EUROBOND OPPORTUNITIES FOR APAC ISSUERS

Reaching a New Investor Base via the ICSD Model

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Reaching a New Investor Base via the *ICSD Model*

The international bond market, commonly known as the Eurobond market, encompasses a diversified range of fixed income debt securities products, ranging from short-term to extremely long-term (or even perpetual) debt, and from plain vanilla bonds to structured instruments.

At the end of the second quarter of 2020, Clearstream/Euroclear figures show that the market hosted €10.7 trillion in outstanding issuance from thousands of financial and nonfinancial companies, with bonds in scores of currencies (although issuance in dollars, euros, yen, and sterling predominates).

"Despite their name, Eurobonds can be issued in any currency, including the issuer's home currency, and do not have to be issued and/or placed in Europe," says Rosa Scappatura, Head of ICSDs Relationships at BNY Mellon Corporate Trust. "Instead, the common features of these products are that they are issued internationally (typically outside the market where the borrower resides) and through the International Central Securities Depositories (ICSDs) (Clearstream and Euroclear)." The Eurobond name is a legacy of the first issuances in the 1960s denominated in U.S. dollars and placed with European investors. From the start of the market, and especially today, the market has always been global in nature.

Asia-Pacific borrowers have accessed the Eurobond market for decades, but issuance has grown strongly in the past decade. In 2019, Asia-Pacific achieved an issuance volume equivalent to €1.78 trillion, a 6% year-on-year increase on the previous record year of 2018, and the fourth consecutive year that a new record had been set.[1] Despite this growth, there is a widespread view that structural changes in APAC's economy are likely to spur further international issuance in the years to come.

> *The increasing role of Asia-Pacific, and in particular China, in the global economy means that international investors' allocations to bonds from the region are growing as they add exposure.*

Kenneth Cheong
Head of Corporate Trust and APAC Business Development at BNY Mellon

[1] www.dealogic.com/insight/dcm-highlights-full-year-2019/

"The emergence of China as a global economic superpower and the increasing importance of other APAC countries is resulting in a growing number of companies from the region expanding regionally and globally," says Jonathan Brierley, Strategy & Business Development, International Eurobond Market, at Clearstream. "Many of these companies are longstanding borrowers in their domestic bond markets but are now looking for new sources of finance."

"Borrowers that have been primarily focused on issuing in their home markets increasingly find that those markets are saturated," says Dan Kuhnel, Head of International (Primary) Debt Capital Markets at Euroclear. "They are fighting for investor attention as more entities issue bonds. Therefore, in order to meet their funding and investment targets, many are considering global bond markets for the first time in a bid to diversify their investor base and access new sources of finance that are potentially larger and more varied."

The steady growth of international investor appetite for APAC credit is an important element in the appeal of the Eurobond market for borrowers from the region. "The increasing role of Asia-Pacific, and in particular China, in the global economy means that international investors' allocations to bonds from the region are growing as they add exposure," says Kenneth Cheong, Head of Corporate Trust and APAC Business Development at BNY Mellon. One recent survey of global institutional investors with exposure to Asia's bond market showed that 96.6% are planning to increase their exposure to the Asian credit market over the coming year.[2] "These investors are accustomed to international best practices and operational standards. Therefore, Eurobond issuance, given its settlement and clearance via ICSDs, provides an additional level of comfort to investors that is ultimately beneficial for issuers."

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[2] www.gbm.hsbc.com/-/media/gbm/insights/attachments/asia-bond-investor-survey-round-8-infographic.pdf

Attractions of the *Eurobond Market*

The key advantages of the Eurobond market compared to domestic bond markets for issuers are scale, flexibility, and reach. The market offers specific benefits including:

MULTICURRENCY SOLUTIONS

Eurobonds can be issued in up to 100 currencies, and issuance can occur in one of two ways. The first is full settlement, meaning that a security is issued, settled, and has income and redemption payments made in that currency. Alternatively, bonds can be issued in a number of additional (emerging market and frontier market) currencies available for denomination purposes only, but with settlement against payment, income, and redemption payments made in a full settlement currency.

