An introduction to debt securities

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A debt security is any instrument which is, or may be traded more or less freely among investors in the market. Securities are either expressed to be payable to the bearer or state that entitlement is determined by reference to a register of holders. Bearer securities will usually be "negotiable instruments". Broadly speaking, this means that title to the security can be transferred by mere delivery and that the transferee is unaffected by any third party claim against the transferor. In practice, bearer securities are usually lodged with a depository or custodian for safe-keeping, because of the risk of loss or theft, and are traded through clearing systems such as Euroclear and Clearstream, Luxembourg.

By contrast, securities in registered form are not themselves documents of title; in the event of loss or theft, the register can always be produced to establish who is the true owner.

Debt securities may be used for short, medium or long-term financing and may carry a fixed or a floating rate of interest or no interest at all (zero coupon). Terminology varies but, generally speaking, securities with a maturity not exceeding one year are referred to as commercial paper (in practice, always in bearer form) while securities with a maturity of more than one year are called bonds or notes. UK companies also issue loan stock (effectively, bonds in registered form) but this is generally only sold in the domestic market or as part of the consideration for a takeover. In the UK, a company must be a public limited company (PLC) to obtain access to the public debt securities market, as such securities constitute debentures which private companies cannot issue to the public.

There is a wide variety of debt securities issued including those convertible into equity (convertibles), those linked to an index or formula or price of a particular commodity and those issued on a subordinated basis.

Securities may also be issued with warrants to subscribe for equity. Debt securities are usually unsecured unless forming part of a structured or project financing or a securitisation transaction. Debenture stock secured by fixed and floating and sometimes merely a floating charge over a company's assets are now rarely issued as they normally conflict with the negative pledges contained in committed bank facilities.

Generally the debt securities markets are only open to companies whose names are known to prospective investors unless credit support is provided.

Types of debt security

Commercial paper

Commercial paper is normally created pursuant to a programme and, when issued in the Euromarket, is commonly called "Euro-commercial paper" (ECP). An ECP programme will provide for the issue of ECP notes (usually for a period of one or three months, but can be up to 12 months) from time to time at short notice to one or more dealers on a non-committed basis at a price agreed at the time. ECP is usually non-interest bearing and is, therefore, issued at a discount to face value. However, interest-bearing ECP can also be issued for all but the shortest maturities. The programme will typically set an overall maximum for outstandings. ECP notes issued under an ECP programme are typically unlisted.

Medium-term notes

Bonds and notes for longer maturities may be issued either on a "one-off" basis or pursuant to a programme. Such a programme is commonly known as a "medium-term note" (MTN) programme but this name is misleading since such a programme may permit the creation of bonds and notes of any maturity over one year; indeed, some MTN programmes even double as ECP programmes, permitting the creation of short-term paper.

An MTN programme functions in much the same way as an ECP programme although documentary requirements are somewhat stricter and can be used for private placements or more widely distributed syndicated issues. Issues can still be done at short notice. However, issues under an MTN programme will often be listed or subject to special terms (e.g. a redemption formula) and this usually adds a number of days to the issue process. In spite of the relatively high cost of setting up an MTN programme, many companies have them as, in the main, convinced that the initial expense is outweighed by the flexibility and cost savings which the programme provides over time.

An MTN programme can be used to tap the Eurobond investor base and gives a shelf for issuance by creating a comprehensive set of documents that includes the standard terms and conditions under which a company will issue in the Eurobond markets. Notes issued under the programme are usually admitted to listing by either the Luxembourg Commission de Surveillance du Secteur Financier or the UK Financial Services Authority and admitted to trading on a market of the Luxembourg Stock Exchange or the London

Stock Exchange. The prospectus (sometimes referred to as an offering circular or information memorandum) is updated annually to comply with the requirements of the relevant listing authority/stock exchange.

Note issues, syndicated among a group of investment banks, may be launched by producing a short "final terms" which specifies the terms of the individual deal. Typically, a syndicated issue will be supported by relevant legal opinions and auditors' comfort letters. An MTN programme also enables a company to issue smaller non-public deals to individual investors (often referred to as "private placements").

Domestic and Eurobond issues

Companies wishing to raise a substantial amount for a fixed maturity in one go have the choice of issuing a bond on a stand alone basis or under an MTN programme. Such an issue may be syndicated among a group of banks, or privately placed. In order to ensure that the offer does not constitute an "offer of securities to the public" in the UK, offers are usually restricted to certain classes of market professionals or denominated in amounts of EUR 50,000 or greater.

An issue may be listed on – or, to use the terminology from the EU Prospectus Directive (2003/71/EC), admitted to trading on – a stock exchange (e.g. in London, Luxembourg or Ireland), although it should be noted that stock exchanges generally disapprove of the practice of listing issues which have not been widely distributed. In order to obtain a listing, listing particulars or a prospectus describing the issuer and the terms of the issue must be produced in compliance with the listing rules of the relevant exchange or listing authority. For a UK company, a listing by a recognised stock exchange or listing authority will be necessary to take advantage of an exemption from UK withholding tax, so that investors can receive interest payments free from UK withholding tax.

