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The Investment Association Guidelines for New Issue Transactions in Fixed Income

The UK bond market is a cornerstone of the UK economy. It is an important source of capital that allows lenders to invest at their required rate of return and borrowers, including the Government, to obtain funds in relatively liquid markets. In addition, it is important in determining the price of other assets and bank interest rates that usually follow market-determined interest rates on bonds. Therefore, it is in the interests of all market participants to develop and maintain practices which promote the efficient function of the market and hence support the broader economy.

The Investment Association's members, as investors in fixed income instruments, are keen to ensure that the UK bond market serves both the interests of both issuers and investors. However, they have been concerned about some of the market practices for new fixed income transactions, in particular, the sell-side's approach to pre-sounding, book-building and allocation in non-EMTN issuance. With this in mind, The Investment Association approached the International Capital Markets Association (ICMA) to discuss how to develop and promote best practice both within buy-side and sell-side firms.

The ICMA Primary Market Handbook contains 'Recommendations' that are the primary means of promoting good practice amongst Eurobond Syndicates (including those in the UK market) on a number of issues including:

- Investor meetings;
- Pre-sounding;
- Initial price thoughts;
- Allocation priorities of issuers;
- Bookbuilding duration;
- Documentation availability to investors
- Book disclosure; and
- Distribution disclosure.

In addition, it contains Appendix 12: Pre-sounding, Bookbuilding and Allocations that seeks to provide the sell-side with practical information on these processes and to serve as a reference point for bookrunners when explain their working practices to issuers and investors. (See Appendix)

Following a review of these documents, The Investment Association has decided to endorse publicly these Recommendations and the practices set out in the Explanatory Note. The Investment Association believes that these documents set out the minimum standard sell-side firms should adhere to when interacting with the buy-side in fixed income transactions.

Below we set out key investor expectations that supplement those set out in the ICMA Primary Markets Handbook. They also include some recommendations for buy-side firms.

Investor Meetings

- Investors encourage early engagement. The appropriate timeframe for each engagement should take into account how well known the Issuer is and the complexity of the transaction.

Pre-sounding

Buy-Side Firms

- In line with the recommendations of the Stewardship Code, buy-side firms should set out clearly, on their websites or in their stewardship statements, who should be contacted at first instance by sell-side firms.

Sell-Side Firms

- Sell-side firms should:
  - develop a uniform template for initial wall-crossing, this should include a requirement for sell-side to begin a pre-sounding call by clearly stating the purpose of the call and seeking investors' agreement to be wall crossed prior to proceeding with the call.
  - only contact a potential investor once they are able to provide all the relevant details required to enable investors to make their own analysis to whether to accept being wall-crossed.
  - develop a standard confidentiality agreement template.
  - refer to the buy-side firm's website or stewardship statement to ensure they contact the nominated individual at first instance.

Cleansing and notification

- Sell-side firms should develop a template that sets out the cleansing and notification procedures when a deal is announced or abandoned.
- Where a sell-side representative seeks an extension on the cleansing date, there should be some guidance the length of the extension being sought.

Prospectuses

- Sell-side firms should ensure that there is early publication and timely distribution of all the relevant information and documentation, including prospectuses.
- The practice of having a red herring issued in advance of opening the order book, as is the case in high yield deals, should be adopted more widely in investment grade issuance.

Order book

- Sell side firms should develop a uniform process for solicitation and submission of IOI including clarity on the purpose of an IOI and how this will impact the allocation process.
- Syndicate banks are encouraged to allow the electronic transmission of:
  - orders for new issues from the buy side to one lead manager or directly to the syndicate book, and
  - allocations back to buy-side firms once the order book has been closed, so as to minimise the risks associated with manual order procedures.

- Sell side firms provide investors with the exact time that the order book will be open. This information should be made available through a medium that is readily accessible to investors.
- The order book should:
  - be open only after the roadshows (if any) have been completed. Before then investors should only be able to put in indications of interest ("IOIs").
  - be kept open for a minimum of 60 minutes following the publication of the red herring and the investor call (if there is no roadshow), with a 15 minute warning before books close, to allow investors to review the transaction properly and place their orders.
- There should be no price talk changes in the last 15 minutes before books close.
- During the bookbuilding process, sell side firms should not disclose any information on the size of the order book until the books close.

