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# Corporate Bond Underwriting and Distribution Practices

*Presentation to the US Securities and Exchange Commission*

*May 2015*

The Credit Roundtable
In association with the Fixed Income Forum

*The Credit Roundtable ("CRT") was formed in 2007 by a group of large institutional fixed-income managers. It currently has 35 member firms which include investment advisors, insurance companies, pension funds, and mutual funds, representing more than $3.5 trillion of fixed-income assets under management.*

*The object of CRT's efforts is to benefit all bond market participants through increased transparency, efficiency and liquidity. Its primary mission is to advocate for and facilitate improvements in the market for investment-grade corporate bonds by, among other things, strengthening bondholder covenant protections and promoting reforms in the underwriting and distribution of new issues, as well as in the tender offer and consent process.*

# Summary

The corporate bond market is an important source of capital for a wide range of companies. The size of the market and the number of issuers has grown rapidly in recent years, spurred by the borrowing needs of companies from around the globe, historically low interest rates, and strong demand from investors seeking incremental sources of yield for their portfolios.

The Credit Roundtable (CRT) believes that the market generally functions well, intermediating the needs of borrowers and investors. But we have grown increasingly concerned that the underwriting and distribution process for corporate bonds has material flaws that may create significant risks to the investing public, including sophisticated institutional investors.

Our main concerns surround such issues as the time allowed for investors to make informed purchase decisions, the availability of information, the disclosure of how proceeds will be used, and the timing of new issue allocations and pricing.

We are hoping to engage in a formal dialogue with underwriters, issuers, and their legal counsel to establish improved market practices that will provide additional protection to investors, while helping to ensure that the debt capital markets remain open and available to issuers at fair and reasonable terms throughout the economic cycle, including inevitable periods of market stress.

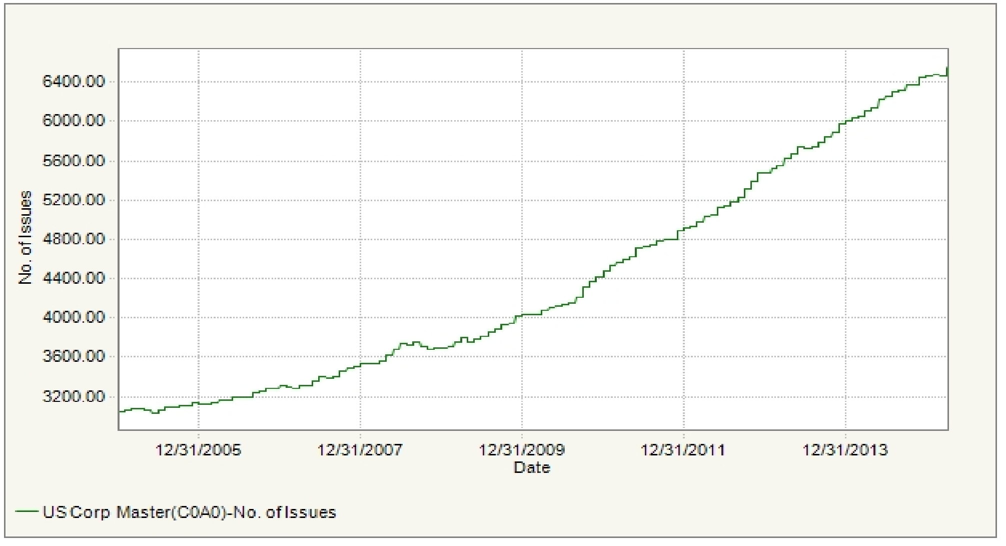
The CRT believes that it would be extremely helpful for the Securities and Exchange Commission staff to join with us in this process, providing regulatory expertise and guidance, as well as encouragement to the interested parties about the importance of their good faith participation in this effort.

# Corporate Bond Market Background

The US Investment Grade Corporate Bond market has a market value of $5.3 trillion, up from $3.1 trillion as of March 31, 2010. The market consists of 6,551 issues from 1,109 issuers, up from 4,034 issues from 784 issuers five years ago. The number of issues has more than doubled over the past ten years.