A checklist of issues for the treasurer issuing a Eurobond is contained in the Appendix.

High yield

High yield debt is typically rated sub-investment grade, i.e. below Baa, in the case of Moody's, BBB, in the case of Standard & Poor's or BBB, in the case of Fitch. It usually has a term of five to 10 years and will either be fixed rate with a bullet repayment at maturity or issued at a discount to its maturity value. It will usually be listed on an international stock exchange. For a company in the start-up phase with negative cashflow, it has the advantage of providing long dated debt with fewer and lighter financial covenants than typical bank debt. However, it is a more expensive source of funding and will not be attractive to those able to access the European investment grade bond or loan markets.

The covenants commonly found in high yield debt are quite different from bank loan covenants, e.g. high yield covenants tend to be monitored on an "incurrence" basis (i.e. when something happens like the assumption of new debt) unlike bank debt covenants which are monitored on a regular ongoing basis. In addition, high yield covenants usually impose a test (e.g. a ratio test) which, if satisfied, means the covenant is relaxed until the issuer wants to do something, whereas bank covenants tend to apply on an ongoing basis.

High yield debt usually subjects the issuer and its "restricted" subsidiaries to the covenants and the distinction between "restricted" and "unrestricted" subsidiaries is clear cut unlike the concept of "material" subsidiaries. Furthermore the issuer will have some discretion on an ongoing basis as to what constitutes a restricted subsidiary, whereas under a syndicated loan the borrower will have no say as to what constitutes a material subsidiary.

Most high yield issues by UK companies have been structured so that the high yield debt is subordinated to the issuer's bank debt, so that if the issuer becomes insolvent, the high yield debt cannot be repaid until senior creditors have been paid in full. There are different ways of achieving subordination and in the European high yield market this is generally achieved "structurally", i.e. the high yield debt will be issued by a holding company in the issuer's group which usually has only a shareholding in the group's operating companies as its assets and holders of the high yield debt will only have a claim against the assets of other companies in the group as an unsecured subordinated creditor.

The senior debt will be incurred by operating companies in the group which have more significant assets. This is proving somewhat controversial with high yield investors as it gives the investors significantly reduced influence in a situation where a default has occurred on the senior debt compared to the position in the US where the high yield market originated.

Advantages and disadvantages of debt securities

There are a number of advantages for a company in raising finance by the issue of securities. These include:

- *tighter pricing* – by tapping the market directly instead of borrowing through a commercial bank, a company often gains access to cheaper funding. This is known as "disintermediation". In this respect credit agencies such as Moody's, Standard & Poor's and Fitch play an important role by furnishing an independent credit assessment of the leading borrowers in the market. An investment grade rating from a recognised rating agency can be a key factor in attracting a broad range of investors and obtaining the tightest available pricing;
- *diversified funding base* – issuing securities helps a company diversify its funding. Instead of relying for its financing needs on a relatively small number of banks, the company can spread its debt around the market;
- *less onerous terms* – in order to maximise the liquidity of an issue of debt securities, the terms of the issue are kept as straightforward as possible. Covenants and events of default are standardised to a greater degree than in loan documentation and are nearly always less onerous for the company. An investor in debt securities will be chiefly interested in the issuer's overall financial standing; and
- *higher profile* – an issue of securities is an opportunity for a company to raise its own profile. While a privately placed issue will receive little or no publicity, an offering of

securities to the market at large puts a spotlight on the issuing company, its financial condition and its corporate strategy.

Set against the advantages of an issue of securities there are also considerations which tend to be in the opposite direction and which need to be borne in mind when weighing the pros and cons of this method of finance. These include:

