European Commission

Identifying market and regulatory obstacles to the development of private placement of debt in the EU

BCG

THE BOSTON CONSULTING GROUP

Linklaters

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Abstract

Private placement of debt can play a key role in the financing of EU businesses. In line with the CMU Action Plan, this study identifies best practices in the well-functioning EU markets of private placements (mainly the German *Schuldschein* and the French Euro-PP) as well as potential barriers to their development. The study shows a considerable growth potential for private placements of debt in the EU as they create specific opportunities to issuers and investors alike. Most notably, private placements allow medium-sized firms to access new funding opportunities and reduce their reliance on bank funding. They allow investors to diversify their investment portfolio to unrated, private firms while earning an attractive return. Further, the risk-profile of private placement instruments is not substantially different from senior unsecured debt. No major regulatory barriers preventing further growth of private placements in the EU have been identified as requiring immediate attention. However, some steps could be taken at European and national level in order to foster the development of private placement markets.

Résumé court

Le placement privé de la dette peut jouer un rôle clé dans le financement des entreprises européennes. En ligne avec le Plan d'Action CMU, cette étude identifie les meilleures pratiques (best practices) dans les marchés de placements privés européens d'ores et déjà existants et les barrières potentielles à leur développement. L'étude montre que les marchés de placements privés ont un potentiel de croissance important, car ils créent des opportunités spécifiques tant pour les émetteurs que pour les investisseurs. Plus particulièrement, les placements privés permettent à des entreprises de taille moyenne de diversifier leur financement et de réduire leur dépendance au financement bancaire. Ils permettent aux investisseurs de diversifier leurs investissements dans des entreprises privés et non notées par une agence de crédit, tout en obtenant un rendement attractif. De plus, le profil de risque des outils de placement privé n'est pas substantiellement différent de celui des dettes senior non garanties. Aucune barrière réglementaire significative empêchant la croissance des placements privés dans l'UE n'a été identifiée comme nécessitant une attention immédiate. Certaines mesures pourraient néanmoins être menées tant au niveau national qu'européen pour soutenir le développement des marchés de placements privés au sein de l'UE.

Zusammenfassung

Die Privatplatzierung von Schuldinstrumenten kann bei der Finanzierung von Unternehmen in Europa eine Schlüsselrolle spielen. Im Rahmen des Aktionsplans zur Schaffung einer Kapitalmarktunion (CMU Action Plan) stellt diese Studie die besten Praktiken von gut funktionierenden EU-Märkten für Privatplatzierungen (der deutsche *Schuldschein* und der französische *Euro-PP*) sowie die Rahmenbedingungen für die weitere Entwicklung der Märkte für Privatplatzierungen dar. Die Studie identifiziert Wachstumspotenziale für Privatplatzierungen von Verbindlichkeiten in der EU, die den Optionenraum für Finanzierungen bzw. Investitionen sowohl für Emittenten als auch für Investoren erweitern. Vor allem ermöglichen Privatplatzierungen es mittelgroßen Unternehmen, auf neue Finanzierungsinstrumente zuzugreifen und weniger von einer Finanzierung durch Banken abhängig zu sein. Investoren bieten Privatplatzierungen die Möglichkeit, ihr Investmentportfolio mit Schuldtiteln von nicht börsennotierten Unternehmen zu diversifizieren und dabei eine attraktive Rendite zu erzielen. Derzeit unterscheidet sich das Risikoprofil der untersuchten Privatplatzierungsinstrumente nicht wesentlich von nicht besicherten erstrangigen Verbindlichkeiten. Es wurden keine wesentlichen regulatorischen Hürden festgestellt, die weiteres Wachstum von Privatplatzierungen in der EU verhindern und sofortiges Handeln erfordern würden. Dennoch sollten auf europäischer und nationaler Ebene Maßnahmen ergriffen werden, um die Entwicklung von Privatplatzierungsmärkten zu fördern.

Background and objective

One of the key priorities of the European Commission is to build and foster a stable and viable European economic area in order to ensure the wealth of its citizens. This includes promoting growth and job creation, but also responding to emerging financial risks. One of the key initiatives to support these goals is to build a **true single capital market** for all 28 European Member States.

In February 2015, the Commission launched the Action Plan on Building a Capital Markets Union (CMU Action Plan), as an umbrella for the several steps that need to be taken to deliver a unified capital market.[1] The priorities it identified will help to mobilise capital in Europe and channel it to all companies, including small and medium-sized enterprises. In addition, unified capital markets will deepen financial integration, increase the stability of the financial system and enhance European competitiveness. Specifically, the Action Plan's priorities are:

- Providing more funding choices for Europe's businesses and SMEs;
- Ensuring an appropriate regulatory framework for long-term and sustainable investment and financing of Europe's infrastructure;
- Increasing investment choices for retail and institutional investors;
- Enhancing the capacity of banks to lend;
- Bringing down cross-border barriers and developing capital markets for all 28 Member States.

As part of the provision of more funding choices for Europe's businesses and SMEs, the Commission highlights the importance of innovative forms of business financing, including private placement of debt for European companies.

In recent years, corporate private placement of debt[2] markets in Europe have experienced steady growth; the German Schuldschein (SSD) market grew to a new record level of €25B in 2016 and the French Euro-PP market – created as recently as 2012 – reached a total issuance volume of approximately €4.5B.[3] Nonetheless, there is still room for improvement. The most established private placement market in the US accounted for a total issuance volume of around €47B in 2016.[4] Furthermore, the development of private placement markets is very heterogeneous across the EU. Issuers of private placements are mainly concentrated in a few Member States and not only issue in the EU markets but also continue to tap the US PP market.

The CMU Action Plan has set two main objectives regarding private placements to overcome challenges and to foster private placement markets across the EU:

- Sharing and promotion of best practices across EU Member States through appropriate initiatives

[1] (European Commission 2015); according to (ECB 2017), also the ECB is a strong supporter of the CMU and its goals

[2] For a definition of private placement of debt in this study, please refer to p.11

[3] Taking into account only corporate private placement issuances; excluding issuances from public (governmental, educational) or financial organisations; (BCG analysis based on Dealogic 2017); (BCG analysis based on LoanConnector 2017)

[4] (BCG analysis based on Thomson One 2017); (BCG analysis based on Dealogic 2017) yields a market volume of around €41B. See *Appendix* (pp.208ff) for more information on data availability.

- Assessment of potential recalibrations of capital charges under Solvency II for insurance companies investing in privately placed debt

To support these objectives, the European Commission contracted The Boston Consulting Group (BCG) and Linklaters LLP (Linklaters) to conduct the present study entitled "*Identifying the regulatory and market obstacles to the development of private placement of debt in the EU*". The objective of this study is to identify best practices for and barriers to the development of private placement markets in order to define measures to further promote and develop these in the EU. More specifically, the study might potentially serve the following functions:[5]

- Increasing awareness of private placement instruments and their advantages for the different market participants (issuers, investors, arrangers) to encourage the use of private placements when appropriate
- Assessing the growth potential of private placement markets in the EU
- Elaborating and sharing best practices to encourage EU Member States to take concrete measures to (further) develop their private placement markets
- Assessing the need for modifications of the calibrations of capital charges under Solvency II for insurance companies investing in privately-placed debt
- Identifying regulatory barriers at EU or at national level that can prevent issuers and investors from accessing the existing and well-functioning private placement markets in the EU.

The study acknowledges that private placement of debt is not uniform. This study uses the International Capital Market Association's (ICMA) definition of 2015, that defines private placement as a "*medium or long-term debt financing transaction between a listed or unlisted company and a limited number of institutional investors, based on deal-specific documentation negotiated between the borrower […] and the investor(s) […] with the participation of one or more bank intermediaries as arranger […] usually acting in an agency capacity*".[6]

This study is comprised of two parts: an economic part and a legal part. The **economic part** (pp.17ff) covers five sections:

i. *Stock-taking of existing and well-functioning private placement markets*: The study focuses on the countries where private placement as a funding tool has been most successful, namely (i) the Schuldschein (SSD) market in Germany and (ii) the Euro-PP market in France. For comparison purposes, the study also analyses (iii) the US PP market in the United States as the most established market for private placements. In this section, the respective market structures are analysed and their functioning and development in recent years are assessed. Successful features and characteristics of these markets are highlighted as best practice.

ii. *Cost-benefit analysis of private placements vs. other financing instruments*: This section explains the benefits of private placements as complementary financing instruments through a qualitative and stylised description. It also highlights advantages and disadvantages of private placements over other financing instruments from the different stakeholders' perspectives. Lastly, it assesses the costs related to the issuance of, and the investment in, private placement instruments.

[5] (FISMA, European Commission 2016)
[6] (International Capital Market Association (ICMA) 2015)

iii. *Assessment of growth potential of private placement markets in Europe*: The study evaluates growth potential of private placement markets in EU Member States where this funding instrument is still underdeveloped. Based on economic assumptions, EU Member States with a larger potential for developing a domestic private placement market or cross-border activities are identified.

iv. *Risk analytics of private placements*: The fourth section assesses the risks of existing private placement transactions, analysing key risk categories for different private placement instruments, i.e., Schuldschein, Euro-PP and US PP, in comparison to other financing instruments, with a focus on corporate bonds.

v. *Mapping of innovation in the private placement sector*: The economic part concludes with a list of innovation use cases in the private placement sector and evaluates these use cases compared to previously identified success factors.

The **legal part** (pp.117ff) includes three sections:

i. Analysis of regulatory best practice in well-functioning private placement markets: This section analyses the legal environment for private placements in the jurisdictions where private placement as a funding tool has been most successful, namely: (i) the Schuldschein market in Germany; (ii) the Euro-PP market in France; and (iii) the US PP market in the United States. In particular, this section describes the legal and regulatory framework applicable to private placements at a national level in such jurisdictions and any soft law measures aimed at facilitating the issuance of privately placed debt in such jurisdictions. It also identifies any areas in which the regulatory framework applicable to private placements in such jurisdictions could be improved.

ii. Identification and analysis of regulatory obstacles to the development of private placement markets across the EU: This section identifies regulatory obstacles to the development of private placement markets across the EU. In particular, it discusses potential impediments on a pan-European level stemming from EU law before examining the specific regulatory frameworks of the EU Member States where the private placement market remains underdeveloped and where economic analysis indicates a potential for growth.

iii. Analysis of most common risk-mitigation clauses in private placement transactions: This section provides an overview of the typical form of documentation in each of the Schuldschein market and the Euro PP market. It then analyses the most common risk mitigation provisions used in Schuldschein and Euro PP documentation to address the key risks associated with an investment in such PP instruments. For comparison purposes, this section also analyses the equivalent risk mitigation provisions in the LMA's private placement documents.

Methodology

For the economic part, three different approaches are pursued. First, for the analysis of existing private placement markets in the EU and the US, the study uses information from commercial databases, including Thomson Reuter's LoanConnector, Thomson One, Dealogic, CMS Bureau Francis Lefebvre and the Private Placement Monitor.

Second, to assess the growth potential for cross-border activities and the development of new domestic markets, information on relevant companies in the respective

national markets are collected from Orbis, Capital IQ and Bloomberg. For each country, the potential issuer base is determined and a scenario is derived.

Third, qualitative data was collected to close gaps in the databases and to obtain insights that are beyond pure numbers. A literature review covers academic and press reports on private placements as well as analyst reports and publications from rating agencies and regulators. Furthermore, BCG and Linklaters jointly conducted over 60 interviews with a wide range of issuers, arrangers, investors and regulators to include their expertise on both existing and potential new markets.

For the legal part, three different approaches are used. First, to identify regulatory best practices in the well-functioning private placement markets, the study focuses on the legal environment for private placements in Germany, France and the United States. In order to identify aspects of the legal and regulatory framework and any soft law measures aimed at facilitating the issuance of privately placed debt in such jurisdictions, the study analyses the applicable legislative and regulatory framework at a national level in such jurisdictions and reviews the relevant legal literature concerning such private placement instruments.

Second, to identify regulatory obstacles to the development of private placement markets across the EU, both at an EU level and at a national level, additional interviews were conducted with regulators to understand their concerns about the current regulatory framework. Local experts were commissioned to provide an overview of any regulatory obstacles at an EU or national level hindering development of either a local national private placement market or cross-border transactions with the more established private placement markets.

Third, a detailed analysis of the typical form of documentation used for each of the established European private placement instruments was undertaken in order to identify the most common risk mitigation provisions used to address the key risks associated with an investment. With respect to the Schuldschein market, which does not have a market "standard form", this entailed an analysis of a substantial selection of Schuldschein documentation and the legislation underpinning such documentation. In respect of the Euro-PP market, this entailed analysis of the standard form Euro-PP documentation and analysis of a substantial selection of Euro-PP deal documentation in respect of the more bespoke provisions (e.g., financial covenants). Finally, the LMA private placement documentation was analysed for comparison purposes.

Economic part

I. Stock-taking

This first part of the study focuses on understanding key existing private placement markets by examining differences in instrument features, structure, stakeholder groups and developments across markets.

The study analyses the French Euro-PP market, the German Schuldschein (SSD) market and the US private placement (US PP) market, acknowledging that private placements are not uniformly defined and some might have a wider definition of private placements. The definition used for the context of this study is based on International Capital Market Association (ICMA) that is defining a private placement (subsequently also abbreviated as PP) as "*medium or long-term debt financing transaction between a listed or unlisted company and a limited number of institutional investors, based on deal-specific documentation negotiated between the borrower […] and the investor(s) […] with the participation of one or more bank intermediaries as arranger […] usually acting in an agency capacity*".[7,8] The common practice of placing corporate bonds of larger corporations to investors in a private transaction is not considered to be a private placement as outlined in the definition above and for the context of this study, but rather perceived as using a 'PP technique' that is used to obtain specific advantages, such as higher level of confidentiality and/or an alleviation of the administrative burden associated with a public offer of financial instruments.

The German SSD and the French Euro-PP are the most well-known and developed private placement markets in Europe. As the markets differ substantially, for example in terms of issuer and investor profile, they can both serve as sources for best practices and potential barriers to the development of further private placement markets.

All private placement instruments in this study involve three major stakeholder groups[9:]

i. The **issuer** (also known as 'borrower') is the stakeholder group which is seeking financing. The focus of this study is on privately placed corporate debt instruments, i.e., focusing on corporate issuers.[10]

ii. The **arranger** acts as the intermediary between issuer and investors. The level of engagement varies between transactions and the different private placement instruments; however, generally, it is the arranger's responsibility to bring the two parties into contact with each other and facilitate the issuance process.