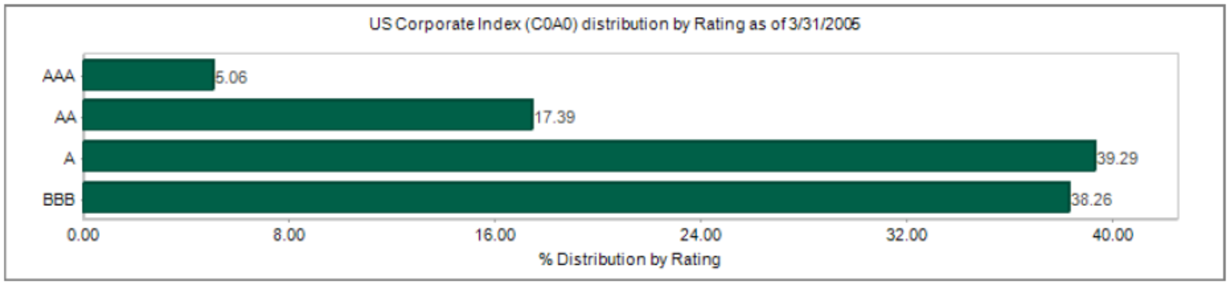
Approximately 70% of the current index market value is from US domiciled companies, down from 74% five years ago and 85% ten years ago.

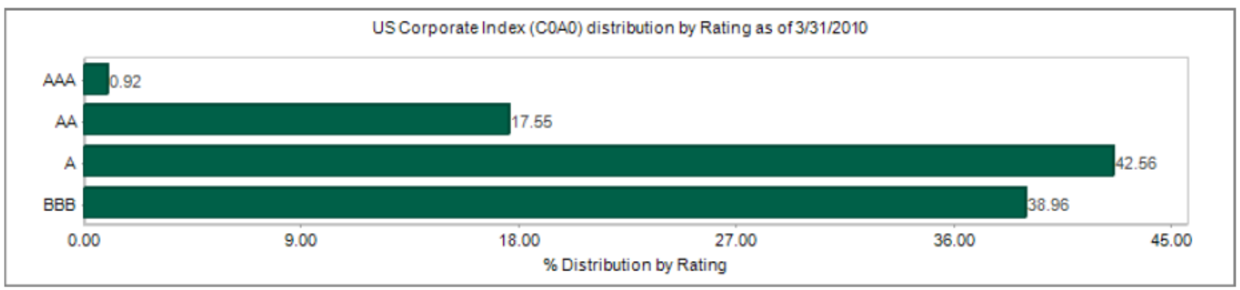
**Number of Issues in BofA Merrill Lynch US Corporate Index**

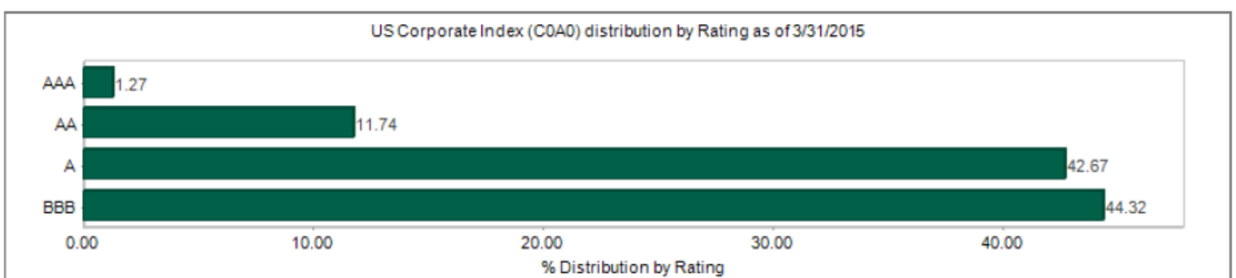



Source: BofA Merrill Lynch US Corporate Index data

Overall corporate credit quality has declined in recent years, underscoring the need for more intensive credit analysis.



