided by rival UBS to the government of Papua New Guinea, but was blocked due to internal concerns over political risk and reputation damage.

The 2014 loan, which became the subject of a Swiss investigation last week, is shaping up as a potential headache for the Australian arm of UBS, which reaped at least US\$120 million in fees and interest from the deal while Port Moresby suffered heavy losses.

Opposition politicians in PNG are now pushing to reopen inquiries into the deal and to determine the full extent of losses suffered by the state.

The Australian Financial Review has been told BAML was in the advanced stages of formulating a potential refinancing deal in 2015, but could not get past the concerns of its compliance department.

Questions around political risk and reputation damage "could not be overcome", according to one person directly involved in the proposed transaction.

Such a knockback raises questions about how the original loan was approved by UBS, given PNG's then treasurer refused to sign off on the deal and it was not approved by the country's Parliament, contrary to legal advice.

The deal was pushed through by Prime Minister Peter O'Neill, who has been the subject of corruption investigations in PNG and would typically be viewed as a politically exposed person (PEP) by a compliance department.

UBS and BAML did not provide comment.

The US\$1.2 billion loan allowed PNG to purchase a 10 per cent stake in the ASX-listed Oil Search, but it quickly turned sour as the share price fell in line with oil prices.

The money received by Oil Search allowed it to purchase a 23 per cent stake in PNG's Elk Antelope gas fields, a buyout of minorities which cleared the way for French giant Total to take an equity stake in the project and become its operator.

PNG has never disclosed the full extent of its losses, but opposition politicians, including former Prime Minister Sir Mekere Morauta, have put the figure at 1 billion kina (AUD\$420 million).

Ben Micah, a cabinet minister when the UBS loan was approved, said over the weekend he regrets supporting the deal, which channelled substantial state funds into a "speculative investment".

"The investigation by the Swiss banking and financial regulators will hopefully uncover the full extent of the costs associated with the UBS loan and the irreparable damage to our public finances," he said in a posting circulated on social media.

The planned BAML deal was part of a broader effort by the investment bank to make Woodside's US\$11.6 billion takeover bid for Oil Search in 2015 more attractive to the PNG government, which effectively held a blocking stake.

BAML was seeking to refinance PNG's US\$1.2 billion loan on more attractive terms in an effort to convince the O'Neill government to accept the bid. When the takeover fell over in late 2015, BAML sought to complete the refinancing, but this had been blocked by its internal compliance division.

BAML was advising Woodside on its bid for Oil Search. The PNG government also spoke to Deutsche Bank about a possible refinancing of the debt, which was structured as a \$330 million bridging loan and \$905 million main facility.

Loan documents and an independent report commissioned by a PNG government entity show UBS was permitted to charge PNG interest rates of 8.2 to 10.16 per cent during the first nine months of the bridging loan.

The main loan was underpinned by a complex "cap and collar" scheme designed to limit any losses if the share price fell, while also capping gains.

The documents show PNG pre-paid US\$107 million in interest and incurred fees of US\$10.9 million from UBS and a further US\$1.6 million from professional service firms Ashurst, Norton Rose and KPMG.

Traders familiar with how a "cap and collar" operates said UBS would have also made substantial profits from managing its exposure to Oil Search shares.

PNG was forced to sell the last of its Oil Search shares in September 2017 at around US\$6.70 after buying in at US\$8.20, after it was refinanced by UBS and JP Morgan.

Swiss Finance Minister Ueli Maurer was asked about the loan in parliament last week and said the regulator was checking whether UBS had complied with local regulations.

The Swiss Financial Market Supervisory Authority (FINMA) has confirmed it is "familiar" with the deal and said it is "in contact with the bank" .

SOURCE: FINANCIAL TIMES/PACNEWS