- *Disclosure* – commercial banks lending to a company will often already be familiar with its business and will themselves investigate its financial condition. Even where a loan is to be syndicated, a short information memorandum will usually suffice. By contrast, investors in debt securities will not have direct access to the company and will rely on information provided by the company to the market in general. For a listed issue this will be supplied in the listing particulars or in a prospectus (and the level of disclosure will be prescribed by the rules of listing authority/ stock exchange) but even for an unlisted issue a prospectus or other disclosure document will usually be produced. Investors will expect any such document to contain a relatively detailed description of the company. The process of producing and checking this description is often called "due diligence". It can be a time-consuming affair both for the issuer and for its investment banking advisers. If an issue is to be wholly or partly placed in the US, the due diligence process is much more rigorous because of the perceived higher liability risks and the consequent higher disclosure requirements and can significantly increase the cost of the issue.
- *Higher fees* – while the interest rate (often referred to as the "coupon") on an issue of securities will generally be lower than on a corresponding term loan, it will usually be more expensive to arrange the transaction (unless there is an existing programme). Most companies will need to retain the services of an investment bank to help document and sell the issue and, if a wide distribution is essential or a large amount is to be raised on an underwritten basis, more than one will be required. The fee structure will reflect the tasks which the investment banks are asked to perform. A simple private placement may involve only a single arrangement fee. A syndicated underwritten issue will involve management and underwriting commissions (usually combined in a single fee) and perhaps also selling concessions or placement fees to encourage distribution. Typically, the fees will be expressed as a percentage of the face amount of the securities.
- *Other up-front expenses* – the issuer will also be expected to pay the costs of any listing or rating of the securities and will have to pay the fees and expenses of the paying agents and any trustee for the holders throughout the life of the issue. There will also be the cost of printing the prospectus or other selling document (where one is produced) and of security-printing the securities where they are being issued in definitive bearer form. The issuer will also need to budget for the accountants' and lawyers' fees and expenses involved in the checking of its financial condition, the due diligence process and the production of the legal documentation.
- *Less flexibility* – the covenants and events of default for an issue of securities will usually be lighter than for a loan. However, a company can always seek a waiver from the provisions of its loans or even enter into negotiations to reschedule them. It is considerably more difficult to modify the terms of a debt security. If it is in bearer form, the company will usually not know the identity of the holders. In any event, an issue of securities will typically be held by a large number of different investors and, if the issue is liquid, the investors may be changing from day-to-day. Save in the case of ECP, the terms of the issue will provide for the convening of a meeting of holders or their representatives and for the passing of a resolution which will bind all the holders. But because of the publicity involved in convening a meeting and the high quorum and voting requirements on which the market insists, this is often not a practical option for the issuer. Appointing a trustee for the holders of the securities as part of the issuance structure can increase the flexibility of an issue of debt securities, but for more significant waivers or alterations, a trustee will nevertheless usually insist on a meeting of holders being convened. The advantages and disadvantages of appointing a trustee are discussed later under the heading "Documentation of debt securities".

Key bond markets

There are two key markets of bond investors available for UK corporates to tap outside the UK domestic investor base; the US debt markets and the Eurobond (or international) market.

US debt markets

US investors comprise the deepest, most liquid and arguably most sophisticated of all global fixed income investor bases. UK corporates can raise debt finance in the US markets in three ways, as:

- *a public bond* – registered with the Securities and Exchange Commission (SEC) and traded freely in the debt markets (this type of dollar instrument is commonly known as a "Yankee"– a US domestic bond issued by a non-US resident);
- *a quasi-public bond* – not registered with the SEC but tradable by qualified institutional buyers (QIBs) in secondary markets ("144A issues" as issued under the Rule 144A exemption from SEC registration); or
- *a private placement* – not listed or traded, but placed directly with a small group of institutional investors which will typically own the note to maturity.

Two formal debt ratings (usually from Standard & Poor's and Moody's) are required to issue a Yankee and are commonly obtained for a 144A bond. Both rated and non-rated companies can execute private placements.

Yankee and 144A issues are typically underwritten by an investment bank. Private placements are not usually underwritten but are undertaken on a "best efforts" basis.

Most public US bonds are between USD 300 million and USD 1 billion in size. Public bond issues in the US markets exceeding USD 1 billion in issue size are not uncommon. The most common maturities are five, seven and 10 years but there is a deep and active market in longer dated paper – 15, 20 and 30-year issues are standard, while the so-called "century" bond or 100-year issue sporadically enjoys popularity.

Documentation for a Yankee issue is very time-consuming as SEC registration requirements are extensive, necessitating reconciliation of financial statements to US generally accepted accounting principles (GAAP) (although the SEC does now permit IFRS financial statements to be used without reconciliation to US GAAP), substantial disclosure and regular reporting to the SEC. The requirements for a 144A issue are less stringent, but still lengthy.

Private placements can be arranged in any size from USD 25 million to USD 300 million, and sometimes even more. The term is usually between five and 12 years. Deals can be split between (for example) a five-year and a 10-year tranche if the borrower prefers and investor demand permits. Documentation for a US private placement has become increasingly standardised. Some financial covenants are usually required.

Eurobond markets

A Eurobond (or international bond) is a publicly traded debt instrument with a standard format admitted to listing by a listing authority, typically the UK Financial Services Authority, the Luxembourg Commission de Surveillance du Secteur Financier or the Irish Financial Services Regulatory Authority and/or admitted to trading on a recognised exchange, typically the London, Luxembourg or Irish Stock Exchanges. Eurobonds are usually bearer instruments, with legal title evidenced by production of the Note, whether in global or definitive form.

For more information see United States *Country Guide on page 390*

Payment of coupons and repayment of the principal at maturity is effected through the two main euromarket clearing systems, Euroclear or Clearstream, Luxembourg, or can be made manually by presentation of the note to or to the order of a paying agent if held in definitive form.