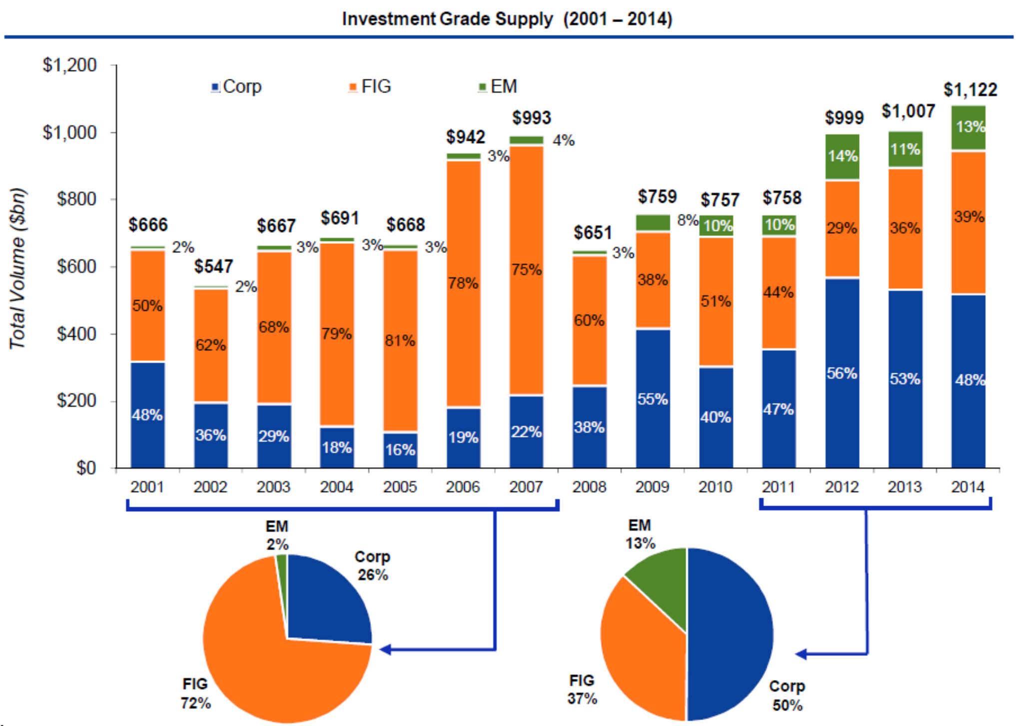




Source: BofA Merill Lynch

## Issuance Continues to Grow

Investment grade issuance was a record $1.1 trillion in 2014. First quarter 2015 supply of $345 billion was up 12% over the prior year.

Investors continue to see new borrowers from both developed and emerging markets, highlighting the greater sovereign risk component imbedded in many corporate issues. There are also more complex issue types that require additional credit and structural analysis.



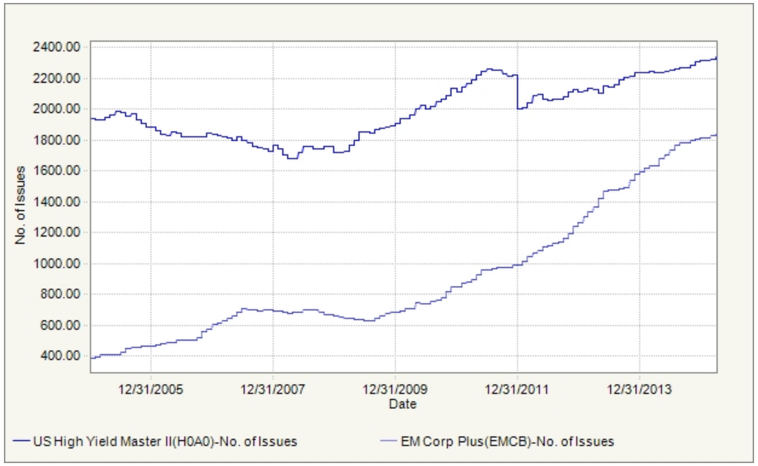

Source: Deutsche Bank Securities

The significant growth of the high yield and emerging market corporate bond markets puts added pressure on the resources of many Credit Roundtable member firms.

The US High Yield Corporate Bond market has a market value of $1.4 trillion, up from $851 billion as of March 31, 2010. The market consists of 2,335 issues from 1,088 issuers, up from 1,965 issues from 894 issues five years ago

The US dollar denominated Emerging Market Corporate Bond market has a market value of $1.3 trillion, up from $431 billion five years ago. The market consists of 1,836 issues from 796 issuers, up from 711 issues from 373 issuers five years ago.

**Number of Issue In BofA Merrill Lynch US High Yield and EM Corporate Plus Indices**




Source: BofA Merrill Lynch

# Examples of Current Market Practices that Concern the Credit Roundtable

## New Issue Timing

Most investment grade new issues are announced and priced on the same day.

