EURONOTES AND COMMERCIAL PAPER G A WALKER

4. INTERNATIONAL BOND FINANCE

(6) Euro Medium Term Notes

Medium Term Notes (MTNs) are unsecured debt instruments (generally promissory notes) issued for durations between nine months and fifteen years[1]. These are accordingly interim maturity instruments between long bonds and short notes. MTNs are issued on a rolling or continuous basis under a programme agreement with a separate agency agreement and information memorandum as well as possible trust deeds[2].

MTNs were introduced in the US in the early 1980s[3]. Total issue volumes increased from US 12 billion in 1984 to 36 billion dollars by 1986[4]. They are issued in small denominations (of between US 2 – 5 million dollars), bear interest and are quoted at a percentage of their face value. Issuers and investors both benefit from increased flexibility in terms of the options available in structuring the amount, maturity and interest payable on the notes at any time.

US MTNs issues will have a set of posted rates and maturities of between nine months to one year, one year to eighteen months, eighteen months to two years. Investors can then elect particular maturity dates. Most maturities are less than five years[5].

MTNs also benefit from certain regulatory concessions being issued on a continuous basis[6].

Variations on the plain vanilla MTN include:

(i) Euro MTNs (EMTNs)[7];
(ii) Global MTNs[8];
(iii) Continuously Offered Long Term Securities (COLTS)[9];
(iv) Continuously Offered Intermediate Notes (COINS)[10];
(v) Multi-Tranche Tap Notes (MTTNs)[11].

(7) Euronotes

Euronotes are short dated bearer promissory notes with maturities of between seven days and one year[12]. Euronotes are usually issued at a discount and redeemed at par. Euronotes are usually issued in US Dollars or Euros with other countries prohibiting locally denominated notes. Currency swaps may, nevertheless, be used to obtain funding in a particular currency. Short dated instruments can, nevertheless, be issued as Sterling Commercial Paper under the relevant UK provisions. The terms Euronote and Commercial Paper are sometimes used interchangeably, although

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1 Sarawl (n) 201. Wood notes that Euro MTNs can have a maturity range of between one month and thirty years. Wood (n 26) 9.37.

2 Wood (n 26) paras 9.38 – 39.

3 Early issuers were General Motors Acceptance Corporation, Ford Motor Credit and other automobile credit companies. Sarwal (n 62) 203.

4 Sarwal (n 62) 201.

5 Sarwal (n 62) 201. Interest may be fixed or floating.

6 MTNs fall within SEC Rule 415 (Shelf Registration) or may be exempt under SEC Regulation D. Foreign banks can now issue US MTNs (referred to as Deposit Notes) since September 1986 in place of earlier certificates of deposit (CDs). Non-banking based issues can also be made without registration provided a “letter of credit” is entered into by an exempt entity such as a bank. This is referred to as credit support. Sarwal (n 62) 202.

7 The EMTN market began in 1986. Maturities are generally between one and five years, with the notes being listed and cleared through Euroclear or Clearstream.

8 The issuer may either use the domestic US or Euro market with non-dollar denominations being supported by a currency swap.

9 World Bank issues are referred to as COLTS with a maturity of between three and thirty years.

10 Euro MTNs issued through an offshore insurance company.

11 Merrill Lynch developed issues with an initial issue followed by subsequent tap issues to enhance liquidity. Sarwal (n 62) 204 – 205.

12 Sarwal (n 62) 121 – 129; Tennekoon (n 23) Ch 23 and 24; and Penn, Shea and Arora (n) Ch 10. See also Ugeux, *Floating Rate Notes* (1985); Bankson and Lee (ed), *Euronotes* (1985); Fabozzi, *Floating Rate Instruments* (1986); and Bullock, *Euronotes and Euro-Commercial Paper* (1987). See also Henderson, “Structuring and Documenting Euronotes” (1985) *IFLR* 18; Beaumont, “The Difference Between NIF’s and RUF’s” (1985) *IFLR* 31; and “Euronote Offer Documents Under UK Law” (1985) *IFLR* 32. [The first Euronote issuance was by Citicorp Investment Bank for New Zealand Shipping Corporation in 1978. The commercial objective was to create an instrument parallel to a bank certificate of deposit (CD) which could be issued by a high credit non-banking institution. Penn, Shea and Arora (n) para 10.02.

Euronote issues are generally underwritten by banks, whereas Commercial Paper is not. Euronotes are also generally issued by non-banks, with bank paper being referred to as certificates of deposit (CDs)[13].

