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# What's in store for corporate issuers?

Capital market financing

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**Issuing securities in the international capital market is gaining popularity with corporates looking for affordable access to cash liquidity. Dan Kuhnelt, Head of Primary Market Services at Euroclear Bank, looks at three things corporates should consider when developing their funding strategies.**

**Also below:** Cagamas, a leading Malaysian debt issuer, discusses what it takes to build successful relationships with international investors ([https://www.euroclear.com/en/news-views/news/news-content/2016/what-s-in-store-for-corporate-issuers-.html#par\\_coloredbox](https://www.euroclear.com/en/news-views/news/news-content/2016/what-s-in-store-for-corporate-issuers-.html#par_coloredbox))

Corporate debt issuance has been brisk in recent years. This is due in part to low interest rates, however increased levels of volatility are now limiting issuers' room to manoeuvre.

Sources of uncertainty stem from both regulatory and macro-economic developments. Many firms that traditionally had a heavy reliance on bank funding have experienced reduced lending appetite since the financial crisis of 2008. But the rolling introduction of the Basel III capital adequacy framework is continuing to squeeze bank lending capacity tighter, even where relationships are well-established and credit status exemplary.

On the macro-economic front, the distant prospect of rising rates is unlikely to choke off corporate debt issuance in the near term, but investor sentiment is hyper-sensitive to economic shocks. From concerns about Chinese debt levels to tumbling commodity prices to slumping price-earnings ratios, there are many potential causes of market volatility that can suddenly impact and limit funding supply.

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## Developing the optimal funding strategy

With low GDP growth levels leaving many corporates needing predictable and certain cash flows, constraints on funding options are increasing the pressure on CFOs and directors of treasury to make the right choices when reviewing their funding strategies.

The debt capital markets continue to offer attractive opportunities to corporates, but it is important to identify the optimal approach – from both the issuer and investor perspective – as the funding window may close unexpectedly, potentially compromising overall corporate financing aims.

When developing a funding strategy, we would suggest that corporates weigh up three key factors.

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### 1. Low funding costs

First, and perhaps most importantly, potential issuers will understandably focus on cost.

The debt issuance process chain can be long and complex, involving many steps before, during and after issuance, with services required from investment banks, legal firms, tax advisors as well as pre- and post-trade service providers. Because of the disparate nature of fees and charges, the all-in cost of issuance is hard to estimate at the outset.

One advantage of issuing international debt through an international central securities depository (ICSD), and certain national central securities depositories (CSDs), is that primary market issuance services are provided free of charge. As such, a number of services that incur a fee in domestic bonds markets – eligibility analysis, ISIN generation and allocation, settlement – can be discounted from the cost of international debt issues.

Issuers will of course still have to factor in other types of issuance cost, but the removal of issuance fees at the (I)CSD level from the equation may well make the difference between the ability to tap into investor demand at short notice and having to hold off and miss out on a period of positive sentiment in such volatile times.

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## 2. Broad access to investors

A second factor is scope and certainty, in regard to investor relations.

When issuing debt, especially for firms that do not have the market visibility of top-tier issuers, it is important to reach as wide a range of long-term investors in the most efficient manner possible. In the short-term, issuers will want to guarantee their ability to receive funds from investors on the dates expected. In the longer-term, issuers will also want to ensure that investors benefit from high levels of post-purchase support, in terms of asset servicing (notably tax and cash management, and corporate actions) as well as having access to secondary market liquidity in order to increase or decrease their holdings cost-effectively in the future.

In uncertain market conditions, an issuer's best hope of future investment is likely to come from existing investors that understand its 'story'. This depends on a number of factors of course, but it can be easily undone by poor accessibility of securities or failure to deliver income or redemption proceeds on an expected date. On this criteria, international debt issuance offers the long-term comfort and certainty that can tip the balance of an investment decision in the issuer's favour.

### *Example*

Take for example a European firm looking to reach out to Asian or South American investors, perhaps to take advantage of their high profile with retail consumers. To appeal to both new and existing investors, the issuer may want to consider issuing international debt instead of domestic, not least because of the greater familiarity of investors globally with the norms of international debt issuance. This can be critical to the success of an issue, particularly if the issuer needs to be sure the funds will be received and available for use on a particular date, perhaps to support an expansion or acquisition.

A non-European investor could fall foul of local systems, rules or processes, resulting in non-delivery of funds on the expected date. On the international capital markets, not only is lack of familiarity far less likely to be a problem, but also the (I)CSDs offer dedicated support and risk mitigation tools to issuers and agent networks to minimise risk of failure of funds on the scheduled issue date.

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## 3. Choice of instrument structure

The third factor is instrument choice. Any issuer will think carefully before choosing the structure and currency of its debt issue. Balancing the needs of the issuer and the target investor base means structuring the instrument vehicle to provide the income required by the issuer – which may vary in terms of volume and schedule – while taking account of the priorities of investors, in terms of rights, responsibilities and returns.

At a time of increased market volatility, choice of currency can also assume greater importance, as currency risk can act as an impediment to investment. Whether the issue settles on an asset-backed structure, or offers particular rights or warrants, there is a wide breadth of choice on offer through the international capital markets.

While issuance structures available on domestic markets reflect the needs of the local market participants as well as national legal and regulatory frameworks, the international debt capital market is built on meeting a more diverse range of investors' requirements across multiple jurisdictions, governing laws and issuance currencies.

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## An issuer's experience

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### **Cagamas: from domestic to international issuance**

When Cagamas, Malaysia's largest non-governmental local issuer of debt securities, decided to diversify its funding sources beyond its borders, the national mortgage corporation knew that long-term relationships with international investors would be critical to its success.

According to President/CEO Chung Chee Leong, discussions held with potential investors in 2012-13 confirmed that secondary market liquidity was a key pre-requisite to their participation in Cagamas' planned EMTN (foreign currency medium term note) programme.

The AAA-rated firm, established in 1986 to support affordable mortgage availability and expand home-ownership in Malaysia, appreciated the importance of liquidity to its future cost of funds and ability to frequently tap international investors. As such, Cagamas took a number of steps to ensure this criteria was met. These included: 70% distribution to non-Malaysian investors; inclusion of its securities on major indices; and ensuring the eligibility of its paper as collateral in repo transactions. This last step was facilitated by its choice of Euroclear as one of the international central securities depositories for the planned transactions.

"To support our strategy, we needed a partner with global relationships and capabilities, a robust infrastructure, and the ability to respond flexibly to market dynamics," said Mr. Chung.

So far, the strategy has been an unqualified success. Launched in 2014, the USD and CNH tranches of the EMTN programme (totaling USD2.5 billion) were four times oversubscribed. Moreover, international investors have further demonstrated their support for Cagamas by increasing their holdings of the firm's ringgit-denominated debt securities.

For Mr. Chung, the firm's efforts to support relationships with international investors must continue. "To purchase mortgages from lenders on a regular basis, we need frequent access to competitively-priced funding in the international markets. Investors understand and like our business model, but we must continually optimise our appeal through constant, positive engagement to support secondary market liquidity."