[7] (International Capital Market Association (ICMA) 2015)
[8] It should be noted that the involvement of an arranger is not formally required and therefore sometimes neglected in practice
[9] The regulators of private placement products are a further stakeholder group. See the *Legal part* (pp.113ff) for further details.
[10] Private placement issuances by public institutions (government, education, etc.) and financial institutions are out of scope for this study.

iii. The **investor** is the stakeholder group seeking opportunities to invest its capital. For private placements, there are two main groups of professional investors (as classified under MiFID II): bank investors and institutional investors[11], such as insurance companies, pension funds and asset managers. These two subgroups differ regarding their investor profile, behaviour and investment strategy – although most investors follow a buy-and-hold strategy.

[11] Please note that the legal part uses the term 'institutional investors' including bank investors.

The German Schuldschein market

The German Schuldschein market is a mature and yet growing market, which has been characterised by high-quality investment issuances through mostly investment-grade (or investment-grade-like) issuers and a lean documentation process. Overall, the Schuldschein market functions well and is a suitable source of examples of best practice.

Definition of a Schuldschein

A Schuldschein (or Schuldscheindarlehen, abbreviated SSD) is a privately placed (typically unsecured and unsubordinated) loan agreement governed by German law. Due to its structure it combines characteristics of corporate bonds, bank loans and syndicated facilities.[12] As a loan, a Schuldschein loan does not require a listing or any kind of securities prospectus.[13]

Characteristics of a private placement

Corporate SSDs generally have maturities of less than 10 years. Even though there are also a few corporate SSDs with longer maturities, the majority of investments with maturities above ten years are structured as registered bonds governed by German law, i.e., 'Namensschuldverschreibungen' (NSVs).[14]

Due to the medium-to-long-term nature of the SSD, it is typically used to fund acquisitions or long-term projects as opposed to corporate loans that often act as working capital financing.[15] While originally issued by German issuers and aimed at German investors, the SSD's reach has become increasingly international, with almost 40% of all SSD transactions being done by international issuers in 2016.[16] Most investors follow a buy-and-hold strategy which results in a relatively low liquidity on the secondary market.[17]

A Schuldschein deal often has tens of investors, but in larger deals there might be over a hundred investors involved.[18] Smaller Schuldschein deals with a smaller number of investors, mostly around five to seven, are also referred to as 'club deals' by some market participants.[19]

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[12] (Soffers 2017)
[13] See the *Legal part* (pp.113ff) for the legal aspects of an SSD
[14] As SSDs are issued under the German Civil Code ('BGB'), corporate issuers have a right of cancellation after 10 years, yielding issuances with longer maturities that are less attractive for investors. For a legal definition of Schuldscheindarlehen and Namensschuldverschreibung, please refer to p.111 in the *Legal part*.
[15] (BCG interview with arranger 2017)
[16] (BCG analysis based on LoanConnector 2017)
[17] (International Capital Market Association 2016); (Loan Market Association 2014)
[18] (BCG interview with financial expert 2017)
[19] (BCG interview with arranger 2017). The terminology 'club deal' is also used in different contexts (cf. p.45).

The Schuldschein is a funding instrument that is primarily used by larger mid-sized companies as well as large companies (see Figure 10).[20] While private companies might use the Schuldschein as a first step towards gaining full capital markets access and to assess new investor groups, large companies particularly appreciate its complementary nature to a corporate bond and therefore the option of diversifying their funding.[21]

Target companies	External rating	Listing	Format	Deal size	Typical years to maturity	Typical investor strategy
Revenue ~€150M–€5B	Not required	Unlisted	Loan	Median size €70–120M	3–5 years	Buy-and-hold

Figure 1: Characteristics of SSDs[22]

Development of the SSD market

The Schuldschein market with the current SSD format has been around for several decades. However, it only started to gain critical size in 2007/08. Since then, it has experienced two big growth periods, in 2008/09 and from 2014 until now.

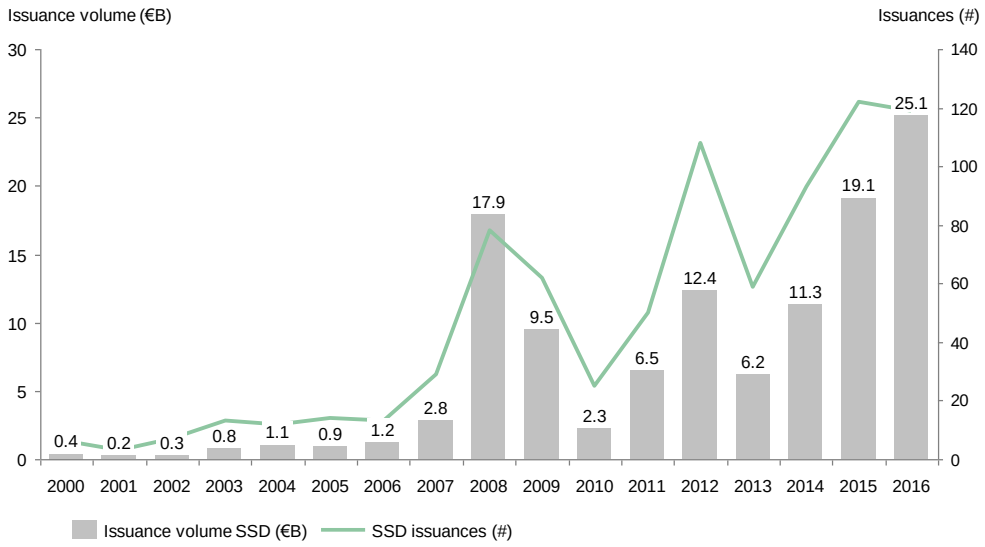

Figure 2: Development of the SSD market in terms of issuance volume and number of deals[23]

When examining the boom in 2008/09, there are two main drivers:

i. During the financial crisis of 2008/09, the Schuldschein had its "moment of truth". It became an important **substitute** debt instrument, as bond markets were volatile and banks in distress.[24] After the crisis, when banks and the bond

[20] (BCG analysis based on LoanConnector 2017)
[21] (BCG interview with arranger 2017); (BCG interview with issuer 2017)
[22] (BCG analysis 2017); (BCG interview with arranger 2017); (BCG interview with investor 2017)
[23] (BCG analysis based on LoanConnector 2017)
[24] (BCG interview with arranger 2017)

market regained financial stability and companies looked to retrench to internal funding sources, the Schuldschein market shrank significantly.

ii. From 2007 until today, the Schuldschein documentation has on average transformed from more complex construction into a more **standardised document** that can be easily adapted for new issuances, even though there is no standardised documentation required for the issuance.[25] Meanwhile, also legal requirements were harmonised and simplified such that external legal support is often not needed. In particular, in 2011/2012 the Loan Market Association developed its guide to Schuldschein loan agreements. More specifically, the documentation "in respect of representations and warranties, covenants (e.g., financial covenants), events of default, events of early redemption and conditions precedent is increasingly mirroring documentation used for syndicated loan agreements".[26] Furthermore, the existing variabilities of tenors were reduced and ultimately also the different types of issues converged to a more standardised one. This increased transparency, which allowed stakeholders to get a better understanding of the instrument and how to issue it as well as scalability.[27]

In 2010, the Schuldschein market fell back to pre-crisis levels[28], mostly due to the recovery of the banking landscape and capital markets. A few years later however, the Schuldschein market experienced a second growth period, culminating in record levels of €25B issuance volume in 2016. This current growth trend is continuing: the first six months of 2017 were the busiest half-year in terms of transactions and issuance volume[29] and in 2017, the market is expected to at least reach the record levels of 2016 with a total of €20-25B.[30]

Four main drivers for this recent boom have been identified:

i. After the financial crisis, the Schuldschein issuances became more frequent and showed a **certain degree of standardisation** of both the issuances (size, economic parameters) and the documentation in practice. Therefore, the instrument was perceived as more transparent than in the period before.[31] Corporates recognised more the SSD's competitive edge of minimal publication requirements and relatively easy legal processes.[32]

[25] (ECB 2017)
[26] (Loan Market Association 2016)
[27] (Whittaker, Roundtable: Schuldschein market strives to stay special as appeal broadens 2015)
[28] (LBBW 2016)
[29] (Scope 2017); (UniCredit 2017); (CAPMARCON 2017); 76 deals recorded with issuance volume €17.1M according to (BCG analysis based on LoanConnector 2017)
[30] (LBBW 2016); (Scope 2017)
[31] (BCG interview with arranger 2017)
[32] (BCG interview with investor 2017)

ii. The Schuldschein shifted from being a pure substitute to traditional debt instruments towards being **complementary**.[33] Issuers started to appreciate the diversification of funding and the minimal publishing requirements. In fact, the majority of interview partners stated that diversification of funding was a very important driver of growth in recent years.[34]

iii. The surge in **liquidity** in recent years has caused banks, the main investor group of the Schuldschein market, to look for new investment opportunities, causing increased interest in SSDs. This investor push was one reason that has caused coupons of the SSDs to decline, which in turn attracted more issuers.[35]

iv. The boom in **M&A activity** in recent years has fuelled the overall debt markets.[36] Since corporate acquirers were in need of debt to finance these takeovers, more companies turned to the Schuldschein market for additional funding.[37] Due to the regular oversubscriptions of transactions, the SSD was a great instrument to raise the necessary funds for their takeovers.[38]

Most market participants expect the market growth to slow down in the future and continue to operate at the current market volume.[39] Growth rates of recent years might not be sustainable in the future due to an increasing level of saturation of the domestic market. Furthermore, the domestic investor base is expected to plateau in the future.[40] However, there are three drivers that might enable the market to grow further:[41]

i. *Further internationalisation*: International investors could increase and widen the investor base in the future and thus lead to more demand in the market. In particular investors from the Asia-Pacific region have already entered the market. Especially for non-European international investors it can be an attractive option to tap the European private placement markets in order to get credit exposure and access to European mid-sized firms.[42] On the issuer side, the internationalisation trend, especially in Europe, continues.[43] Southern European issuers have returned to the market44 while the market has also started spreading eastwards with issuers from Poland, Russia, the Czech Republic and Hungary.[45] In the first six months of 2017, multi-currency deals already amounted to 20% of all transactions.[46] Finally, international arrangers are also entering the SSD market (e.g., HSBC or Chinese banks), therefore facilitating the entrance of both international issuers and investors.[47]

[33] (LBBW 2016)
[34] (BCG interview with arranger 2017); (BCG interview with issuer 2017); (BCG interview with investor 2017)
[35] (Scope Ratings 2016)
[36] (JPMorgan 2016)
[37] (Wadewitz 2014)
[38] (BCG interview with arranger 2017)
[39] (BCG interview with investor 2017); (BCG interview with arranger 2017)
[40] (BCG interview with arranger 2017)
[41] (BCG interview with arranger 2017); (BCG interview with association 2017)
[42] (BCG interview with arranger 2017)
[43] (UniCredit 2017)
[44] (BayernLB 2017)
[45] (Scope 2017)
[46] (Scope 2017)
[47] (BCG interview with rating agency 2017); (BCG interview with arranger 2017)

ii. *Increased institutional investor activity*: Institutional investors have substantial liquidity and seem to have appetite for the risk return profile of the Schuldschein market in general. This potential needs to be tapped by issuers and arrangers to further grow the investor base.

iii. *Bond market development*: Market participants expect that a change in the ECB bond purchase program might influence the SSD market – especially in the segment of large corporations that issue both bonds and SSDs. A reduction in the bond purchase program and therefore a decrease of bond prices would render SSDs more competitive for those large issuers.[48]

Several market participants also see a further driver in a significant number of upcoming SSD maturities. Repeat issuers have been a driver of growth in recent years and more companies are expected to return to the Schuldschein market to either refinance their outstanding debt or to optimise their maturity profile.[49] Furthermore, repeat issuers can also expect to receive better conditions than for first issuances due to a lower risk premium.[50]

In terms of deal size, in recent years the Schuldschein market has on average issued deals of around €100-200M with median deal sizes of approximately €70-120M. Both the average and the median deal size have steadily increased in the last few years, driven by an increased number of very large issuances with deal sizes over €500M (so-called 'jumbo deals'), such as the Bosch GmbH issuance of €1.5B in 2016.[51]

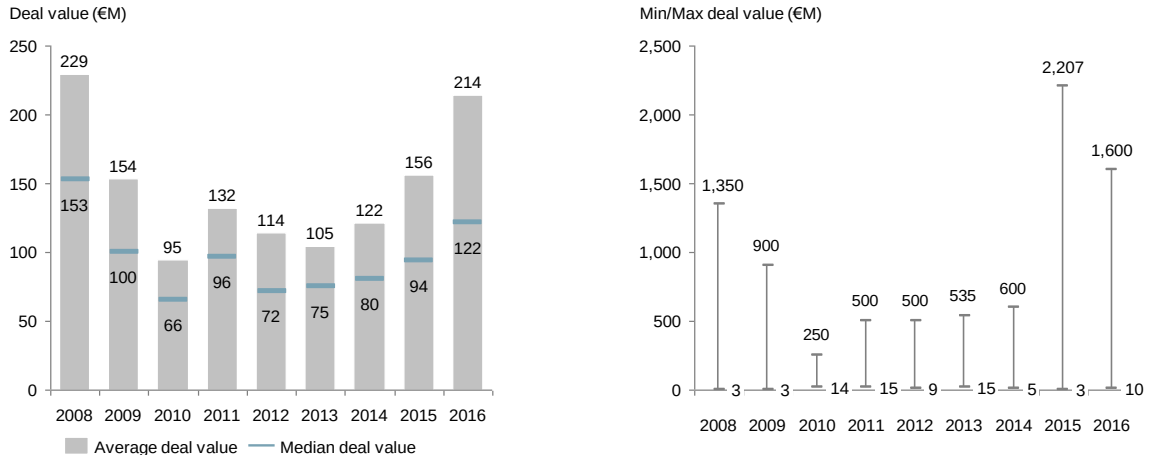

Figure 3: Development of SSD deal volumes[52]

Examining the deal size of SSD transactions over the past few years shows that the Schuldschein is a very flexible instrument in terms of size. It is used for large deal issuances as well as for small deals with sizes of €25M or less.