The Eurobond market is split into different currency sectors, e.g. the Eurodollar sector, the Eurosterling sector, and, the "euro" sector. These different sectors each have their own characteristics deriving from the composition of the domestic investor base and the degree of non-domestic demand for the currency:

- *Eurodollars* – typical issue size between USD 100 million and USD 500 million, with corporate issues exceeding USD 1 billion being rare. The standard maturities are three, five, seven and 10 years;
- *Eurosterling* – typical issue size GBP 150 million to GBP 350 million. The standard maturities are five, seven, and 10 years as well as a very well developed and long established market in long dated maturities 15 to 30 years, driven by the UK pension funds and insurance companies demand for long dated assets; and
- *euro* – the standard maturities are three, five, seven and 10 years. Issue size can be very large, i.e. in the billions.

Eurobonds issued by entities in most jurisdictions may be bought by investors globally free and clear of withholding tax. There are, however, selling restrictions in most countries which will often restrict sales to retail buyers. There are additional stringent regulations governing sales into the US and generally speaking a bearer Eurobond cannot be sold into the US until 40 days after closing, and even then there are further restrictions if the notes form part of the underwriter's original allocation.

Documentation is more straightforward and less extensive than for a Yankee or 144A issue, particularly in the case of an investment grade issuer. A company does not formally need a credit rating to access the Eurobond markets, but increasingly investors are stipulating that they will only buy rated issues. Thus at least one long-term rating from Standard & Poor's Moody's or Fitch is the norm. Because of the dominance of a relatively small number of UK institutions in the sterling bond markets, it is possible for UK companies to rely on domestic name recognition and issue in this sector without a rating. As more and more non-domestic issuers and investors participate in the sterling market, a formal credit rating is likely to become more important even for a sterling bond issue.

Comparing the US and Eurobond markets

Choosing between the different bond markets will depend upon several criteria:

- relative pricing levels;
- amount required;
- choice of investor base;
- most appropriate maturity for your business;
- preferred currency (taking account of the availability and cost of the appropriate currency swap);
- covenants;
- ease of documentation/management time; and
- subject to the above discussion on ratings requirements for a Eurobond, need for a rating.

See Table 1.

Pricing of debt securities

Bonds and private placements may either carry a fixed coupon or pay a floating rate of interest ("floating rate notes", or FRNs).

The fixed coupon is set equal to an agreed spread ("the

Table 1 : Comparing the US and Eurobond markets

	Advantages	Disadvantages
US/Yankee/144A/ private placements	■ Gives secure term finance and spread of refinancing risk ■ Establishes access to the world's deepest investor base ■ Largest issue size ■ Longest available maturities (except possibly for the Eurosterling market) ■ Flexible structures available	■ Usually more expensive than bank debt except for very best AAA, AA and some A-rated companies ■ Yankee and 144A-documentation relatively onerous and expensive ■ US private placements require covenants ■ Inflexible – prepayment usually expensive
Eurobonds/MTN	■ Provides term debt and enables spreading of refinancing risk ■ Establishes new permanent investor base capable of speedy access ■ Advent of euro gives an investor base to rival the US in terms of size ■ MTN market permits opportunistic financing ■ Straightforward and time efficient procedures and documentation ■ Enhances company profile and investor relations ■ MTN programme provides flexible and rapid market access	■ Usually more expensive than bank debt except for very best AAA, AA and some A-rated companies ■ Inflexible – prepayment usually expensive ■ MTN programme expensive to set up and can involve significant management time

re-offer spread") over the market benchmark government bond for the given currency and maturity. The bond will be launched publicly, with an announcement on trading screens specifying the re-offer spread, and the bond will then be priced at a pre-specified time. The coupon will be rounded to the nearest 1/8% and the price at which the bond is issued will be adjusted relative to par to maintain a yield equal to the benchmark bond plus the re-offer spread.

Pricing is a function of the credit standing of the issuer and market conditions.

Credit ratings are important in determining a range at which the successful bond should be launched, but sentiment towards a particular name can play a key role. It is not uncommon for A-rated "household names" to trade at tighter credit spreads than AA-rated companies. Factors such as industry sector and name recognition play an important part in determining the spread. Current secondary trading levels of comparable companies are important reference points.

Market conditions are impacted by a number of factors. Macro-economic global events can lead to large moves of global capital and big changes in investor sentiment which impacts both bond prices and liquidity. Domestic economic trends such as monthly releases of inflation data and employment numbers can be important indicators as to future moves in interest rates and can alter market sentiment. The relative strength of the currency will influence overseas investors and affect the flow of capital into or out of any given government bond market, and also many of the Eurobond markets where non-domestic investors play a big part. Finally, the volume of other bond issues and the market reaction to these will also be a key factor in determining new issue conditions.