A WIDE RANGE OF DEBT INSTRUMENTS

Options include structured debt, sustainability bonds (including green, social and, most recently, COVID-19 bonds), Islamic finance (sukuk), convertible bonds, covered bonds, a variety of tenors that stretch from short-term commercial paper to perpetual bonds, and the ability to issue in a range of jurisdictions. No domestic markets offer comparable flexibility. The breadth of the Eurobond market enables issuers to target their issue to varying types of investors, enhancing their appeal and increasing their ability to raise funds in size, and at an attractive cost.

ACCESS TO A GLOBAL INVESTOR BASE

Eurobonds have the potential to reach thousands of investors located in more than 90 countries, including major investor centres in the U.S., Europe, and Asia-Pacific. Combined with the flexibility to issue multiple types of debt from a single programme (and in a single transaction), this depth of demand means that the market can support regular multibillion-dollar deal sizes. In April 2019, Saudi Aramco raised $12 billion with its first international bond issue after receiving more than $100 billion in orders.[3] The Eurobond market's large global investor base enables more than 6,000 issuers located in 150 countries to issue more than 300,000 instruments a year.[4]

THE ABILITY TO RAISE AN ISSUER'S INTERNATIONAL PROFILE

Issuance enables companies to raise their profile internationally, which may be a strategic corporate objective. For a company that is expanding to new markets, it can be valuable to improve their investor recognition in a target country in advance of an operational expansion. It also lays the groundwork for potentially gaining access to funds in a different currency for future M&A activity.

A SHORT AND SAFE CUSTODY CHAIN

"Every Eurobond has a qualified paying agent," says Scappatura at BNY Mellon. "In addition, there is a third-party safekeeping network, with institutions appointed by the ICSDs having to pass a number of due diligence measures to qualify as safekeeping entities. Furthermore, the ICSDs act as a trusted, resilient market infrastructure, instilling confidence in relation to the provision of notary and settlement services to the market as a whole. By providing investors with comfort, these measures benefit issuers' ability to raise funds."

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[3] www.reuters.com/article/us-aramco-bond-demand/aramco-sells-12-billion-bonds-out-of-record-100-billion-demand-idUSKCN1RL0NF

[4] Clearstream

The Role of ICSDs in the *Eurobond Market*

All Eurobonds are issued through, and deposited with, ICSDs; indeed, both Clearstream and Euroclear were specifically established to clear and settle Eurobonds. ICSDs offer three sets of services to Eurobond issuers.

SETTLEMENT SERVICES

ICSDs support primary and secondary market activity, for both OTC and trading venues' flows (cleared and non-cleared) via connections to the main central counterparty clearing houses, stock exchanges, and trading venues. Closing and issuance mechanisms include syndicated (delivery versus payment), which is usually for larger transactions with multiple managers; non-syndicated (delivery versus payment), where a payment agent distributes proceeds to the issuer, which is usually for smaller transactions with a single manager; and non-syndicated (free of payment), where a lead manager pays proceeds directly to the issuer (usually for smaller transactions with a single manager). ICSDs have dedicated teams that monitor accounts and coordinate settlement distribution to ensure a high level of settlement efficiency.

ASSET SERVICING

Across the life cycle of a security, from new issue distribution to redemption.

ASSET OPTIMISATION

For example, by lending issuers' securities to third parties. ICSDs also provide a range of cash and liquidity services to optimise the efficiency of clients' settlement and custody activity, and ease issuance and secondary market activity.

ICSDs liaise with clients' supporting banks in multiple ways, including eligibility and documentation review (which includes advice on structure and support for the international model) and how to make transactions attractive from an asset servicing and marketing perspective. There are no ICSD costs associated with the issuance process. The ISIN, review of documentation, and consultation with the issuer's legal counsel to refine documentation, are free of charge.

Dispelling *Eurobond Myths*

Given that many APAC corporates focus on their domestic bond market, they may have limited knowledge of the processes associated with Eurobond issuance. Some prospective borrowers may therefore have concerns about changing their practices and creating potential operational risk; no borrower wants to come to market and have the primary distribution of their new issue fail. Certainly, ICSD issuance is fundamentally different from domestic CSD issuance. However, over three decades Eurobonds have proven their worth to international borrowers, both in terms of fundraising and the certainties of the processes around issuance.