Distribution Disclosure

- Sell side firms should provide deal statistics to investors within 48 hours of pricing. This will help investors understand their allocation.
- At a minimum syndicate desks should disclose:
  - the coverage of the order book;
  - the strike price; and
  - distribution broken down by investor type and geographic location and average allocation.
- This information should be provided for all new fixed income transactions via sales desks and commercial information providers.

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Appendix 1: Extract of the ICMA Primary Markets Handbook

Investor meetings

R3.6 Any dissemination of the scheduling of investor meetings that might result in subsequent issuance should occur on a public basis, whether or not required under applicable law or regulation. See further A12.

Pre-sounding

R3.7 Prior to any pre-sounding, there should be a discussion, among the managers intending to participate in it, as to:

a) what information is proposed to be disclosed in the course of such pre-sounding;

b) whether such information is to be treated as 'inside information' under applicable market abuse rules; and

c) what procedures will be applied in managing the disclosure of such information (including as to any wallcrossing and potential subsequent 'cleansing' of 'stale' information) to ensure compliance with such rules.

Extract of ICMA Primary Market Handbook glossary

pre-sounding: discussions prior to any public announcement of a primary offer with selected third parties to gauge market appetite for a potential transaction

Initial price thoughts

R5.1 For a pot deal, any dissemination of tentative pricing information between the announcement of a transaction and the opening of orderbooks (and related issuance of formal price guidance) should:

a) be referred to as "initial price talk"; and

b) occur on a public basis (even if not required under applicable law or regulation).

Allocation priorities of issuers

R5.9 Specific issuer allocation interests or priorities (or related broad guidelines), if any, should be obtained at the earliest opportunity, and at least prior to draft allocations being presented to the issuer for discussion.

Bookbuilding duration

R5.10 For a pot deal, orderbooks should be kept open for a minimum of 60 minutes, unless otherwise agreed with the issuer.

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Documentation availability to investors

R5.11 For debut or infrequent issuers into Europe, the latest version of any offer document should be available upon request to investors at least three days prior to the opening of the orderbook.

R5.12 Notwithstanding the prior publication of any offering materials (notably programme offer documents), direct access to such materials should be arranged, as soon as practicable, for investors placing orders.

Book disclosure

R5.13 For a pot deal, any disclosure of investor demand should:

a) be agreed by the bookrunners in advance of being made; and

b) occur on a public basis even if not required under applicable law or regulation.

Distribution disclosure

R6.3 Any disclosure of distribution should:

a) be agreed by the bookrunners in advance of being made; and

b) occur on a public basis, even if not required under applicable law or regulation.

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Appendix 12 - Pre-sounding, bookbuilding and allocations

Introduction

1. The purpose of this note is to provide some practical information on investor meeting, pre-sounding, bookbuilding and allocation processes (and related disclosure), as often used in the prevalent 'pot' context of the European cross-border syndicated institutional primary debt markets today. Market practice in this area is continually evolving and individual transactions are structured according to their specific circumstances, so this memorandum is not intended to prescribe or endorse particular structures or practices. Rather it is intended to be both a document designed to enhance transparency for, and serve as a helpful point of reference to bookrunners when explaining their working practices to, colleagues, issuers and investors. Some markets (notably in the US) may operate in ways different to those outlined here. *September 2015*

2. Bookrunners of new bond issues seek to ensure transactions are executed as smoothly and as efficiently as possible, whilst meeting the issuer's size, pricing and distribution objectives (if any) and taking into account possible secondary market performance and an investor base willing to participate in this and subsequent transactions. Each bookrunner has internal procedures relating to the pre-sounding, bookbuilding and allocation process. These are applied to individual transactions, but may be tailored where appropriate to accommodate any issuer requirements, other bookrunner procedures and any specificities of the market segment concerned. In this respect, discussions with the issuer and between the individual bookrunners begin at an early stage and continue throughout the transaction. *September 2015*

Investor meetings

3. Many issuers, particularly in volatile times, focus on ensuring investor familiarity with their businesses in order to maximise their ability to take advantage of short and unpredictable issuance windows. This may include holding a series of meetings with investors that, unlike transaction-specific or 'deal' roadshows, are not intended to market a specific immediate transaction (though one might follow if particularly encouraged by investor feedback). Whilst issuers should not communicate material non-public or inside information concerning their businesses in such meetings (focusing rather on outlining published financials, issuance programme prospectus, etc), notice of such meetings is generally publicly disseminated at the time participants are invited (including pursuant to ICMA Recommendation R3.6). This helps address any participant concerns that knowledge of the mere scheduling alone of such meetings might subsequently be characterised as constituting material non-public or inside information of forthcoming issuance under the EU's Market Abuse Directive or similar regulatory regimes. *September 2015*