[48] (Schuldschein Forum 2017), (Whittaker, Global Capital Roundtable: Schuldschein market strives to stay special as appeal broadens 2015)
[49] (BayernLB 2017)
[50] (BCG interview with financial expert 2017)
[51] (Thomson Reuters 2017); (Scope Ratings 2016)
[52] (BCG analysis based on LoanConnector 2017)

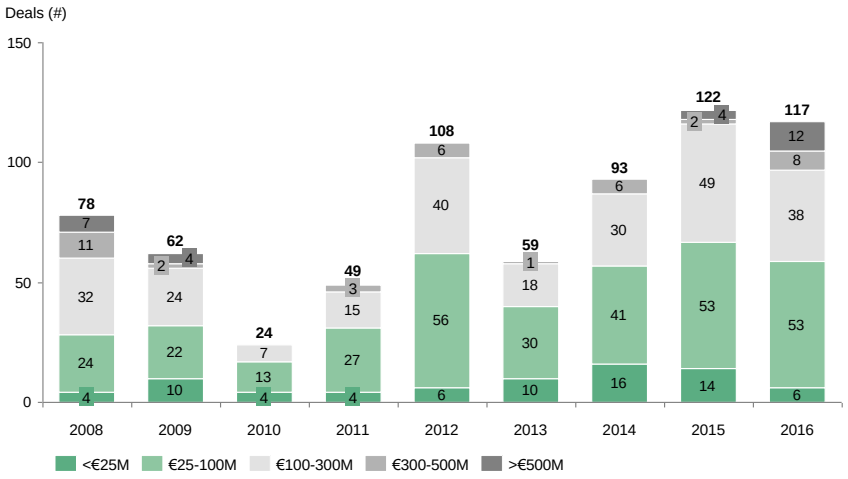

Figure 4: Development of SSD deals per size bracket[53]

Regarding the tenor of the Schuldschein, the majority of SSDs are being issued with a tenor of three to five years. In fact, 84% of all tranches issued in 2016 were within this range. Over the past few years, there have not been any meaningful changes in the original tenor.

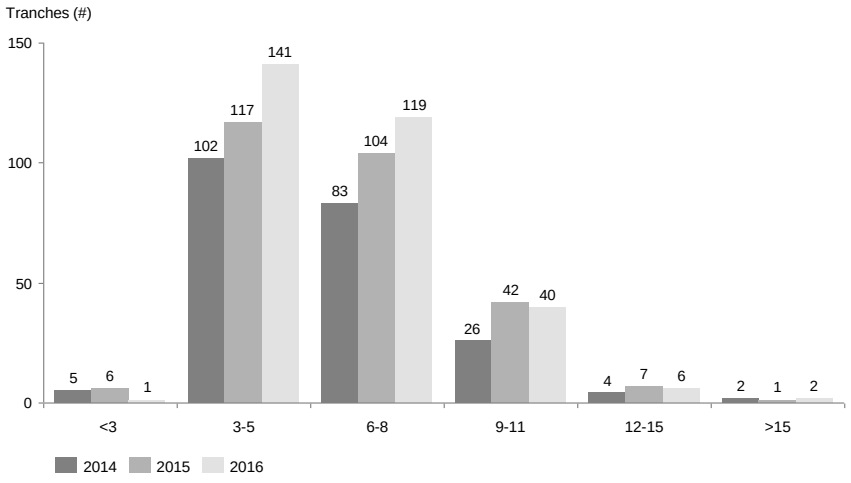

Figure 5: Distribution of tenors in SSD market[54]

Both fixed and floating interest rates are frequently being used in the SSD market. When using a floating rate, the EURIBOR seems to be the standard index for the Schuldschein market.

[53] (BCG analysis based on LoanConnector 2017)
[54] (BCG analysis based on LoanConnector 2017); Note: Number of tranches displayed, as one deal might have several tranches with different maturities

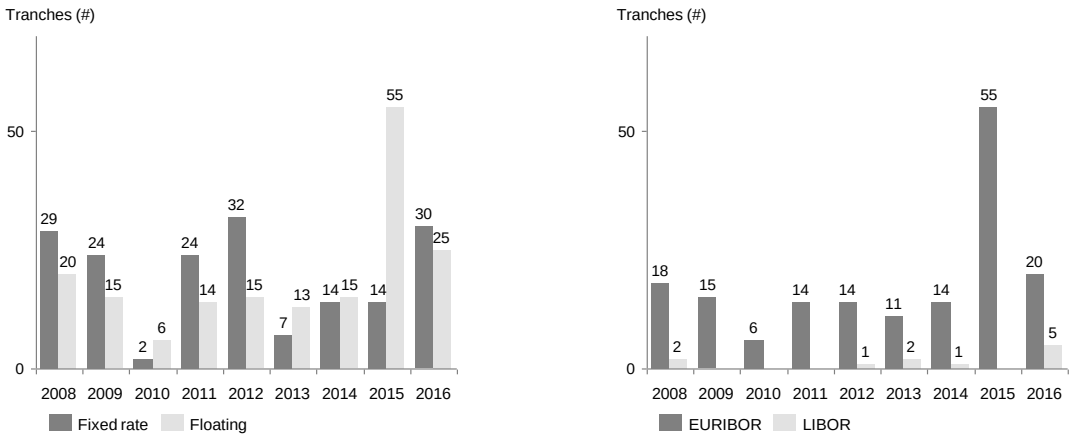

Figure 6: Base rate details per tranche[55]

Stakeholder groups

The following section describes the three stakeholder groups in the SSD markets and also explains key practices for new issuances. The roles of the stakeholders are similar across the three markets in focus, as is the process for new issuances.

A new issuance is usually initiated by the issuing company. The *issuer* decides on preliminary considerations regarding the maximum or minimum volume to issue, acceptable price margins, desired maturities and other aspects of the SSD. In the next step, the issuer mandates a bank to arrange the transaction and compiles all necessary financial information for the investors. Once investors have submitted their indicative offers, the issuer's management team communicates with investors in roadshows or calls to answer any questions regarding the company's strategy or financial situation. Upon signing the contract and payment of the principal, it is the responsibility of the issuer to regularly communicate agreed-upon information about the company. This usually includes submitting financial statements every half-year or year for non-public companies.

The *arranger* has the role of an intermediary party between the issuer and investor. Since the market is private by definition and therefore opaque, it is helpful to have a party with a network of potential issuers and investors. In fact, almost all BCG interview partners have stated that this is the single most important aspect of a good arranger[56]. From an issuer perspective, the selection of the arranger determines into which type of investors an issuer can tap[57]. It is also the arranger's responsibility to carry out credit research that gives a fair representation of the issuer and can be trusted by the investor. The arranger then approaches investors and invites first indicative offers. The arranger also supports the preparation and crafting of the necessary documentation, and leads negotiations. During the duration of the SSD, the arranger is also responsible for 'market-making', i.e., establishing contact between potential buyers and sellers of the SSDs in order to facilitate a secondary market.

[55] (BCG analysis based on LoanConnector 2017)
[56] (BCG interview with investor 2017); (BCG interview with arranger 2017); (BCG interview with financial authority 2017)
[57] (BCG interview with issuer 2017)

Arrangers in the SSD market also typically keep a part of the Schuldschein volume on its books.[58] Having **skin-in-the-game**, as it were, ensures that the arranger's interest is aligned with the investor's and provides a quality signal to potential investors. Furthermore, it also provides a good investment opportunity for the arrangers.[59] Larger commercial banks, Landesbanken, and the cooperative central bank play an especially important role as they are often the lead arranger and resell SSD tranches to smaller bank investors.

The *investor* is the stakeholder party that seeks to invest and fund financing requirements of issuers. The majority of these SSD investors are banks (see *Investor landscape*, pp.33ff), mostly savings banks (Sparkassen and Landesbanken) and commercial banks. The investor is mainly responsible for obtaining sufficient and adequate information about the issuer and conducts a diligent credit analysis to fully assess the issuer, the associated SSD and the underlying credit risk. [60] During the term of the SSD, the investor is also responsible for monitoring all developments that could affect the investment's quality as well as the compliance with all covenants.

Besides the issuances that are initiated by the issuers, the process can also be investor-driven. Potential investors seeking new investments often directly approach an arranger to look for suitable issuing companies – or the investors already have identified a potential issuer that fits their investment needs. The arranger will then approach the potential issuer to initiate the private placement process.[61]

The entire issuance process of structuring and placing an SSD deal is significantly shorter than for listed capital market instruments. For repeat issuers, the process can be completed within three to four weeks while new issuers may need more time and effort to prepare the terms and documentation of the deal and to find investors. According to market participants and arranger banks, the actual placement of the deal can take up to six weeks.[62]

[58] (BCG interview with arranger 2017)
[59] (BCG interview with arranger 2017)
[60] For smaller issuers in particular, additional audited financial reports can complement the assessment but do not substitute the credit due diligence.
[61] (BCG interview with arranger 2017); (BCG interview with financial expert 2017)
[62] (Nord/LB 2016)

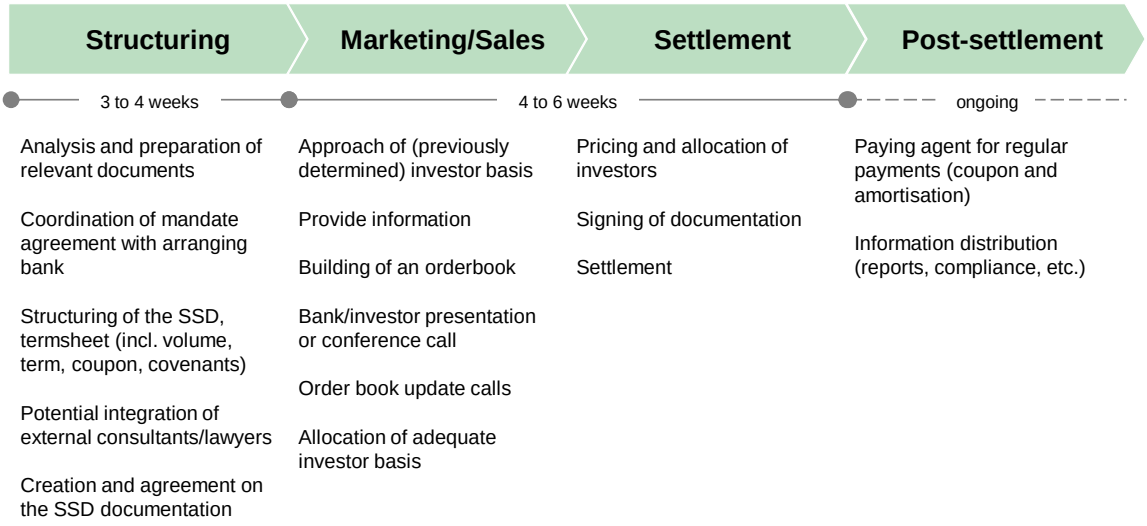

Figure 7: Typical timing of Schuldschein issuance for first-time issuers[63]

Issuer landscape

In the past three years, the number of active issuers on the market ranged between 85 and 109 per year. Simultaneously, the share of first-time issuers increased to over 50% in 2016, indicating a continuous interest in the SSD market also for new market participants.[64]

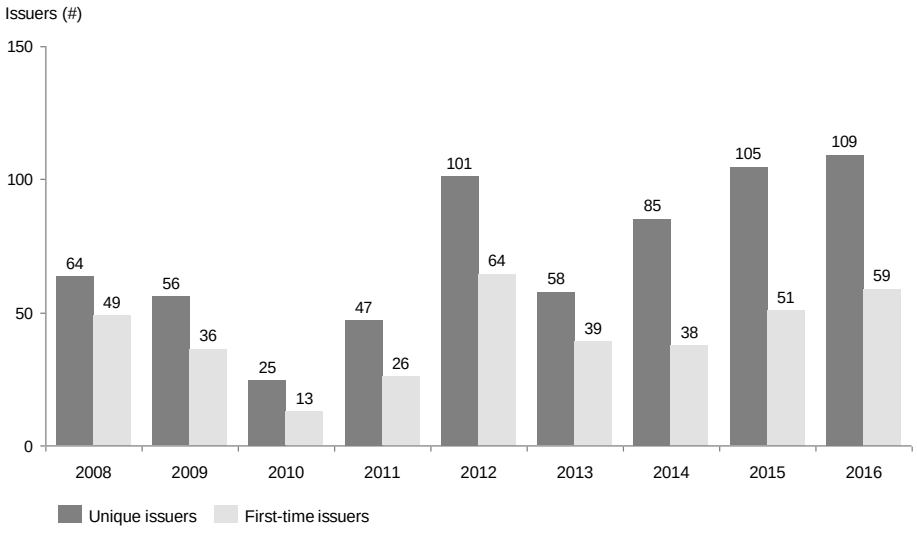

Figure 8: Development of number of issuers in SSD market[65]

[63] (BCG analysis based on data from arranger banks 2017)
[64] (BCG analysis based on LoanConnector 2017). The actual share of first-time issuers may be below 50%. According to financial experts (BCG interview with rating agency 2017); (BCG interview with arranger 2017), the share of first-time issuers is estimated around 40%.
[65] (BCG analysis based on LoanConnector 2017); as one company may issue more than one issuance per year, the number of deals and the number of "unique issuers" may not coincide

In recent years, the issuer base has become more international, with around 40-50% of international issuers in 2016.[66] In 2016, issuers from Austria, Switzerland and France[67] each accounted for up to 10% of the deals.[68] Most of the international issuers either do already have a relation to the German market; either through a German subsidy or as a well-known multinational company.[69]

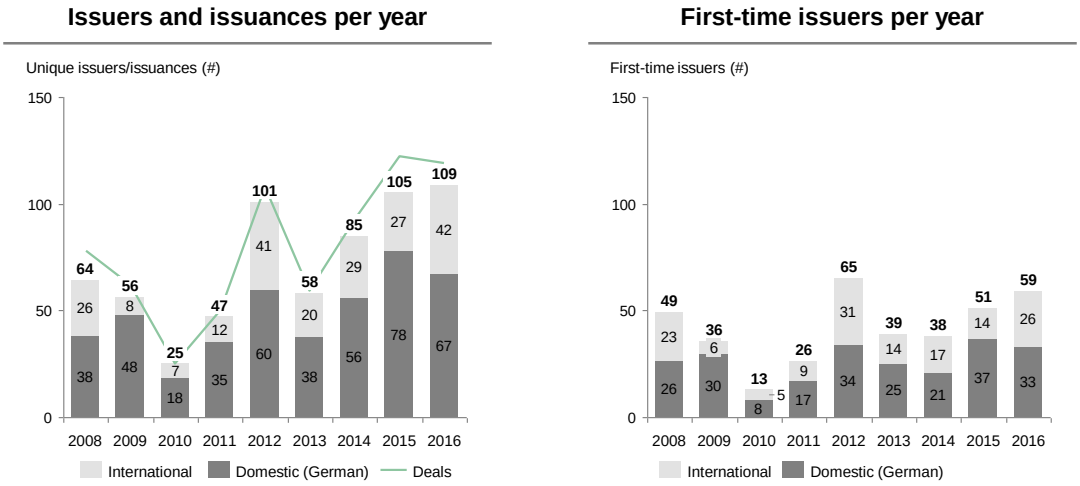

Figure 9: Nationality split of issuers in SSD market[70]

As mentioned before, international issuers are considered to be one of the main growth driver for the SSD market in the future.[71] However, they also create new challenges for the industry, since some of their documentation, e.g., annual reports, may differ from the German standard. It is usually the duty of the arranger to ensure that all information and documentation meets the standard of the investors, thus it is important for them to maintain similar quality standards as for German issuers.[72] Language is not a major hurdle, as many SSD contracts are in both German and English.[73,74]

Schuldschein issuers represent different industries and have different ownership structures. Regarding the size of issuers (in terms of revenue), the SSD proves to be a flexible instrument as it is used by a wide range of companies. The majority of active issuers (73% in 2016) have revenues between €150M and €5B per year. More specifically, around 45-55% of issuers are larger than €1B, while around 30-40% are between €150M-€1B. In the large company segment, there are some multinational

[66] (BCG analysis based on LoanConnector 2017); (Global Capital 2017)
[67] According to (BCG interview with arranger 2017), French issuers with a strong credit quality also tap the SSD market instead of the Euro-PP market due to lower cost and lower yield expectations from investors than in the Euro-PP market.
[68] (Global Capital 2017)
[69] (BCG interview with arranger 2017)
[70] (BCG analysis based on LoanConnector 2017)
[71] (BCG interview with arranger 2017)
[72] (BCG interview with arranger 2017)
[73] (BCG interview with issuer 2017)
[74] Please refer to the *Legal part* (pp.179ff) for further details on the differences in terms of documentation between German and international SSD.

companies, for example Daimler AG and Bertelsmann AG, which are active on both private and public markets.

