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4. INTERNATIONAL BOND FINANCE

The principal alternative to bank lending is the issuance of debt securities. These are most commonly referred to as bonds although particular bonds of Government securities may be issued (such as UK gilts or US Treasury bills) with corporate bonds constituting debentures.

The principal advantage of bonds or debenture stock is that they are inherently transferable following primary issuance on either formal or over-the-counter (OTC) secondary markets. This makes the debt more attractive to investors which increases supply of funds for investment stock. Transferability allows more flexible management of investment portfolios while secondary trading increases liquidity. While bonds can generally mimic loans with identical amounts, term and interest, borrowers with good credit standing will be able to obtain funds at considerably lower cost.

Government bond markets have always constituted a significant component within any domestic financial system with investment restrictions (such as on insurance companies or pension funds) requiring mandatory minimal investment amounts. Many companies have also preferred to issue debenture rather than equities as this avoids the need for increased shareholder representation, accountability and control. International bonds were also developed at an early stage in the evolution of the Euro-dollar markets although they became of particular importance during the 1980s especially with the restructuring of Third World Debt and the Debt Crisis beginning in 1982. A large number of variations have also been developed in recent years, in particular, with shorter duration euro notes (including floating rate notes (FRNs), medium term notes (MTNs) and note issuance facilities (NIFs)) and dis-intermediated commercial paper (CP) programmes.

Bond documentation tends to be simpler than with loans and, in particular, syndicated lending facilities. The number of documents involved may nevertheless be larger especially where the bonds are underwritten, coupon payment is to be made in more than one country and a bond trustee is to be appointed. Additional regulatory requirements will also apply where a public offering is involved. This will require compliance with all relevant local company and public listing or issuance requirements.

One of the most notable significant developments in international finance in recent decades has been the preference for transferable security based financing in preference to loan facilities. This increase in securitisation based credit has been further stimulated by the increase in cross-border lending and investment which favours the use of security based instruments. This growth has been further stimulated by the expansion and changing role and function of stock markets and exchanges including their demutualisation (incorporatisation) and subsequent consolidation. The introduction of demobilisation (depository held securities) and subsequent dematerialisation (issuance in only an electronic or digital form) has also further stimulated this process. Bond financing will accordingly become of even more importance in future years with the continued globalisation and digitalisation of modern credit provision.

The purpose of this chapter is to consider the nature and structure of the bond market including the principal characteristics of the instruments involved and the participating parties in the market. The different types of bond instrument available are then reviewed. The main types of issuance procedure are outlined. The principal documents and terms and conditions involved are reviewed including those produced by the main international trade associations, the International Capital Markets Committee (ICMA). Additional regulatory and tax issues are also reviewed.

BOND MARKETS

Bond markets can be considered to constitute the earliest types of security markets[1]. The earliest official or government debt instruments date from the 1300s in the City of Florence with the first issuance of long term municipal debt (the *Monte Commune*)[2].

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[1] A security is a type of transferable financial asset or claim which either represents a debt obligation issued by a government or corporate body or an interest in the body concerned. Walker, 'financial markets and exchanges ' para 1.56 in M Blair and G A Walker, *Markets and Exchanges Law* (OUP Oxford 2006), Ch 1. A security will either take the form of a debt obligation such as a bond or debenture or a share or equity interest.

[2] The Monte Commune was issued by the City of Florence with interest being paid through tax collections. The price of the debt subsequently fell when taxes fell into arrears. Early banking families, such as the Medici held shares in the Monte Commune, although they also engaged in private banking as well. The first clearing bank was the *Casa de San Giorgio* which

Long term annuities were subsequently developed in other cities, including by the Habsburgs in The Netherlands[3]. Early shares were introduced with the Dutch East India Company in 1609 which combined the benefits of the safety and transferability of bills of exchange with the investment advantages of the perpetual annuity[4]. Shares were subsequently transferred from Amsterdam to London at the end of the 17th century[5]. Earlier annuities were then converted into perpetual and redeemable Three Percent Bank Annuities in 1726 and then the Three Percent Consols in 1751[6].

London's position as the centre of the international capital markets was then confirmed following the Napoleonic wars. This can be explained in terms of a number of factors, including British dominance in international trade, the development of the supporting bill of exchange market based in London, the stability provided by the gold standard, the enormous growth that occurred in the placement of government debt and corresponding appetite for investment with the necessary provision of suitable financial instruments and appropriate markets on which the new securities could be bought and sold. London's position was further strengthened with the confirmation of the position of the Bank of England in the markets[7] and supporting statutory changes introduced which, in particular, allowed the expansion of joint-stock banking in Britain[8]. The Gold Standard had been adopted de facto in England in 1717. It was adopted in America (1879) and across Europe from the mid 1800s and formally confirmed between 1880 and 1914[9]. Japan, Russia and India subsequently joined the Gold Standard during the 1890s.

The Gold Standard was suspended during World War I, a number of countries attempted to restore a gold exchange standard following the War, although this was eventually abandoned with the onset of the Great Depression between 1929-33. The rules to operate the international financial system between WWI and WWII were largely agreed at the conference in Genoa in 1922[10]. Central bank co-operation was further strengthened with the establishment of the Bank of International Settlements (BIS) in 1929. These attempts to create a stable financial order then broke down during the 1930s. Many countries abandoned the Gold Exchange Standard in 1930 and 1931, with many countries adopting protectionist measures in the period up until the outbreak of WWII.

A further attempt was made to design a new international financial system to take effect following the end of WWII with the Bretton Woods Conference in July 1944. This provided for the establishment of a replacement

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was set up in Genoa in 1407. This was followed by the *Monte de Paschi* in Sienna in 1472. Larry Neal, 'Development of Financial Institutions ', *The New Palgrave Dictionary of Money and Finance* (Macmillan Press Limited, London and New York 1992) 659 – 661.

3 Long term annuities developed into active markets supported by the government's pledge to service them from provincial excise and property taxes. These included life annuities over the duration of one or more individuals nominated by the purchaser and heritable annuities which were perpetual but redeemable by the State's General. Neal (n 2) 659. See also L Neal, *The Rise of Financial Capitalism: International Capital Markets in the Age of Reason* (Cambridge University Press, Cambridge 1990). See also J D Tracy, *A Financial Revolution in the Habsburg Netherlands: 1515 – 1565* (University of California Press, Berkeley 1985).

4 Neal (n 2) 660.

5 The English and French Governments initially assumed large national debts to fund their wars between 1689 and 1713 through the use of irredeemable annuities. The disadvantage was that the debt could not be cancelled and replaced by lower interest facilities after the wars. The English and French Governments then converted the annuity based debt into equity in the large new monopoly trading companies that were set up on the model of the Dutch and East India Companies. These were intended to take advantage of the weakened condition of the Spanish Empire following the war of Spanish succession. It was the trading and placement of these large volumes of public shares that led to the Mississippi and South Sea bubbles in [1719 and 1720]. This had the effect of retarding the development of capital markets in France for a period, although practice was simply revised and further expanded in London and Amsterdam. Neal (n 2) 660.

6 Debt was effectively transferred from being constituted by an equity interest in perpetual joint stock companies or irredeemable annuities to perpetual but redeemable annuities with the three percent bank annuity in 1726 and three percent consol in 1751. The effect was to give the holder an equity interest in the financial condition of the state. Neal (n 2) 660. The value of the instrument was supported by its transferability, the confirmed payment terms and the price transparency available.

7 Between 1797 and 1821, the Bank was required to maintain the value of sterling during its non-convertibility into gold, act as a support lender to the financial system and manage the London money markets through its control over the discount rate on commercial paper presented to it. Neal (n 2) 661.

8 Joint-stock banking expanded after the Bank Act of 1826 and the Bank Charter Acts of 1833 and 1844. Cheques also increasingly replaced bank notes and bankers' orders.

9 On Gold Standard theory, Michael De Bordo, 'Gold Standard: Theory ' *Palgrave* (n) 267 – 271. See also Marcello de Cecco, 'Gold Standard ' *Palgrave* (n) 260 – 266.

10 This provided for the establishment of central banks of issue which would be independent from state government. Countries would re-adopt the Gold Exchange Standard and maintain convertibility of national currencies either directly into gold or into a tied gold currency. Neal (n 2) 661.

dollar exchange standard with the US dollar becoming the new anchor currency. The dollar was fixed to gold at 35 dollars per ounce and all other currencies fixed to the value of the dollar. The conference also provided for the establishment of the International Monetary Fund (IMF) and International Bank for Reconstruction and Development (World Bank)[11]. An International Trade Organisation (ITO) was also to be established, although subsequent support from the US Congress was not available, with the General Agreement on Tariffs and Trade (GATT) being implemented until a formal World Trade Organisation (WTO) could be set up in 1996[12].

The international capital markets had continued to expand during the 19th and early 20th century, up until WWI. The debt nevertheless tended to be issued in the form of foreign bonds denominated in the country of the currency of issuance[13]. It was not until after WWII that the currency of the debt was separated from the country of issuance with the introduction and subsequent expansion of the Eurodollar market[14]. The Euroloan and Eurobond markets began to expand during the late 1950s and early 1960s, following the restoration of currency convertibility in 1958. This was supported by the large volumes of US dollars that flowed to Europe and London and the restrictions imposed on US foreign currency lending and foreign investment[15]. The first Eurobond issue was in 1963 for Autostrade[16]. Investors were attracted due to the anonymity created by the bearer nature of the debt issued and the absence of withholding tax. Individual investment would later be supplemented and then replaced by institutional purchase of the new bonds. A US attempt to re-attract the market back with the re-opening of the domestic Yankee Bond Market in 1975 failed.

The bond markets expanded rapidly during the 1980s, supported by the deregulatory measures adopted in many countries and the removal of residual impediments on capital mobility. The appetite for transferable security rather than loan based debt also further stimulated investors' interest. New issue volumes increased substantially, with the reduction in interest rates between 1982 and 1986 with Japanese investors and borrowers also becoming major participants in the market with the Japanese trade surplus.

The continued growth in the market then turned between 1987 and 1990. Many investors moved to cash or near cash options with the increase in interest rates during the late 1980s. A number of losses were suffered by firms and investors, with the stock market crash in October 1987. There was also a reaction to corporate debt, especially following the abuse of the junk bond market in the US during the late 1980s from 1988 onward. Confidence was further damaged with the falls in stock market values in Tokyo in 1989 and 1990 with a substantial reduction in the Japanese current account surplus. (This fell from 87 billion US dollars in 1987 to 35.8 billion dollars by 1990.)

Markets then began to recover, with the reductions in short term rates beginning in 1991[17]. This allowed substantial expansion again in the markets during the early and mid 1990s. [ ]

BOND STRUCTURES

Debt securities are generally either referred to as bonds or notes, although the term bond may be used collectively to refer to all debt based instruments[18]. These essentially consist of debt obligations issued by a

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[11] Walker, *International Financial Regulation Law Policy in Practice* (Kluwer Law London 2001) Ch 1.

[12] Dosoo notes that the markets were partly supported by the personal wealth accumulated by individuals and the regressive nature of the taxation system. Individuals were then able to amass large amounts of personal income which they were anxious to invest in secure government debt. Foreign investment was also facilitated by free movement of capital and the non-exhaustion of local government demand. Foreign bonds were purchased by a prosperous investment class in Great Britain, Holland, France, Switzerland, Belgium and Sweden. George Dosoo, *The Eurobond Market* (Woodhead-Faulkner, Hemel Hempstead 1992) 4-5.