Pre-sounding

4. In certain market conditions (for example where there is high volatility and uncertainty and the issuer and the bookrunners are looking for confirmation of pricing rationale), seeking initial feedback from a small number of investors, representative of the issuer's targeted investor base, may help the bookrunners in assessing the depth of demand and formulating appropriate initial price guidance, and so help guide the terms of the transaction ahead of a public announcement. In some cases, sufficient feedback may be obtained through disclosing general information not amounting to material non-public or inside information. In other cases, this may be insufficient and more specific information, potentially amounting to material non-public or inside information, might need to be disclosed. In such cases, the bookrunners carrying out the sounding will initially seek the consent of the investors they wish to approach by indicating that they wish to sound them for a potential transaction on *September 2015*

the basis of information that may amount to material non-public or inside information and that the investors could, as a result, be subject to restrictions under laws and regulations applicable to the possession of such information (including restrictions on trading in related securities) – i.e. indicating that the investor is to be 'wallcrossed'. This may be understandably problematic for some of the investors concerned. Incidentally, records are generally required by law to be kept (e.g. of the persons who have been pre-sounded, of the time of the pre-sounding and of the information disclosed), and insider lists are to be updated. Such requirements are generally also incorporated into applicable compliance policies.

5. The interpretation of what constitutes inside information may differ. ICMA issued ICMA Recommendation R3.7 so that bookrunners may confer, and hopefully agree, a uniform approach in the context of individual transactions (both as to whether information may be inside and as to the specific wallcrossing format). The views of the bookrunners however do not constitute legal advice and so cannot and should not be relied upon by the investors, who would need to consult their own compliance functions as to the potential status of the information and the potential scope of the restrictions (including their duration). *September 2015*

6. The practice of wallcrossing is naturally limited by investors' ability and willingness (if they consider the related advantages worthwhile)[1] to be approached in this way and to provide meaningful feedback. Some financial institutions may sound 'hypothetical' transactions for which no issuer mandate has been contemplated (and where by definition no inside information can arise) so as to build up a continuous stream of information for use if needed. Investors may also make 'reverse enquiries' – proactively contacting financial institutions to indicate interest in certain similarly hypothetical transactions. *September 2015*

Intermediate price discovery – "initial price talk"

7. Even following public announcements of transactions, issuers and bookrunners may at times have insufficient certainty as to likely pricing to be able to formally issue price guidance and open orderbooks (bearing in mind that investors expect price guidance, in very limited number of iterations, to be only tightened towards final pricing). If required by market conditions and absent sufficient prior investor feedback, bookrunners may implement an intermediate price discovery step following public announcement of the transaction. This involves public dissemination (recognised by ICMA Recommendation R5.1) of more tentative price indications, on which bookrunners then actively seek feedback. Such indications need to be clearly distinguished from formal price guidance (see further below) – this is because, unlike formal price guidance, they may involve several successive iterations that may widen as well as tighten. The designation generally used (and also recognised by ICMA Recommendation R5.1) is "initial price talk", though designations like "price discovery", "initial price thoughts" and "price level under discussion" are also sometimes used. *September 2015*

Bookbuilding – duration

8. Generally, transactions for frequent issuers (with an established credit curve and documentation) move on an abbreviated timeline (and are less likely to involve roadshows or preliminary offer documents) compared to transactions for inaugural and infrequent issuers. *September 2015*

[1] Any comfort as to an issuer making, if needed, a public 'cleansing' statement to at least limit the duration of any potential investor restrictions could be a relevant consideration in this respect.