The Euronote market was established in the late 1970s following the removal of exchange controls and other deregulatory changes and the dis-intermediation and securitisation of credit markets[14]. The first programmes were referred to Note Issuance Facilities (NIFs)[15]. Revolving Underwriting Facilities (RUFs) were subsequently developed in the early 1980s[16]. Other options included the Grantor Underwritten Note (GUN). These either operated on a sole placing agency (or Tap) basis or with a tender panel. Later variations included:

(i) Dual or Multiple Placing Agency[17];
(ii) Dealership Placement[18];
(iii) Issuer Set Margin[19];
(iv) Specialised Tender Panel[20];
(v) Unsolicited Tender[21];
(vi) Transferable Revolving Underwriting Facility (TRUF)[22].

The issuer will pay separate participation, underwriting, commitment and utilisation fees[23]. NIFs are generally 0.10% and 0.50% cheaper than a syndicated loan.

Euronote variations include:

(i) Short-Term Note Issuance Facility (SNIF);
(ii) Securities Note Commitment Facility (SNCF);
(iii) Revolving Acceptance Facility by Tender (RAFT);
(iv) Global Note Facility.

(8) Euro Commercial Paper

Euro Commercial Paper (ECP) provides for the issuance of unlisted short dated paper for periods of up to one year. This was initially developed by banks during the early 1980s to allow them to buy and sell short term notes between themselves. ECP is generally issued in accordance with the British Bankers' Association London Market Guidelines as revised[24]. Short term instruments may alternatively be issued as low duration notes under a Medium Term Note (MTN) programme. The difference is that these are often separately negotiated and not issued on standard terms as with ECPs.

Commercial Paper constitutes a negotiable unsecured promissory note. The notes are issued under a programme with maturities of between 1 and 365 days. Facilities are uncommitted and issued on a discount basis without interest being paid on the paper[25].

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13 Sarwal (n 62) 121.

14 Sarwal notes that the first issue was by a non-US company which could raise funds from investors in Europe more easily than in the US domestic market. The second issue was by a sovereign borrower which was offered competitive financing provided that it could issue a marketable security rather than a loan. (n) 121 – 122.

15 A NIF is a medium term programme under which a borrower can issue short term securities in its own name with underwriting banks either purchasing any unsold notes or providing standby credit. NIFs were issued in denominations of over 500,000 dollars and had maturities of between five and seven years, with notes being issued on a revolving basis.

16 The first RUF was in 1982. This provides for the separation of the underwriting and sale with a sole placing agent (placing the notes) and a separate underwriting group purchasing any residual notes or extending loans in an equivalent value. A tender panel was subsequently introduced in 1983 to provide a back-stop facility with member banks bidding for notes with a specified spread. Continuous tender panels were then developed in 1984 to allow the underwriters to purchase notes from the lead manager up to a specified proportionate amount. Tender panels can be made up of between thirty and sixty member banks. Sarwal (n 62) 122 – 123. [A Tap issue is used with a sole placing agent to allow the borrower to feed paper into the market depending on investor interest, using one or more placing agents.]

17 Dealers compete to place the notes on a best efforts basis, with the competition producing better prices for the issuer.

18 Banks act as agents (rather than principal) in selling the paper and maintaining a secondary market.

19 The issuer sets the interest rate, with underwriters taking up agreed proportions through a continuous tender panel at the agreed (cap) rate.

20 A smaller tender panel is used with an existing high quality client base to take up the issue.

21 The banks bid to place paper as selling opportunities arise.

22 Underwriters are entitled to transfer their commitment subject to borrower approval.

23 The participation fee is for front end management in setting up the facility (0 – 0.20%). Annual or quarterly underwriting fees ($^{1}/_{32}$% and $^{1}/_{8}$%) and commitment fees (0.05% - 0.10%) based on the unutilised facility. A separate utilisation fee may also be charged for large "maximum spreads" (0.05% - 0.20%).