Foreign loans were still issued in sterling after WWI, although the US dollar and French franc had become the strongest currencies (supported by a stabilisation package in the 1920s). No restrictions had been placed on the purchase of foreign investment by UK investors pre 1914, although the Government began to introduce an unofficial system for the co-ordination of new issues which role was later assumed by the Capital Issues Committee. Foreign loans were nevertheless commonly issued during the 1920s rather than domestic debt. Confidence in the international capital market was then damaged with the stock market crash in 1929 and subsequent depression. Chapter 1.

[13] Chapter 1.

[14] Dosoo (n 12) Ch 1.

[15] These were introduced under Regulations Q and D and interest equalisation tax. Chapter 1 and Walker (n 1).

[16] This was managed by S G Warburg. Walker (n 1) Ch 1 (n).

[17] The US Federal Reserve reduced the three month Treasury Bill rate from 6.88% in December 1990 to 3.88% by end 1991. Dosoo (n 12) 4.

[18] The term bond was generally used for fixed interest rate instruments and notes for floating rate variations. The term note may also be used to refer to shorter duration instruments or to more specific modern forms such as derivative or credit related variants.

sovereign or corporate entity in a registered or bearer form. The debt obligation in respect of registered securities is constituted by the record maintained by the company with the certificate only constituting a secondary representation. Bearer securities constitute and evidence the debt directly. Registered and bearer securities may be issued in an immobilised form with the securities being represented by a single global note rather than multiple instruments. Registered securities may also be issued in an electronic or dematerialised form without the need for any paper instrument.

Bonds and notes are principally issued by sovereign entities or other government agencies and departments or by corporate bodies. The securities are initially issued in the primary market and then bought and sold in a secondary market. The secondary market may either take place on a regulated stock exchange or on an Over-The-Counter (OTC) basis. The securities will mainly be held by institutional and private investors.

Bond structures and payment procedures tend to be more complex than simple loan arrangements. As the securities are issued in a tradable form and may be supported by a trustee arrangement with other extended options also being available (including guarantee or collateral support, conversion or pre-emption rights and subordination), a number of additional documents are generally required with a series of parties also being involved. The parties will include the issuer and any trustee, as well as various paying agents and separate guarantors, registrars or custodians, depending on the particular debt structure set up.

As a legally enforceable debt obligation, the bond will be determined having regard to its amount, duration or term, interest rate (or discount), payment schedules and ultimate redemption as well as any supporting conditions or obligations (including collateral or guarantees) as a security instrument, its priority of payment or redemption may also be adjusted through some form of subordination. Extended rights may also be made available through some form of transfer or conversion or entitlement to additional securities.

(1) Amount, Term and Interest Payment

The debt issuer will initially decide on the amount, term and interest to be payable on the bonds. The principal amount to be issued will be determined in accordance with its credit needs at any particular time as well as market condition and appetite for the debt, having regard to the issuer and related economic factors.

Simpler plain vanilla bonds were often issued for equivalent terms to syndicated loans. This may have been for ten to 15 years or up to 30 years. Where shorter instruments (such as Euro Notes) are to be used, these may have a duration of between 2 and 5 years. These could be issued in the same principal amounts, although simply on shorter durations with the debt being rolled over on each redemption date.

Rather than issue medium term notes, borrowers would now generally prefer to issue shorter commercial paper for between 30 and 360 days. This will then be issued in smaller principal multiples of between 1 and 5 million pounds for example in even shorter durations with the debt being rolled over as required. The total or aggregate amount borrowed at any one time would then be adjusted depending on the credit needs of the particular issuer.

The interest payable on the debt may either be fixed or floating. Floating rates are generally determined in accordance with the most commonly used market indices, such as Libor. Debt instruments may be issued on a zero coupon basis, with no interest being payable. Such instruments are usually issued at a discount below their par or redemption values. Where the discount is significant, these are referred to as deep discount instruments.

A distinction has to be made between coupons, receipts and talons. Coupons apply with regard to interest payments. These are generally made half yearly with debt holders tearing off coupons and presenting them for payment to the local payment or fiscal agent. These may also be detached and traded separately 'coupon stripping '. Receipts refer to repayment of principal instalments rather than interest payments. Talons are used where large numbers of interest payments are to be made or long maturity securities are issued. Debt instruments generally only provide for 27 coupons under relevant ICMA (ISMA) guidelines. Coupon sheets usually only contain 27 coupons. Where more are required, one talon is attached (equal to two coupons) with 25 additional coupons.

(2) Form

As noted, debt instruments may be issued in a registered or bearer, global or immobilised, or dematerialised form basis. Registered securities are constituted by the record held by the company and transferred in accordance with the relevant company law procedures. Transfers must be appropriately recorded by the company or government registry. Bearer securities are constituted by the instrument itself and transferable by delivery alone. They are

also generally negotiable insofar as perfect title can be transferred, provided that the transferee acquires without any prior defect in title notice of any prior defect in title.

Securities may be represented by a single (or possibly limited number) of global securities on issuance. These temporary instruments will then be replaced by definitive securities which may either be produced in a bearer or registered form. These will then replace the provisional paper used.

Securities may also be issued in a purely electronic or dematerialised form. As this was not provided for under the common law in most jurisdictions, this will have to be effected under relevant statutory rules. In the UK, this is carried out under the Uncertificated Securities Regulations as amended.

(3) Parties

A number of parties are involved with the issuance and subsequent management of a bond issue. The instruments are initially produced or executed by the issuer and will ultimately be held by the investor or investors. The issuer will be assisted by a lead or managing bank. The bonds may be sold by a single manager or through a larger selling group. The issue will also often be underwritten either by the lead manager or by separate underwriting groups. The issue may also be separately guaranteed with the guarantor ensuring that all necessary payments are properly and timely made under the bond documentation[19]. A trustee may be appointed to represent the interest of bond or security holders.

A number of paying agents will also be appointed on behalf of the issuer. A fiscal agent or principal paying agent is used to make payments of interest and redemption under the bonds. Fiscal agents are appointed where a trustee is not involved. Separate calculation, transfer or exchange agents may also be appointed. Calculation agents assist with the processing of any calculation requirements set out in the bond documentation. Transfer agents assist with security transfers. Exchange agents are used where bond holders can exchange bearer for registered instruments. Other agents may also be appointed under separate instruments such as where warrants are involved.

A registrar is generally appointed in connection with registered issues. This will often be the issuer's own registrar. The registrar is responsible for keeping appropriate ownership of beneficial entitlement records as well as issuing security certificates, effecting transfers and processing redemptions. Custodians will also be appointed to hold the securities or supporting collateral. The initial custodian for Eurodollar issues are usually Clearstream and Euroclear, although a number of separate custodians and sub-custodians may also be used in other jurisdictions depending on issue structure and collateral arrangements.

Bond documentation generally excludes the creation of any rights under the Contracts (Rights of Third Parties) Act 1999 which came into effect on 11 May 2000. Bills of exchange, promisory notes and other negotiable instruments are expressly excluded under s(61), although the Act also refers to 'contracts on ' relevant instruments. As the point is unclear, it is common to exclude the Act and to execute instruments as deeds or have a separate deed of covenant (in connection with MTN programmes).

(4) Documentation

A number of separate documents are also used in connection with bond issues due to the more complex debt structure created. The initial issue terms will be set out in the subscription agreement entered into between the issuer and lead bank. The subscription agreement will record all of the principal terms including issue amount, term and interest as well as all of the ancillary rights and obligations of the issuer and debt holders. These parallel the equivalent provisions set out in a loan agreement and generally consist of a series of pre-issue, pre-payment and post-payment terms.

Separate selling group and underwriting agreements are entered into for distribution and underwriting purposes. A lengthy trust deed will also be used where a trustee is to be appointed on behalf of bond holders or security holders. Separate guarantee and collateral arrangements may also be entered into. These are constituted by a series of initial representations and warranties (pre-issue), conditions (pre-payment) and covenants (continuing post-payment obligations). Breech will again be supported by a series of events of default and remedies. Although these generally replicate loan terms, bond provisions will often be simpler and less severe in terms of economic sanction and legal effect.

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[19] This may also involve the use of a 'keep well provider '. The keep well provider ensures that the issuer is in sufficient funds to discharge its payment obligations without any additional obligations or liabilities being undertaken.

(5) Ancillary and Additional Provisions

Various additional arrangements may also be provided for. These may include guarantees or security or collateral. Security may, for example, often be provided in the form of separate securities held by an appointed custodian. Security may alternatively be granted over the assets purchased by the funds raised, such as in connection with a project finance arrangement where bonds are used in addition to syndicated loans. Security in the form of credit enhancement may also be used in securitisation structures.

Bond or security holders may have rights to convert payment obligations into different currencies. This may apply either or both with regard to interest during term or principal on redemption. Instruments allowing the holder to receive instrument in a currency different from that of the security of issue are sometimes referred to as dual currency interest notes or dual currency redemption notes, where the final principal amounts can be paid in an alternative currency. Interest and redemption payments may also be tied to separate share or commodity indices[20]. The priority of payment under the instruments may also be adjusted through some form subordination. Contractual subordination provides for the postponement of repayment of debt on the insolvency of the issuer. The effect is to prioritise general (senior) debt as against the postponed (junior) debt[21]. This is distinct from other forms of subordination such as turnover or structural subordination[22]. Subordination is generally dealt with under the terms of an inter-creditor agreement between the postponed (junior) and preferred (senior) creditors and the common debtor with a supporting security trust deed where collateral is provided.

Additional rights or entitlements may be conferred on bonds and security holders. These may include converting bonds into equity shares of the issuer or a connected company (convertibles) or in a third party company (exchangeable). Separate warrants may also be provided which allow the security holder to subscribe for additional bond or equity instruments under specified terms and conditions.

Various security identification codes may be used. The most common is the ISIN (International Security Identification Number). This is required for clearing purposes either through Euroclear or Clearstream. A separate common code is also provided for Euroclear and Clearstream clearing. Separate CUSIP numbers are used for US Depository Trust Corporation (DTC) clearing. These are provided by the CUSIP Service Bureau. Traded securities will have a CINS or CUSIP International Numbering System coding.

BOND ISSUANCE

The issue procedure for the bond will depend on the particular structure adopted. UK Bond procedures have generally involved the appointment of a lead manager with a primary underwriting group and a separate sub-underwriting and selling group. US structures would generally only involve a single underwriting group, although a separate selling group may be appointed as necessary. Selling groups are generally used where some retail as opposed to institutional or wholesale investors are involved, such as to wealthy individuals. More modern structures generally use simpler management, underwriter and selling groups, although all of these functions are increasingly undertaken by a single management group.

Modern structures also tend to be ‘pre-priced ‘ rather than ‘open-priced ‘ deals. Open pricing was commonly used in the 1970s and allowed the lead managers to fix the principal terms with regard to pricing coupon subsequently[23]. Most deals are now pre-priced with the principal terms being fixed under the initial mandate

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[20] These may either be referred to as index linked interest notes or index linked redemption notes.

[21] The contract may specify that the subordinated debt is only conditional or contingent on the debtor being able to pay the non-subordinated debt in full to avoid any difficulties with the pari passu payment of unsecured debt on a debtor’s insolvency.