The Eurobond market has some specificities that potential issuers need to understand. "One is that because the Eurobond market is a highly complex and developed market, and involves many legal jurisdictions, a global certificate is held in a common depository, which operates on behalf of both Clearstream and Euroclear," explains BNY Mellon's Scappatura. "The processes associated with global certificates are proven and tested, and the ICSD book-entry system is extremely efficient, with clearly defined roles and responsibilities in the chain. Nevertheless, this is different from many APAC domestic markets, which are dematerialised, with no physical certificates to represent outstanding debt. Instead, bonds are simply a book entry at the CSD." As a result of COVID-19, additional flexibility has been added to the global certificate system to minimise interaction with notes deposited in vaults. Moreover, there is a goal to move to a digital model in the medium term.

More specific to potential APAC issuers is the lingering belief among some that because the Eurobond market originated in Europe (and was subsequently embraced by the U.S.), APAC issuers are somehow disadvantaged. This has not been the case for at least a decade.

Both ICSDs have had an operational presence in the region for many years as part of efforts to increase support for issuers' and investors' activity in APAC. This presence includes 24/7 processing and broad functional coverage, including settlement, credit, treasury, and client services—broadly mirroring the range of services available at their head offices—throughout the Asian day. The ICSDs have also been involved in initiatives to support the internationalisation of China's renminbi.

Other historical challenges that have faced APAC issuers in the past have been largely overcome. For example, Japanese tax handling has been addressed through an International Capital Market Association procedure. And, while there remain some issues relating to the liquidity of some issuance currencies, workarounds—including monitoring processes in the primary market—have been developed to address these. "When you issue through ICSDs, you have certainty that the borrower will receive the funds they expect on that day," says Kuhnel. "There are multiple checks and balances in the lead-up to the closing to ensure that the counterparties are sufficiently funded or have collateral to cover their obligations; the risk of the deal not closing on the intended date is fully mitigated."

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Head of ICSDs Relationships at BNY Mellon Corporate Trust

