# MAKING GOOD IN JAPAN

**RICHARD PROUDLOVE** HAS WORDS OF ADVICE FOR ISSUERS WISHING TO BRAVE THE JAPANESE MARKETS: BE PREPARED, BE CLEAR AND BE QUICK – ONCE INTEREST RATES RISE AGAIN THE CLIMATE WILL CHANGE DRAMATICALLY.

The Japanese market has provided funding opportunities for international issuers for many years. However, to fully capitalise on this market it has been important for many potential issuers to analyse the fundamental driving forces behind the Japanese market and investors. The main factor behind the differences from other countries is the Japanese economy, both in its current state and the reasons behind it.

The property market bubble of the late 1980s, and subsequent collapse in the stock market, led to an increasingly nervous investor community and a bias towards fixed income securities. If we combine this with the Bank of Japan's efforts at stimulating the economy then we have an investor base that is wanting to buy fixed income securities but finding it increasingly difficult to find assets providing them with adequate returns. Over recent years, the market in Japan has not been conducive for international issuers to issue large public vanilla trades, as interest rate and basis swap levels pushed yields to levels that were too low to attract the investor community.

As investors look to enhance returns this naturally moves them on to buying more complex bonds with views on interest and FX rates. As these are generally individual investor-specific views this has led to the development of the largest market for investor-driven structured private placement bonds in the world. These trades are mainly small in size, of between ¥500m and ¥2bn, long dated, and include such structures as reverse dual currency bonds, power reverse dual currency bonds, inverse floating rate notes (FRNs) and callable step-up bonds.

Naturally, as issuers will rarely want to take the directly opposing view to any specific investor requirement, they will enter into an cross currency swap hedging them fully back to their desired funding currency. In general, most issuers find that, given the size of the trades and the reverse enquiry nature of the business, a euro medium term note (MTN) programme provides the most efficient route. Drawdowns from these programmes are quick and cost efficient and, as this is not a domestic programme for issuance, regulatory filings are kept to a minimum.

This market has been tapped for over a decade by international issuers wishing to capitalise on this opportunistic funding. Initially, the market was confined to issuance from supranational and quasi-sovereign entities, as investors took the strictest view on acceptable credits. European and Australian banks then began to source funds from this market, aided by their flexibility on structure. Most recently, we have also seen increasing demand for corporates, as investors seek increased spread and become more sophisticated in their own credit analysis.

**IT TAKES ALL SORTS.** Issuers should initially take time to get acquainted with the investors in Japan. There are a number of types of investor, each focusing on certain types of structure, credit and tenor. At the shorter end are the money market funds or ITMS. These generally buy shorter-dated plain vanilla securities, of usually less than two years, and either fixed rate bonds or regular yen Libor FRNs. In 1999 and 2000, there were an abundance of buyers of one-year paper from all types of credit BBB+ and above, which provided a large source of funding for many international issuers. More recently, they have become less active, but remain potentially the largest source of funding for most corporate issuers, given they have the potential to invest $100m or more at a time.

The next most interesting category of investors are probably the insurance companies, and in particular the non-life insurance sector, known as the fire and marine insurers. These again are buyers of a wide variety of credits with an appetite for the middle of the curve, between three and seven years.

Again, they are buyers of vanilla structures but tend to have a smaller appetite, with the average ticket size being about $20m equivalent. This sector has provided some useful opportunistic funding to a selection of single A rated corporates.

A large number of the life insurance companies and the smaller regional financial institutions are still restricted to buying only quasi-sovereign issuers, as most of their investments are at the longer end so are probably of less relevance for bank or corporate funding. However, this does not exclude them all together, and there are still opportunities out there for certain names that may require longer dated funds. Similarly, there is a reasonably active corporate investor base buying a variety of structures to suit their views on interest rates and FX rates.