[22] Turnover subordination provides for the payment by the postponed (junior) creditor of receipts to the preferred (senior) creditor under a transfer or trust arrangement. The postponed (junior) creditor may alternatively agree only to pay an amount equal to the money received (a debtor-creditor turnover subordination). Structural subordination refers to ability of a creditor only to proceed against the assets of a parent or holding company rather than those of the operating company, with the parent company possibly only holding shares in the subsidiary company alone. Insider subordination refers to the locking in of connected company debt (such as a parent or major shareholder) by preventing its repayment before external senior creditors are paid in full. Other types of instruments include mezzanine loans (secondary syndicated lending), high yield securities (holding company bonds postponed to senior bank loans), payment blocks (complete subordination) or contingent payment blocks (springing subordination), vendor subordinated loan notes (postponed purchase components).

[23] Fisher, *International Bonds* Ch 2. See also Ravi Tennekoon, *The Law and Regulation of International Finance* (Butterworths 2004) 150.

given to the lead manager[24]. The most commonly used pre-priced deals used are now 'bought-deals ' where the lead manager legally commits itself to purchase the whole issue and either place them directly or sell them on through dealers. Other marketing options include private placements,[25] preliminary prospectus offerings[26] and impact day offerings[27]. This is commonly used in Eurobonds as well as US and Canadian offerings.

Although a number of variations may be used in practice, certain key stages can be identified within common bond offer procedures. These generally include the following:

(1) Mandate

The issuer must initially provide the lead manager with a mandate. This may follow the manager's approach and one or more preliminary presentations to discuss possible market reception and key terms. The mandate letter will be in similar terms to that used in connection with a syndicated loan offering. This will be made subject to contract, although most of the key terms will already have been agreed in modern pre-priced deals[28].

(2) Launch Date

The issue is launched through a public announcement being sent out by the lead manager. The manager will contact other prospective banks and securities firms to form the managing and possibly underwriting and selling groups. These approaches are either conducted over the telephone or through screens. The initial informal approaches are then followed up with a formal invitation telex to participate in the issue.

The invitation telex will contain all of the key issue terms, although this is still issued subject to contract and will form the basis of the final subsequent issuance. The terms set out in the invitation telex are rarely changed as a matter of market practice except in extreme circumstances[29]. The telex will specify all of the key terms, including price, interest, amount, currency, maturity and redemption price. Certain other matters are generally referred to, including ratings, guarantees, negative pledges, early redemption, sales restrictions, stabilisation, cross default and force majeure[30].

(3) Documentation

The lead manager will prepare all of the draft documentation, including the prospectus or offering circular, subscription agreement, underwriting agreements, selling agreements, managers' agreement and either a trusted or fiscal agency agreement. The documentation sets out the legal nature and terms of the bonds, determines the rights and liabilities of all of the parties concerned and assists with the marketing process.

The prospectus or offering circular restates the terms and conditions of the bonds. It will include background with regard to the issuer and its business activities as well as information with regard to the issuer's financial condition. The other documentation to be entered into is outlined. The issuer confirms that the information

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[24] FSA Glossary.

[25] The issue is taken up by the management group and placed with private clients or a limited or single group of institutional or private investors.

[26] The price and coupon are set after exploratory contact with a prospective investment group on the basis of the terms set out in preliminary offer documents. The principal terms are then set depending on the market response received. The documentation will include the use of a preliminary prospectus which is sometimes referred to as a 'red herring ' or 'pathfinder ' prospectus. Philip Wood, *Loans and Bonds* (Sweet & Maxwell, London) para 8.15.

[27] Impact day offerings are used in UK domestic offers. The price and coupon are fixed and announced through public and announced through public advertisement with subscription being left open for a particular period.

[28] Subject to contract is used to avoid creating legal liability at the pre-offer stage. The parties will generally only wish to enter into committed legal undertakings at the time that the formal documentation is signed. Any preparatory exchanges must accordingly be appropriately qualified. *Winn -v- Bull* (1877) 7 Ch d 29. No legally enforceable obligations arise until a complete agreement has been entered into. *Perry -v- Suffields Ltd* [1916] 2 Ch 187; and *Pagman Spa -v- Feed Products Ltd* [1987] 2 Lloyds's REP 601. [A complete contract can be deemed to have arisen even where key commercial terms are still to be agreed. *Okura & Co Ltd -v- Navara Shipping Corporation SA* [1982] *2* Lloyds's REP 537. Preparatory documentation including incorporating key terms and conditions can be considered to constitute a complete and legally enforceable agreement. *Branca -v- Cobarro* [1947] KB 854; *Clipper Maritime Ltd -v-Shirlstar Container Transport Ltd, The Anemone* [1987] 1 Lloyds's REP 546. [T46].

[29] IPMA recommendation 1.1. The invitation telex will also generally follow the terms of the initial approaches. IPMA recommendation 1.1(3).

[30] IPMA recommendation 1.1(2). The telex will also include relevant tax liabilities and costs and expenses. Appendix A and C.

provided is complete and accurate. The key parties and terms are summarised on the front cover and all participating professional parties and advisers (the football team) listed on the inside back cover.

Where the bonds are to be issued, the prospectus will also constitute the listing particulars under the relevant national law. It will therefore have to comply with all relevant conditions, for example, those set out in the UK FSA's Listing Rules. EU prospectuses are now also prepared in compliance with the relevant provisions set out in the Transparency Directive to benefit from full cross-border passporting rights[31]. Shorter form documents may be used where the issuer is already listed and all relevant information is already available. The application for listing can either be dealt with by the lead manager or by a separate listing agent or sponsoring broker. Listing is generally effected either on the London Stock Exchange or Luxemburg Stock Exchange.

(4) Terms

If the deal is not pre-priced, the managers and issuer will agree the final key terms, including, in particular, the subscription price and coupon. The bonds may, for example, be issued at par, discount or premium, with interest being calculated on a fixed or floating basis.

(5) Signing

The subscription agreement and any selling group agreement are formally entered into at the signing. This is typically seven to fourteen days after the initial launch. The managers' agreement and underwriting agreements will also be formally signed. All parties are now legally committed from the signing date.

Documents must generally be signed by authorised parties with copies of the signature pages being provided. Supporting board resolutions must also be made available. Faxed signatures may be used provided that the final documents are signed by the same parties. Special rules may nevertheless apply with regard to deeds, notarisation rules or witnessing. Separate provisions may apply in connection with Consular requirements. Some countries may require signature on each page. Separate jurisdiction acceptance statements are no longer generally required under European Council Regulation No 44/2001 on Jurisdiction and Regulation and Enforcement of Judgements in Civil and Commercial Matters which replaces the earlier Brussels Conventions from 1 March 2002. This may still be required with regard to Denmark or Lugano Convention States (including Norway, Iceland, Switzerland and Poland).

(6) Dealing and Stabilisation

The bonds may be dealt with on a grey market from the launch date. This is referred to as the 'grey market '. The bonds will accordingly be sold short with dealers hoping to make a profit on subsequent issuing. The managing or selling group members may also enter the grey market and sell the bonds at a discount to their nominal value (but still above their purchase cost)[32].

The lead manager may attempt to support the price of the bonds to counterbalance the effects of such short selling or dumping. This pre-issue market support is permitted under precise stabilisation rules contained in the securities laws in more sophisticated markets. The current UK rules are set out in the FSA Handbook.

One of the difficulties that may arise is that the selling group may not receive as many bonds as they have pre-dealt on final allotment. The lead manager may, in particular, restrict the allotment to particular parties[33]. IPNA rules have attempted to deal with this partly through requiring that final allotments are made on the next business day following the launch[34] and by ensuring that pre-allotments are of not less than 50% of the finalised or expected minimum underwriting commitments[35]. Other mechanisms include, for example, the use of a 'fixed price re-offer ' with the price being fixed at which participants may pre-sell the securities[36].

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[31] Richard Blierly, 'Listing ' in Blair and Walker, *Financial Services Law* (n) Ch.

[32] The managing and selling group will receive the bonds at face value less their selling commission. They can accordingly still make a profit on the bonds by selling them at any discount above the net price. Tennekoon (n 23) notes that the bonds may have a face value of 100 with a selling commission of 2 dollars. The bonds can accordingly be sold at any price above 98 dollars by the managing or selling group at a profit. Tennekoon (n 23) 156.

[33] This is referred to as a 'short squeeze '.

[34] IPMA recommendation 1.2.

[35] IPMA recommendation 1.3.

[36] Tennekoon (n 23) 156. See also Wood (n 26) paras 8-22.

(7) Allotment

Formal Bond Allotments are made under an allotment telex following signing. This will specify the specific number of bonds offered to members of the managing and selling groups. The prospective amounts will already have been set out in the earlier invitation telex. The offer is legally 'accepted ' when the funds are transferred on closing[37]. Pre-priced allotments are made within one business day of the launch[38].

(8) Trust Deed

The Trust Deed will be entered into where a trustee is to be appointed. The trustee will act as agent on behalf of the investing group. Where a trustee is not to be appointed, a separate fiscal agency agreement is entered into appointing a paying agent and sub-paying agent in each of the main international financial centres within which bond holders will be able to collect interest coupons and redemption amounts. A paying agency agreement will be entered into where a trustee is also to be appointed.

(9) Listing

Listing on the relevant stock exchange will be confirmed. Any additional information required will have been provided and the arrangements for the listing and issuance of the bonds on the particular exchange verified.

Listing facilitates both initial marketability and secondary trading or liquidity. Listing may make the bonds both attractive to potential institutional and private investors as well as complying with any relevant restrictions on wholesale or institutional investor purchases. Many institutional investors may, for example, only be required to hold certain portfolio amounts in unlisted securities. Listing will also assist subsequent secondary trading, especially with the additional advantages of price transparency and dealing protection provided. In practice, however, many bonds may be rarely traded and if then only on an over the counter (OTC) market.

Listing may, nevertheless, involve additional cost and delay as well as restriction on secondary dealing. The lead manager will have to comply with all relevant requirements set out in the listing rules of the particular stock exchange in preparing relevant documentation including, in particular, the prospectus or offering circular. This will then have to be submitted and pre-approved by the relevant section within the exchange. The issue will also have to comply with the particular trading conditions of the particular exchange with the bonds then requiring both admission to listing and admission to trading. This may cause some delay, although most exchanges have appropriate procedures to facilitate the quick examination and approval of relevant documentation. As a listed security, the relevant significant continuing obligations will then be imposed on the issuer and possible market traders[39].

(10) Closing

The closing refers to the completion of the original issuance procedure. The bonds themselves will already have been pre-placed by the managing or selling group. On the closing, the subscribers will transfer funds to the lead manager's account which will be passed on to the issuer by same day transfer, less relevant commissions and expenses. Closing used to take place within one week of the signing of the subscription agreement[40].

The issuer will deliver the conditions precedent documentation. Where a non-dematerialised issuer is involved, a single global certificate representing the definitive bonds to follow will be presented and transferred by the lead manager to a local custodian acting on behalf of one of the two clearing systems selected, Clearstream and Euroclear. The sub-custodian will act as a common depository for the bond certificates, either in single global or final definitive form. Where the bonds are issued in a dematerialised form, the issuance and trading will take place by screen.

Where not already entered into, the trust deed and paying agency agreement or separate fiscal agency agreement and any other documents will be signed at the closing.

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[37] Sub-section 8 (below). Tennekoon (n 23) 157.

[38] IPMA recommendation 1.2. Where pre-priced offerings are only syndicated among the managing group of underwriters, final allotment should be made by the next business day after launch or as soon as practicable after the management group is formed.

[39] UK LA and UK Listing Rules. Wood also notes that additional paying agent or trustee conditions will be imposed, although not under the London or Luxemburg Stock Exchanges. Wood (n 26) para 8.25.

[40] T 158.