Documentation of debt securities

Agreeing documentation for an issue of securities by a company (or for an MTN or ECP programme) rarely gives rise to as many concerns for the company as the negotiation of a loan document. In the securities market, documentation is, to a large extent, standardised as an aid to liquidity and, generally speaking, imposes fewer burdens on the company raising the funds than would be the case for an equivalent loan.

However, there are many similarities between loan and securities documentation and a lot of the matters dealt with above will be relevant, in whole or in part, to the way in which a securities issue or a programme is written.

The principal documents involved in an issue of debt securities usually include:

- listing particulars or a prospectus for the contents of which the issuer, and in certain circumstances its directors personally, are responsible;
- subscription, underwriting, placing or dealership agreement;
- a paying or fiscal agency agreement; and
- a trust deed (if there is a trustee).

The following paragraphs summarise some of the points for which an issuer should particularly watch.

■ Trustee or fiscal agent?

An important initial question for an issuer is whether it wishes to appoint a trustee for the holders of the securities. Where the issue is secured, a trustee will be necessary to hold the security for the benefit of the investors. But even in the case of an unsecured issue, a trustee provides a valuable point of contact for the issuer – which is especially important if the issue is in bearer form.

A trustee is able to consider requests for waivers in situations where the investors will not be materially affected. In this respect the trustee fulfils a similar role to that of the agent in a syndicated loan. If the issuer runs into difficulties, the trustee can also protect against the "maverick investor"; the holder of a relatively small number of securities who accelerates (with all its cross-default implications) in a situation where most investors would prefer to grant a waiver or reschedule. This is because, where a trustee is appointed, it is customary to provide that investors can only direct the trustee to take action (for example, to accelerate the notes) if a specified percentage (by value) of the holders so decide. Where there is no trustee, the usual practice is to give to each holder an independently exercisable right to take action in respect of his own holding.

The disadvantage of appointing a trustee is the additional outlay; legal costs for the trust deed at the outset and ongoing trustee's fees and expenses.

Prospectuses, selling restrictions and other legal requirements

Issuers should ensure that they take appropriate legal advice on issue requirements. For example, issuers will need to ensure that they comply with standards for prospectuses in the market in which the listing is to take place. Following the implementation of the Prospectus Directive in 2005, disclosure requirements for listing and admission to trading in any EEA state (i.e. the EU member states plus Iceland, Liechtenstein and Norway) are broadly the same.

Advice should also be sought on any legal restrictions on the investor base to whom an issue can be marketed. For example, the US securities laws are complex and their applicability will depend on the nature of the securities and the extent to which it is envisaged they will be offered or sold in the US.

Representations and warranties

The securities themselves will not contain representations or warranties but it is usual for the issuer to be required to give them to the underwriters (often referred to as managers) or dealers in the subscription/underwriting/placing/dealership agreement. They will cover much the same ground as the equivalent provisions in a loan facility agreement. However, they will be tailored to reflect the responsibility which the issuer shares with its investment bankers to ensure that adequate disclosure is made to the market and that the securities are distributed in accordance with all relevant laws and regulations.

Indemnity

It is usual for the underwriters or dealers to require the issuer to agree to indemnify them against any breach by the issuer of its representations, warranties and undertakings in the subscription/underwriting/placing/dealership agreement. However, they do not always volunteer a reciprocal indemnity in respect of their own undertakings to ensure that the securities are sold in accordance with applicable laws and regulations. An issuer should endeavour to obtain such an indemnity if possible; it will make it considerably easier to recover losses if the issuer suffers a loss as a result of a breach of selling restriction by an underwriter or dealer.

However, an issuer should also be aware of the very real barriers which exist within some investment banks to the giving of such indemnity protection.

Covenants (negative pledge)

ECP does not usually contain any covenants at all. Euromarket securities with a maturity of more than one year normally contain a negative pledge (unless the credit standing of the issuer is very strong) but other covenants are relatively rare. The negative pledge will often be weaker than in a loan document.

Typically, it will prohibit the creation of security for indebtedness for borrowed moneys but this may be limited so that the prohibition applies only to such indebtedness where it is represented by marketable (or even just listed) securities. Certain permitted encumbrances will often be identified. The negative pledge may occasionally also include restrictions on the giving of guarantees.

The issuer should always bear in mind that, if the negative pledge is over-complicated, there is a risk that the market will be reluctant to buy the paper because of the extra time involved in analysing the provision. It is also important to remember that it is difficult to obtain a waiver from the negative pledge in an issue of debt securities because of the obstacles to identifying the holders. The issuer should, therefore, endeavour to ensure that the provision is as concise and as liberal as the market will accept.

