

Trustee toolkit downloadable



An introduction to investment

Case example 5 of 5: Enron

Here you can find out about two different cases of extreme corporate bond risk, as described by Matt Logan, a business and financial journalist.



This case example is linked to the tutorial **Risk and reward**.

The Pensions
Regulator

What was Enron?

'A lot of people will remember Enron. It was the US energy giant that crashed in 2001. Its third quarter results in October 2001 revealed a large black hole that sent its share price tumbling. By December, it was filing for bankruptcy.'

What happened?

'Well, it was alleged that Enron had been inflating its profits. The way they did this appears to have been very complicated, including an elaborate web of transactions.'

So the share price came tumbling down?

'It certainly did, although the executives had sold their shareholdings before the news broke. A lot of other companies were involved, in particular Andersen, who were the auditors of the company. They could not continue in business and were taken over shortly afterwards.'

What about the bonds?

'After the October 2001 results, the credit rating of the company was reduced which meant that the bonds were downgraded to 'junk' status. This had huge implications for, among others, four Japanese financial institutions. Nikko Cordial and three other Japanese banks had regarded the Enron bonds they held as risk-free. But between them, they ended up losing \$8 billion.'

But I thought bonds were safe?

'Well, corporate bonds always carry a higher risk than government bonds. But in general you're right – provided the credit rating of the organisation is sound. Enron's obviously was not. But they were a rather spectacular exception.'

Are there any other similar cases?

'A less spectacular UK example was Shell. It emerged in the press in January 2004 that the company had been overstating its oil reserves and immediately the credit rating and the share value of the company fell substantially.'

You have now reached the end of this case example.

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