



FINANCIAL TIMES **Guides**

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# BOND AND MONEY MARKETS

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# **THE FINANCIAL TIMES GUIDE TO BOND AND MONEY MARKETS**

The lead manager (often in cooperation with other syndicate members) will help the issuer prepare the **prospectus** to be presented to potential investors, detailing the issue and explaining the company and its finances. It will also deal with the legal issues and other documentation, using either an in-house legal team or an external one.

Fees as a percentage of funds raised for underwriting (agreeing to buy those not sold to the public) and selling bonds tend to be greater for longer maturities and for those lower down the credit rating scale, but smaller for large issues given the economies of scale. Fees will rise if the issue is more **exotic** (unusual and/or complex) rather than straight vanilla, but are typically in the range 0.25–0.75% of the par value. The issuer will also have to factor in their own time and that of their accountants, legal advisers, etc.

When pricing a bond the lead manager often focuses on a benchmark bond currently trading in the market with the same maturity as the new issue and uses that as a reference. The new bond might be priced as so-many basis points of spread over or under the benchmark.

## Private placements

In **private placements** an investment bank(s) uses its contacts to find financial institutions willing to purchase the whole issue between them, usually no more than ten in the group. This allows the issuing company to develop a closer relationship with a tight-knit group of investors, first gaining understanding of the business and later communicating progress, perhaps opening the possibility of raising more at a later date. Private placings also avoid the cost of obtaining and maintaining a credit rating for publicly traded bonds and the costs of additional disclosure.

In the US, where this market is very strong, privately placed bonds are **unregistered** with the Securities and Exchange Commission, with minimal disclosure required, and so can be resold only to large, financially sophisticated investors; they are therefore not available to retail investors. Most privately placed bonds are **144a securities**, meaning that they are exempt from SEC registration under Section 144a of the 1990 Securities Law. Private placement costs much less than a **public offering** because the issuer does not have to comply with generally accepted accounting principles and because marketing to only a handful of investing institutions is cheaper. A detailed prospectus

does not need to be prepared; instead a much simpler **private placement memorandum** is sent to prospective investors.

Privately placed bonds tend to be illiquid and so are generally bought by institutions willing to buy and hold without going to the secondary market; interest rates tend to be higher to compensate for the illiquidity and because most of the issuers are less well known than for publicly placed bonds – the bonds are generally not ‘investment grade’, i.e. with credit ratings under BBB–. Europeans are trying to grow a strong local private placement market – see Article 4.10.

## Article 4.10

# Thirst for funds lifts appeal of private placements

By Andrew Bolger

Financial Times June 24, 2014

Britvic is an official supplier to Wimbledon, where its Robinsons Squash has helped quench the thirst of many tennis players since the invention of Lemon Barley Water in 1935.

This quintessentially British company has found inventive ways of quenching its funding needs, including in recent years £650m in private placements, a market that was developed by US insurers as a way to make strong returns from long-term investment in companies.

Insurers and pension funds – including some from Europe – achieve this by issuing securities that are not sold through a public offering but instead directly to chosen investors.

Now leading European investors and finance trade bodies that admire this US funding model are trying to develop a similar pan-European placement market.

‘The development of the market should stimulate further growth, enabling more companies to access the capital markets in Europe and provide investors with a new investment opportunity,’ says Calum Macphail, head of private placements at M&G Investments, which has invested €5.6bn in private placements since 1997.

The private placement market for European issuers has grown in recent years, especially in France and the UK, which had an estimated combined volume of €8bn in 2013.

Private placements typically provide fixed-rate financing of between three and 15 years, most commonly for seven to 10 years. Mr Macphail says pension funds





are attracted to the characteristics of private placements – strong, stable cash flows and covenant protections similar to a loan.

‘In addition to diversification and stronger documentation compared to public bonds, investors benefit from an illiquidity premium when investing in medium or long-term assets which provide regular income, giving a pension fund more bang for their buck,’ he says.

The International Capital Market Association is co-ordinating the work of the pan-European Private Placement Working Group that aims to establish a guide to best market practice, principles and standardised documentation. The working group will build on a Charter for Euro Private Placements, a French initiative.

The European private placement market is smaller than its \$50bn US equivalent, which issued €12.4bn to European companies, and Germany’s *Schuldschein* market, which issued €8.5bn to European companies last year.

The *Schuldschein* is a fixed- or floating-rate loan instrument, ranging in size from €10m to €500m. The market is used primarily, but not exclusively, by investment-grade companies.



Source: Bolger, A. (2014) Thirst for funds lifts appeal of private placements, *Financial Times*, 24 June.

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Despite the progress made in Europe, even today European companies often choose to issue privately placed bonds on the other side of the Atlantic where there is a well-established clientele, infrastructure, regulation and procedures – see Article 4.11.

## Article 4.11

# Midsized issuers welcome funding scheme

By Andrew Bolger

Financial Times February 16, 2015

An ambitious framework for a European private placement market has been published that aims to widen access to finance by midsized companies.

For many years, lots of midsized European businesses have accessed the US private placement market, which allows insurers to provide long-term finance to companies that wish to avoid the expense and scrutiny of issuing publicly listed bonds.



But a working group led by the International Capital Market Association has launched a voluntary guide for common market standards and best practices which it says are essential for the development of a pan-European market.

‘The guide will be a big help in communicating with and within mid-sized corporates about an alternative source of finance,’ says Colin Tyler, chief executive of the Association of Corporate Treasurers. ‘For potential mid-sized issuers that have not used private placements before, it will give confidence that there are clear paths to issuing – it is not venturing into Wild West territory.’