24 The Guidelines were initially issued in April 1999 and then revised under the FSMA 2000.

25 A promissory note is defined as an unconditional promise in writing, signed by the debtor, undertaking to pay a specific sum at a stated time. Bills of Exchange Act 1882 s . This is distinct from a Bank Bill (or Bankers' Acceptance) as it only binds

The distinction between the Euronotes and Commercial Paper is nevertheless unclear and would generally appear simply to be dependent on the nature of the underlying issue programme. Commercial Paper is generally unsupported, although there is also no underwriting commitment under an NIF as distinct from a Committed RUF.[26]

The Commercial Paper market originated in the US in the early nineteenth century to allow companies to borrow funds across state lines[27]. Sterling Commercial Paper (SCP) could not be issued in the UK until April 1986 as this was considered to amount to deposit taking, requiring authorisation under the Banking Act 1979 (and then 87). Financial institutions could only issue London Certificates of Deposit or CDs before then. Regulations then permitted the issuance of SCP provided that the issuer was listed and had minimum net assets of twenty-five million pounds. The paper must be issued in minimum denominations of one hundred thousand pounds and mature between 8 and 364 days (subsequently extended to five years). Standard issue procedures have been produced by the British Bankers' Association. Japanese Commercial Paper (Yen or Euroyen CP) was introduced on 20 November 1987[28].

The separate market in Euro Commercial Paper (ECP) began in 1985. These are generally denominated in US dollars, with minimum denominations of one hundred thousand pounds and maturities of between 2 and 365 days. Settlement is effected either through Euroclear or Clearstream. ECP programmes may either operate through a single note, universal notes or grid notes[29]. Global Commercial Paper (GCP) may also be issued, which allows the borrower either to draw on the Euro or the US Commercial Paper market.

Commercial Paper is distinct from Euronotes in that it is not underwritten. The paper is issued under a programme but can be exercised within hours rather than days. Maturities can vary between 7 and 365 days (rather than have fixed maturities). Settlement is same day rather than seven days for Euronotes. Smaller denominations or US dollar one hundred thousand are typical, rather than minimum US dollar five hundred thousand for Euronotes.

Commercial Paper is issued under a dealer or programme agreement. Separate issuing and paying agency agreements, a deed of covenant, deed of guarantee and an information memorandum are used. Standard forms are available from the Euronote Association. The dealer or programme agreement will specify the issue procedures and timetable to be used. This will include standard representations, warranties and indemnities and restrictions on non-authorised sales. The issuer will deliver pre-signed notes to the paying agent. The notes are completed by the agent who authenticates them before issue. The purchase amount and redemption funds on maturity are also paid through the agent bank. The deed of covenant obliges the issuer to pay account holders in the event that the global note is not replaced by definitive notes. A deed is used to allow note holders to enforce the obligation without having been party to the initial document. A separate deed of guarantee may also be used in particular cases[30].

Commercial Paper is generally treated as a negotiable instrument as a matter of market practice.[31] SCP was permitted under the Banking Act 1979 (Exempt Transactions) (Amendment) Regulations 1986 (SI 1986 No 769). This followed a notice issued by the Bank of England on 29 April 1986. SCP is open to corporate entities complying with minimum listing and net asset rules. Banks and building societies are expected to continue to issue CDs rather than SCPs.

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the issuer and not the drawee or accepting bank. The paper is also not tied to any specific trade transaction as with a bankers' acceptance.

26 Beaumont N Bankson and Lee, *Euro Notes* ( ) ch7 cited in Tennekoon (n 23) 437 (n) 3. Contrast Penn (n) para 10.01. Sarwal simply comments that the differences between Euronotes and paper are essentially mechanical and that the debt instrument is the same in each case. Sarwal (n 62) 124.

On Commercial Paper, see Heller (ed), *Euro Commercial Paper* (Euro Money Publications 1988); Felix (ed), *Commercial Paper* (Euro Money Publications 1987). See also Tennekoon (n 23) ch 23 and 24; and Penn (n) ch 10. See also Penn, "Sterling Commercial Paper" [1986] *BFLR* 195 – 209; Johnson and Keslar, "Here Comes Euro CP" (1985) *Euro Money Corporate Finance*; Goodall, "Offers of Commercial Paper in the UK" (April 1984) *IFLR* 15; and Bullock, "Euro Notes and Euro Commercial Paper" Butterworth 1987

27 Banks were prohibited from expanding across states under the McFadden Act which caused credit problems in less wealthy states. Companies would then raise funds through commercial paper and bankers' acceptances in other states. The market was initially used by industrial and commercial companies, although subsequently by consumer finance companies in the 1920s and then by holding companies, foreign companies, banks and sovereign borrowers. Sarwal (n 62) 79. The paper is exempt from SEC registration and disclosure, provided it matures between 2 and 270 days. Some paper is letter of credit backed.