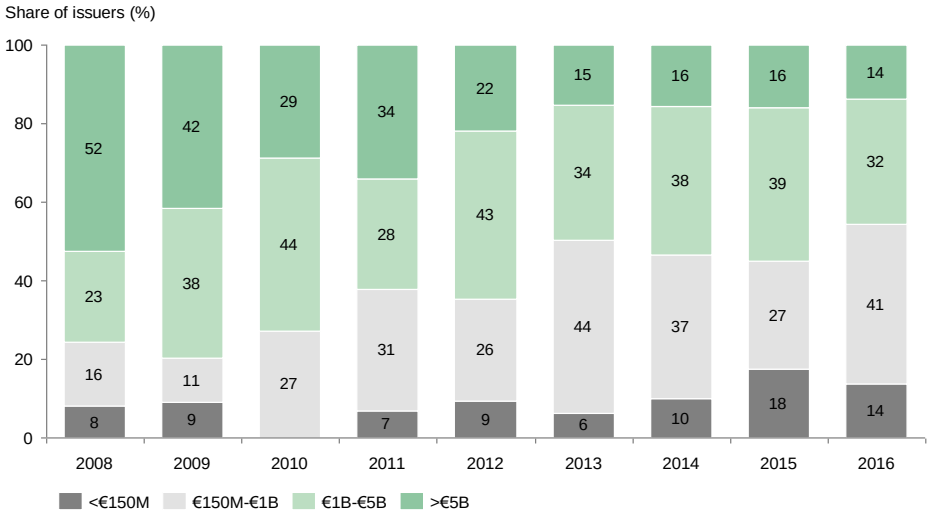

Figure 10: Revenue split of issuers in SSD market[75]

With regards to industry sectors, "Industrial Goods" stands out as it includes a wide range of sub-sectors, from aerospace to chemicals and transportation.

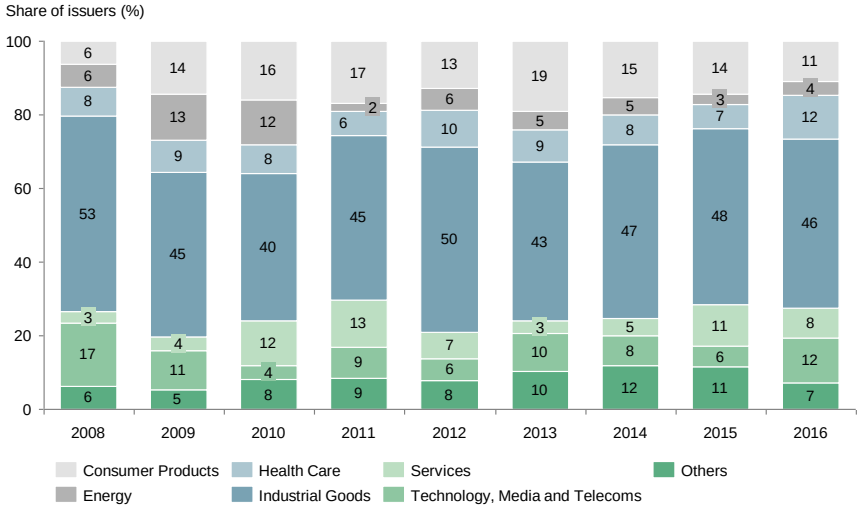

Figure 11: Sector split of issuers in SSD market[76]

The percentage of unlisted issuers has increased in recent years, from approximately 40% in 2008 to more than 60% in 2016. This trend can at least partially be attributed to the recovery of the corporate bond market since 2008/09, which allowed listed companies to access adequate financing through these channels instead of the

[75] (BCG analysis based on LoanConnector 2017); (Capital IQ 2017); (Orbis 2017); representation of percentages due to data availability, figure with absolute values dedicated to the *Appendix*, see Figure 74.
[76] (BCG analysis based on LoanConnector 2017)

Schuldschein market. Unlisted companies on the other hand find it more difficult to access the corporate bond market due to the high publication requirements, such as external rating, regular investor updates and others.[77] Additionally, several market participants stressed the special role of the Schuldschein market as a first step towards capital markets.[78]

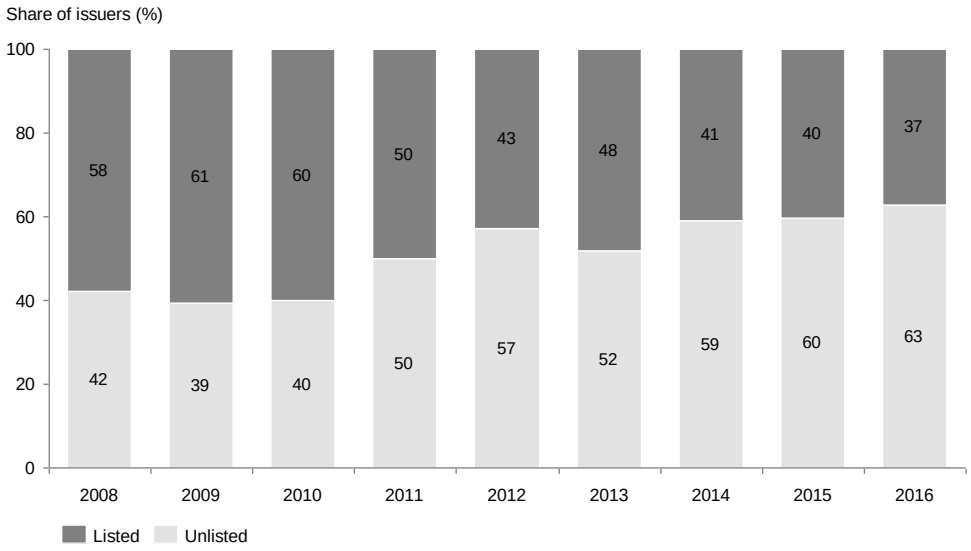

Figure 12: Share of listed and unlisted issuers in SSD market[79]

Around 85-90% of SSD issuers are typically unrated.[80] This, however, is not a sign of lower credit quality. Helaba, for example, states that credit metrics (e.g., net debt/EBITDA) of unrated issuers often outperform those of rated companies.[81] Overall, the SSD market is considered to be an investment grade market, i.e., issuers of all sizes traditionally have strong credit quality. This perception is shared by many market participants and supported by the research of Landesbanken. For example, LBBW's assessment of the credit quality in the market of H1/2015 is displayed in Figure 13. While 21% of the issuances were not rated by LBBW, 71% are in the investment range (BBB- or higher) and only 8% are in the non-investment range.[82]

[77] (BCG interview with issuer 2017)
[78] (BCG interview with arranger 2017). Several cases can be identified, but the available data does not allow for clear-cut conclusions regarding a correlation.
[79] (BCG analysis based on LoanConnector 2017); (Capital IQ 2017); (Orbis 2017)
[80] (LBBW 2016); (BCG interview with arranger 2017)
[81] (Kirschner (Helaba) 2017)
[82] More recent reports point in the same direction: according to (CAPMARCON 2017), the average rating of all issuers in the market is BBB-, repeat issuers are rated higher with average rating BBB

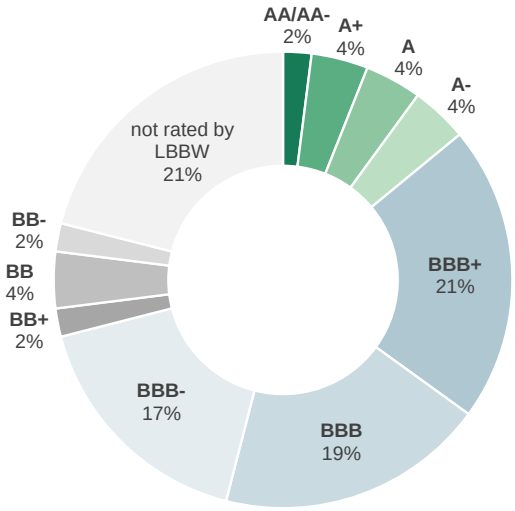

Figure 13: Issuer rating based on VÖB/LBBW report[83]

Two recent studies, however, have a more critical assessment of the credit quality of the SSD market. A recent report from Moody's and one from Scope Ratings from 2015 point out that there are signs that a side market with sub-investment grade issuers is developing.[84] An indicative assessment of Scope Ratings states approximately 75% of the 25% externally rated issuers held an investment grade rating, with a median of BBB (dark green bars in Figure 14).[85] However, only 40% of the unrated issuers (light green bars) would have an investment grade, with a median rating of BB+.[86] This implies that 38% of the issuers would be non-investment grade. This however does not match the roughly 22% of investors that are willing to invest in these sub-investment grade ratings, according to Scope Ratings. Thus, the report concludes that this could potentially indicate how some investors might consider buying investment grade SSDs even though a thorough credit analysis might not support this.[87]

[83] (VÖB 2015)
[84] (Moody's Investors Service 2016); (Scope Ratings 2015)
[85] Indicative assessment based on the credit quality of 30 unrated German, Austrian and French issuers; assessment based on publicly available information and on Scope Ratings' methodology
[86] Based on Scope Ratings' methodology
[87] (Scope Ratings 2015)

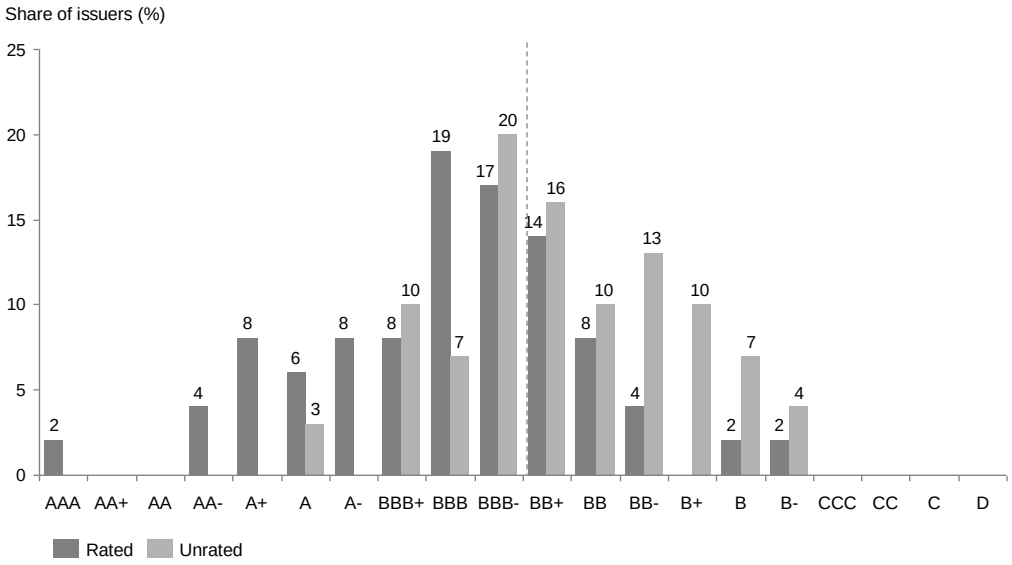

Figure 14: Indicative credit assessments of selected SSD issuers[88]

There are two possible explanations for these diverging assessments. On the one hand, the underlying methodology may differ between the different institutions. For example, some banks may use a one-year probability of default (PD), other institutions may use a three-year PD.[89] Additionally, rating agencies from the US evaluate certain indicators differently than European rating agencies, for instance cash positions and pension liabilities.[90] On the other hand, a higher rating by banks may also be due to a certain conflict of interest as they not only rate the quality of private placements but are also involved in the arrangement of the deals.

Currently, established market players share the ambition of keeping the SSD market an investment grade market with only a smaller share of cross-over issues, i.e., issues with higher yields than investment grade issues but less risk than the broad high-yield market. Nevertheless, cross-over quality SSDs can be an attractive addition to an investment portfolio given an adequate risk return profile and indicative assessments estimate their share up to 15-20% of the total market volume.[91] According to market experts, smaller players trying to enter the market with issuances with sub-investment grade quality will remain an exception.[92]

Arranger landscape

In the past, most of the arranging institutions in the Schuldschein market were 'Landesbanken'. The Landesbanken LBBW, Helaba and BayernLB make up approximately 50% of the total market. In recent years, however, some large and international commercial banks have entered the market, attracted by the increasing market size and arranger fees.[93]

[88] (Scope Ratings 2015)
[89] (BCG interview with arranger 2017); (BCG interview with association 2017)
[90] (BCG interview with rating agency 2017)
[91] (BCG interview with arranger 2017)
[92] (BCG interview with arranger 2017); (BCG interview with investor 2017)
[93] (BCG interview with arranger 2017)

2015			2016			H1 2017		
Rank	Arranger	Share (%)	Rank	Arranger	Share (%)	Rank	Arranger	Share (%)
1	LBBW	25.1	1	LBBW	22.0	1	LBBW	22.2
2	BayernLB	13.6	2	Helaba	15.4	2	BayernLB	12.7
3	Commerzbank	10.6	3	BayernLB	14.0	3	HSCB	10.7
4	Helaba	9.0	4	HSBC	8.3	4	Helaba	8.9
5	UniCredit	6.7	5	UniCredit	7.5	5	Commerzbank	7.5
6	DZ Bank	5.3	6	Commerzbank	6.2	6	Deutsche Bank	6.2
7	BNP Paribas	5.3	7	BNP Paribas	5.7	7	DZ Bank	6.1
8	HSBC	4.6	8	Deutsche Bank	5.1	8	UniCredit	5.8
9	NordLB	4.5	9	ING	3.3	9	RBI	5.1
10	ING	3.5	10	NordLB	2.1	10	NordLB	3.4

Figure 15: Schuldschein arranger league tables[94]

In general, there are three main incentives for arrangers to become active in the Schuldschein market:

a. The **fee structure** of the Schuldschein is financially highly attractive for the lead arranger. It may vary for very large and very small transactions but is approximately 0.1–0.7% of the issuance volume.[95]

b. By arranging a Schuldschein for the issuer, the bank has the opportunity to build a **relationship** with the corporation. The arranger could potentially also work with the issuer for any issuances of debt instruments in the future, which would significantly increase the customer lifetime value.

c. Less important but still relevant is the opportunity of **cross-selling**. Some Landesbanken, and especially commercial banks, might see cross-selling potential to issuers, for instance covering an issuer's payment transactions or providing hedging-instruments. Nevertheless, as the lead arranger is often already a key bank for the issuer and offers a broad range of banking services, the additional potential is generally limited.