(11) Definitive Bonds

Where paper certificates are to be used, the definitive bonds will be prepared and delivered to the trustee by the issuer following the closing. Where a trustee is not appointed, the bonds will be presented to the fiscal agent. The trustee and fiscal agent are then required to pass the bonds on to the relevant clearing house or its designated sub-custodian or common depository.

The definitive bonds are often not passed on for a forty day period following the closing. This 'lock-up ' period is required under US Securities and Tax laws which prevent the issuance of the definitive bonds for a specified period.

(12) Global Bonds and Securities

Global bonds and securities may either be issued in a temporary or permanent form. The principal advantage is that this allows having to incur the initial cost of printing large volumes of definitive notes at the time of issuance. Definitive notes will nevertheless have to be produced where the global security is temporary only. The global note may nevertheless be issued in a permanent form. This may not be possible in some cases such as where US tax law requires that a global security is initially issued for a forty day lock-up period. Under the D Rules issued under TEFRA, holders of a security must certify before the fortieth day that they are not holding any interest in the security on behalf of a US person.

The definition of the holder of a security, bond or note will either refer to the bearer or registered holder or the clearing system where a global security is to be issued, either on a temporary or permanent basis. The documentation may distinguish between payment and all other rights with the effect that the clearing system will receive payment (as security holder) although the underlying account holder will exercise all other rights (including attending meetings and voting).

BOND NEGOTIABILITY

Negotiability refers to the ability of the purchaser of a legal instrument to acquire perfect title free from any prior defects. This is accordingly distinct from transferability or assignability which is only concerned with the general passage of title rather than perfect title[41]. Perfect title is accordingly transferred either by delivery of a bearer instrument or endorsement and delivery of a registered instrument. If an instrument is not negotiable, transferees can only acquire the title held by the transferor and will accordingly take subject to any prior defects, defences or other "equities"[42]. If an instrument is non-negotiable, priority of claim is determined in accordance with the date that notice is given to the debtor of the assignment[43]. The debtor can also set-off any counterclaims against the holder[44].

An instrument is negotiable if it falls within the definitions set out in the Bills of Exchange Act 1882 (of a bill of exchange, promissory note or cheque) or it is otherwise recognised as such by mercantile custom or judicial

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41 *Goodwin -v-Robarts* (1875) LR 10 Exch 337; and *Bechuanaland Exploration Co -v- London Trading Bank Ltd* [1898] to QB 658.

42 *Gurney -v- Behrend* (1854) 3 E&B 622; and *Mangles -v- Dixon* (1852) 3 HL Cas 702; and *Business Computers Ltd -v- Anglo-Aftican Leasing Ltd* [1977] 1 wlr 578. See also Benjamin, *Sale of Goods* (Sweet and Maxwell 3 ed 1987) para 450 (p 907). See also Halsbury's *Laws of England* (4 ed) vol 4 paras 302 – 303; *Chitty on Contracts* (26 ed) Ch 19 paras 1435, 1428; and Morris, *Conflict of Laws* (11 ed) r 195. [ ].

43 *Dearle -v-Hall* (1823) 3 Russ 1; and *Bence -v- Sherman* [1898] 2 Ch 582.

44 *Newfoundland Government -v- Newfoundland Railway C O* (1883) 13 App Cas 199.

precedent[45]. A bond does not fall within the 1882 Act[46]. The negotiability of bearer bonds is nevertheless recognised by market practice and judicial precedent[47].

Whether all bonds can automatically be treated as negotiable is nevertheless uncertain. Negotiability must be recognised within the British markets[48], having regard to the volume and frequency of transactions carried out[49]. It is probable that most modern forms of bearer bonds will be treated as negotiable, provided that they are of a sufficient market size and use, even if they only constitute new forms or variations of instrument[50]. Negotiability will generally only apply to bearer rather than registered instruments[51].

The governing law determining negotiability will generally be the law of the place of negotiation or the *lex situs* of the instrument at the time of delivery[52]. Neither the UK Contracts (Applicable Law) Act 1990 nor the Bills of Exchange Act 1882 will apply[53].

The parties may decide on an express choice of law, although this will still only apply with regard to contractual rather than proprietary matters[54]. Even if the *lex situs* applies with regard to negotiability and its effects, practical difficulties still arise in determining the place of delivery where definitive bonds are held by an assigned depository, either under the Euroclear or Clearstream systems[55]. It is possible that the express choice

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45 *Picker -v- London and County Banking Co* (1887) 18 QBD 515, per Lord Esher M R and Bowen L J at 518 and 519; *Bechuanaland Exploration Co -v- London Trading Bank Ltd* per Kennedy J at 666 and 671; and *Edelstein -v- Schuler & Co* [1902] 2 K B 144, Bingham J at 154 – 155.

46 A bond contains a promise rather than order to pay and will therefore not constitute a bill of exchange under (s31). A bond will also not constitute a promissory note as it does not include an unconditional promise to pay a sum certain in money. Eurobonds, in particular, are conditional in that they contain a sales restriction against their acquisition by US nationals. The amount is also unconditional due to the gross-up provisions on withholding tax. The obligation to pay at either a fixed or floating interest rate is, nevertheless, sufficiently certain while payment by instalment or on default is still payable at a fixed or determinable future time under s83. *Bank of England -v- Vagliano Bros* [1891] AC 107. For comment, Tennekoon (n 23) 164. See also Wood (n 26) para 8.29.

47 *Edelstein -v-Schuler* (n) per Bigham J 155. "In my opinion, the time has passed when the negotiability of bearer bonds whether government bonds or trading bonds, foreign or English can be called in question in our courts. Existence of their usage has been so often proved and its convenience is so obvious that it must be taken now to be part of the law . . ." This follows Kennedy J in *Bechuanaland Exploration Co* (n) in 1898. See also *Goodwin -v- Robarts* (n) in 1875.

48 To be negotiable under English Law, this must strictly be recognised within the English markets, including principally the City of London. It is, nevertheless, highly unlikely that an instrument recognised as being negotiable in London would not be treated in the same manner either in Scotland or Northern Ireland as well as Guernsey or Jersey.

49 Per Bigham J in *Edelstein -v- Schuler*. Russian Government Scrip was considered to be negotiable in *Goodwin -v- Robarts* although Prussian Government bonds were not, although they were treated as being negotiable in Prussia they were not in London. *Picker -v- London and County Banking Co.*

50 The core test would then appear to be volume and frequency (rather than duration). It is probable that most modern forms of bearer bonds will then be treated as negotiable, provided that they are of a sufficient size and frequency, even if they have only been recently introduced to the market. Wood nevertheless stresses that frequency as opposed to duration is the key test. Wood (n 26) para 8 – 29. Tennekoon nevertheless stresses that volume as opposed to spread is the determining factor from Bigham J in *Edelstein -v- Schuller.* Tennekoon (n 23) 165. Wood is nevertheless contrasting frequency with duration and it is probable that the two core tests to be applied in any modern situation would be volume and frequency.

51 Contrast Wood (n 26) para 8.29 and Tennekoon (n 23) 162. It is possible that registered instruments could be treated as negotiable, although this has not arisen as a matter of market practice or judicial recognition to date.

52 Negotiable instruments are generally treated as chattels for conflict of laws purposes. *Dicey and Morris* ( ) 1306 and r195. See also 1322 – 1325 and r197.

53 The Rome Convention is enacted in the UK under the Contracts (Applicable Law) Act 1990, although this is disapplied with regard to obligations arising under promissory notes and other negotiable instruments to the extent that these relate to the negotiable character of the particular instrument concerned. art 1(2)(c) of the Rome Convention in Sch 1 of the Contracts (Applicable Law) Act 1990. The *lex fori* was referred to in the Giuliano and Lagarde Report O J C 282, 31.10.80. This can be taken into account by a UK court in considering the application of the Convention. (s33) of the 1980 Act. See Tennekoon (n 23) 166.

A several laws rather than single law approach is adopted under the Bills of Exchange Act. Falconbridge, *Essays on the Conflict of Laws* (2ed 1954) 340. Such contractual aspects as formal validity, interpretation and possibly essential validity are determined under s72. See also *Alcock -v- Smith* [1892] 1 Ch 238 per Romer J; contrast *Enbricos -v-Anglo-Austrian Bank* [1905] 1 KB 677, Vaughan Williams L J at 685. The 1882 Act does not deal with proprietary issues that arise, including whether a person is a holder, holder for value or bona fide holder for value and whether the holder obtains title and how the title is transferred. Tennekoon (n 23) 166.

54 This would include the formal and essential validity of the bond, the rights and obligations as well as status of the parties. Tennekoon notes that neither the 1882 Act nor preceding cases prevent the choice of a single proper law by the parties to the bond instrument. Tennekoon (n 23) 167. This may also not be restricted to the *lex loci contractus* or *lex loci solutionis* as suggested in Dicey and Morris (n) 1311, commentary to r196.

55 While the electronic accounts will be held at the head offices of Euroclear and Clearstream in Brussels or Luxemburg respectively, the definitive bonds will be held by common depositories in London or elsewhere. Transfers will

of law selected by the parties may govern all contractual and proprietary aspects, especially where the definitive bonds are held by a depository within the jurisdiction selected (such as London). Where these differ, however, some difficulties may arise in practice. Separate issues will arise where the bonds are issued and traded in a dematerialised manner, although the express choice will generally apply.

BOND CLEARING

Bond transfers are generally effected through one of the two principal international clearing systems, Euroclear in Belgium or Clearstream in Luxemburg. The clearing houses will then be involved both on the initial issuance of the bonds and in secondary trading. A number of unresolved issues still arise in connection with the proper legal entitlements involved. Three separate stages arise concerning the post-launch but pre-close dealing in the (then non-existent) bonds, transfers during the forty day lock-up period (with the bonds represented by a Temporary Global Bond (TGB)) and subsequent secondary trading in the definitive bonds (although still generally held within the clearing systems).

Buying and selling of the bonds will begin at any time following the initial launch. Such transactions will occur in the OTC grey market with dealers effectively trading in promises or undertakings to deliver the definitive bonds subsequently. The transactions are short in that the seller will not actually own any bonds at that time. Specific difficulties can arise for the lead manager where the result of the short selling is to reduce the price of the bond below the projected issue price. It is for this reason that some stabilisation dealing is permitted in certain countries while the lead manager can also take some punitive action against dealers, either within the managing, selling or underwriting groups.

On the closing of the issue, the lead manager and managing group will exchange the initial purchase funds for the TGB produced by the issuer. The manager will then credit the securities accounts of the initial subscribers with either Euroclear or Clearstream. No definitive bonds will exist at this time with the issue simply being represented by the TGB. The TGB will itself be held by a depository on behalf of the clearing house. The TGB can be considered to constitute a *suri generis* debt instrument[56].

The TGB is not considered to be a negotiable instrument[57]. The holder is entitled to call default and accelerate payment (in the event that definitive instruments are not issued) although it is unclear who the holder is. It is probable that the clearing system will be treated as the holder, at least, during the lock-up period until the definitive instruments are issued.

The clearing house will then again become the holder of the definitive bonds or notes following their exchange for the TGB. The members or participants in the clearing systems have rights to call for physical delivery of instruments where they have securities accounts[58]. Transfers will be effected by account entries with records being credited and debited between securities account holders. Known-participant trades have to be carried out through a dealer who holds a securities account within the system. The ultimate investor will then be credited with an entry in the account held between the investor and the dealer. The bond holding will then be represented in the accounts held by the dealer within the clearing system. Any subsequent transfers can then be effected either solely between accounts held by individual investors with the dealer where bonds are only bought and sold between investors or the dealer directly. Where a separate bank is involved, transfers will have to be effected through the account entries held by the dealer and the other participant member at the clearing house level.

