PARA BELLUM ADVISORS

INFRASTRUCTURE · OPERATING PHASE

Callable Debt and Swap Coordination, Regulated Network Portfolio

SCENARIO TYPE	Infrastructure – Operating Phase (Liability and Optionality Management)
ASSET CLASS	Regulated Utilities and Essential Infrastructure
RISK FOCUS	Callable debt optionality erosion, swap termination asymmetry, refinancing timing risk, governance paralysis under rate volatility
PRIMARY OFFER	Structuring-as-a-Service™
RELEVANT SERVICES	Callable debt optimisation · Swap optionality redesign · Swaption overlays · Hedge accounting coordination · Refinancing execution support

THE SITUATION

An Australian infrastructure fund owning three regulated electricity distribution networks issued AUD 700m of 15-year public callable bonds in 2019, maturing in 2034. The bonds carried a par call option exercisable from August 2024 with semi-annual call dates thereafter. To align funding with preferred exposure, a swap overlay synthetically converted the bonds.

At issuance, the structure looked conservative and well-designed. The long tenor matched asset life, the call option was presented as inexpensive flexibility, and the fund locked in access to a deep institutional investor base. The intention was straightforward: if rates fell, call and refinance; if rates rose, carry the debt synthetically floating.

What was not fully examined was how the bond and the swap would interact at the point the fund attempted to exercise the call – particularly what the swap would cost to unwind and how those mechanics would affect refinancing decisions under a live rate regime shift.

By late 2023, after the RBA hiking cycle and early signs of easing, the fund had a callable bond that looked valuable but without a clear, executable path to use it.

HOW THE TRAP FORMS

The call option exists only on specific dates with fixed notice periods. The swap carries continuous mark-to-market exposure. When the two are contractually linked, calling the bond mechanically accelerates a decision on the hedge – regardless of whether that hedge outcome is economically desirable.

As rates move, incentives diverge. Falling rates improve headline refinancing economics. At the same time, the swap can move deep in- or out-of-the-money, creating termination payments, collateral movements, and accounting consequences that were never part of the original call decision.

What looked like refinancing flexibility becomes a bundled decision involving swap close-out economics, collateral and liquidity capacity during the notice period, audit and hedge-accounting treatment, and the practical ability to execute inside governance timelines. The call option is no longer a clean right – it is a conditional action whose cost depends on market conditions that can shift materially inside the notice window.

WHAT TYPICALLY BREAKS

The call option has no operational owner

Approved as a concept, but no framework exists for when or how it should be exercised. The option decays without ever being deliberately used while teams debate timing without a common decision rule.

The hedge was designed to achieve funding, not preserve optionality

Termination mechanics were accepted as boilerplate. When the call window arrives, swap mark-to-market becomes the dominant factor – turning what appears to be a rational refinancing into a governance problem.

Decision-making becomes rate-anchored, not outcome-anchored

Boards focus on whether rates are low enough while ignoring execution frictions, termination costs, credit spreads, and fees. By the time the full economics are assembled, the notice deadline is too close to act comfortably.

Liquidity and accounting are addressed reactively

Margin calls, CSA thresholds, and audit sign-off become last-minute constraints. The fund defers the call even when economics are favourable – the option that was paid for silently bleeds value.

THE STRUCTURAL INSIGHT

Callable debt rarely fails because the option was mispriced. It fails because the organisation reaches the call window without having removed the structural traps that make execution politically, operationally, or financially impossible.

Under the original documentation, calling the bond automatically terminated the swap at market value. That meant the fund could only refinance if it was also willing to accept whatever mark-to-market existed on that date – a visible one-off hedge settlement that frequently overwhelmed the headline refinancing benefit.

The structural fix: the fund, not the ISDA, must control whether the hedge terminates. Restructuring the hedge so that termination on a call date becomes an election rather than an obligation converts a binary path-dependent settlement into a controllable decision. Once this is done, refinancing stops being hostage to swap mark-to-market.

The call decision is then framed as a single economic act covering replacement funding levels, hedge continuation or close-out economics, credit spreads and fees, and execution timing. The decision framework is agreed before the window opens. That matters more than any rate view – when the call date approaches, the fund executes a pre-approved rule set rather than improvises under deadline pressure.

INTENDED OUTCOMES

- Optionality converted from theory into action – the call feature becomes a governed decision with defined triggers, lead times, and authority rather than a conceptual benefit that decays unused.
- Swap termination risk removed as a gating constraint – refinancing no longer depends on accepting an uncontrolled, visible hedge loss at whatever mark-to-market exists on the call date.
- Refinancing economics assessed on a true all-in basis – decisions evaluated net of hedge behaviour, spreads, fees, and timing, preventing superficially attractive refinancings from failing real hurdle rates.
- Liquidity pressure removed from the notice window – collateral flows and settlement mechanics anticipated rather than discovered mid-process.
- Governance clarity and repeatability across the portfolio – a reusable framework applicable to other callable liabilities without re-litigating the same issues under pressure.

WHERE THIS APPLIES

Works best where callable bonds or loans represent a meaningful portion of the liability stack; a swap overlay exists that would terminate or change materially on redemption; the issuer faces a shifting rate regime where windows can open and close quickly; and governance requires board or IC sign-off, making decision speed and evidence critical.

Less relevant where debt is non-callable or make-whole only; there is no linked hedge or the hedge is already independently cancellable without mark-to-market cliffs; the issuer has no realistic ability to refinance due to credit constraints or covenant lock-ups; or the callable feature is de minimis relative to refinancing costs.

TYPICAL ENGAGEMENT PATH

Structuring-as-a-Service™ – Liability and Hedge Optionality Coordination. Secondary: Callable swap restructuring or termination-right alignment, swaption overlays, refinancing decision framework design, hedge accounting memo pack covering optionality, modification risk, and designation continuity.

Illustrative case study for discussion purposes only. Details have been anonymised. Outcomes depend on transaction structure, counterparty documentation, market conditions, regulatory treatment, and accounting constraints. Not investment advice.