Investor landscape

The investor landscape in the SSD market is very unique: most national investors are banks, including commercial banks (30-40%), *Landesbanken* and *Sparkassen*, i.e., state-owned banks and savings banks (35-45%), and *Volksbanken* (German for "people's bank"), i.e., co-operative banks (~10%). Institutional investors such as insurers and others only account for (5-15%).[96]

[94] (Thomson Reuters 2017);
[95] (BCG interview with arranger 2017); (BCG interview with financial expert 2017)
[96] (Global Capital 2017); (BCG interview with arranger 2017); (BCG interview with financial expert 2017). Overall, there are almost 2,000 banks operating in Germany—significantly above European average (Deutsche Bundesbank 2017)

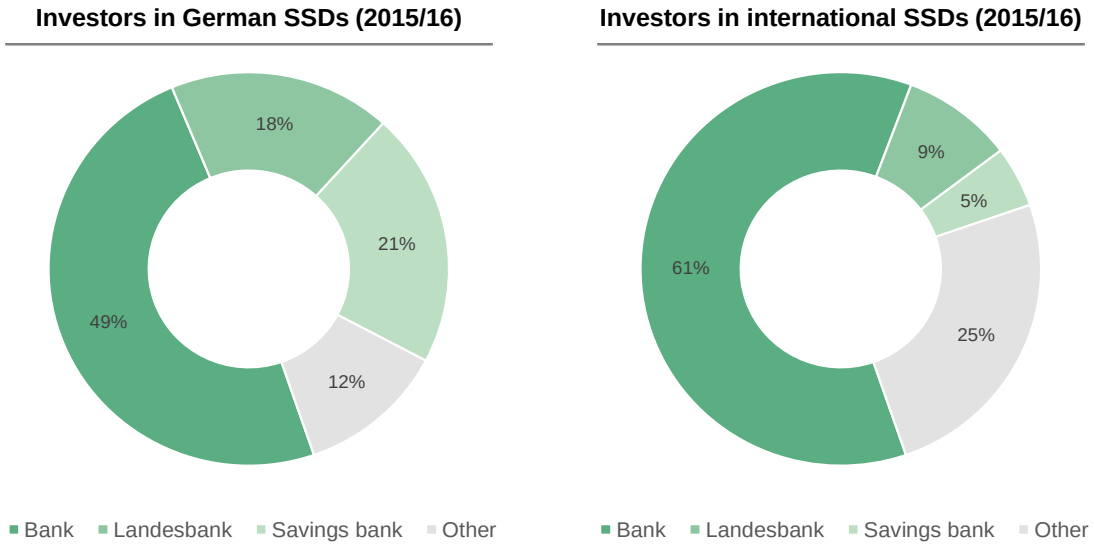

Figure 16: German and international Schuldschein deals in 2015-2016[97]

Overall, the number of investors is estimated at around 800-1,000, and the share of international investors has recently increased to around 30-40%.[98] The relevant set for international issuers is around 100 investors – predominantly banks which account for about 80% of international investors.[99] The share of bank investors is higher for SSDs issued by international companies (over 60%) than for SSDs from German issuers, due to regulatory limitations for German Landesbanken and savings banks (see Figure 16).

With banks not only arranging the deals but also providing around 90% of the investment volume, a very unique investor landscape compared to other PP markets and also adds to the competitive environment is created.[100] As outlined before, there are several reasons for this trend:

i. In the past few years, banks have experienced a strong **deposit surplus** due to the ultra-low interest rate environment. This deposit surplus has forced banks to look into new investment opportunities such as the Schuldschein market. According to BCG expert interviews, this trend will eventually continue in the near future. However, there is exposure to changes in interest rates, as is explained in more detail in section *IV. Risk analytics* (pp.93ff).[101]

ii. The **accounting treatment** of the Schuldschein allows investors to include private placements with their nominal value in their balance on an accrual accounting basis, i.e., there is no mark-to-market valuation of private placements, which is often required for publicly-listed assets such as corporate bonds.[102,103] Thus, the value of the Schuldschein does not need to be adjusted to

[97] (Schuldschein Forum 2017); (BCG interview with arranger 2017); Other = cooperative banks, asset managers and other institutional investors; German SSD deals refer to SSD issuances from German companies
[98] (LBBW 2016); (BCG interview with arranger 2017)
[99] (BCG interview with arranger 2017)
[100] (BCG interview with arranger 2017); (BCG interview with association 2017)
[101] (BCG interview with arranger 2017)
[102] (Moody's 2017); (BCG interview with arranger 2017); (UniCredit 2011); (Koller 2014)

market prices and therefore makes the investment more resilient to market volatilities.

iii. It is common practice in the Schuldschein market for arrangers to keep a certain share of the issuance volume on their books (see above). Having some proverbial **skin in the game** demonstrates the arranger's confidence in the loan. Additionally, the financial commitment ensures alignment of interest with investors.

iv. Due to the attractive fees for arrangers in the market, market participants have stated that banks sometimes invest in a Schuldschein not primarily to generate returns on the investment, but in order to have a **common touch point** for future arrangement negotiations with the issuer and gain a competitive advantage over other potential arrangers.

Institutional investors currently make up only approximately 10-15% of the investor base.[104] This small share of the total investor base can be explained by four factors:

i. The comparatively **shorter time-to-maturity** (3-5 years) of the Schuldschein is less attractive for institutional investors since they prefer longer durations of their assets (around 7+ years).[105]

ii. The **ticket size allocation** is often too small for larger institutional investors. As most SSDs are oversubscribed, institutional investors may often not get the minimum allocation size they need to meet their internal requirements to justify their investment, despite the option to diversify their asset structure.[106] In addition, **competitive pricing** in the SSD market makes such an investment even less attractive.[107]

iii. The **infrastructure** and **capabilities** of many institutional investors is still geared towards securities, not loans. This may result in a longer duration of the credit assessment as compared to banks.[108] As SSDs are often oversubscribed, it is a first-come-first-served dynamic. Nevertheless, the majority of the institutional investors already active in the market are present for several years and have therefore built-up capabilities and gained sufficient experience.[109]

iv. German insurers, for example, prefer on average **larger deals** and **higher rated** issuers.[110]

Despite these underlying barriers for institutional investors, market experts stated that the share of institutional investors is likely to rise in the future, as they build up credit analysis capabilities in-house and adapt their internal guidelines as well as an increasing number of international institutional investors entering the market.[111]

[103] For more information on the accounting treatment of SSDs, please refer to pp.112ff
[104] (BCG interview with arranger 2017); (Global Capital 2017)
[105] (BCG interview with investor 2017)
[106] (BCG interview with investor 2017)
[107] (BCG interview with arranger 2017)
[108] (BCG interview with arranger 2017)
[109] (BCG interview with financial expert 2017)
[110] (BCG interview with investor 2017)
[111] (BCG interview with arranger 2017); (BCG interview with association 2017)

Key lessons learned from the SSD market

The following key lessons learned from the German SSD market could potentially be applied to other markets with growth potential.

Lean documentation	Around 20 pages, based on German Civil Code, **minimised issuance costs**, short legal due diligence, enough **flexibility** for risk-based adjustments via covenants
Market discipline	Strong market discipline to retain **investment-grade quality of market,** good credit quality allows lean documentation and increases investor confidence, **close monitoring** of market and credit quality by banks
Long-standing relationships	Long-standing relationships between market participants, issuers mostly use **house bank as arranger, unique constellation** of arrangers and investors, i.e., Landesbanken and Sparkassen, DZ Bank and Volksbanken
Skin in the game	Arranger often keeps **tranche of the arranged SSD**, alignment of interests of arranger and investor, increased trust in transaction
Access to arranger rating	Access to private rating of arranger banks for associated bank investors, complement to own credit assessment, based on unique constellation of arranger bank and bank investors in Germany, i.e. Landesbanken and Sparkassen, DZ Bank and Volksbanken

Figure 17: Best practice examples from the SSD market

Firstly, the *lean documentation* of the Schuldschein is being perceived as one of the most appealing features of the instrument. Contracts are often only a couple of pages long (below 20 pages) and thus minimise issuance efforts and cost while investors enjoy a short legal due diligence.[112] The reason for this small legal due diligence is that loan regulation is set out in detail in Section 488 et seq. of the German Civil Code (*Bürgerliches Gesetzbuch*) and the SSD is considered a loan. Consequently, the Schuldschein contract only needs to address the aspects that have not yet been addressed by the German Civil Code. The short documentation also leaves enough flexibility for issuers and investors to add any adjustments, if needed, such as the use of covenants. The flexible use of covenants goes hand-in-hand with the lower risk associated with most Schuldschein issuers, i.e., they require, on average, fewer or less complex covenants than issuers with a higher risk profile (see *Legal part*, pp.117ff).

Another best practice is a strong *market discipline* of all market participants. This discipline results in primarily investment grade quality of issuers (mostly triple B-range) which in turn allows the above mentioned lean documentation.[113] Both arrangers and investors are interested in keeping the market to investment grade with a smaller portion of cross-over issuers that have a healthy economic basis. A substantially higher share of non-investment grade issuers might endanger the market by increasing the likelihood for credit events. Then, especially smaller investors might withdraw from the market due to relatively complex credit restructuring.[114] Therefore, banks closely monitor the market and credit quality in their own interest.

The SSD market also benefits from *long-standing relationships* between different market participants. Most issuers use their house bank, which usually knows the issuer and its business model for many years, as lead arranger which significantly

[112] (BCG interview with arranger 2017)
[113] (LBBW 2016); (BCG analysis 2017)
[114] See p.61 for more details

facilitates the credit analysis. This also instils trust to other investors. Arrangers and investors also have often a very close relationship due to the unique constellation in Germany of Landesbanken and their associated banks, Sparkassen, as well as the DZ Bank to Volksbanken. This close-knit relationship of arrangers and investors increases incentives to maintain the good quality of the market.

In addition, arrangers usually keep some skin in the game, i.e., a tranche of the SSD stays on their accounts or they are inverted in other debt products of the issuer, to also align the interests of arrangers and investors. As a service, the *private rating of arranger banks* is accessible to associated bank investors to complement their own credit assessment, i.e., Sparkassen have access to the internal rating of their Landesbanken and Volksbanken to the one from the DZ Bank.

The French Euro-PP market

The French Euro-PP market is the second largest private placement market in Europe. It was established in 2012 and therefore provides a suitable example to analyse best practices in the design as well as challenges in the initial phase of a new market.

Definition of a Euro-PP

Similar to other private placement instruments there is no single legal definition for Euro-PP transactions in its different formats. The Euro-PP working group[115], however, has published a definition as a result of an effort to facilitate a common understanding which will be used throughout this report: "*A Euro Private Placement (Euro-PP) is a medium or long-term financing transaction between a listed or unlisted company and a limited number of institutional investors based on deal-specific documentation negotiated between the borrower [in the following the 'issuer'] and the investors, generally with the participation of an arranger. Negotiation of contractual terms and conditions is an important feature of Euro-PP transactions; it distinguishes them from public or syndicated bond issues, such as Eurobond issues where investors merely subscribe to an issue without having any say in the terms and conditions. For this reason, the process for carrying out a Euro-PP transaction more closely resembles negotiating a bank loan agreement than preparing the documentation for an issue of listed bonds*".[116]

Characteristics of private placements

A Euro-PP is a debt funding instrument catered to the specific needs of mid-sized companies. An overview of some key characteristics of Euro-PPs is given in Figure 18.

Target companies	External rating	Listing	Format	Deal size	Typical years to maturity	Typical investor strategy
Revenue <€1B	Not required	Listed or unlisted	Bond or loan	Median size €35–50M	6–8 years	Buy-and-hold

Figure 18: Characteristics of Euro-PPs[117]

A Euro-PP transaction can either be in a loan or a bond format. The issuers and the investors choose between these two formats depending on their individual needs. Issuing as a loan has less publication requirements compared to a listed bond and many smaller issuers are already familiar with issuing loans. However, the bond format is less complicated regarding execution and settlement.[118] In recent years, the share of Euro-PP loans increased from almost none to 30% – mostly driven by insurers which can invest in loans since 2013 and make up about 80% of investors in the Euro-PP (see *Investor landscape*, pp.49f).

[115] The Euro-PP working group is composed by several professional organisations under the auspice of Banque de France, French Treasury and the Paris IDF Chamber of Commerce and Industry
[116] (Euro PP Working Group 2014)
[117] (Euro PP 2017); (Fildes 2015); (BCG analysis based on Dealogic 2017)
[118] (BCG interview with issuer 2017); (BCG interview with investor 2017)

Format	Documents	Listing	Confidential transaction	Transferability
Bonds, traded on a RM	Bond	Euronext Paris, Luxembourg	No	Yes
Bonds, traded on a MTF	Bond	Alternext or Euro MTF	No	Yes
Unlisted bonds	Bond	None	Yes	Yes, but limitations may be set out in a transfer approval clause
Loans	Bank	None	Yes	Yes, but only to the extent permitted by the loan agreement

Figure 19: Existing Euro-PP formats[119]

Background of the Euro-PP market

The Euro-PP market constitutes a useful example for how to set up a new market: in 2011/12, the Euro-PP was initiated by a collective effort of several stakeholders, including the French Treasury, the Chamber of Trade and Industry, Banque de France, AMAFI and others, to facilitate financing for intermediate-sized enterprises (*entreprise de taille intermédiaire*). During the financial crisis in 2008, this segment of the economy faced significant challenges in securing bank financing and therefore needed more financing options.[120] At that time, the ratio between bank financing (loans) and total public market financing, i.e., not only for intermediate-sized enterprises, was around 75% to 25%.[121] The objective of the market and the involved stakeholders was to increase the share of market financing in order to provide companies with more flexibility, and ultimately to improve the resilience of the French economy.[122] Another goal was to facilitate the entry to the capital market for mid-size companies.[123] The number of potential issuers was estimated between 1,000 and 2,000 companies.[124]

The following approach was taken to ensure a successful organisation of the new private placement market[125]:

i. *Alignment of all stakeholders*: it was ensured that all market participants - issuers, arrangers and investors – were aligned in the common goal of establishing a private placement market and building a system of co-operation and long-term relationships.

ii. *Regulation adjustments*: financial authorities adjusted regulation to facilitate activity in the market, for example, by amending the insurance code.