**FIGURE 1**
NIKKEI 225 INDEX 1985-2001.

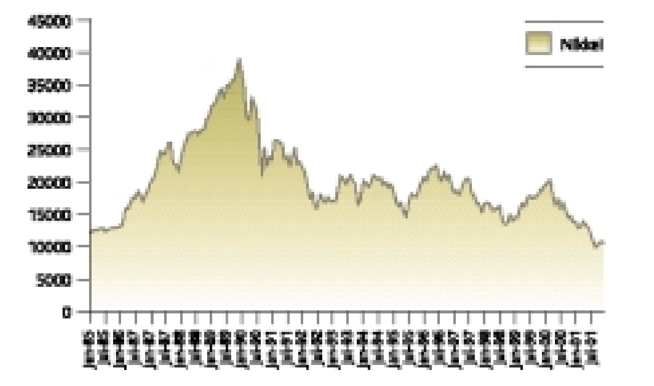


**FIGURE 2**
JAPANESE YEN INTEREST RATES 1987-2001.

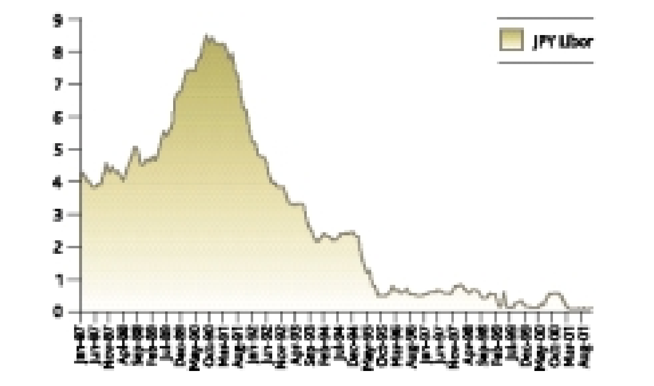


**TABLE 1**
UK CORPORATE ISSUANCE INTO JAPANESE YEN.

| | ISSUANCE (JPY BNS) | YEAR OF ISSUE | | |
|---|---|---|---|---|
| | | 1999 | 2000 | 2001 |
| | Total issuance | 324,266 | 1,093,105 | 291,800 |
| | Non-syndicated | 254,266 | 1,093,105 | 215,800 |
| Rating | A or AA | 103,300 | 732,000 | 44,600 |
| | BBB | 220,966 | 361,105 | 247,200 |
| Maturity | 2yrs and less | 163,266 | 1,030,605 | 130,300 |
| | 2yrs to 5yrs | 120,000 | 62,500 | 76,900 |
| | Longer than 5yrs | 41,000 | – | 84,600 |

The retail market has also appealed to issuers over the recent years, but it is a market that primarily requires name recognition. The regulatory filing requirements required for uridashi and samurai bonds can often be a laborious process but issuers can often find a way to overcome this hurdle, given the likely returns.

**SMOOTHING THE WAY.** The next step that a potential issuer should consider are the logistical obstacles involved in issuing into the Japanese markets. The first of these is probably the time difference. Depending on the time of year, Tokyo is eight or nine hours behind London, and although most of the execution is likely to take place in the brief crossover period most of the investor preparation work takes place while London is asleep. Consequently, to ensure a smooth process, dealers find it crucial that any potential issuer is absolutely clear from the start of their issuing parameters. Issuers need to be clear and consistent about details such as size, tenor and structure in order to aid dealers to effectively put together a deal. Invariably, investors in Japan need to go through a lengthy and rigorous approval procedure to gain approval to buy a bond, and failure to deliver will cause embarrassment.

Swap lines and preferably master ISDA agreements should also be in place before attempting to tap the Japanese market, as with any international market. Given the structured nature of the market and the unlikely event of UK issuers needing yen funding, most bonds issued into the Japanese market will need a cross currency swap to hedge the issuer back to their target funding. In particular, the cross currency nature of these swaps means they can be reasonably credit intensive. Credit mitigants, such as break clauses or margining agreements, are often used by the more frequent issuers, but often these can be unsuitable for non-financial institutions to put in place, so prudent use of lines and diversification of swap counterparties need to be considered.

The Japanese investor base is definitely increasing in credit sophistication and as it does so their dependence on the ratings agencies will diminish. However, in the current market it is unwise to expect to raise any money without a rating from one of the main two rating agencies. Once these criteria are in place, most of the work has been done. What remains is then, in essence, a waiting game, as dealers put together the pieces of the puzzle required to show out ideas to the investment community.

To keep on top on the current market, a regular dialogue with relevant dealer groups is advisable. This will ensure funding targets are consistent with any issuer's strategy and will also keep them abreast of any market developments. On the flip-side, it helps to keep dealers aware of any change in policy from the issuer's side as well. For anyone attempting to use the Japanese market for a significant amount of funding it is worthwhile making the time for a brief roadshow in Tokyo to present their credit. This should be mainly aimed at banks and securities firms, but sometimes it is also a smart move to make individual investor presentations.

As mentioned above, the Japanese market does possess great potential for anyone willing to put in a reasonably simple effort and has not gone unnoticed by the rest of the world. European, Australian and US issuers are all keen to tap the market and the competition is ever increasing. Additionally, this market is unique due to nature of the Japanese economy and interest rate environment, consequently will undergo a dramatic change in the event that rates begin to climb higher. Hence to anyone involved in the market the best words of advice I can think of are – be prepared, be clear and be quick.

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