Private placements are medium- to long-term senior debt obligations – in bond or loan format – issued privately by companies to a small group of investors. The private placement market typically provides fixed-rate financing of between three and 15 years, most commonly for seven to 10 years.

With private placement deals providing longer maturities than many bank loans, this helps to release companies from the burden of refinancing bank debt every couple of years.

Calum Macphail, head of private placements at M&G Investments, one of the largest European investors in private placements, says the guide provides companies interested in exploring this market an understanding of the process, who was involved and information potential investors would require.

‘As the financing landscape changes as banks de-lever, natural sources of longer-term finance, namely pension funds and institutional investors, are filling this gap,’ he says. ‘Pension funds are attracted to the characteristics of private placements – strong, stable cash flows and covenant protections similar to a loan.’

In addition to diversification and stronger documentation compared with public bonds, he says investors will also benefit from an illiquidity premium which could provide an enhanced yield as well as regular income over the medium to long term.

The popularity of private placements has accelerated since the onset of the financial crisis, with markets in countries such as France and Germany providing borrowers with a local solution.

ICMA, which represents institutions across the international capital markets, says demand for private placements is set to increase as the EU’s approximately 200,000 mid-sized companies look to diversify their sources of funding away from the traditional bank loan market, and view private placements both as an alternative and as an intermediate step towards the listed bond markets.

The guide builds on existing practices and documents used in the European bond and loan markets, especially a charter developed by the Euro PP Working Group, a French financial industry initiative. It is expected costs will be lowered by promoting the use of recently standardised documentation.

Daniel Godfrey, chief executive of the Investment Association, says common market standards for European private placement transactions will remove a significant barrier to the development of the private placement market in the UK and Europe.



‘Our members are major investors in UK businesses and, having worked closely with members and government on the proposed withholding tax exemption for privately placed debt in the UK, in December 2014, we were able to announce that five institutions intend to make investments of around £9bn in private placements and other direct lending to UK companies,’ he said.

The French and German domestic private placement markets issued approximately €15bn of debt in 2013 in addition to a further \$15.3bn raised by European companies in the \$60bn US private placement market.

Standard & Poor’s estimates €2.7tn of debt will need to be refinanced by midsize companies between now and 2018, at a time when banks continue to retreat from long term lending markets.

As well as trade bodies, the pan-European private placement initiative has received strong support from government officials in the UK and France, as it is closely aligned with the European Commission’s goal of bringing about a capital markets union, on which a green paper is expected this week.

Welcoming the guide, Fabio Panetta, deputy governor of the Bank of Italy, said: ‘It is a useful tool for developing a European private placement market for corporate debt and, consequently, for broadening and diversifying sources of funding to the European economy.’



Source: Bolger, A. (2015) Midsized issuers welcome funding scheme, *Financial Times*, 16 February.

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## Timetable for an issue

The timetable for a bond issue can range from a few days to several months; it is longer for more complex issues, those in numerous jurisdictions, when it is the first bond for this issuer, and when the bonds are to be listed on a stock exchange. Here are the basics of the process (except for a bought deal or private placement):

- **Pre-launch and launch.** The lead manager appoints the trustee or fiscal agent, the principal paying agent, the other members of the syndicate, and prepares the prospectus and other documents. The lead manager or co-lead managers will discuss with the issuer and potential investors the specifications, such as size of issue, coupon and price. As discussion progresses these will be ‘firmed up’. A book-building public promotion period might span two weeks (‘pre-selling the bonds’). Within that, a roadshow and a series of conference calls might take four days with, say, 10 to 100 attendees per meeting in different cities across the country.

- *Announcement day.* It is only on the announcement day that the issue is formally announced (a press notification is usual), including the decision on the maturity and coupon rate or range of coupon rates. The lead manager formally invites the prospective syndicate members to participate, telling them the timetable and their obligations. On the **pricing day**, the price of the bond relative to par (say £99.85 if the par is £100) is agreed by the borrower and the syndicate group.
- *Offering day/signing day.* The bonds are formally offered the day after the pricing day. The borrower and managing group sign the agreement on the specifications. The size of the allotments to syndicate members is announced by the lead manager. Signing usually occurs between two days and one week before closing and can take place at a meeting or, more frequently these days, by fax or email.
- *Closing.* The trust deed or fiscal agency agreement are signed, the bond is created and investors pay for the bonds they have purchased.
- *Listing.* For listed bonds the relevant documentation must be delivered to the listing authority (e.g. in Britain it is the UKLA, part of the FCA) and the stock exchange.

## Auction issue

In an **auction issue** the cost of management fees is bypassed because the issuer goes to investors directly asking for price and quantity bids for prospective bonds with specified maturity and coupon. The disadvantage is that the expertise of the lead manager and others in the syndicate is forgone with regard to market knowledge, contacts, reputation, etc. Thus auction issues are for high-quality, well-known borrowers only.

## United States of America

The US has the largest corporate bond market in the world. The **Financial Industry Regulatory Authority (FINRA)** supervises all aspects of bond trading and its participants. FINRA ([www.finra.org](http://www.finra.org)) lists over 40,000 corporate bonds, with details of each bond (coupon, maturity, etc.) and, if it has one, its credit rating. To take an example: the Ford Motor Co has about 190 bonds listed, with maturities ranging up to 2097 and coupon rates varying from