Under US Law, all transferees will acquire proprietary, in addition to pure contractual, rights through electronic or book entry transfers under art 8 of the US Uniform Commercial Code (UCC). Under English Law, the

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then only involve some form of "constructive delivery" which must be assumed to take place where the bonds are physically located, rather than the electronic accounts held. The related difficulty that arises is whether the relationship between the issuer and transferee should be governed by the accidental law of the place of constructive delivery. For comment, Tennekoon (n 23) 168.

[56] The TGB is issued in bearer form with a promise to pay the holder the principal amount due under the bond issue, with the agreed interest. The holder will be entitled to exercise the same rights as the holder of definitive bonds until the principal amount has been exchanged for the definitive instruments. The TGB will be exchangeable wholly or partially in return for definitive bonds, with the value of the TGB being reduced proportionately on each exchange. The TGB will also be expressed to be subject to the terms of the trust deed or separate fiscal agency agreement.

[57] It does not fall within the definition set out in the Bills of Exchange Act 1882 and there has been no market or judicial recognition and acceptance of its negotiability. TGBs have never been separately traded in the markets and do not specify that title passes by delivery as with bonds or notes. The TGB strictly also only provides the holder with the right to principal and interest in the event that the definitive bonds are not subsequently issued. For comment, Tennekoon (n 23) 175.

[58] See, for example, art 4 of the Euroclear, *Terms and Conditions Governing the Use of Euroclear* (December 1982).

clearing system can either be regarded as the holder or as bailee with constructive possession[59]. Alternatively, the bank acting as the common depository may be treated as the true holder of the instrument[60]. Difficult issues accordingly arise with regard to overlapping chains of holding and custodial interest. This can most simply be considered in terms of parties having interests in securities rather than rights to securities directly[61]. This has since been simplified by European legislation to some extent.

BOND STRUCTURE

Bonds may be issued in a number of forms, with differing rights and entitlements, as well as corresponding obligations attached. Bonds are essentially negotiable certificates (either paper or an electronic representation) evidencing an underlying medium to long term debt. The issuer undertakes to pay the principal amount (set out on the face of the bond) on maturity as well as to make interest or coupon payments (on either a fixed or floating basis) during the term of the bond.

The four main classes of bonds are international (Eurobonds), domestic government and domestic corporate as well as foreign bonds (issued by overseas parties in a local capital market). While original issues were ten to fifteen years (and up to thirty years), the more recent trend has been towards short medium (two to ten years) and then other short notes (of less than one year). These principally include US Medium Term Notes (MTNs) and Euronotes (including Note Issue Facilities (NIFs) or Revolving Underwriting Facilities (RUFs)) and Commercial Paper (US or UK) (the difference between Euronotes and Commercial Paper is that there is an underlying commitment to purchase Euronotes). A large number of variations nevertheless exist within each of these main formats.

Some of the most commonly used structures are considered next.

(1) Eurobonds

Eurobonds are transferable debt securities denominated in a currency other than that of the issuer's home territory. Eurobonds are generally unsecured and issued in a bearer form. They are usually negotiable as well as transferable and sold to international investors rather than solely within the domestic capital markets. The investor group principally consists of other financial institutions or professional investors as well as other sophisticated investors and wealthy individuals.

The Eurobond markets began in the early 1960s and developed in parallel with the syndicated loan market. The first Eurobond issue was for the Italian motorway corporation, Autostrade (US dollars 15 million) in July 1963. Early growth was stimulated by the imposition of an interest equalisation tax in the US in 1963 by President Kennedy. As well as the Voluntary Restraint Program introduced by President Johnson. The first imposed a tax on the purchase of foreign bonds by American investors while the second required international investors to obtain funds outside the US[62]. Subsequent growth was substantial, mainly due to the transferable and anonymous nature of
the instrument.

The use and value of the security was subsequently improved with the development of a large number of variations on the core debt obligation involved.

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[59] If the clearing system is treated as the holder of the instrument, investors and transferees will only acquire contractual rights to require delivery of the bonds with no proprietary claims. This is nevertheless contrary to party intention and market expectation. The Belgian Royal Decree no 62 (10.11.1967) also specifies that Euroclear is to be treated as the equivalent of a bailee under English Law, with its assets being owned in common by the account holders in proportion to their respective holdings. The Euroclear Standard Terms also suggest that the holder of the bond is the Securities Clearance Account holder (art 4).

The account holders may be treated as the holders of the bonds with the clearing system only acting as bailees with constructive possession. This will nevertheless require that they have rights to a specific chattel while clearing system holdings are generally dealt with on a fungible and non-specific basis. See, for example, art 4 of the Euroclear Terms and Conditions. The fungible and unascertained nature of the holding may then prevent the clearing system from acting as a bailee under English Law.

[60] The bank acting as the common depository may be considered to be the actual holder of the bond, being in physical possession of the instrument. The investor will then have a right to require delivery, although this will only be contractual. The proprietorial interest will be held by the depository bank. Again this would appear to be contrary to the intention of the parties and market practice.

[61] Joanna Benjamin , *Rights in Securities* (OUP); and Benjamin , *Global Custody* (OUP).

[62] Arun Kumar Sarwal, 'KPMG International Handbook of Financial Instruments and Transactions' (Butterworths London 1989) 94.

(1) Plain Vanilla and Variable Bonds

The basic Eurobonds is referred to as a plain vanilla fixed coupon instrument. This pays the interest or coupon in fixed equal amounts at agreed intervals (usually six months) in arrears calculated having regard to a specified reference rate. Other fixed rate options include:

(i) Zero Coupon Bonds[63];
(ii) Foreign Currency Bonds[64];
(iii) Reverse Dual Currency Bonds[65];
(iv) First Coupon on Partly Paid Bonds[66];
(v) Currency Change Bond[67].
(vi) Annuity Bonds[68];

(2) Floating Rate Notes (FRNs)

Floating Rate Notes (FRNs) provide for the payment of interest at a variable rather than fixed rate. The most commonly used reference rate is the London Inter Bank Offered Rate (LIBOR)[69]. The first FRN was in 1970 with FRN issues making up 37% of the bond market by 1983[70]. Maturities were also shortened as issuers were reluctant to commit themselves to long periods of fixed interest payments with the high levels of market volatility that persisted. Typical maturities were between five and fifteen years with minimum denominations of 1,000 dollars[71]. FRNs nevertheless still have the disadvantages of not being able to offer flexible draw downs or interest payment adjustment options[72].

Apart from plain vanilla FRNs, other options include:

(i) Floor FRNs[73];
(ii) Drop Lock FRNs[74];
(iii) Double Drop Lock FRNs[75];
(iv) Cap FRNs[76];
(v) Caller FRNs (or Minimax FRNs)[77];
(vi) Inverse FRNs (or Bull/Reverse FRNs)[78];

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[63] No interest is paid with the investor benefiting from the increase in value of the bond over time. This may either be issued at a discount and redeemed at par or issued at par and redeemed at a premium. Deep discount securities are issued at a substantial discount, with a lower interest being paid during term. Zero coupon bonds pay no interest with the investor benefiting from the difference between the original discount price and the par value.

[64] Interest is paid in a different currency (other than that in which the bond was originally issued and denominated) at the spot rate at the time of payment.

[65] Interest is paid in a currency other than that of denomination at a fixed rate (rather than spot rate as under a foreign currency bond).

[66] Interest varies having regard to the amount of the issue price paid up.

[67] Interest payments are made in different currencies at fixed exchange rates set at the time of issue.

[68] Partial repayments of principal are included within the fixed interest rate payments.

[69] LIBOR (or LIBID or LINEAN) will be calculated on six monthly intervals with regard to the relevant LIBOR rate. Shorter three month LIBOR rates may also be used or six month SUS Treasury Bill Rates.

[70] Fisher, *International Bonds* (Euro Money).

[71] Sarwal (n 62) 96.

[72] Sarwal notes that they were described as "disguised syndicated loans" despite these disadvantages. Sarwal (n 62) 98.

[73] The note only fluctuates above a minimum floor rate such as 5% (for US, Sterling and French Franc bonds) and 3% (for earlier Deutsche Mark bonds). An "initial floor" FRN only operates for a minimum commencement period. 80% of FRNs issued in 1986 were Floor FRNs. Sarwal (n 62) 107.

[74] The interest becomes fixed at the floor rate when it arrives at an agreed "trigger level". If interest rates subsequently rise, the bonds may be purchased by other investors preferring fixed rate instruments (such as pension funds or insurance companies) for a ¾% or 1/16% annual fee. Sarwal (n 62) 107.

[75] The interest rate only becomes fixed or Locked where the trigger level is breached on two consecutive fixing dates. This is used where rates may vary widely.

[76] The interest rate is limited (or capped) at a certain level (such as 13% for US dollar FRNs). This imposes an upper limit. A "Delayed Cap FRN" only operates for a specified period after the initial commencement time.

[77] Both maximum and minimum interest rate limits are imposed (floors and caps). A Minimax FRN operates within narrower upper and lower limits.

(vii) Step Down FRNs[79];
(viii) Step Up FRNs[80];
(ix) Margin as a percentage FRN[81];
(x) Floating then Zero FRNs;
(xi) Fixed then Floating FRNs;
(xii) Variable Rate Notes (VRNs)[82];
(xiii) Zero Coupon (or Deep Discount) FRNs[83];
(xiv) Rolling Rate Notes (RRNs)[84].

Other interest rate options include:

(i) Bunny (or Multiplier) Bonds or Notes[85];
(ii) Lender's Option-Borrower's Option (LOBO)[86];
(iii) Borrowers' Option-Lender's Option (BOLO)[87].

Other interest rate variations include:

(i) Graduated Rate Coupon Bonds[88];
(ii) Deferred Coupon Bonds[89];
(iii) Profit Sharing Bond[90];
(iv) Indexed Bonds[91];
(v) Duet Bonds[92].

(3) Perpetuals

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78 Interest rates move in an inverse relationship with the benchmark rate selected. They are also known as Yield Curve Adjustable Notes (YCANs). "High Margin FRNs" operate on a fluctuating basis until a specified rate is reached, after which they are converted into inverse FRNs. Sarwal notes that Inverse FRNs were used after mid-1986. Sarwal (n 62) 108.

79 The margin is reduced proportionately over time. This is only common in longer bonds such as thirty year or perpetual FRNs. This will be supported by a right of re-purchase (callable at par) after an initial period (such as five years) "high first coupons" provide for an initial large payment and then subsequent fixed rate margins over the life of the bond. Sarwal (n 62) 108.

80 The margin increases proportionately over the duration of the instrument. A "Step Up With Claw Back" allows negative interest payments to be deducted subsequently where the margin was set at a rate below the reference rate.

81 The rate is set as a percentage of the benchmark rate.

82 The margin or spread is re-set for each interest period. This can either be calculated on an auction basis (such as under the Warburg model) or by agreement (under the Merrill Lynch model). These were introduced in 1988 to promote interest in declining FRN use. Sarwal (n 62) 110.

83 Deep discount securities are issued at a discount on their par or redemption value with a lower interest or coupon being paid during term. Zero coupon bonds pay no interest with an amount equivalent to the interest otherwise payable over the life of the instrument being deducted up front. They are then redeemable at par value. The interest would effectively be rolled up within the redemption price which would benefit from capital gains tax which may be payable at a rate lower than income tax. This was particularly attractive in the UK for corporate and wealthy individual investors, although the tax advantage has since been closed. Sarwal (n 62) 197 – 198.