Gross-up

It should not be necessary to negotiate the tax gross-up provisions in a debt security; they are standard as a matter of market practice. In ECP the gross-up will usually take the same form as in a loan document, providing for the issuer to assume the risk of withholding tax in all jurisdictions from or through which payment is made. In other Euromarket securities the gross-up is more restricted in that the issuer is only obliged to gross up for withholding tax in its own jurisdiction. However, in the case of both ECP and other Euromarket securities, investors lose the benefit of even this limited provision if they have some connection with that jurisdiction other than the mere holding of the paper or present for payment more than 30 days late (where no tax would have been imposed if they had presented within the 30 day period).

An "EU standard" carve-out from the requirement to gross-up has been adopted in the market to address any impact from the EU directive on the taxation of savings, which might require withholding in certain circumstances. Issuers should check that the market standard has been adhered to in any documentation submitted to them for approval. Debt securities do not contain any obligation for the issuer to indemnify the holders for any taxes imposed on the receipt of payments, even though such an obligation is common in the case of a loan. An obligation to furnish tax receipts to investors is also extremely rare because of the logistical difficulties in making them available to a wide range of often anonymous investors.

It is however customary for the issuer to be given a right to prepay the whole issue if the gross-up obligation is triggered as a result of a change in tax law after the issue date of the notes. The form of this provision has been largely standardised but an issuer should resist the need for legal opinions to be produced as evidence of the withholding requirement where it considers that a directors' certificate will suffice. UK issuers will normally need to rely on the quoted Eurobond exemption in order to enable them to pay interest without deduction of tax which means that, among other things, the securities will have to be listed by a recognised stock exchange.

Events of default

ECP usually has no events of default but these will almost always be found in securities with a maturity exceeding one year. The events of default which the market generally expects to see are non-payment of principal or interest, breach of any other term of the issue, cross-default and bankruptcy (however described). It will be difficult for an issuer to negotiate away from any of these and in practice it may be necessary to concede other events as well. However, an effort can be made to introduce suitable grace periods for non-payment and an appropriate threshold for the cross-default. Grace periods for non-payment under a debt security are often a little longer than those encountered in loan documentation.

If it is felt that an event should give the investors a right to repayment but the issuer does not regard it as a default event which should be permitted to cross-default other indebtedness, consideration should be given to ensure that its occurrence will give rise to a right to require the issuer to redeem the securities but will not be regarded as an event of default.

APPENDIX: Eurobond issuance checklist

This section describes the process of issuing Eurobonds, including a description of the parties to a bond issue and the documentation involved.

1. Background

1.1 What is a Eurobond?

A Eurobond is a publicly traded debt instrument with a standard format admitted to listing by a listing authority, typically the UK Financial Services Authority, the Luxembourg Commission de Surveillance du Secteur Financier or the Irish Financial Services Regulatory Authority and/or admitted to trading on a recognised exchange such as the London, Luxembourg or Irish Stock Exchanges. Eurobonds are usually bearer instruments and generally the interest received by investors is free of withholding tax. Eurobonds can be issued in any currency (subject to compliance with relevant regulations) but most issues are in USD or EUR.

1.2 Medium-term note (MTN) programmes

Eurobonds may be issued on a one-off basis or under an MTN programme. An MTN programme contains the standard Eurobond documents which have been pre-approved by the relevant listing authority and/or stock exchange and agreed between all the normal parties to a Eurobond issue.

There is also a "programme agreement" (also referred to as a dealership or dealer agreement) and "procedures manual" which set out the ongoing obligations of the parties and the procedures for issuing a Eurobond. The programme has to be updated annually.

Companies that plan to issue Eurobonds regularly may find that using an MTN programme is a cost effective method which improves the speed of the issue.

2. The parties to a Eurobond issue

2.1 The issuer

Various types of issuer access the Eurobond market:

- companies including banks;
- governments;
- public authorities; and
- supranationals such as the World Bank.

The issuer will need to ensure that it has the authority to issue the Eurobond.

2.2 The lead manager and co-managers (the "managers"- also referred to as underwriters)

The lead manager will be an investment bank and will arrange and manage the process of issuing the Eurobond. The lead manager will also advise the issuer on the type, amount and timing of the issue. The issue can have two or more joint lead managers.

The issuer may also have co-managers, again who are investment banks, who along with the lead manager will attempt to sell the Eurobond to investors.

The managers usually underwrite the issue so that the issuer is assured of receiving finance even if some or all of the bonds are unsold. The International Capital Market Association (ICMA) – known as The International Primary Markets Association (IPMA) prior to its merger with the International Securities Market Association in July 2005 – a self-regulatory trade association, produces a handbook setting out best practice for issuing Eurobonds.

2.3 Rating agency

Most issues require a credit rating from at least one of the three main credit rating agencies, Standard & Poor's, Moody's Investors Service or Fitch. Most investors will only invest in bonds rated as "investment grade", i.e. at or above BBB (S&P), Baa (Moody's) or BBB (Fitch). Once issued, the credit rating of a bond may change. The interest rate of a bond is highly dependent upon its rating.

