Why Minimum Standards in Corporate Bonds Communications?

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In recent years, the lack of access to bank credit has forced companies to consider issuing corporate bonds as a means of funding alternative to traditional bank financing or the issuance of shares in the stock markets. This has considerably increased the companies participating in the capital market of corporate bonds for the first time.

In this context, analysts must ask: is there enough quality information about issuers of bonds and their different emissions? What indicators or ratios will be necessary for investors to make informed decisions to buy or sell such assets with sufficient guarantees? How can we standardize the information provided to establish comparative risk-return efficient?

For large companies listed on stock markets this information is provided, usually, by their investor relations departments, with a focus on the needs of markets and regulatory requirements. The analyst's job here is to look for additional information to improve your recommendations. For businesses of medium or small capitalization, listed or not on the Alternative Securities markets, experience shows that there is no adequate information and, therefore, their access to finance by issuing corporate bonds is reduced, due to the uncertainty for investors is this lack of information. This is where the work of analysts can and should add value, setting the minimum information that allows these companies to improve their relationships with investors regarding bond issues.

In this context, the European Federation of Financial Analysts (EFFAS) has been devoted in recent years to raise awareness about the urgent need to improve the communication of such emissions from bond investors and analysts. The research conducted within EFFAS, by German and Austrian associations, have resulted in the document known as "The Minimum Standards for Bond Communication". This document aims to be a set of recommendations, as a guide for action, that allow companies to provide uniform information and market quality in terms of its corporate bond issues.

Here are the main conclusions of the work:

- **Equal Treatment:**

Bond investors, bond analysts and credit analysts are not always treated equally by bond issuers, or provided with the same quality and quantity of information as those on the equity side. Despite a sometimes clearly higher level of investment, and therefore risk, compared to equity investors, it is not unusual for bond investors, for example, to receive financial data, corporate notifications or information on issues affecting the situation of the issuer at a different point than shareholders.

The management of the issuing entity is generally less accessible to bondholders
than it is to equity investors and analysts. A small number of bond issuers have specific contacts in their investor relations team for investors in the bonds of the company. For the most part, however, IR managers are not responsible for bondholders? or do not feel responsible. This is compounded by the fact that at many issuing companies, the people responsible for communication with rating agencies apparently are not sufficiently connected to the investor relations department, so that there is no functioning information flow within the company.

Leakage of information to the press or to individual investors is grossly unfair to bond investors and analysts, yet unfortunately not unusual. Finally, it goes without saying that issuers should keep investors and analysts informed of upcoming capital market events via an event calendar on the company website and specifically invite bond investors to these. After all, the idea is Investor Relations.

➢ Consideration of Specific Requirements

Compliance and corporate governance regulations in Europe were in general predominantly conceptualised for equity investors. This means that information essential to bond investors is sometimes treated as less important in corporate reporting. Among other things, this affects the tools and topics such as risk reporting, refinancing plans, interest income and pension liabilities, which are more important in relation to bonds than equities, given the consequences for the rating of the company and thus the bonds. Performance projections, communication of key strategic decisions and their influence on the financing structure must be reported promptly by bond issuers and in formats utilisable by bond investors.

Standardisation of key figures (primary bond-specific indicators) for the fixed income market is urgently necessary. In addition to these, information about the corporate structure is necessary to allow identification of subordination risks of fixed income instruments and differentiate between the issuer rating and the rating of the issue.

Covenants relating to the bonds, such as change of control, restrictions on asset disposals, compliance with predefined debt ratios etc. are highly important beginning in the initial issue phase for evaluation of an instrument’s rating and price. Covenant details must be presented transparently and comprehensively under a “bright-line rule”, an unequivocal rule that does not permit any scope for interpretation.1 Issuers should make reporting here event-driven.

Meeting the specific requirements of bond investors also creates particular investor relations challenges, such as knowledge about the instruments, financial market events (e.g. CDS) and the effects of changes in corporate structure on derivatives.

➢ Dialogue with Bond Investors

Bond analysts and bond investors are only rarely invited to meetings with the capital market or corporate presentations by a small minority of issuers. This is true of company presentations and broker road shows, as well as one-on-one meetings or management presentations to institutional investors. EFFAS proposes that bond issuers hold an event tailored to the requirements of bond investors at least once a year, to which bond investors and bond analysts are specifically invited and in which senior management personally participates.

In addition, from the perspective of bond investors it is necessary to be invited to participate in conference calls, meetings with investors throughout the year, roundtables, site visits and management visits to investment firms and brokers.
Issue Process

The structure of the issue process itself also plays an important role. The issue process relates to requirements on content and timing. With regard to timing, relevant new information that may influence the rating and price in the issue phase must be communicated to bond investors during the issue process. The guiding principle for structuring issue processes in an investor-friendly way should be the information requirements of investors. These include, for example, information on circumstances, projects and business plans, which influence a company’s financial and business profile (such as M&A projects or expectations of negative earnings figures). If the company has a public rating by an agency, the rating agency and issuer should avoid rating reviews during the issue phase taking into account expected rating changes of which the public is unaware. This means, any rating action that could have been taken prior to or during the issue process is to be avoided immediately afterward.

Information provided during the issue or published in road show materials should address issues relevant to bonds, including: Ownership structure, Stability of cash flows, Liquidity, “Hidden Liabilities”, Covenants. Bond investors also expect information from frequent borrowers on any bond additions, as well as on process and timing.

In order to prevent arbitrage between different currency zones, documentation should always be identical in all currencies. It should always be possible and be a goal that new bonds and documentation contain better creditor covenants and are set out in more investor-friendly ways.

Bond investors also expect bond issuers to implement a lock-up period for further new issues, as is the case with equity issues. Particularly in difficult market phases, some issuers lure investors with unsustainable concessions, or spread rumours that this really is the last new issue for the year or for the foreseeable future. Investors also value it when companies make statements with respect to a rating commitment in the course of the issue, in particular which steps will be taken by the issuing entity to implement this commitment. Contractually secured coupon step-ups in the event of downgrades are helpful to reinforce the company’s commitment and reduce losses to investors.

As to the practicalities of the issue process, EFFAS proposes the following: the book should be open for at least two hours. It should be ensured, as best possible, that the spread range remains constant - and never changes once the book has been closed.

Prospectus and Executive Summary

Prospectuses are often provided to investors too late. Bond prospectuses are also often too voluminous. EFFAS recommends that issuing entities publish an executive summary of the full prospectus, with a maximum of 4-6 pages and made available at the latest at the time of book opening, ideally 3 hours before book opening. The executive summary provides key content from the full prospectus in brief form, yet identical to the full prospectus in terms of both quality and content.