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9. In certain market conditions, with substantially more investor demand than supply, submission of investor orders can potentially exceed the proposed new issue size many times over in a very short timeframe, with orders for billions of euros or dollars submitted in just a few minutes in some extreme cases. Aside the general show of market confidence, the additional orders may not bring issuers any material advantage (with even a small amount of oversubscription being sufficient for any desired increase of the initial anticipated size). Aside from further reducing individual allocations, this level of oversubscription can delay the allocation process (extending the parties' uncertainty and potential exposure to market risk). A swift closing of the orderbook helps address this, but may leave some investors aggrieved at not having had sufficient time to place orders reflecting their full demand. Issuers may even face a situation where interest expressed during roadshows alone exceeds the proposed new issue size. These challenges have tended to occur in the context of non-financial corporate issuance rather than in the context of issues by sovereigns, supranational institutions, international agencies or financial institutions. *September 2015*

10. Timing may present a challenge for some investors in that they may, for example, need to review their knowledge of the relevant transaction documentation, obtain credit approvals or to consult colleagues internally to consolidate interest stemming from several sub-funds (potentially across several time zones). There will also be different reaction speeds amongst a broad range of investors. In terms of documentation, frequent issuers (the majority of the market) usually issue off programmes, whilst inaugural or infrequent issuers usually come to market with preliminary offer documents – in both cases published in advance of opening of the orderbooks. For investor convenience however (and pursuant to ICMA Recommendation R5.12), bookrunners generally attach, or include links to, the relevant documentation to or in transaction announcements (or make it available through their orderbook management system). Regular participation in an issuer's roadshows and other investor-facing communication efforts should also assist in investors being kept up to date, in advance of the new transactions, on developments regarding that issuer and so in being ready to participate. In this respect, the few investors participating in any transaction pre-sounding may not be better placed to submit orders on a timely basis. *September 2015*

11. In order to address the above, and with investors currently seeming to favour the ability to place orders over the potential for delayed and reduced allocations, many bookrunners are generally keeping orderbooks open, unless otherwise agreed by the issuer, for a minimum period of 60 minutes from the formal announcement of the transaction. This is reflected in ICMA Recommendation R5.10. *September 2015*

Bookbuilding – price guidance

12. Some form of pricing information is required for investors to be able to decide what, if any, orders to place. Generally, bookrunners will open orderbooks after issuing initial price guidance. Even with prior feedback from a pre-sounding process, the guidance may need to be amended to reflect market conditions and response, with one or more iterations needed to identify the optimum pricing point. Essential to keeping this process efficient and to minimising the number of iterations (pursuant to investor expectations as noted above), is that investors give clear commentary as to the extent, and limits, of their demand by reducing or cancelling their orders at specific pricing levels and/or deal sizes they consider will be unacceptable. Distinctly, issuers faced with 'inflated' orderbooks (see further below) risk being misled into seeking pricing tighter than the market is able to absorb, which may lead to transactions performing poorly in the post launch market. It is for this reason that bookrunners seek to 'scrub' books ahead of allocation, as described below. *September 2015*

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Allocation

13. Orders on a new issue may exceed the issuer's initially planned size. In some cases, the issuer may decide to increase the issue size, but, notwithstanding this, orders may even exceed any such increase. Issuers generally have very clear objectives for the amount they wish to borrow in advance of any deal announcement. These views are unlikely to be materially changed by the size of an orderbook. The challenge for bookrunners is firstly to reconcile (e.g. identify duplication) and consolidate the various orders (as books are generally built through several participating banks), secondly to establish true demand (as opposed to apparent demand) and thirdly to allocate the transaction in as efficient and fair a way as possible. *September 2015*

14. On the first aspect, efficiencies are being sought through increased automation with bookrunners increasingly connecting their orderbook management systems in a manner enabling unique investor identification. *September 2015*

15. The second aspect is complex. An investor might place an order larger than its true internal demand (order 'inflation') if, for example, it (i) anticipates that its order will be reduced on allocation because of oversubscription, (ii) overestimates demand that it was unable to confirm internally prior to placing its order, or even (iii) anticipates particularly strong demand by other investors and so expects to liquidate part of its allocation in initial secondary trading to crystallise the initial issuance premium ('flipping'). In this respect, it seems that some investors are unable or do not wish to inflate their orders, others appear to do so frequently, and yet others may do so just occasionally according to market conditions. Leaving aside how order inflation might be treated under applicable market abuse regulations, bookrunners may well apply a discount factor to, or even entirely exclude on allocation, orders they view as being potentially inflated (bookrunner views in this respect will inter alia account for previous experience with specific investors). Investor transparency to bookrunners is an important factor in avoiding mischaracterisation in this respect. In particular, investors may find it helpful to explain orders that (i) appear to be out of proportion compared to orders on previous transactions or to apparent assets under management, or (ii) are placed or increased at a relatively late stage during the launch process (and so appear to be based on perceived levels of demand rather than on transaction fundamentals). This later aspect is further complicated in that delayed demand may be due, as mentioned above, to investors legitimately needing to confer internally with colleagues managing sub-funds. *September 2015*

