Appendix A12

Pre-sounding, bookbuilding and allocations
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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.

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.

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.
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 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).

6. The practice of wallcrossing is naturally limited by investors’ ability and willingness (if they consider the related advantages worthwhile) 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.
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.

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.

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.
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.

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.

**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.
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.

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.

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.
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, by submitting clear indications of interest / orders, 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.

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 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. Issuers may participate in allocation calls, bearing in mind that such calls cannot be delayed without potential transaction detriment and that any proactive issuer participation should involve appropriately knowledgeable and empowered issuer staff to avoid such delays.

18. Following an erroneous allocation, the bonds concerned are, prior to being free to trade, either (as appropriate) re-allocated as part of primary execution (subject to any issuer preference) or applied to the syndicate position. After being free to trade, any buying or selling generally takes place at market prices.
Orderbook and distribution disclosure

19. 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).

20. 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.

21. 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.
Public dissemination

22. 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 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.

Note

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.