28 Minimum denominations are set at Yen one hundred million with maturities between 1 and 6 months. Issues are placed through dealers (rather than directly with investors) although they are free from withholding tax. Issues may be underwritten by banks or securities houses and non-Japanese borrowers may use the market from January 1988. Sarwal (n 62) 83.

29 The programme may be represented by a single global note with transfers being effected by book entry. Separately printed universal notes may be used, with their own serial numbers, although these will still be held by the depository unless a specific investor calls for delivery. The global note may also have a grid printed on the back which the grid agent can use to record entries and transfer. Sarwal (n 62) 81 – 83.

30 Wood (n 26) paras 9.32 – 36.

31 Tennekoon (n 23) 439; and Penn, Shea and Arora (n) para 10.16 and 10.34.

Commercial Paper will, in practice, not constitute promissory notes for the purposes of s83 of the Bills of Exchange Act 1882 as they are not unconditional (containing purchase restrictions) and do not contain a promise to pay a sum certain in money (due to the effects of withholding tax and grossing up). Commercial Paper is generally treated as constituting a debenture for the purposes of the Companies Act 1985[32]

Account holders of the notes are not "holders" under English Law and can therefore not enforce any payment obligations against the issuer directly. The issuer is required to issue definitive notes in the event of a default which replace the global note held with the depository although this may cause difficulties in practice. A deed of covenant by way of deed poll is accordingly entered into by the issuer which creates enforceable promises to pay by the issuer in favour of each account holder in the event of the global note becoming void.[33]

(9) Certificates of Deposit (CDs)

Certificates of Deposit are transferable certificates or securities evidencing an underlying deposit of funds with a bank. CDs are generally issued in accordance with the EDA's Guidelines on Certificates of Deposit on the London Market – Market Guidelines (November 1999).

London CDs are issued by regulated institutions in the UK, issued and payable in the UK and defined to trade primarily in the London market. Non-London CDs are issued by non-authorised institutions, including principally non-BBA banks. These must be labelled 'non-London ', satisfy the BBA's 'Standards for London Good Delivery ', not breech the FSMA and state the location of the issuing branch, where interest and redemption proceeds will be paid and whether a UK issuing or paying agent is employed. Separate Overseas Domestic CDs may also be issued, although these are not covered by the standard terms set out in the Guidelines.

(10) Multi Option Funding Facility (MOFF)

Multi Option Funding Facilities (MOFFs) allow borrowers to draw funds down under one or more credit structures or arrangements. This extends the NIF by including additional funding options. The first MOFF was first granted to a sovereign entity in 1984[34]. One of the key advantages, apart from draw-down flexibility, is being able to obtain funds in different currencies, including those that may not be available with a Euronote.

MOFFs tend to operate as short MTNs with durations between five and seven years. An MOFF is distinct from a multiple loan facility as it includes a Euronote component with additional committed and uncommitted facilities (including Commercial Paper). [A Borrower's Option for Notes and Underwritten Standby (BONUS) can be regarded as being a specific type of MOFF[35]. MOFFs are also known as Multiple Component Facilities (MCFs) or Multi Option Facilities (MOFFs).

Typical facilities include:

(i) Short Term Advances (in more than one currency)[36];
(ii) Swing Line Facilities[37];
(iii) Commercial Paper or Euro Commercial Paper;
(iv) Bankers' Acceptances[38];
(v) Medium Term Notes (MTNs).

[32] s 744 CA 1985; *Edmonds -v- Blaina Furnaces Co* (1887) 36 Ch D 215; and *Levy -v- Abercorris Slate and Slab Co* (1888) 37 Ch D 260. Penn para 10.3]

[33] Tennekoon (n 23) 446 – 448; Penn (n) para 10.14; and Wood (n 26) para 9.36.

[34] MOFFs were subsequently used by UK and French corporate entities during 1987 and subsequently. Sarwal (n 62) 133. Such facilities tend to only be provided by the largest banks with the capacity to place the funds in each of the sub-markets involved.

[35] This includes an uncommitted note placement facility with a US commercial paper programme and a committed standby credit facility. Sarwal (n 62) 131.

[36] The advances option allows the borrower to draw down funds directly in one or more currencies without the need for the underwriting banks to purchase notes.

[37] Temporary is provided either to cover the period when separate advances are being arranged or while the borrower is switching between options. The Swing Line Facilities can be drawn down at short notice.

[38] Funds are made available against discounted eligible bank bills (acceptances) although this must be covered by a self liquidating asset. Sarwal (n 62) 131.