16. The third aspect is less complex, though 'scrubbed' final orderbooks are, despite the bookrunners efforts, not certain to be entirely inflation free. Aside any preference being given to specifically targeted investor groups (for example where an issuer is seeking to diversify its investor base), some preference may be given to long-term investors that (i) have shown interest in the transaction, for example through actively participating in roadshows, investor update calls, etc., and/or (ii) have a history of investing in the issuer or its sector, and (iii) do not have a history of flipping. Helpful participation in the pre-sounding process may be rewarded by some prioritisation during allocations, though this is limited and seems to be insufficient for many investors to agree to being pre-sounded. A commercial relationship with other parts of bookrunners' firms is not a relevant consideration, being in any case restricted by regulation. Bookrunners frequently discuss their general allocations procedures with individual investors. *September 2015*

17. Bookrunners undertake the above in the interest of their issuer clients. Bookrunners make an allocation proposal to the issuer based on (i) their internal allocation policies developed *September 2015*

in relation to their understanding of generic issuer interests (notably such as those outlined above) and (ii) any specific issuer interests/priorities explicitly communicated by the issuer (including pursuant to ICMA Recommendation R5.9) or otherwise arising from the bookrunners' understanding of the issuer's activities. Issuers may choose simply to rely on the bookrunners' suggestion or to make specific amendments. Such amendments will be given effect – to the extent they are not subject to regulatory restrictions and the bookrunners are otherwise satisfied that the issuer is aware of any related implications. As transactions are executed pursuant to mutual (and ultimately contractual) agreement between issuers and their individual bookrunners, their completion of the transaction necessarily requires them to have reached a consensus on any amendments. A few very sophisticated and frequent issuers may choose to allocate entirely themselves, with bookrunners then providing just a limited book management service.

Orderbook and distribution disclosure

18. Investors should, and generally do, make their investment decisions on the basis of transaction 'fundamentals' (i.e. the issuer's business and the proposed terms of the issue) rather than 'technicals' (e.g. demand from other investors). Some investors may have understandable reasons for wanting to know levels of demand, and so seek disclosure of orderbook status. However, some investors also seek such information in order to magnify their orders where there is substantial oversubscription and so to improve the likelihood of securing individual allocations that, albeit reduced because of the oversubscription, match their true underlying demand (see further above on inflation of orders and principles of allocation). *September 2015*

19. Though individual bookrunners try to manage investor expectations whilst orderbooks are open, ultimately they will collectively agree, in the circumstances of individual transactions, what degree of disclosure is appropriate to be made before publicly disseminating it. This is reflected in ICMA Recommendation R5.13. Any such disclosure is required by law to be clear, fair and not misleading and issuers and bookrunners focus on ensuring any disclosure is representative of investor demand. This may result in a conclusion in individual cases that no information relating to the orderbook should be disclosed before the book closes. Distinctly, bookrunners may also seek (as one mitigant to order inflation) to limit disclosure of book size to just whether transactions are subscribed or not, without stating the scale of any oversubscription. *September 2015*

20. Investors' understanding of transactions ex-post may help moderate disappointments as to lower than expected allocations and, in this respect, many bookrunners are seeking to distribute, where possible, deal statistics to investors via sales desks within 48 hours of pricing. Any such disclosure of distribution, if made, will also be collectively agreed in advance by the bookrunners pursuant to ICMA Recommendation R6.3. *September 2015*

Public dissemination

21. Under the EU's market abuse rules, information ceases to be unpublished price-sensitive information once it has been made public in any way. Issuers are sometimes required to publish information using designated information services, and publishing information via those services can also constitute a 'safe harbour' from allegations of market abuse in relation to that information. Such safe harbour channels tend to be both national- and equity market-focused in scope and so might not be the most efficient or practical means to disseminate transaction-related information for the international bond markets. In the context of new bond issuance, bookrunners generally seek, where they can, to use any information channels that participants in the relevant market segment are reasonably *September 2015*

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expected to have access to. These channels might not necessarily be the above designated information services and/or free of charge. Such channels might also be used when publically disseminating information (e.g. the scheduling of investor meetings, initial price talk and investor demand as referred to in ICMA Recommendations R3.6, R5.1 and R5.13 respectively) that might not necessarily otherwise constitute unpublished price-sensitive information.