[119] (Euro PP Working Group 2014)
[120] (BCG interview with issuer 2017)
[121] In comparison, in the US the ratio between bank and capital market financing was 20% to 80%. (Fildes 2015)
[122] (BCG interview with issuer 2017)
[123] (BCG interview with investor 2017)
[124] (BCG interview with financial authority 2017). In section *III. Growth* potential (pp.69ff), this study also estimates a number of potential private placement issuers in every Member State but takes weaker modelling assumptions. For France, this study identifies ~5,700 potentially suitable companies.
[125] (BCG interview with issuer 2017); (BCG interview with financial authority 2017); (Euro PP 2017); (Association Française des Marchés Financiers 2016)

iii. *Clear guidance on market-sounding rules*: the Autorité des marchés financiers General Regulation and the AMAFI Code of conduct, dated 4 March 2014, regulated market soundings for both equity and bond markets. Under this regime, discussions with potential investors for the purpose of negotiating the terms and conditions of their participations in a Euro-PP transaction were considered not to fall within the definition of market sounding rules. However, in July 2016 the Market Abuse Regulation (MAR) entered into force and repealed this regime, consequently bringing back uncertainties as to the application of MAR market sounding rules to Euro PPs.

iv. *Common market standards*: in 2014, the Euro PP working group[126] released the 'Euro-PP Charter', which provided a non-binding framework of best market practices. The Euro-PP working group also released two model private placement agreements. In addition, the AMAFI published a 'Code of best practices for Euro-PP arrangers' in 2016. The ECPP Working Group led by ICMA is currently working on a collection of best practice for credit analysis, including due diligence, financial analysis and selection of transactions as well as recommendations for portfolio monitoring in case of a credit event.[127]

Development of the Euro-PP market

In its first year, the Euro-PP market already registered a significant number of transactions (23 recorded deals) with €2.9B in issuance volume. Since then, the market experienced clear growth. 2015 was a record year both in terms of total issuance volume (€7.8B) and number of Euro-PP deals (99 recorded).[128] The market growth was driven by (i) diversification needs of issuers and (ii) a strong demand from investors looking for attractive investment opportunities.

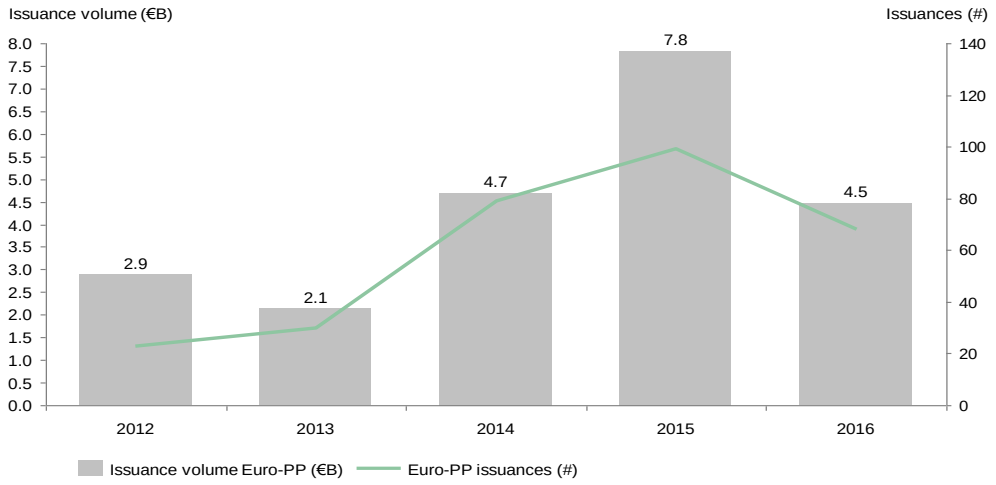

Figure 20: Development of the Euro-PP market in terms of issuance volume and number of deals[129]

[126] Comprised of market professional associations and Euro-PP market participants under the auspices of the Banque de France, the French Treasury and the Paris IDF Chamber of Commerce and Industry

[127] (BCG interview with association 2017)

[128] (BCG analysis based on Dealogic 2017)

[129] (BCG analysis based on Dealogic 2017); Dealogic data on the Euro-PP market might differ from other sources, such as S&P's, for two main reasons i) broader

In 2016, the Euro-PP market showed a drop to an issuance volume of around €4.5B and 68 recorded deals.[130] This development can be explained by the following factors[131]:

- Increased liquidity in the banking sector, which led to increased competition between 'classical' bank lending and Euro-PP investors, i.e., institutional investors;
- An increased number of deals that were not reported;[132]
- Increased competition from the SSD market due to more competitive pricing from an issuer perspective, especially for larger issuers with investment grade credit rating;
- A lower number of large deals compared to prior years, i.e., higher share of smaller transaction volumes (<€50M), driven by smaller issuers.

Overall, as it has only been established in 2012, the yearly volume of the Euro-PP market is still significantly smaller than the SSD market. Also, the number of issuers is still low in comparison to the estimated market potential. In H1 2017, 30 deals were recorded with a total issuance volume of €2.2B, therefore approaching similar ranges as in H1 2016 (36 deals recorded, €2.3B total issuance).[133] Looking ahead, most market participants expect the Euro-PP market to further develop in the future[134] and the following drivers are expected to support the growth:

i. *Enlarged issuer base*: there are still many companies in France that have not yet issued a Euro-PP but are included in the estimated potential issuer base of the Banque de France. Banks are also seeking to leverage their local networks to enter this market.[135] In addition, first-time issuers might return to the market.

ii. *Increased awareness*: the market is still relatively young and increased awareness of the Euro-PP's use and its benefits will attract more issuers and investors, both nationally and internationally.

iii. *Increased cross-border activity*: in 2016, there were already around 30% non-French issuers; this share might increase in the future as the Euro-PP gains traction across the EU.

iv. *Changing environment*: the Euro-PP can serve as a complementary financing instrument for companies in case they need to adapt their funding to changing market and macroeconomic environments.

In terms of deal size, a 'typical' deal in the Euro-PP market is smaller than in the German SSD market. In the last three years, the average deal size was around €60-80M and the median deal size was around €35-50M. Both the average and the median deal size, have constantly decreased from 2012 to 2015. This can be explained by a

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definition of Euro-PP, e.g., S&P's includes Italian mini-bonds, and ii) greater network/coverage of data sources, i.e., arranger banks

[130] Due to data availability – especially for non-listed transactions – this number may vary between different data sources

[131] (BCG interview with issuer 2017); (BCG interview with investor 2017); (BCG interview with legal advisor 2017)

[132] All databases on private placements rely on information provided by arrangers, issuers and/or investors. If this information is not provided, a deal is not recorded and included in the database. See also *Appendix* (pp.210ff) for further information.

[133] (BCG analysis based on Dealogic 2017)

[134] (BCG interview with financial authority 2017)

[135] (EY 2017)

shift in the size of issuers: the market started with larger companies has since shifted towards smaller and mid-sized issuers.[136]

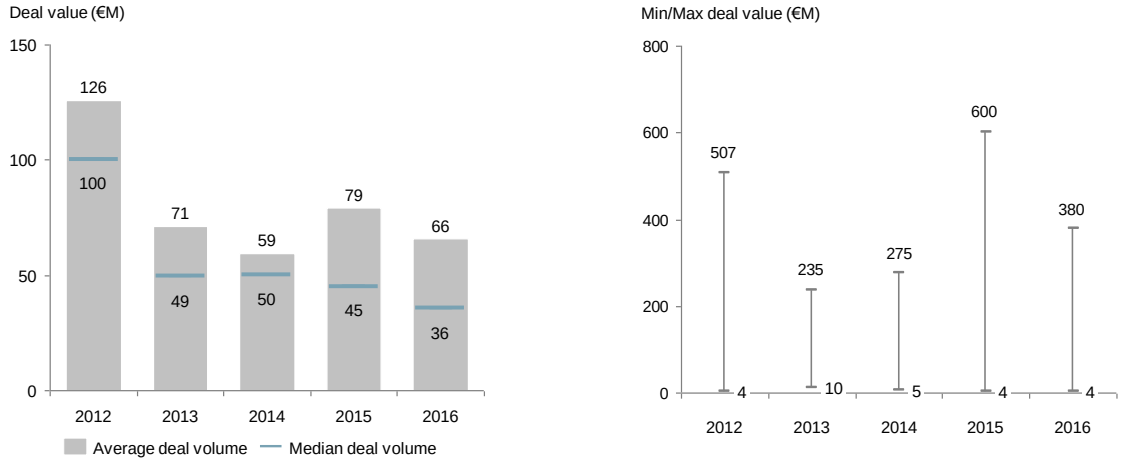

Figure 21: Development of Euro-PP deal volumes[137]

Around 50% of the deals have a volume between €10-50M. The difference in deal size compared to the SSD market is likely a result of the difference in issuers between the SSD market and the Euro-PP market. The Euro-PP market attracts more small and medium-sized companies, which in turn issue smaller amounts in comparison to larger companies in the SSD market. The issuance of very large deals (so-called 'jumbo deals' above €500M) has so far been a rare exception; in 2012, BSA International issued a Euro-PP of €507M, and in 2015, Hipercor SA issued one of €600M.[138]

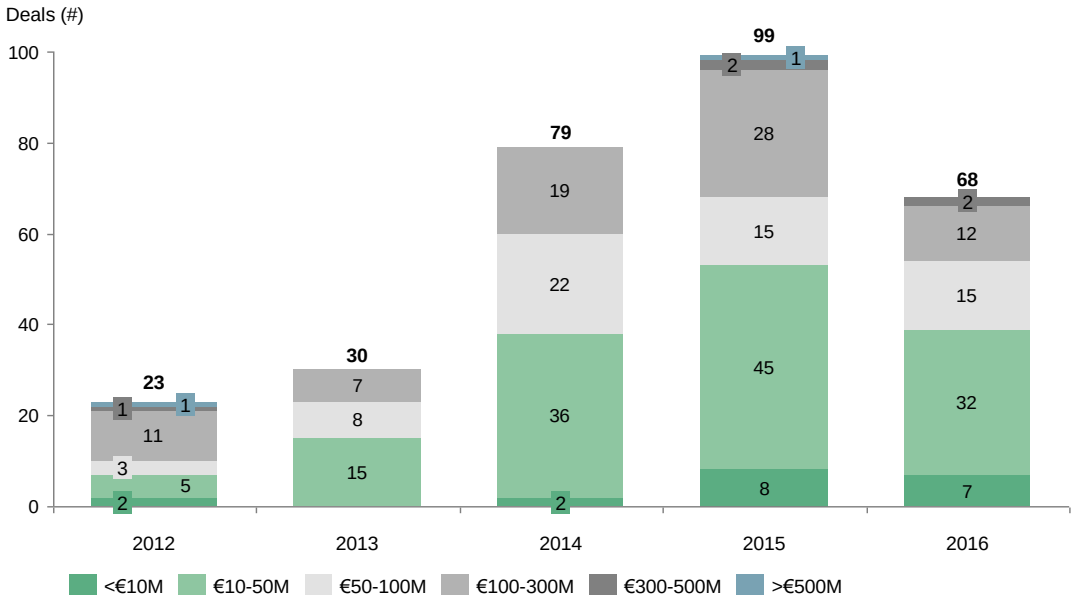

Figure 22: Development of Euro-PP deals per size bracket[139]

[136] (BCG interview with investor 2017); (BCG interview with issuer 2017)
[137] (BCG analysis based on Dealogic 2017)
[138] (Statista 2017); (El País 2015); (BCG analysis based on Dealogic 2017)
[139] (BCG analysis based on Dealogic 2017)

After a change in regulation in August 2013, which amended the Insurance Code (see *Legal part*, pp.117ff) and allowed insurance companies and mutual funds to also invest in unlisted Euro-PPs[140], the share of unlisted Euro-PPs increased. While in 2012, 30% of deals were unlisted, in 2013 this share was already at 50% and in 2016, 75% of deals were unlisted. Apparently, an increasing share of issuers with a preference for confidentiality regarding details of their business performance entered the market.[141] As the share of unlisted deals is expected to stay at the level of 2016 only a minority of deals are expected to be listed in the future.[142]

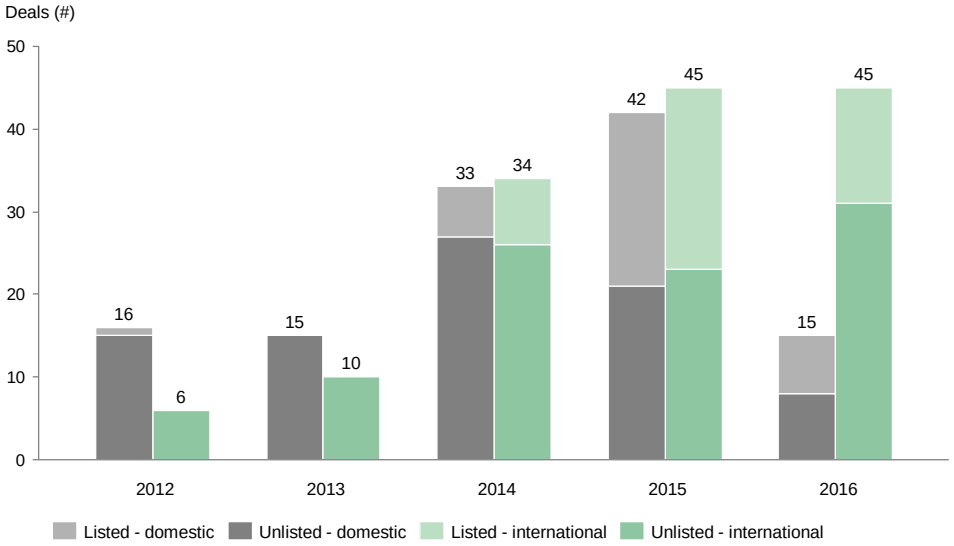

Figure 23: Listing of Euro-PPs[143]

The decision to list a Euro-PP is mostly investor driven; some investors prefer a listed Euro-PP due to increased transfer options or because of internal requirements. Issuers mostly prefer an unlisted Euro-PP due to lower issuance costs and increased confidentiality. There are some issuers, however, that prefer a listed bond as a preparation for future capital markets activities or because they already issued a listed Euro-PP in the past.[144]

When listed, Euro-PPs are mostly listed on a regulated market in France but are also present in other Euro-denominated countries.