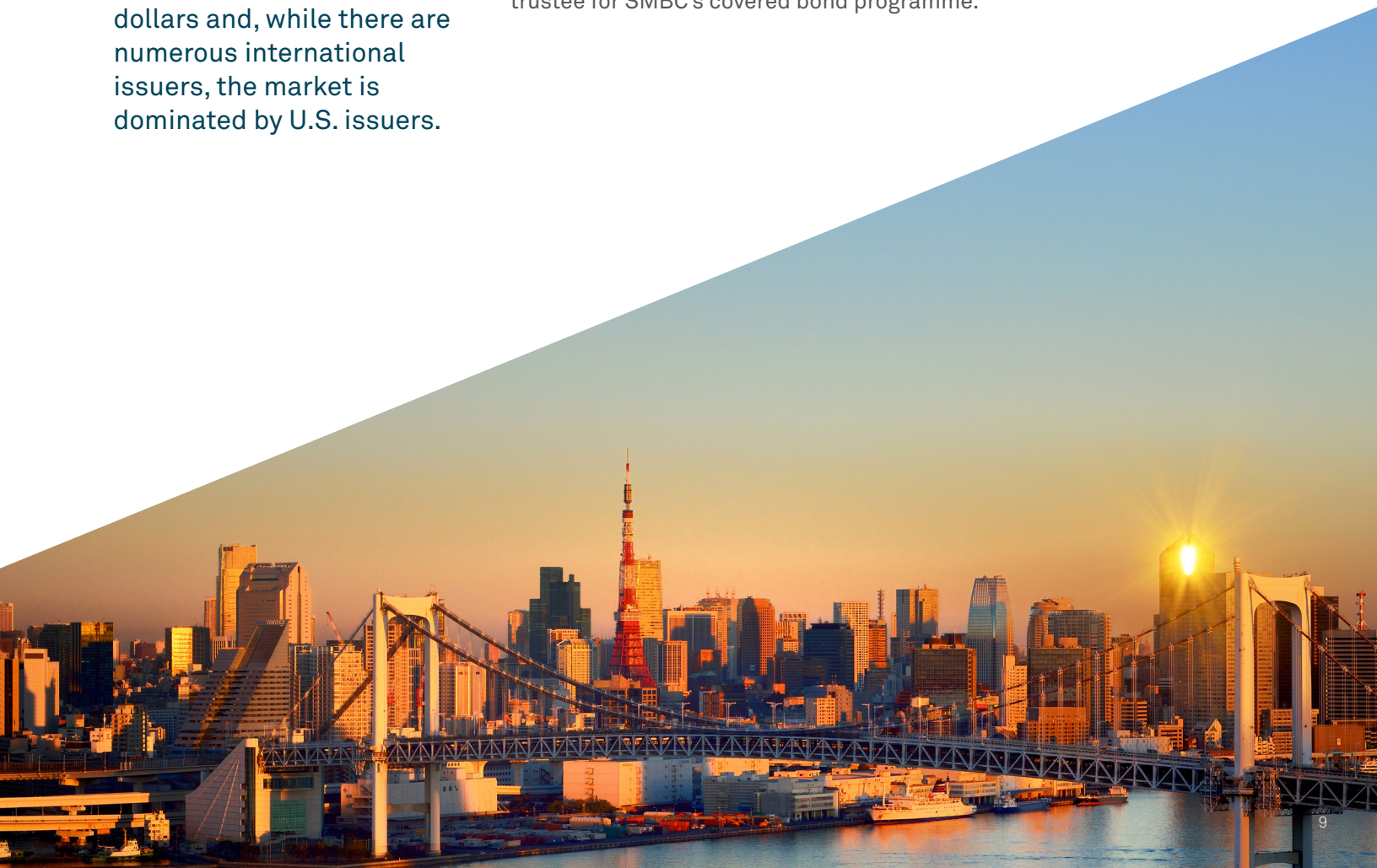
Comparing *Eurobonds and DTC*

For issuers considering the international debt markets, one alternative to Eurobonds is U.S. domestic issuance via the Depository Trust Company (DTC). The U.S. market compares with the Eurobond market in terms of overall scale and the potential size of individual deals. However, it is important to note that issuance is only in U.S. dollars and, while there are numerous international issuers, the market is dominated by U.S. issuers.

Eurobond issuance in no way limits the potential investor base for an issue. "It is a common misconception that U.S. bonds are the best way to reach U.S. dollar investors—the majority of these investors also have ICSD accounts," says Cheong at BNY Mellon. "Indeed, many large investors choose to hold their DTC bond positions via the link with an ICSD."

Eurobond issuance has a number of advantages over U.S. domestic bond issuance. In the DTC, cash and securities settlement occur as separate processes, whereas in the ICSD model there is full delivery versus payment settlement with both cash and securities settling—and achieving finality—within a single system and directly into the relevant accounts. In addition, ICSDs have long operating hours for Eurobond trading, helping to improve liquidity.

"The sizes and structures that can be achieved in both markets are broadly comparable. Sumitomo Mitsui Banking Corporation's €20 billion covered bond programme, launched with an inaugural issue in October 2018, indicates what is possible in the Eurobond market," says Cheong. SMBC was the first Japanese issuer to use the covered bond market (which is a means of refinancing property mortgages using bonds collateralised against a pool of assets that remain on the balance sheet of the issuer). Among other roles, BNY Mellon is paying agent and bond trustee for SMBC's covered bond programme.



It is possible for issuers to structure mixed funding programmes that include a combination of DTC and Eurobond issuance via ICSDs. However, both Reg. S and 144A U.S. bonds can be issued through the ICSDs, which offer a more efficient transfer process, with conversions between ICSD issued/safekept Reg. S and 144A securities. Mixed structures can also include domestic issuance via selected CSDs. However, such arrangements increase complexity (and potential costs) without significantly increasing investor reach. For example, issuers might be attracted to the idea of continuing to issue in domestic markets in order to access local currency. However, this is possible using Eurobonds (although seldom utilised, as local currency issuance can limit the attractions of an issue to international investors and therefore the diversification benefits to the issuer. Consequently, while issuers may need funds in their home currency, they often raise money in international currencies—dollars, yen, euros, and sterling—and then swap it back to their home currency).

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What Support Do ***Eurobond Issuers Require?***

With a presence and local language capabilities in Australia, Hong Kong, Singapore, South Korea, and Japan, BNY Mellon's Client Service professionals can help APAC corporates with issuance and support for their Eurobonds through the ICSD model; each client has their own dedicated Client Service Manager.

BNY Mellon has proven cross-border capabilities, in-market expertise, multi-jurisdictional knowledge, and strong relationships with market participants that facilitate full service, from security admission to settlement. "The bank's expertise and experience have enabled it to become the number-one international payment agent by volume, with around a quarter of the outstanding market," explains Cheong. "Our scale offers comfort to clients that we have the robust setup necessary to accommodate issuers' needs when utilising ICSDs for their Eurobond issuance."