84 Interest is calculated on a monthly but payable six-monthly basis using the agreed six month reference rate with the accrued interest being added to the capital amount. George S Ugeux, *FRNs* (Euromoney); Fisher, *International Bonds* (Euromoney); and "Types of Bonds" *Current Issues of International Financial Law* [116].

85 The investor is given the option to have the interest payments re-invested in identical bonds which provide a separate income stream. The option allows the issuer to pay lower interest rates while this may also be of advantage to the investor, depending upon whether interest rates are expected to rise or fall and the investor's preference for fixed or floating instruments. Sarwal (n 62) 110.

86 The investor can vary the interest rate at their choice, subject to the issuer's right to redeem at face value. This has been used by UK local authorities in issuing twenty year securities with an agreed opening interest rate.

87 The issuer is entitled to vary the interest, with the investor either being able to accept or call for redemption of all outstanding amounts due.

88 Interest is paid at different rates in the schedule attached at issue.

89 The first fixed interest payment is delayed until a pre-determined time.

90 Interest payments are linked to dividends on equity issued by the same company. The alternative is to make the bond convertible into equity.

91 Fixed interest payments calculated with regard to an agreed index, such as the Retail Price Index (RPI) in the UK.

92 The purchase and sale of two fixed rate bonds in different currencies which allows the issuer to benefit from different interest rates in the markets selected. Sarwal (n 62) 106 – 107.

Bonds may have fixed or variable maturities, with additional redemption rights possibly being made available. Fixed rate bonds will generally have fixed maturities, although FRNs and other variations may have different rights attached.

(i) Perpetual Bonds[93];
(ii) Put Option Bonds[94];
(iii) Put and Call Options[95];
(iv) Extendables[96];
(v) Retractable Bonds[97];
(vi) Stepped Up Puttable Bonds[98];
(vii) Sinking Fund Bonds[99];
(viii) Purchase Fund Bonds[100].

Mandatory early redemption requires that the principal amount outstanding is amortised (repaid) in instalments.[101] Bonds can be called where provision is made for early redemption. Stepped Calls allow the issuer to redeem on coupon dates after a specified period. Rolling Calls allow the issuer to redeem at any time after a specified period. Immediate calls allow for the bonds to be redeemed at any time after issue. The terms and price at which the bonds may be redeemed will be set out in the Call Schedule.[102]

Bonds may either be redeemed at discount, par (face value), or premium. Options may include:

(i) Bullet Bonds[103];
(ii) Annuity Bonds[104];
(iii) Foreign Currency Bonds[105];
(iv) Dual Currency Bonds[106];
(v) Heaven and Hell Bonds[107];
(vi) Capped Heaven and Hell Bonds[108];

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93 Perpetual Bonds are issued with no fixed maturity date, although they can be accelerated if an event of default is triggered. Perpetual Bonds may be issued by UK companies under s193 Companies Act 1985. The first Perpetual was issued by National Westminster Bank in 1984. Watkins cited in Tennekoon (n 23) 215 (n20). One of the main advantages was that the interest payable could be deducted before tax, unlike with dividend payments. They also did not create additional shareholders' rights as under a rights or equity issue. Perpetuals became of less importance from the mid 1980s onwards. Fisher, *International Bonds* (Euromoney); Ugeux, *FRNs* (Euromoney). It is reported that the market collapsed in December 1986 following concerns that the Japanese Ministry of Finance would no longer permit their inclusion in banks' capital base. The market was previously worth 18 billion dollars. Sarwal (n 62) 112.

94 Debt holders can elect to have the bonds redeemed at a fixed price. Perpetuals with Put Options are referred to as "Puttable Perpetuals". Sarwal (n 62) 112.

95 Separate Put and Call Options are conferred on the investor and issuer operating at different prices. See also Tennekoon (n 23) 216.

96 A Put Option allows the investor to sell the bonds back to the issuer at pre-determined periods corresponding with interest payment dates.

97 The issuer has a Call Option to redeem or the investor a Put Option to re-sell at a common price.

98 The investor can either sell the bonds back to the issuer at pre-determined times or retain them with interest being paid at a higher rate.

99 Sinking Funds are used for redemption purposes where all bonds are not to be redeemed at the same time. Selection for redemption may either be determined by drawing lots (Sinking Fund by Drawing), Serial Numbers (Serial Sinking Fund Bonds or Serial Bonds) or by market purchase (Sinking Fund by Purchase). The use of serial numbers creates the greatest certainty as the bonds will be redeemed in accordance with a pre-set schedule. The disadvantage is that the holders will have to be registered with the issuer or one of the main clearing houses. Sarwal (n 62) 111; and Tennekoon (n 23) 196 – 197. Watkins, "Types of Bonds" *Current Issues in International Financial Law* (1985) Malaya Law Review and Butterworths.

100 A Purchase Fund is a support fund used to purchase bonds where the price falls below a pre-set level. The purchases will be made by a purchasing agent and not subject to subsequent re-issue.

101 Tennekoon (n 23) 196.

102 Sarwal (n 62) 112.

103 Bullet Bonds are fixed rate bonds with pre-determined durations and redemption procedures.

104 Repayment is fixed under the terms of the bond, although principal is amortised over term.

105 The bond holder may elect the currency in which the bonds are repaid.

106 Interest and redemption are made in separate currencies to benefit from interest rate differentials. A mixed dual currency bond allows for interest and redemption in a pre-set combination of currencies.

107 Interest is paid in the currency of denomination with repayment of principal, although redemption is calculated on the basis of the spot exchange rate of two separate currencies. Sarwal (n 62) 114. This is also referred to as an "Indexed Currency Option Note" (ICON).

(vii) Reverse Heaven and Hell Bonds[109];
(viii) Bull-Bear Bonds[110];
(ix) Index Linked Bonds[111];
(x) Commodity Price Linked[112];
(xi) S&P 500 Indexed Link Notes[113];
(xii) Convertible Bonds[114];
(xiii) Flip-Flop Bonds[115].

(4) Warrants

Bonds can also be issued with warrants attached which confer on the bond holder the right to purchase further bonds (but not the obligation) on pre-determined terms (including price). These became popular during the late 1970s and 1980s as they allowed the issuer to pay a lower interest rate while the holder acquired the option to purchase an asset that may increase in value. If the bond does not rise in value, the holder is under no obligation to purchase. The warrants can also be detached and actively traded in the secondary market.

The host bonds are issued with the warrants included as detachable certificates. The warrants may be exercised immediately or during a specified period (Window Warrants). The warrants may either be issued in the form of Equity Warrants or Debt Warrants. Equity warrants may be in the shares of the same company, or a separate company. The holder can also either pay cash for the new shares or convert the existing host bond (Conversion Equity Warrants). A number of distinct types of debt warrants can be identified[116].

Warrant options also include:

(i) Puttable or Redeemable Warrants[117];
(ii) Naked Warrants[118];
(iii) Covered Warrants[119];
(iv) Option Warrants[120];
(v) Commodity Warrants[121].

[Bonds can either be fully or partly paid. There may also be a deferred payment with the residual amount being paid up at a pre-determined time.] [Eurobonds also include Sushi Bonds[122], a Kiwi Bond (denominated in New Zealand Dollars), an Aussie Bond (denominated in Australian Dollars), a Zipper[123] and a Micro Bond[124].

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108 A ceiling (or cap) is set on the profit that the investor may generate under the “Heaven and Hell” redemption calculation.

109 The proceeds on redemption increase as the currency of denomination depreciates and decrease as it appreciates. Sarwal (n 62) 114.

110 Two tranches are used with separate interest rates and redemption values, which are calculated with regard to a separate index, commodity or instrument (usually bond price, stock market, or commodity price).

111 The redemption proceeds are tied to an index such as the Retail Price Index (RPI).

112 The redemption proceeds are calculated with regard to the price of a commodity or commodity index, such as gold or oil.

113 The redemption proceeds are calculated with regard to the value of the Standard & Poors 500 Equity Index. These are also referred to as “SPINS”.

114 The bond may be converted into another instrument including another bond, equity shares (convertible debt) or possibly a commodity. Available options may also include converting interest rates and currencies or other terms. Sarwal (n 62) 116 – 117.

115 Bonds may be converted into another type of instrument and then re-converted back at the issuer’s option.

116 (a) warrant into host bond (further amounts of the same bond at face value); (b) warrant into back bond (another identified bond); (c) a wedding warrant (exchangeable into bullet (virgin or back bonds) on surrender of the host bond); (d) callable warrants (issuer’s right to have the unexercised warrant called to limit price rise); (e) naked income warrant (interest paid until exercise with higher rate payable on new bond); (f) conversion bond warrant (right to purchase new bond or convert host bond into new bond with alternate terms); (g) harmless warrant (issuer’s right to call in bonds to limit total amount outstanding); and (h) currency warrants (the right to purchase bonds in alternative currency). Sarwal (n 62) 120.

117 The exercise price is set at that of the original issue or some other pre-determined amount to limit potential loss. These are also referred to as “money back warrants”.

118 Independently issued warrants not attached to any specific bond or equity issue, giving the holder the right to convert into debt or equity as agreed.

119 The right to purchase debt or equity in a separate company with the availability of the new instruments being guaranteed by the issuer.

120 Right to exercise the warrant as either an equity or debt warrant on pre-determined terms.

121 Right to purchase commodities at a pre-determined price in place of equity or debt.

The rights and obligations attached to the warrant will be set out in the original documentation issued with the host bonds. The procedure for exercise of the warrants can be set out in a separate warrant agency agreement entered into between the issuer and a warrant agent. The warrant agent will issue a public notice confirming the option period. The original bonds, warrants and new bonds or equity will generally be held by one of the principal clearing systems, Euroclear or Clearstream. The warrants may then be represented by a single global warrant with entitlement being recorded in the accounts of the bond holders or their representative agents with the depository. Exercise can then be effected by delivery of a notice to the depository before the exercise date. The global warrant will then be reduced and global bond increased with the respective amount of the exercise. The new bonds will then be credited to the investor's account and their cash account debited with the purchase price[125].

(5) Equity Linked Bonds

The bonds then pay regular interest with the additional advantage of possible increase in value in the warrant assets. The issuer may then be able to negotiate lower interest rate and other preferred terms, such as less restrictive covenants or debt subordination. The availability of the warrant option may also allow the duration of the bonds to be extended, increasing maturity. The fixed income element may also be attractive to institutional investors or other trustees who would not otherwise be able to purchase shares or warrants directly. There is also an element of deferred equity financing with the exercise price reflecting a higher longer term value of the company than would otherwise be available on initial issuance. The disadvantage for the issuer is, ever, that it will dilute its stock value by issuing shares below the current market price.[126] Conversion rights may be terminated by issuer pre-payment, acceleration, liquidation, take-over or amalgamation.[127]

The pre-emption rights of existing shareholders may have to be dis-applied by possibly by general meeting for both Companies Act and Stock Exchange purposes. Shares cannot be issued at a discount as this would dilute capital, contrary to *Mosely -v- Koffyfontein Mines* [1904] 2 Ch 108 (CA). Conversion price must generally be fixed above market value. Bond documentation will generally include anti-dilution provisions preventing the company from undermining the value of the warrant by adjusting its share structures. Bond holder may have no separate protection in the event that express controls are not included.[128]

The issuer will generally undertake to maintain sufficient authorised but unissued capital to cover the exercise. The issuer will not modify the rights attaching to the shares and notify any changes to the conversion price which may be made. The issuer will also undertake to ensure that the new shares are appropriately listed.[129]

(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[130]. 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[131].