[140] (BCG interview with financial authority 2017); (BCG interview with legal advisor 2017)
[141] (Statista 2017); (Fildes 2015)
[142] Please refer to the assessment of the regulatory framework in the Euro-PP market in the *Legal Part* (pp.129ff) for further details
[143] (BCG analysis based on Dealogic 2017)
[144] (BCG interview with investor 2017); (BCG interview with issuer 2017)

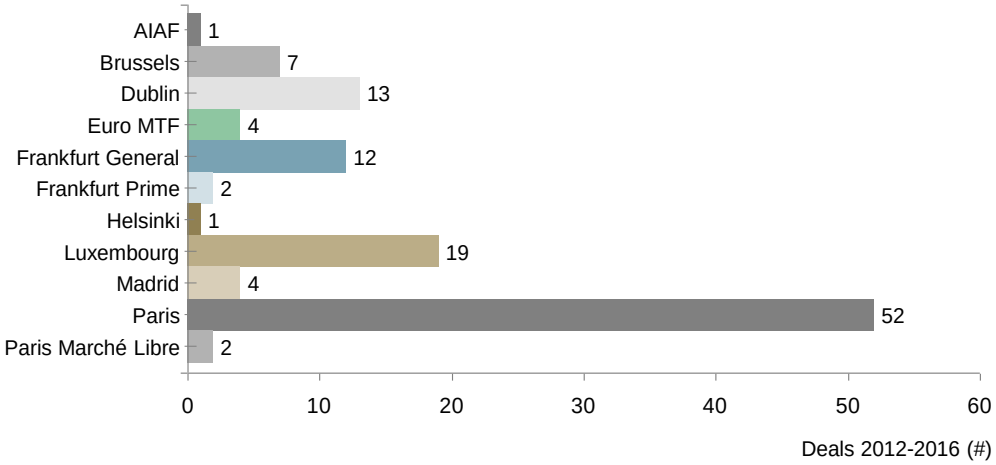

Figure 24: Place of listing of Euro-PPs[145]

The average time-to-maturity of Euro-PP deals ranges from six to eight years, about three years above SSD average maturities. The main objective of the Euro-PP is to match the financing needs of medium-sized companies with the long-term investment needs of institutional investors. Some issuers explicitly mentioned that they appreciate the longer maturities to finance their working capital.[146] In addition, for maturities of up to five years there is a great deal of competition from bank lending.[147]

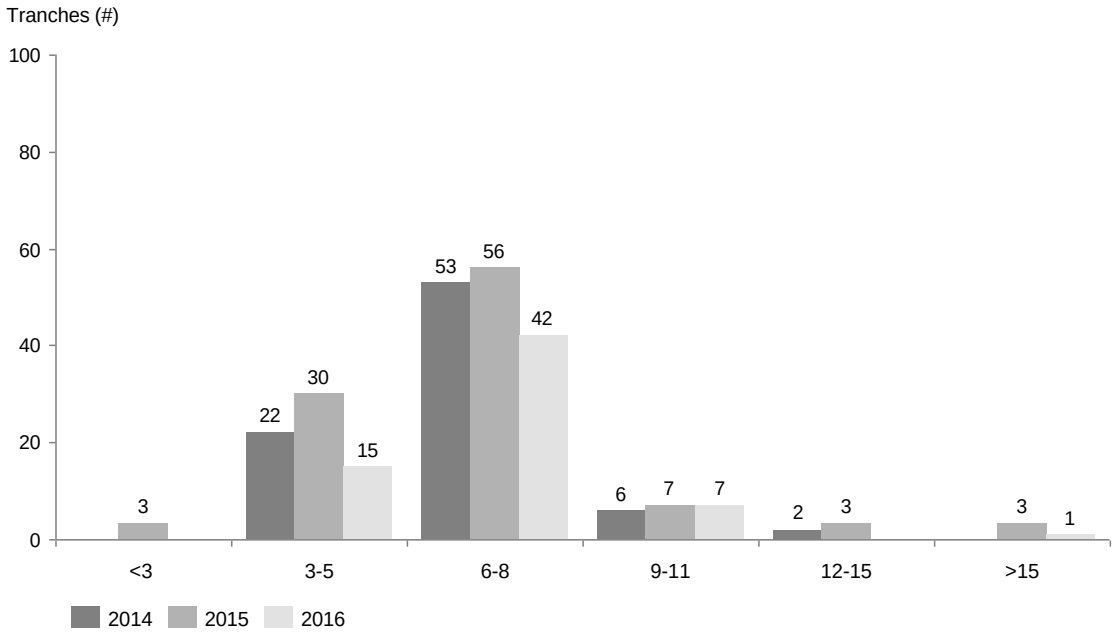

Figure 25: Distribution of tenors in Euro-PP market[148]

[145] (BCG analysis based on Dealogic 2017); for more information on the place of listing, see *Euro-PP market – additional information* (pp.218ff)
[146] (BCG interview with issuer 2017)
[147] (Fildes 2015)
[148] (BCG analysis based on Dealogic 2017)

Stakeholder groups

The issuance process for a Euro-PP is very similar to an SSD issuance (please refer to the relevant section on p.25 for further details) and a typical Euro-PP transaction usually takes about 4-8 weeks.[149]

The specific roles for issuers, arrangers and investors as well as the legal, regulatory and professional standards and requirements around Euro-PPs are outlined in the Charter for Euro-PP.[150] These standards are also comparable to the stakeholders' roles in an SSD issuance.

The issuer decides upon the specifications of the issuance and is responsible for providing all relevant information to potential investors. The investor usually implements a so-called 'credit committee', which conducts a diligent credit analysis and several meetings with the issuer to fully assess the company, the associated Euro-PP and the underlying credit risk. Other investors have adopted an organisation that separates asset managers from the credit analyst and mandates an independent strategy committee with a non-binding advisory role.[151] In contrast to the SSD issuance process, this preparation and assessment phase typically takes longer, but is often appreciated by smaller issuers as they receive professional input from experienced investors.

The arranger is an optional agent in the issuance process of a Euro-PP. Nonetheless, most transactions are completed with the help of an arranger that supports the sourcing, the preparation of the transaction and the final execution of the deal.

Issuer landscape

Being a young market, the growth of the Euro-PP market can be largely attributed to first-time issuers. However, there are also a number of companies which have repeatedly issued a Euro-PP, for example renewable energy developer Akuo Energy, which issued a Euro-PP of €36M in 2015, and three Euro-PPs of €29.2M, €7.7M and €5.6M in 2016.

[149] (BCG Interview with investors 2017). Please also refer to section *II. Cost-benefit analysis* (pp.57ff)
[150] (Euro PP Working Group 2014)
[151] (Comité Euro PP 2017)

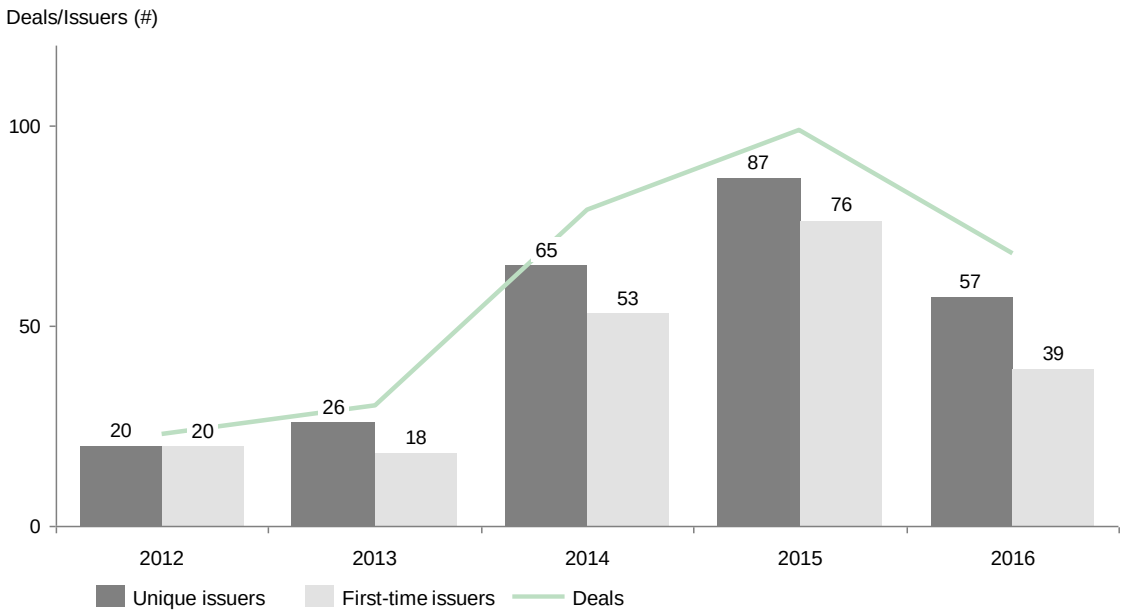

Figure 26: Development of number of issuers in Euro-PP market[152]

Overall, the majority of issuances in the Euro-PP market were domestic, i.e., French. However, the number of international issuances is increasing. Especially in 2015, which showed the largest yearly deal volume thus far, the share of international issuances rose to almost 50%.

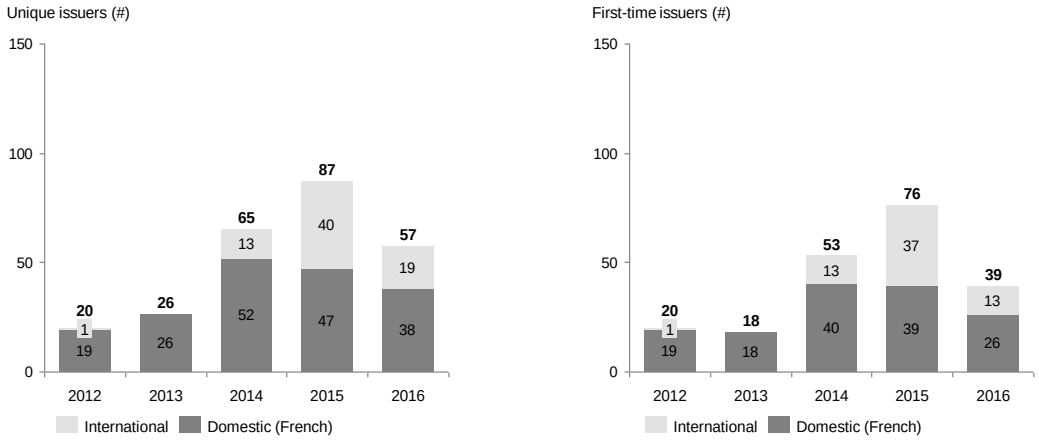

Figure 27: Nationality split of issuers in Euro-PP market[153]

As mentioned before, the Euro-PP market is mainly catered at the needs of mid-size companies which usually issue Euro-PPs with volumes around €20-100M. In 2015 and 2016, around 80% of issuers had revenues below €1B, with around 30-40% being even below €150M.

[152] (BCG analysis based on Dealogic 2017)
[153] (BCG analysis based on Dealogic 2017)

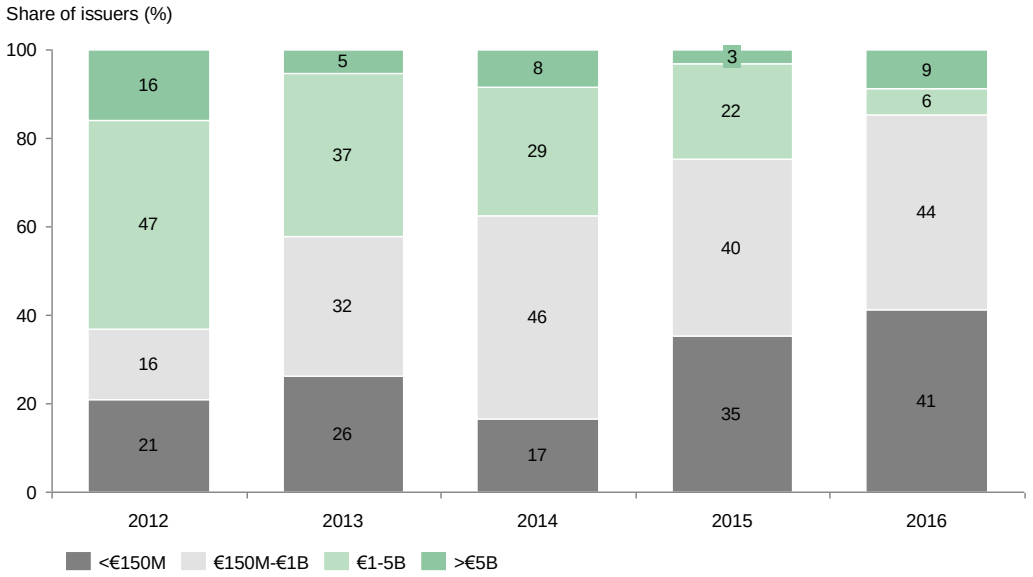

Figure 28: Revenue split of issuers in Euro-PP market[154]

As for the SSD market, there is no industrial sector that dominates the market of Euro-PPs. The shares of issuers from health care (4% in 2016), energy (7%) and technology (4%) are relatively small, but private placements are financing instruments that are used across all sectors.

