TURNING JAPANESE

COMPANIES SEEKING ALTERNATIVE FUNDING OPTIONS SHOULD CONSIDER THE TOKYO PRO-BOND MARKET, SAY DAVID LYON AND KENJI SETOGAWA

Earlier this year, Dutch bank ING sought Barclays' help to access the Japanese bond market. The move was a calculated initiative by ING to broaden its investor base in Japan, taking advantage of a relaxation of the stringent requirements associated with the issuance of traditional samurai bonds.

The JPY50.7bn (€500m) issuance by ING on 10 April 2012 was the first transaction on the Tokyo pro-bond platform, a new bond market for Japanese professional investors launched in May 2011. A number of international issuers are now set to capitalise on the pent-up demand among Japanese investors for non-domestic names in their portfolios.

For years, Japanese investors and international issuers have looked at each other longingly, frustrated in the knowledge that the country's traditional samurai market posed too many cultural and procedural hurdles for it to be easily and regularly accessed. So in 2008, the Japanese government decided to tackle this by incorporating the Tokyo pro-bond market into its Financial Instruments and Exchange Act.

The benefits of pro-bonds

Thanks to pro-bonds, non-domestic financial institutions, corporates and even sovereign issuers have a practical and viable alternative to full Japanese-language samurai disclosure for the first time. They can now use English-language disclosure to place their securities.

In addition, pro-bonds have other characteristics that should make them attractive to corporate treasurers who want to diversify their investor base:

- Japan's eligible investor base is large and encompassing. It includes qualified institutional investors, listed companies and well-capitalised private companies, as well as major banks, asset managers and insurers.
- Pro-bonds have a flexible format and a substantially quicker execution timeframe than samurai bonds. This allows issuers to tap the market in much wider windows compared with the traditional samurai process.
- Maintaining a pro-bond programme costs significantly less time and money than maintaining a samurai bond programme.

The decision to attract Japanese fixed-income investors was a natural step for ING to take. While it's in the process of formally separating its banking and insurance businesses, it has been in the Asian markets since the 1970s and is present in over 40 countries worldwide. It currently operates retail banking and insurance businesses in seven key Asian markets.

ING began its pro-bond programme at the end of March 2012 by listing a shelf programme worth JPY200bn (€2bn) that allows it to issue bonds over the following 12 months, parallel with a euro medium term note (EMTN) programme.

WHAT IS THE TOKYO PRO-BOND MARKET?

The Tokyo pro-bond market is a new bond market for professional investors (hence 'pro' stands for 'professional investors'). It was established under a 2008 revision to Japan's Financial Instruments and Exchange Act that provides a legal framework for the establishment of markets intended solely for financial professionals.

The Tokyo pro-bond market offers flexible and timely issuances of bonds, and provides more convenience to issuers, investors, securities companies and other market participants, both in Japan and overseas, than the traditional samurai bond format.

The Tokyo pro-bond market contributes to the development of Japan's bond market as a central player in Asia's financial markets.

WHICH ISSUERS SHOULD CONSIDER THE TOKYO PRO-BOND MARKET?

The Tokyo pro-bond market is suitable for a broad range of issuers across the financial institution, corporate, sovereign, supranational and agency sectors. The potential issuers that should consider pro-bond format include:

1. Issuers that do not currently have a samurai programme in place;
2. **Issuers that are looking to further diversify their funding platforms and investor base;**
3. Issuers that are keen to raise their profile in the Asian markets; and
4. **Issuers that would prefer to access the Japanese domestic investors via a platform that minimises documentation, translation, time and cost requirements.**

DIFFERENCES BETWEEN PRO-BONDS AND SAMURAI BONDS

SAMURAI		PRO-BOND
Mandatory semi-annual disclosures Japanese language	DISCLOSURE	Annual update of issuer filing information (akin to EMTN) English language
High	LEGAL COSTS	Moderate
Onerous	DUE DILIGENCE	Less onerous
All types of Japanese investors Limited participation from overseas investors likely due to Japanese disclosure	INVESTORS	All types of professional Japanese investors Higher participation from overseas investors likely due to English disclosure

After an important investor road trip in which ING senior management and investor relations successfully articulated the company's fundamentals and growth plans, ING issued a JPY50.7bn bond, which priced on 10 April. The deal was distributed via 40 tickets across a spectrum of banks, asset managers and insurance companies. Bonds were even distributed to international investors who favoured the English disclosure.

The deal priced at 100 basis points above the comparable yen swap curve – not an insignificant point in understanding this transaction. Given the persistent low-yield environment in Japan, local investors are constantly alert to opportunities that offer a yield pick-up. Crucially, ING could offer Japanese investors an appealing headline spread at an all-in level that remained cost-competitive to the euro and US dollar markets.

The devil is in the detail

It is important to examine particular elements of the deal to understand the reasons for its success and why it augurs so well for further activity in this market.

- Japanese officials are actively encouraging pro-bond deals. They see them as a way to release the 'trapped liquidity' that exists within their domestic markets. They sensed the need to create a bond market that can compete with the US dollar and euro markets.
- Japan is a very conservative market. Due to the numerous and stringent protocols surrounding the more traditional samurai market (which have deterred all but the most sophisticated and prolific issuers), there is huge pent-up demand for new, non-domestic credits, particularly those with good brand equity, a track record and a credit profile that reflects a stable and well-managed business model. ING fits that bill well.
- ING's three-day road show in Japan allowed the bank to explain in detail its plan to split its banking and insurance operations and its future strategy for its banking business. "We were talking to some of the most sophisticated asset managers in the world, none of whom pushed back once they heard the story," says Romke van der Weerdt, head of corporate treasury at ING.
- Although the pro-bond market allows issuers to bypass samurai conventions, ING decided to take a more hybrid approach to the deal. It still wanted to incorporate some typical samurai conventions, for example, utilising Japanese law, local settlement, a local fiscal agent and samurai interest payment conventions to show a certain degree of respect and cultural consideration. This also proved to differentiate the pro-bond product offering from the existing euroyen market.

We feel confident that over the next few years there will be a steady flow of issuance on the pro-bond platform. It won't be a heavy flow initially, but the market will develop slowly with high-quality names, particularly among financial institutions, making first use of it.

If you're looking for an analogy, go back to the US in the early 1990s, when 144As started appearing – initially as a way to let people invest in sovereign debt deals. For the first few years, those deals came in a trickle until the 144a asset class developed into a full-bore, high-volume marketplace.

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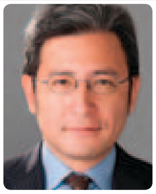

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