MTNs were introduced in the US in the early 1980s[132]. Total issue volumes increased from US 12 billion in 1984 to 36 billion dollars by 1986[133]. 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

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122 The bond is issued by a Japanese company in a currency other than Yen, but targeted at Japanese institutional investors. Sarwal (n 62) 121.

123 Bonds issued in separate tranches on different terms, such as fixed or floating rate payment or zero coupon or deep discount options.

124 A low volume issue which is convertible into ordinary shares in the issuer. Sarwal (n 62) 121.

125 Wood (n 26) paras 9 – 24 – 26.

126 Wood (n 26) paras 9.5 – 6.

127 Wood (n 26) para 9.8.

128 Wood (n 26) 9.14 – 9.18.

129 Wood (n 26) 9.22.

130 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.

131 Wood (n 26) paras 9.38 – 39.

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

133 Sarwal (n 62) 201.

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[134].

MTNs also benefit from certain regulatory concessions being issued on a continuous basis[135].

Variations on the plain vanilla MTN include:

(i) Euro MTNs (EMTNs)[136];
(ii) Global MTNs[137];
(iii) Continuously Offered Long Term Securities (COLTS)[138];
(iv) Continuously Offered Intermediate Notes (COINS)[139];
(v) Multi-Tranche Tap Notes (MTTNs)[140].

(7) Euronotes

Euronotes are short dated bearer promissory notes with maturities of between seven days and one year[141]. 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 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)[142].

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[143]. The first programmes were referred to Note Issuance Facilities (NIFs)[144]. Revolving Underwriting Facilities (RUFs) were subsequently developed in the early 1980s[145]. 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:

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

135 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.

136 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.

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

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

139 Euro MTNs issued through an offshore insurance company.

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

141 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.

142 Sarwal (n 62) 121.

143 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.

144 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.

145 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

(i) Dual or Multiple Placing Agency[146];
(ii) Dealership Placement[147];
(iii) Issuer Set Margin[148];
(iv) Specialised Tender Panel[149];
(v) Unsolicited Tender[150];
(vi) Transferable Revolving Underwriting Facility (TRUF)[151].

The issuer will pay separate participation, underwriting, commitment and utilisation fees[152]. 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[153]. 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[154].
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.[155]

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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.]

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

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

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

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

[150] The banks bid to place paper as selling opportunities arise.

[151] Underwriters are entitled to transfer their commitment subject to borrower approval.

[152] 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%).

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

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

[155] 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

The Commercial Paper market originated in the US in the early nineteenth century to allow companies to borrow funds across state lines[156]. 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[157].

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[158]. 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[159].

Commercial Paper is generally treated as a negotiable instrument as a matter of market practice.[160] 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.

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[161]

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[156] 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.

[157] 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.

[158] 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.

[159] Wood (n 26) paras 9.32 – 36.

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

[161] 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]

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.[162]

(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[163]. 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[164]. 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)[165];
(ii) Swing Line Facilities[166];
(iii) Commercial Paper or Euro Commercial Paper;
(iv) Bankers' Acceptances[167];
(v) Medium Term Notes (MTNs).

BOND STRUCTURES AND CORPORATE BONDS

A range of security instruments are issued by governments and government agencies in all countries. The largest markets are in the US and Japan, although substantial issues are also made in Germany, the UK, France and

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

163 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.

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

165 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.

166 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.

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

Italy[168]. These are used by government and government agencies to borrow funds from the domestic capital markets to fund their various public activities.

Some of the most commonly issued debt instruments include the following:

(1) UK Gilts, Stocks and Bonds

The main publicly issued debt instruments in the UK are as follows:

(a) Gilt-Edged Securities

Gilts are sterling denominated government bonds. They are issued by the Treasury but backed by the government. The most commonly used tranches include shorts (up to five years), mediums (five to fifteen years), longs (over fifteen years) and undateds (irredeemables).

The gilt issues are now managed through the Debt Management Office (DMO). Gilts are now generally issued in a dematerialised form through CREST.

Continuous two way prices are offered by Gilt-Edged Market Makers (GEMMs). Twenty-nine firms were initially licensed by the Bank of England in 1986, although this fell to twenty-two by 1989. There are currently in the market. The original objective was to replicate the forty primary dealers in the US Treasury Bill Market[169]. GEMMs deal on an anonymous basis with each other through Inter Dealer Brokers (IDBs)[170]. Borrowing and lending stock is facilitated through the Stock Exchange Money Brokers (SEMBs)[171]. Other broker/dealers also act as agents on behalf of investors.

(b) Local Authority Stocks

Local authority agents, including towns, boroughs or counties can issue local authority stocks (or British Corporation or County Stocks). The local authority market represents one of the new secondary markets that developed in the UK during the late 1950s and early 1960s following the closure of the earlier Public Works Account. Issuance is conducted through the LSC. The stock is generally registered with issuances being underwritten. Short dated issues can be less than five years, with long dated issues being up to thirty-five years.

(c) Public Sector Board Bonds

Other public sector institutions can also raise funds through bonds. These are generally issued in similar terms to local authority stocks, although yields are higher, due to the lack of secondary trading.

(2) US Treasury, Agency and Municipal Bonds

A range of securities are issued in the US domestic capital market. These principally include Treasury Notes (one to ten year) and bonds (ten to thirty years) as well as municipal (or uni-bonds) as well as other federal agency securities, corporate bonds, US corporate bonds and Yankee bonds[172].

Securities to be traded in the US will either be issued in a registered form or in bearer form but convertible into a registered format. This is necessary under the US Tax Equity and Fiscal Responsibility Act (TEFRA) 1982. This imposes sanctions on non-registered security issues to prevent tax avoidance through abuse of bearer entitlement.

(a) Treasuries

Treasuries consist of notes and bonds issued by the US Treasury. The securities are issued by the Treasury but backed by the US Government. Treasuries are distinct from US Treasury bills which are money market instruments used to control short term money supply[173].

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[168] The global government bond market was worth 6,300 billion US dollars in 1986. This consisted of 49% US issues, 23% Japan, 7% Italy, 4% Germany, the UK and France, and 9% other. Salomon Brothers cited in Sarwal (n 62) 151.

[169] Sarwal (n 62).

[170] Six were originally licensed in 1986. There are presently two main IDB firms.

[171] Ten firms currently act as SEMBs. [ ].

[172] Sarwal (n 62) 147 and 151 - 156 and 160 - 166.

A number of more recent variations have since been developed on the basis of the basic Treasury Notor Bond. These include Treasury Income Growth Receipts (TIGR)[174]; and Separate trading of registered interests and principal securities (STRIPS)[175].

(b) US Federal Agency Securities

Other notes, bonds, debentures or participation certificates (or pass through securities) issued by US Government established agencies are referred to as 'Agencies '. Federal agencies may either be government or privately owned, but government supported. Only government owned securities are fully guaranteed. These were originally developed to provide sources of funding to farmers. The main agencies involved are the Government National Mortgage Association (GNMA)[176], Federal Home Loans Banks (FHLB), Federal Home Loan Mortgage Corporation (FHLMC), Federal National Mortgage Association (FNMA), the Consolidated Farm Credit System (consisting of the Banks or Co-operatives, the Federal Land Banks and the Federal Intermediate Credit Banks) and the Federal Financing Bank (FFB). Agencies include Federal Agency notes, bonds, debentures, mortgage participation certificates and agency pass-through certificates[177].

(c) Municipal Bonds

Municipal (or Muni-Bonds) are fixed rate bonds issued by State and local authorities. Although these were available for general funding purposes, tax exemption is now only available under the Tax Reform Act 1986 for certain purposes. Other partially exempt and taxable instruments are now issued in the form of private activity municipals and taxable municipal bonds. Municipal multipliers or coupon interest bonds are used to provide for the reinvestment of interest payments until maturity[178].

(3) Japanese Government Bonds and Debentures

Japanese domestic security instruments include Japanese Government Bonds (JGBs), Government Agency Bonds, Bank Debentures, Corporate Bonds and Electric Utility Bonds. A Samurai or foreign bond is a Yen denominated instrument issued by a foreign borrower in Japan.

JGBs were introduced in 1966. Issue terms are determined by the Ministry of Finance and the Bank of Japan in discussion with an underwriting syndicate (Shidan) consisting of around thirty-three banks and securities houses. Bonds are issued on a monthly basis. Issues are usually underwritten, by the Shidan. Bonds may either be medium term (two to four year coupon bonds or five year discount bonds), long term (ten year) and super-long (fifteen to twenty year maturity). Minimum denominations are generally Yen 50,000, although 1 million Yen issues may be offered. Secondary trading is generally OTC.

(4) German Government Bonds And Debentures

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[173] Treasury bills (T-bills) are issued on a weekly auction basis by the Federal Reserve Bank of New York acting on behalf of the US Treasury Department. T-bills are generally issued in a bearer form in denominations of 10,000 dollars or 5,000 dollars. Maturities vary between 91, 182 and 12 month bills. Issue is by competitive bidding between the primary market dealers. There are currently between 30 and 40 dealers. [Market Size].

[174] Treasury income growth receipts (TIGRs) were introduced by Merrill Lynch in 1982 to provide for the stripping of coupons on Treasury Instruments. TIGRs operate through the sale of receipts representing individual interest and principal payments on an underlying security which is held in trust by a custodian. A series of zero coupon securities are then created by stripping each interest and principal payment through a special purpose vehicle (SPV). Transaction costs are cheaper, payments are immune from movements in interest rates, credit risk is low and capital gain credits are available on maturity. Later equivalent instruments include Certificate of Accrual on Treasury Securities (CATS), Salomon Brothers, A G Becker Certificates of Government Receipts (COUGR), Shearson Lehman Investment Opportunity Notes (LIONs), S G Warburg Zero Coupon Euro Sterling Bearer or Registered Accruing Certificates (ZEBRAs) and Quadrex Securities Sterling Transferable Accruing Government Securities (STAGS). Sarwal (n 62) 154 - 156.

[175] Treasury receipts (TRs) are created through the official stripping of issues. These include Corpus TRs (zero coupon certificates for principal payments), Coupon TRs (coupon STRIPS only entitling the holder to interest on maturity) and Callable TRs (principal and interest coupons after the call date).

[176] The GNMA issues 'Ginmie Maes'. The GNMA was set up in 1968 to hold non-commercially attractive mortgages.

[177] Sarwal (n 62) 160 - 162.

[178] Sarwal (n 62) 147.

A number of instruments may be issued in Germany. These include the Government and public sector notes (Kassenobligationen)[179], Government debt certificates (Bundesobligationen)[180], Federal savings bonds (Bundeschatzbriefe)[181], Discount Treasury bonds (Unverzinsliche Schatzanweisungen)[182], Government or public sector bonds (Bundesbonds)[183], Mortgage bonds (Pfandbriefe)[184] and Communal bonds (Kommunalobligationen). The most commonly used credit instrument is nevertheless the Suhuldscheindarlehen which are transferable statements of participation in an underlying loan. These are used by the Government, federal and other local agencies, as well as banks and some corporations. Schuldschein are constituted by an underlying loan, although the lender receives a ****? certificate which can be bought and sold in the secondary market. The principal terms parallel those available on the bond market, although issue costs are cheaper.

Commercial banks may also issue debentures, either in the form of a bearer bond, a convertible bond or an option bond (with separate warrants to purchase shares which may be traded separately). Industrial or commercial companies may also issue domestic bonds. Non-resident institutions may raise funds through foreign bonds, these include a public bond, private placement bonds, convertible bonds and option bonds.

