Point and click: debt on the web

Michael Burrow of Lehman Brothers looks at the rise of the 'e-bond', in which issuers and investors use internet technology to streamline market practices.

The onslaught of the internet on everyday activities, from shopping to medical consultations, meant that the wake-up call for the fixed income markets was bound to come sooner or later; it was only a matter of time.

As late as last year, it was equity that dominated on-line activity in the financial markets. Already the scale of this activity on the internet is immense. Currently, leading US brokers Fidelity Investments and Charles Schwab execute on-line 75% and 54% respectively of all their daily trades. By contrast, the debt sector is still making tentative steps towards embracing e-commerce. At present, on-line trading of debt is confined to US Treasury bonds, US agency bonds and some commercial paper products.

Major market participants like Lehman Brothers had long predicted that the application of e-commerce to the fixed income world was inevitable. And like everything else '.com', the pace of development would be rapid. This has certainly proved to be the case so far this year, with a slew of new debt issues by supranational and corporates offered over the internet.

Enhanced distribution

Institutions such as Ford Motor Credit Company and the World Bank (both of which launched highly successful internet-based issues, or 'e-bonds', in early January) have enabled e-commerce to prove its worth to issuers and investors alike. Enhanced distribution capabilities, the ability to target previously marginal investors, as well as an undoubted 'new trend' value, ensured that both issues were strongly oversubscribed and well-publicised.

In the case of the Ford transaction, in the US domestic market, 62% of all orders were received over the internet; and perhaps more interestingly, 87% of the orders were in an amount of $5 million or less, reflecting a much broader distribution than normal to small institutional and retail investors, although this represented only 9% of the deal by value. The World Bank's e-bond enjoyed a similar success, with 30% of a total of $5bn of orders placed on-line. The issue also penetrated successfully middle market and retail accounts which together accounted for 20% of the placement. Figure 1 shows a selection of e-bonds, launched in 2000.

Good response

There were other transactions including a 'point and click' feature which attracted a good response from investors, such as Argentina's US dollar issue and OTE's euro issue. However, they differ from true e-bonds, as their syndication and allocation processes were not fully integrated electronically.

Exactly what makes these e-bond issues different? Is the high-tech revolution beneficial? Without doubt, the internet adds a certain flavour to a bond issue. It is by definition modern, and it certainly appeals to investors; but it cannot work miracles or transform a bad issue into a good one.

What are the key components that define the phenomenon of the e-bond? Clearly, the fundamental aspects of a conventional bond are the issuance and the distribution of the notes in question. If these ingredients of a new bond issue can be classified as internet-based, the market place will classify the issue as an e-bond.

Michael Burrow

Procedurally, investors are able to input orders on-line. These are then aggregated through an electronic syndicate allocation management system. This gives the issuer the ability to monitor book-building in real time. Distribution is to institutional investors, middle market accounts and retail accounts with on-line access. This is largely through underwriters' alliances with on-line brokers such as Fidelity Investments, the market leader in on-line transactions worldwide, with whom Lehman Brothers has an exclusive alliance.

With on-line accounts set to double in the US by 2001 and grow exponentially in Europe, bond distribution via the internet has exceptional growth potential. For the issuer, the main 'plus' of launching a bond via the internet lies with the wide spectrum of new retail and middle market investors who can now more easily access the debt market.

In other words, on-line distribution will allow the targeting of institutional investors who previously have had relatively limited access to the primary markets. For example, Lehman Brothers' internet platform for debt loans enables an issuer to access more than 17,000 institutional investors.

Investor base

As well as the institutional sector, through the internet an issuer can access much more efficiently the huge retail investor base in the US and the growing retail sector in Europe. Through Lehman's exclusive alliance with Fidelity Investments, for example,

FIGURE 1 Selection of e-bonds launched in 2000

Issuer	Industry	Amount	Lead Managers
Ford Motor Credit	Corporate	$1.2 bn	Lehman Brothers
World Bank	Supranational	$3 bn	Goldman Sachs, Lehman Brothers
Lehman Brothers	Finantional Institution	$2 bn	Lehman Brothers
Abbey National	Financial Institution	$1 bn	Lehman Brothers, Goldman Sachs

issuers have access to over 3.3m on-line customers accounting for $200bn in assets. Figure 2 details the largest e-brokers, both in terms of account numbers and customer asset size.

This retail investor base can further be broadened with internet technology thanks to the advent of on-line secondary trading. Until now, smaller retail accounts have been reluctant to buy debt securities, owing to the absence of pricing transparency in the market. Increasingly, the e-bond process will change this, as investors will be able to both buy and sell on-line.

This previously unknown transparency means a great cultural change for the fixed income world. For issuers, real-time information is now available, including overall current demand, order size and price level, geographic mix and investor type. By the same token, investors can access through a single channel all relevant information for an issue: research information, company details and roadshow materials.

Salesmen will no longer need to slave over fax machines transmitting a new issue prospectus to an investor. From the point of view of secondary trading, smaller retail investors will now be better informed, with access to current prices on a much more transparent basis, in much the same way as the equity markets have been able to do for some time.

Brand recognition

From the issuer's perspective, enhancing brand recognition is another prime advantage of an e-bond. Launching a bond on the internet allows issuers to begin a marketing campaign more efficiently as investors will have electronic access to the company's documents, financial presentations and web sites. This feature was utilised particularly effectively by Ford and the World Bank, for example, in their recent e-bonds.

Returning to Europe, and specifically to the UK, what is the impact of the e-bond on the new issue market? First it should be noted that the US financial community is technologically way ahead of continental Europe and the UK. So while the internet aspect of a European or UK e-bond issue would carry the same advantages as in the US, the novelty value of e-commerce means that investors and issuers also need to be suitably educated.

For a traditional market in a traditional continent, the advent of the e-bond represents a significant change in process which requires a willing acceptance of new technology by investors and issuers alike. It also requires very careful management and a willingness among investment banks to embrace the ever changing regulatory constraints in a dozen or so different jurisdictions.

For Europe and the UK, the most attractive aspect of this new technology is the speed at which material relating to the issue/issuer can be distributed and made readily available for investors. Dissemination of information is the key. Its time-saving potential is a recognisably attractive feature with undoubted appeal for both European and UK investors. Greater speed in information dissemination will deliver significant efficiency gains for both issuer and investor alike. 'Red herrings', for example, can be delivered or accessed electronically rather than by the compilation and printing of endless hard copies. In addition, this can be done instantly, at the flick of a switch, or rather the tap of a key.

Revolution

Although the US is a more advanced financial community in terms of technology, it is by no means the only continent to be caught up in the internet revolution. The internet investor base is growing exponentially in Europe, and the UK particularly is racing ahead in developing its e-commerce platform.

It was only a matter of time before a British institution launched a new bond issue over the internet, and in early February, Abbey National launched an e-bond with great success. The issue,

FIGURE 2