2.4 Trustee or fiscal agent

The issuer may appoint a trustee to represent the interests of the bond-holders. A Trust Deed will set out the powers and duties of the trustee, which is likely to be a professional company. The trustee is the interface between the issuer and the investors. The advantages for the issuer are:

- the issuer only needs to deal with one entity rather than the potentially many bondholders; and
- the trustee usually has power to waive defaults if not material and agree minor amendments to the bond terms without consulting each and every bondholder, thus leading to greater flexibility and speed.

If a trustee is not appointed then the issuer will appoint a fiscal agent, who will interface with the bondholders when the need arises e.g. publication of notices. The fiscal agent does not represent the interests of the bondholders.

2.5 Listing agent

The issuer may need to appoint a listing agent if the Eurobonds are to be admitted to listing by certain listing authorities and/or admitted to trading on certain stock exchanges e.g. the Luxembourg Stock Exchange. The listing agent will communicate with the listing authority and/or stock exchange on behalf of the issuer and will ensure that all necessary documents are submitted to the listing authority and/or stock exchange.

2.6 Paying agent

The paying agent is appointed by the issuer to distribute payments of interest and principal.

2.7 Clearing systems

Most Eurobonds are in bearer form and therefore at risk from theft or loss. Clearing systems facilitate the electronic transfer of bonds through the provision of cash and securities accounts for participants as well as dealing with the payment of principal and interest. Therefore investors do not need to physically hold the bonds. The two largest clearing systems are Euroclear Bank S.A./N.V. ("Euroclear") and Clearstream Banking, société anonyme ("Clearstream"). The bonds are usually passed to a bank or in certain circumstances from 30 June 2006, kept by one of Euroclear or Clearstream (the "depository" or "safekeeper") for safekeeping.

Each bond issue has a unique code number known as its international securities identification number (ISIN). Investors who have an account with the clearing system quote the ISIN when buying or selling the bond.

2.8 Depository

The depository keeps the bonds on behalf of the clearing system and is usually a bank however in certain circumstances from 30 June 2006, the depository will be Euroclear or Clearstream.

2.9 Auditors

Usually the manager will require a "comfort" letter from the issuer's auditors stating that the financial information in the prospectus has been correctly extracted from the audited financial statements and the issuer's financial systems and that nothing has caused the auditors to believe that there have been decreases in assets or increases in liabilities of the issuer compared with the financial information disclosed.

2.10 Lawyers

Both the issuer and the lead manager have their own legal counsel to assist in the preparation and review of the legal documents.

3. Documentation

3.1 Mandate letter

This letter sets out the arrangements under which the lead manager will act on behalf of the issuer. It will describe the type of bond to be issued, including the general terms and conditions, and the fees payable to the lead manager.

3.2 Prospectus/offering circular/listing particulars

This document is usually the only document sent to potential investors and details the terms and conditions of the bond. If the bond is to be listed, then the contents have to comply with the listing requirements of the relevant stock exchange or listing authority.

The rest of the section outlines the contents of a prospectus which satisfies the requirements of the UK Financial Services Authority.

3.2.1 Financial Services Authority (FSA).

The content requirements for either listing particulars or for a prospectus are set out in the Listing Rules and the Prospectus Rules of the FSA, contained in the FSA Handbook. The FSA's Disclosure Rules and Transparency Rules are also contained in the FSA handbook which regulates (among other things) market abuse issues such as disclosure and control of inside information.

3.2.2 Responsibility for information

The listing rules require a statement on responsibility relating to the information contained in the prospectus. A typical statement is set out below:

"The issuer accepts responsibility for all the information contained in this prospectus."

3.2.3 Terms and conditions of the Eurobonds

The listing requirements require details of the bonds and will include the following; amount, currency, interest rate or margin above a reference rate (e.g. Libor), interest payment dates, redemption amount, terms of early redemption (if possible), events of default, selling restrictions, governing law and taxation.

3.2.4 Issuer's description

This includes:

- registered office address;
- date of incorporation;
- description of the issuer's activities (e.g. products sold);
- details of pending or threatened litigation (or negative statement);
- financial statements for the previous two years, although these can be incorporated by reference in some circumstances;
- description of significant changes in the financial or trading position since the latest audited statements or a negative statement;
- details of the issuer's directors, such as name, business address and outside activities (e.g. directorships); and
- recent developments and prospects of the issuer, or a statement that there has been no material adverse change in the financial position or prospects of the group since the date of the last published annual accounts.

3.2.5 General duty of disclosure

Notwithstanding the specific requirements detailed in the Listing Rules and the Prospectus Rules, there is also a general duty to disclose information that investors would reasonably require to make an informed assessment of a Eurobond and the issuer.