(5) Other Government Securities

A range of domestic securities are issued by other governments. These include Commonwealth Bonds, Semi-Government Bonds (SEMIS), Corporate Debentures and unsecured notes in Australia. Government funds are principally raised in Canada through Canada Savings Bonds and ordinary Marketable Bonds with provisional funds being raised through Provisional Bonds. National Housing Association (NHA) Mortgage Bonds are also available as well as traditional corporate bonds and foreign bonds. Funds are raised in the Netherlands through Dutch Government Bonds, Dutch Local Authority Bonds, Commercial Bank Bonds and Mortgage Bank Bonds (Pandbrieven). Swiss securities include Confederation Bonds, Cantonal and Municipal Bonds, Bank Bonds (Schweizer Kassenobligationen) and Mortgage Bonds (Pfandbrief)[185].

(6) Corporate Bonds

Corporate Bonds refer to debt instruments issued by companies in the domestic financial market. They are distinct from Eurobonds in that they will be issued in the local currency. They are generally also registered, secured and locally listed. Interest is usually also paid net and semi-annually. Issues will be managed by local investment banks or stock brokers with a domestic investor base.

Most national company laws will provide for the issuance of debt as opposed to equity by corporate bodies. Specific terms may be used, such as Debentures in the UK, although Corporate Bonds constitute a useful generic term applicable in most countries.

Corporate bonds are generally either issued in a straight or convertible basis. Straight bonds will usually carry a fixed interest rate, although floating rate options may be used. Convertibles allow the debt instruments to be transferred into equity at the holder's option. This benefits from possible capital gain at the time of conversion, with convertibles usually attracting a lower interest rate due to this alternative benefit[186]. Most corporate bonds, certainly in the principal financial centres, are rated such as by Standard and Poors, Moody's or Fitch. Rating grades vary between triple A (AAA) to triple D- (DDD-D)[187].

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[179] Guaranteed bearer instruments from between two to five years issued in minimum denominations by tender.

[180] Five year bonds issued by the Bundesbank on behalf of the Federal Government to national residents. These were introduced in 1979. Secondary trading is OTC, although the certificates are quoted.

[181] Sold to retail individual or non-profit making investors on a tap basis. With maturities of six (A) or seven (B) years.

[182] Deep discount bonds with maturities up to two years (referred to as zero bonds or Bundeschaetzchen 'Government Darlings'). These are essentially money market instruments that were previously used to protect the stability of the currency.

[183] Bearer Certificates sold through bank groups with maturities up to ten years.

[184] Bonds issued by privately owned mortgage banks, issued in a bearer or registered form secured on underlying mortgages.

[185] Sarwal (n 62) 139 – 146.

[186] Convertible bonds generally pay around 0.2% - 0.4% less than straight bonds. The US average between 1986 – 1987 was 5.75%. Sarwal (n 62) 182.

[187] AAA (triple A) refers to prime grade debt. AA is highly secure with A being upper medium grade. BBB is medium grade, BB lower to medium grade and B speculative investment. CCC-CC refers to speculative investments, often with no interest being paid. DDD-D grade bonds will be in interest default with principal repayment being questioned. The specific rate refers to the possible degree of salvage on the paper. Sarwal (n 62) 183.

Activity in the domestic corporate bond market is generally dependent on local interest rates and transaction costs. Corporate borrowers will be reluctant to issue debt where interest rates are high, or where they may be competing with high volumes of other government instruments. Companies will then raise funds through bank loans or equity issues. High local regulatory costs for domestic security issuances may also be a relevant factor. Corporate bonds may either be issued at a discount, par or premium, depending on local interest rates and yields. Bond yields tend to be higher than government security yields, although without the same security.

Convertible also includes convertible preferred stock (US preference shares convertible into ordinary common shares or stock) and convertible Eurobonds (transferable into equity or bonds with alternative features). Conversion rates are generally at a premium over the market value of the shares of issuance.

The largest corporate bond markets are in the UK, US and Japan.

(a) UK Debentures and Loan Stock

Corporate entities may either issue debentures or unsecured loan stock in the UK. UK Debentures are generally secured while they are unsecured in the US. UK debenture holders rank against other creditors in the event of a winding-up. Companies may alternatively issue unsecured loan stock which will be postponed to debenture stock but rank ahead of ordinary shareholder stock.

Sterling capital market instruments in excess of three million pounds were subject to guidelines issued by the Bank of England[188]. Debentures are issued on an auction basis[189]. Issues are generally registered and listed, although dematerialised issues may now be available.

The UK corporate bond market was relatively subdued during the 1970s due to high rates of interest and competing government stock. High issue costs have also deterred their use by larger companies. Where possible, companies will use the Eurobond market directly or bank loans or equity issues. UK insurance companies are common investors, holding approximately 40% of issues for long term investment purposes. Issues may be underwritten, with stockbrokers and investment banks providing an advisory role where issues are not rated.

(b) US Corporate Bonds

The largest corporate bond market in the world in terms of initial issuance and secondary trading is in the US. The market had grown substantially during the 1980s due to the ability to pre-register[190] [191], various innovative options have also been developed, including deep discount bonds, debt with warrants, liquid yield option notes (LYONs)[192], SPREADS[193], and REALs[194].

(c) Japanese Bond Market

Growth in the Japanese corporate bond market had been limited due to the previous requirement for all issues to be secured[195]. The main instruments are Straights (with 7, 10 or 12 year maturities) and Convertibles (with 6 or 10 year maturities) although debt with warrants have become increasingly important in recent years.

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188 Bank of England, (July 1987) and (April 1989). The Bank operated a "queuing" system to manage the flow of corporate debt on the market before April 1989. While formal consent was removed, The Bank still had to be notified of any issues in excess of twenty million pounds.

189 The public is invited to subscribe on the basis of the published prospectus. A deposit may be required. The debentures are allocated proportionately following closing.

190 Lower interest rates, especially from 1986 onwards and the desire of companies to re-finance higher costing debt.

191 The SEC allowed companies to file an interest through a "shelf registration" procedure to issue marketable debt securities within a three year period. No specific commitment was required, although this allowed companies to raise funds through debt issues as necessary on a quick and cost-effective basis.

192 Zero coupon bonds convertible into common stock at a pre-determined price. These were first launched in 1986 and attractive to investors due to the ability to deduct imputed interest on an annual basis. Sarwal (n 62) 181.

193 Non-callable debt security with the investor having the right to have the securities re-purchased by the issuer at a fixed date and margin over the price of US Treasuries. This allows companies to borrow at lower rates with the investor being protected through the "put". These were developed by Morgan Stanley. Sarwal (n 62) 181.

194 Real yield securities (or REALs) are 10 – 20 year bonds with floating coupons paying interest at a pre-determined rate over the US Consumer Price Index (CPI). These were introduced by Morgan Stanley in 1988. Sarwal (n 62) 181. [US investment grade bonds which banks may invest in are referred to as Bank Quality Bonds.]

195 The corporate bond market only represented 5% of the total Japanese domestic capital market. Sarwal (n 62) 185.

(7) Foreign Bonds

Foreign bonds are domestic (non-Euro) debt instruments issued in the local market of foreign rather than domestic entities. The foreign bond market may be used by other sovereign entities, international organisations or agencies and corporations from other countries. The objective is to tap the local capital market for funds with additional advantages possibly being available in terms of lower interest rates or borrowing costs as against the borrower's home market.

Commonly used foreign bonds include the following:

(i) Swiss Auslandsobligationen[196];
(ii) Yankee bonds[197];
(iii) Samurai bonds[198];
(iv) Bulldog bonds[199].

(8) Bond Variants

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A number of more innovative or alternatively structured options have been developed in the domestic corporate bond market. These are partly influenced by developments elsewhere including, in particular, in the Eurobond and derivatives markets although this has also been stimulated by increased competition in domestic markets. New options include:

(i) Debts with premium puts[200];
(ii) Debt payable in common stock[201];
(iii) Equity notes[202];
(iv) Exchangeable debt[203]; and
(v) stepped interest debenture issues[204].

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196 Auslandsobigationen are foreign bond public issues or unlisted foreign note private placements which are denominated in Swiss Francs and issued in the local Swiss market. The Swiss foreign bond market overtook the US in 1978. Maturities are between eight and fifteen years, with issues either being straight or convertible. Bonds are issued in minimum denominations of SFR 5,000 with total issues being up to SFR 150 million. Issues over SFR 10 million are managed by the Swiss National Bank in a queuing system. Foreign notes have minimum denominations of SFR 50,000. Bonds are listed and actively traded while foreign notes are only held until maturity. Sarwal (n 62) 187 – 188.

197 Yankee bonds refer to any security issued in the US by a foreign borrower with interest being paid free of withholding tax. Bonds are registered with minimum maturities of three to thirty years in issue sizes of up to US Dollars 100 million to 200 million. Longer issues may be called by the issuer after ten years. All US issued bonds have to be registered with the SEC and rated. The market was inactive between 1964 and 1974, with the Interest Equalisation Tax which had been introduced to limit foreign benefited US market activity. Funds could also be raised through a US private placement which avoids SEC registration and rating, although US investors will be restricted in the amount of non-US debt they can hold. [A Kangaroo bond refers to an Australian Dollar denominated bond in the US domestic market.] Sarwal (n 62) 188 – 190.

198 A Samurai bond is a Japanese domestic instrument issued by a foreign borrower denominated in Yen. Samurai bonds can either be issued in a registered or bearer form (with free conversion) and are issued without withholding tax. Maturities are between 5, 7, 8, 10, 12 and 15 years. New issues have to be notified to the Ministry of Finance (MoF). Bonds are listed, although secondary trading is OTC. The first Samurai instrument was issued by the Asian Development Bank (ADB) in 1970. A "Shibosai" bond is a privately placed foreign bond which is not publicly issued on the private market. This can only be offered up to forty-nine investors and may not subsequently be transferred for two years after issuance. A "Shogun" or "Geisha" bond is a non-Yen denominated issue by an overseas resident on the Japanese market. These are distinct from the "EuroYen" bond which is a Yen denominated bond issued in another overseas market. "Dainyo" bonds were introduced in 1987 which is a specialist type of foreign bond to be used by supra-nationals and listed outside Japan. The first "Dainyo" (Lord) bond was issued by Daiwa Bank for the World Bank in 1987. Sarwal (n 62) 190 – 192.

199 A Bulldog is a Sterling denominated bond issued by a foreign borrower in the UK. Bulldog bonds are either registered or bearer, with maturities from between five and forty years subject to optional pre-payment after twenty years. Issues are either by "offer for sale" following a public announcement, or "vendor placing" or private placement. Bulldog bonds fall within the 3 million Sterling notification requirement imposed by the Bank of England on its management of domestic bond issues. The first sovereign state to borrow was Denmark with the market peaking at 1.1 billion pounds Sterling in 1984 but falling to zero by 1987. Sarwal (n 62) 192 – 194.

200 The bonds can be redeemed for cash through the exercise of the put option without the need to convert into equity.

201 Preferred stock in a parent company held by a trust with matching interest and dividend payments and with redemption being through sale of the preferred stock or conversion to common stock. This is not available outside of the US. Sarwal (n 62) 185 – 186.

202 US note repayable through shares or proceeds from the sale of shares in the borrowing or associated company.

203 Bonds are exchangeable for shares in a third company held within the borrowing company's investment portfolio. Again only available in the US.

204 Interest rates rise over maturity in accordance with a pre-set schedule.