From the time issues are announced (usually early to mid morning New York time), investors generally have a short period to analyze the issue, review covenant protections, and decide if they are comfortable participating at indicated price guidance.

There does not seem to be an accepted standard on how price guidance may be disseminated. Some underwriters will only discuss over the phone while others will provide guidance through Bloomberg messages.

New issue order books can close as soon as 15 minutes after transaction announcement, while some may stay open for several hours. The average tends to be in the 1-2 hour range, but there is no consistent basis for determining when any individual transaction may close.

Books can often close with short notice, inserting a sense of urgency into the process. Underwriters often send out updates indicating high levels of oversubscription, further pressuring investors to make decisions.

We believe there is often inadequate time for analysts to thoroughly review issuer fundamentals, structural features, and covenant protections to make informed decisions about new issues. This is a persistent problem even for institutional investors that have large staffs of experienced credit analysts.

## Availability of Information

The short period to make decisions is often exacerbated by a lack of important information.

Preliminary prospectuses and bond indentures may be unavailable to investors, making it impossible to understand covenant protections or to see updated risk disclosures. Investors may also not have timely access to disclosures about issue ERISA eligibility.

When available, covenant descriptions and terminology may be unnecessarily complicated and obtuse, potentially providing issuers with ways to get around the intended protections; the lack of standardized covenant definitions requires more time to analyze each legal document.

There is often limited or no contact available with issuer management, making it impossible for investors to ask questions or clarify concerns. Most investor calls or meetings with management teams have been entirely eliminated or replaced with pre-recorded net roadshows.

When there are new issue or non-deal roadshows in advance of an issue, investors are usually not permitted to retain any handouts or other information from those meetings.

Updated rating agency opinions and final ratings are often not available when transactions are announced or prior to order books closing, raising compliance concerns for some investors.

## Limited Disclosure of Risk Factors and Potential Use of Proceeds

Risk factors disclosed in the prospectus are often generic and lack company-specific details that are important to the investment decision.

The intended use of proceeds, which can be a material credit factor, is often described only as "general corporate purposes." We believe more detailed statements on how proceeds may be used should be required as a fundamental investor protection.

There have been several recent cases where companies have issued debt and subsequently announced material corporate actions or mergers and acquisitions. These plans were not disclosed to debt investors at the time of issue. There does not appear to be a clear standard of what issuers must disclose or what post-transaction recourse investors have upon lack of material disclosures.

Investors have little understanding of the role underwriters play in performing due diligence on proposed transactions and what standard they are held to if material facts were not disclosed.

## Logistical and Timing Issues

An increasing number of new issues have minimum denominations of $200,000 x $1,000, compared to the older standard of $2,000 x $1,000. These larger minimum denominations can be problematic for smaller funds, sometimes making adequate risk diversification difficult or impossible.

New issue allocations are often released late in the business day, followed by pricing. Transactions are sometimes priced very late in the business day. Late day pricings, sometimes after 4:30pm, create many problems for investors.

Investors may not be able to hedge interest rate risk or fund the transaction by selling other corporate bond issues, leaving them exposed to interest rate movements and credit events overnight.

The process and time required to get new issue CUSIPs and to set up new issues in trading systems means that many committed purchases may not be entered into trading and accounting systems on a same-day, timely basis.

# Discussion Items on Potential Ways to Improve the Underwriting and Distribution Process

## New Order Process and Timing

- Allow more time for analysis before order books close; consider a minimum required period to keep books open and a minimum notice period before books formally close
- Clarify permitted methods of price guidance dissemination
- Require accurate disclosure of size of order book during and post transaction
- Encourage issuers to consider smaller minimum denomination sizes
- Price all transactions no later than 4pm New York time; Any transaction that cannot be priced before 4pm should be held over until the next business day

## Availability of Information and Disclosure

- All important documents, including a prospectus, should be made available electronically at transaction announcement
- Material changes in indentures or covenants from prior transactions should be highlighted
- Hyperlinks to other relevant documents (trust indenture, bank loan agreements, etc.) should be incorporated into the prospectus
- Standardize covenant wording and definitions across transactions, consistent with the Credit Roundtable's model covenant White Paper
- Provide greater access to management during transaction marketing periods and permit retention of materials from all deal and non-deal roadshows
- Require greater clarity on use of proceeds
- Require greater disclosure on any pending corporate activity that may have a material credit impact, and clarify overall standards of disclosure and underwriter due diligence

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