3.2.6 Liability

Errors or omissions from the prospectus can give rise to both civil and criminal liabilities. There is both statute (primarily the Financial Services and Markets Act 2000) and case law which investors can use to sue the issuer if the prospectus is found to be incorrect or misleading.

3.3 Invitation telex/fax

This is sent by the lead manager to the co-managers on the day the bond issue is launched. It provides summary information about the issue, e.g. size, interest rate and fees payable. The telex invites the co-manager to participate in the issue and usually requires them to enter into a customary subscription agreement.

3.4 Subscription agreement (or underwriting agreement)

This is an agreement between the lead manager, co-managers and the issuer and sets out the basis on which the sale of the bonds will be managed. The agreement will cover the following items:

3.4.1 Underwriting

Usually Eurobonds are underwritten, i.e. if the managers cannot place all or some of the bonds, the managers must take the bonds and therefore the issuer is guaranteed to receive funds.

3.4.2 Conditions precedent

The obligations of the manager to subscribe are subject to various conditions. Typical conditions are:

- legal opinion – the delivery of a legal opinion satisfactory to the managers;
- auditors' comfort letter – the delivery of a letter from the issuer's auditors satisfactory to the managers; and
- no material adverse change – a statement from an officer of the company that there has been no material adverse change since the date of the prospectus.

3.4.3 Fees

The amount of fees (underwriting and selling) payable by the issuer will be stated.

3.4.4 Termination

The agreement sets out the circumstances where the manager may terminate the agreement to issue notes on behalf of the issuer if in their opinion the price of notes could be materially affected, e.g. a change in international political conditions.

3.4.5 Costs and expenses

This section details the costs and expenses to be paid by the issuer and usually includes all of the legal costs incurred by the managers, listing authority and stock exchange costs/fees and printing costs.

3.4.6 Representations and warranties

- Prospectus/offering circular/listing particulars – the prospectus/offering circular/listing particulars contains the necessary information to enable investors to make an informed assessment; and the statements in the prospectus are not misleading.

- Corporate authority – the issuer has the authority to issue the debt.
- Litigation – save as disclosed in the prospectus, there is no material litigation against the issuer which could have a significant adverse effect on the financial position of the issuer.

3.4.7 Indemnity
The issuer commonly agrees to indemnify the managers for any loss arising from a breach of representation or warranty.

3.4.8 Selling restrictions
The managers state that they will comply with all selling restrictions.

3.5 Paying agent agreement
This is an agreement between the paying agent, issuer and trustee (if one exists) and sets out the basis of how payments of interest and principal are to be managed. Where bonds are held electronically through clearing systems, the issuer pays interest to the paying agent who then pays the clearing system. Bondholders receive cash from the clearing systems.

3.6 Trust deed
If a trustee is appointed then the trust deed is required to set out the powers and duties of the trustee.

3.7 Auditors' comfort letter
The lead manager usually requires a letter from the issuer's auditors confirming the following:

3.7.1 Extraction of figures
That the figures set out in the prospectus have been correctly extracted from the audited financial statements or the financial systems of the issuer.

3.7.2 No change
That nothing has caused the auditors to believe that, based on certain procedures, there has been a change in the issuer's financial position compared with the disclosed financial information.

3.8 Legal opinions
The managers and trustee usually require a legal opinion on the following:

3.8.1 Corporate authority
The issuer has the authority to issue.

3.8.2 Approvals
Whether any other regulatory approvals are required and if so whether they have been received.

3.8.3 Registrations and filings
Whether all (if any) necessary public registrations and filings have been effected, e.g. has the prospectus been approved by the listing authority.

3.8.4 Legal valid and binding
Whether the issue documents constitute legal, valid, binding and enforceable obligations of the issuer as a matter of the laws of its jurisdiction of incorporation and, if different, the laws governing the issue documents.

4. The form of a bond

Most Eurobonds are issued in "global form"("temporary" and then "permanent") rather than in definitive form (i.e. a separate certificate representing each bond).

4.1 Global note
This document represents all the bonds that have been issued and all the terms and conditions of the bonds as set out in the prospectus are attached to and incorporated in the global note. The circumstances where investors can obtain definitive notes in exchange for their interest in the global notes (e.g. if the clearing systems fail) are set out on the face of the global note. The global note is held by a custodian, the "common depository" or "common safekeeper" on behalf of the clearing systems (who in turn hold the global note on behalf of the bondholders).

The global note is usually issued initially in temporary form for two reasons:

- speed – it is quicker to produce a temporary global note than definitive certificates; and
- selling restrictions – some jurisdictions place restrictions on the sale of securities, e.g. to whom certain securities can be sold. The use of a temporary global note can ensure that certain selling restrictions (and US tax requirements) are complied with (especially US selling restrictions).

The temporary global note is exchanged for a permanent global note after a set period.

4.2 Definitive notes
If issued in definitive form, Eurobonds are usually in bearer rather than registered form.