Scappatura adds, "Our long experience means that we are familiar with the many debt structures possible in international debt issuance, and our strong relationships with ICSDs—we have dedicated professionals that interact with them—make it straightforward to discuss opportunities to innovate new structures, giving issuers the flexibility they need to meet their funding and investment targets."

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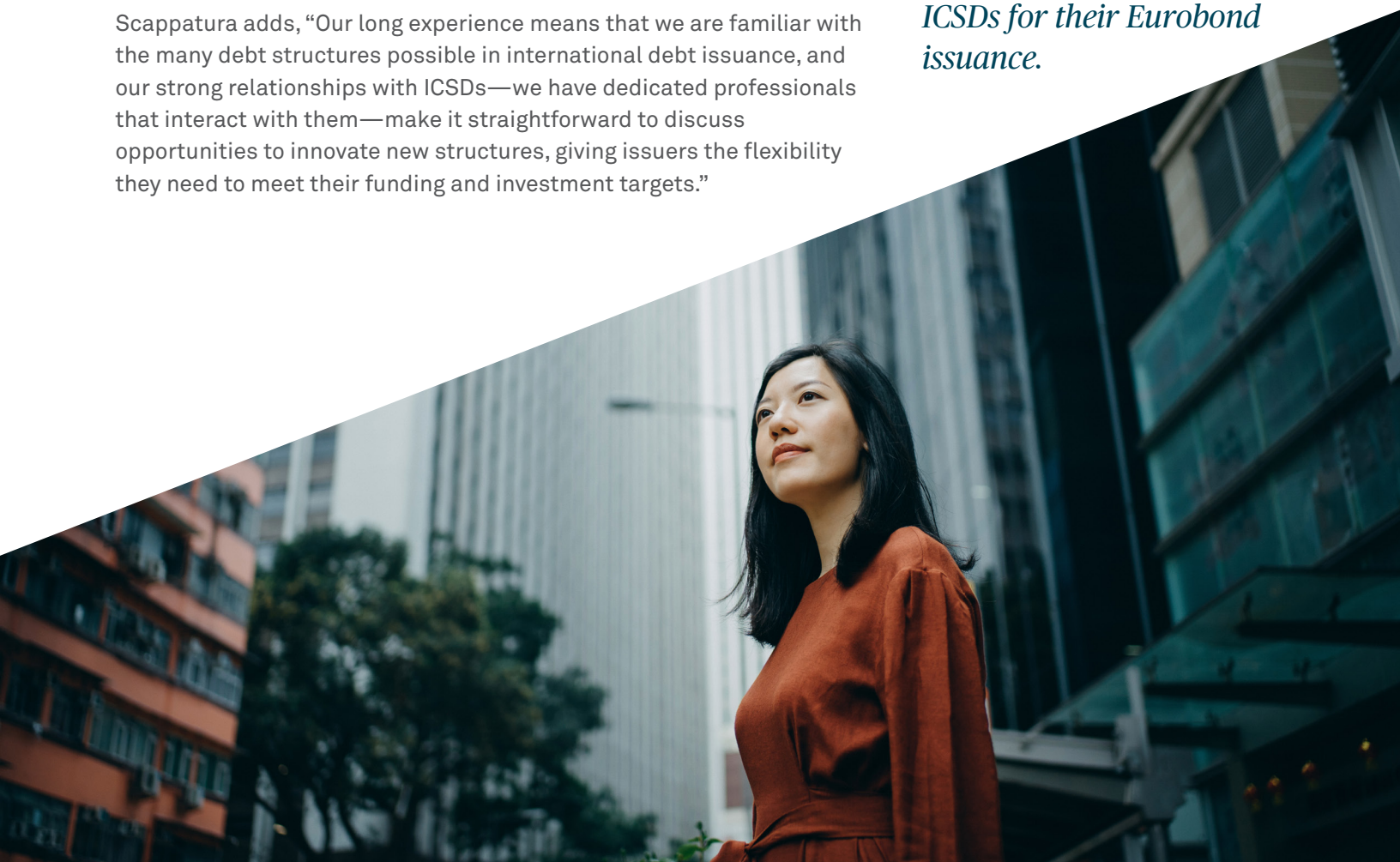

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