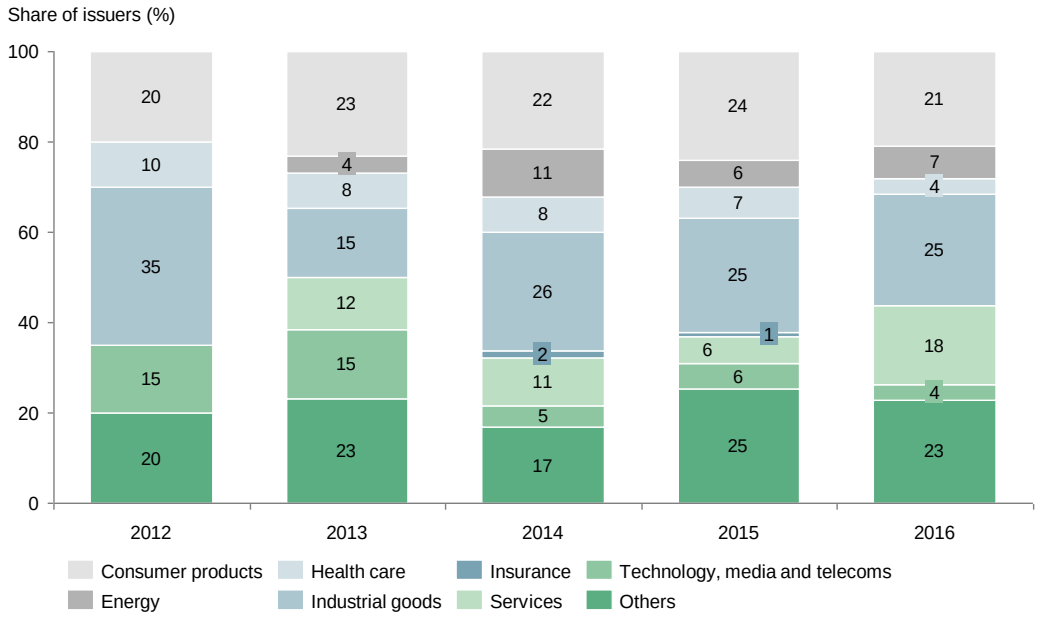

Figure 29: Sector split of issuers in Euro-PP market[155]

Similarly to the increase in unlisted issuances, the share of unlisted issuers in the Euro-PP market has increased continually.

[154] (BCG analysis based on Dealogic 2017); (Capital IQ 2017); (Orbis 2017)
[155] (BCG analysis based on Dealogic 2017); (Orbis 2017)

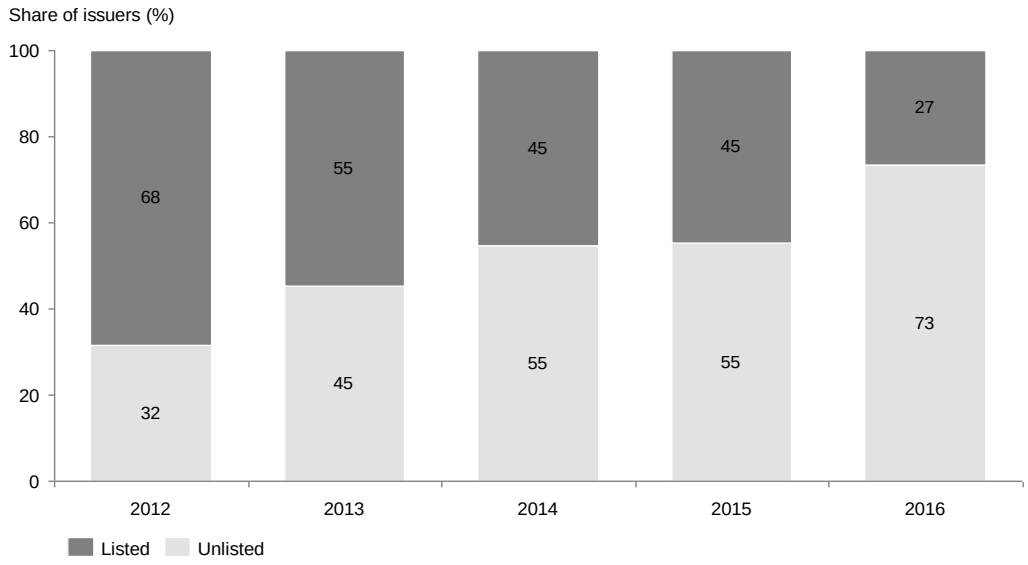

Figure 30: Share of listed and unlisted issuers in Euro-PP market[156]

The majority of issuers do not have an external rating, more specifically around 90% of Euro-PP issuers are unrated.[157] Regarding credit quality, the Euro-PP market is perceived to be more diverse in risk profiles compared to the SSD market and has a larger proportion of non-investment grade issuers.[158] In comparison to the first years, market participants observed that even more companies with cross-over credit quality are tapping the Euro-PP market recently.[159] This, however, is most likely linked to the fact that large companies are less active on the Euro-PP market; investment grade issuers, for example, can find more attractive conditions in the SSD market.[160]

Arranger landscape

The leading arrangers in the Euro-PP market are mostly French banks. Some large Anglo-American banks such as Morgan Stanley and UBS have also been involved in previous years, as shown in the arranger league tables in Figure 31.[161]

[156] (BCG analysis based on Dealogic 2017); (Orbis 2017); (Capital IQ 2017)
[157] (BCG analysis based on Dealogic 2017)
[158] (BCG interview with arranger 2017); (BCG interview with investor 2017); (Fildes 2015)
[159] (Fildes 2015); (BCG interview with arranger 2017); (BCG interview with investor 2017)
[160] (BCG interview with arranger 2017); (Fildes 2015)
[161] (Dealogic 2017); (Dealogic 2016); (Standard & Poor's 2017); (BCG analysis 2017)

2015

Rank	Arranger	Share (%)
1	Morgan Stanley	26.8
2	Crédit Agricole	12.3
3	Natixis	11.8
4	Oddo & Cie	9.2
5	Bank Degroof Petercam SA/NV	8.3
6	BNP Paribas	6.1
7	SG Corporate and Investment Banking	6.1
8	UBS	3.7
9	ING	2.9
10	Unicredit	2.6

2016

Rank	Arranger	Share (%)
1	Crédit Agricole	18.3
2	Morgan Stanley	12.8
3	Natixis	9.6
4	SG Corporate and Investment Banking	9.0
5	Citi	6.5
6	Barclays	6.2
7	Bank Degroof Petercam SA/NV	4.6
8	CM-CIC	4.4
9	BNP Paribas	4.2
10	Oddo & Cie	3.8

H1 2017

Rank	Arranger	Share (%)
1	Crédit Agricole	30.2
2	BNP Paribas	16.6
3	Bank Degroof Petercam SA/NV	13.9
4	Natixis	12.0
5	Kepler Chevreux	9.5
6	SG Corporate and Investment Banking	6.7
7	Deutsche Bank	4.8
8	CM-CIC	3.6
9	Belfius Bank & Insurance	0.9
10	HSBC	0.7

Figure 31: Euro-PP arranger league tables[162]

Investor landscape

The Euro-PP market is designed to cater to the needs of institutional investors, such as insurance companies and pension funds rather than banks.[163] According to HSBC1, there are two types of institutional investors on the market: around 80% are covered by insurers and around 20% by asset managers. [164] Similarly to the US PP market with domestic investors holding 90% of US PP, French investors hold 90-95% of Euro-PP.[165] Overall, as is the total asset management market (174% AuM/GDP), also the institutional market in France is large; at around €3.0T AuM, it is twice the size of Germany's market (around €1.3T AuM for institutional investors, 67% AuM/GDP).[166] The market is also less consolidated than in other European countries with over 620 independent asset management companies (Germany slightly over 300).[167] According to expert estimates, there are currently around 50-60 investors in the French Euro-PP market, with around 15 investors being most active.[168] In the past two years the investor base also experienced further internationalisation, with investors from Italy, the Benelux countries or the UK entering the market.[169]

[162] S&P's league table for 2015 ranks Morgan Stanley #1, Crédit Agricole #2 and Rabobank #3; differences may stem from a) differences in definition or guidelines on which data to include in the analysis, or b) differences in institutions that provide the authors with data; data from (Dealogic 2017)

[163] (BCG interview with investor 2017); (BCG interview with financial authority 2017)

[164] (HSBC 2014)

[165] (HSBC 2014); (BCG interview with rating agency 2017)

[166] (EFAMA 2017); (BCG analysis 2017).

[167] (EFAMA 2017)

[168] (BCG interview with investor 2017); (BCG interview with association 2017)

[169] (BCG interview with association 2017)

	Insurance companies	Asset managers
Description	• Often internationally active insurers • Dedicated corporate debt, or even PP teams	• Large, internationally active asset managers • Some AMs with local focus (France) • Specialised debt funds with high levels of expertise
Rationale	• Risk-return profile • Attractive yields • Long maturities / held-to-maturity instrument	• Risk-return profile • Attractive yield • Extra (illiquidity) premium compared to other instruments • Held-to-maturity instrument
Company examples	• *Example 1:* AM of international insurer with funds of €900M dedicated to PPs	• *Example 1:* AM with private debt platform of €9B AuM • *Example 2:* AM with €1.5B AuM with €500M dedicated to corporates

Figure 32: Investor typology in Euro-PP market[170]

Institutional investors need to have the capacity to conduct in-house analysis and monitor of creditworthiness, as well as contractual documentation. This is particularly true for investors that are subject to Solvency II and which will have to identify, measure, monitor and report the risk associated with Euro-PP transactions.[171,172] Credit analysis on small and medium-sized companies has a significant cost, mainly due to lack of information and the resulting additional efforts. It can therefore constitute a barrier to entry to this market.[173] However, due to the overall low-interest-rate environment in recent years, there has been increasing demand from institutional investors which seek to fulfil their return ambitions.[174] According to some institutional investors, a Euro-PP deal can offer up to an additional 40% return compared to what could be secured in an equivalent deal on the public market.[175] Apart from higher yields, the Euro-PP market also offers attractive maturities for institutional investors (5 years+). Most institutional investors follow a buy-and-hold strategy and appreciate close contact with the respective issuers once the PP transaction is executed. In the SSD market, investors tend to have less direct contact to the issuers post-transaction, except for (bi-)annual investor calls.[176]

Similar to the Schuldschein, investors may include Euro-PPs with their nominal value in their balance on an accrual accounting basis and thus a mark-to-market valuation is not required. The introduction of IFRS 9 also applies to Euro-PPs but still allows classification at amortised cost – given the asset is held to collect contractual flows

[170] (BCG interview with investor 2017)
[171] (BCG interview with financial authority 2017)
[172] Please refer to the section *Regulatory Framework for Euro PP* (pp.126ff) in the *Legal part* for more details regarding the legal requirements
[173] (Fildes 2015)
[174] (Fildes 2015)
[175] (BCG interview with investor 2017)
[176] (BCG interview with issuer 2017)

until maturity and not intended to be sold. Otherwise, the asset is measured at fair value.[177]

Another reason for investors to enter this market is diversification of portfolios. In fact, BCG interview partners have stated that diversification was the most important driver of growth in the investor base in recent years.[178] Furthermore, it provides investors with new investment opportunities as many issuing companies in the Euro-PP market are not listed and usually do not have access to the public market.

In principle a Euro-PP is transferable. However, since it is a buy-and-hold investment by nature, the number of investors is normally restricted. Thus, the Euro-PP secondary market does not see a significant trading volume. According to Euronext information, the average daily trading volume for Euro-PP bonds was €11M only, compared to €6.5B for all corporate bonds.[179] However, liquidity in the secondary market might increase due to a growing level of transactions in the Euro-PP market and supported by favourable changes in the regulatory treatment, such as modifications of the French Insurance Code in 2013.[180]

Key lessons learned from the Euro-PP market

The Euro-PP market is a successful example for the active creation of a private placement market. The collaborative design of that market, i.e., the common effort of all market participants to create a new market ensuring sizeable demand and supply and a level playing field, can therefore be considered as a key best practice example from the Euro-PP market. The Euro-PP market was designed in close interaction of the different stakeholder groups, i.e., issuers, arrangers and investors, in collaboration with national authorities.[181] This strategic decision and effort to build a PP market has led to a shared understanding of the Euro-PP and its use, as well as to the emergence of market standards. The setup of the Euro-PP market might therefore serve as an example for other EU Member States who consider building a domestic PP.

Collaborative market design	**Collaborative effort** of issuers, arrangers, investors and national authorities to create private placement market, ensuring sizeable demand and supply and a level playing field, **shared understanding** of use of Euro-PP and **common market standards**, **potential example** for other EU member states
Active engagement of institutional investors	**Legal modifications** to allow institutional investors to invest more into Euro-PPs, e.g. i) **modified insurance code** to treat Euro-PP in loan format as 'authorised assets', ii) investment funds to grant **loans directly to non-financial companies**, iii) access to independent third party rating (FIBEN)
Use of financial covenants	**Increased use** of financial covenants compared to SSD, covenant package with enough **flexibility** to address respective needs and risk profiles, increased access for a **broader range of issuers** due to simple adjustments of the covenant package

Figure 33: Best practice examples from Euro-PP market

[177] (EY 2016); (PWC 2017); (BCG interview with arranger 2017). Please refer to the *Legal part* (pp.111ff) for more information.
[178] (BCG interview with issuer 2017); (BCG interview with arranger 2017); (BCG interview with financial authority 2017)
[179] (BCG interview with stock exchange 2017)
[180] (Molson und Thibeault 2014)
[181] (BCG interview with financial authority 2017); (BCG interview with arranger 2017)

Another best practice example is the *active engagement of institutional investors* as market participants. In the Euro-PP market this has been particularly promoted by:

- *Adapting regulations to enable institutional investors to invest in private placements*. This was achieved by decree N° 2013-717 which modified the insurance code to allow insurance companies to treat certain loans or bonds as 'authorised assets', which among others concerns unlisted bonds issued by business corporations.[182] There is uncertainty regarding Solvency II rules which replace this decree, and how this will have an impact on the investment decision making process. However, market participants have not identified significant obstacles or 'no-goes' but expect that a more substantial analysis of the terms and conditions of the investment before taking the decision to invest will be necessary.[183]
- *Investors' opportunity to shortcut the arrangers and give loans directly to non-financial companies*. In fact, it is not unusual to see banks and investors team up (also referred to as 'club deals'[184]) to circumvent the arranger in order to quickly access funds (especially in times of 'hot' markets).[185]
- *Increasing the ability of institutional investors to perform their own credit analysis*. These skills are very important for the PP market, because most issuers are unrated companies. To build these skills, many institutional investors started to hire experts from investment banks.[186] Additionally this credit risk assessment can be backed up by a second opinion from FIBEN (Fichier bancaire des entreprises)—Banque de France's credit registry—to increase the confidence of investors.[187]

From an investor perspective, the consistent *use of financial covenants* is another best practice example from the Euro-PP market. Whereas financial covenants are rather scarcely used with SSDs, they are far more common as risk-mitigation measure with Euro-PPs. A Euro-PP's covenant package typically leaves the issuer and investor with sufficient flexibility, depending on their respective needs; an issuer with a riskier profile, for example, might be required to have stricter covenants in their documentation. This, however, increases the access for a broader range of issuers as investors simply adjust the covenant package if necessary.

[182] (Molson und Thibeault 2014)
[183] (Linklaters interview with investor 2017)
[184] Not to be confused with 'club deals' in the context of SSD issuances (cf., *Definition of a Schuldschein*, p.15)
[185] (Reuters 2015)
[186] (BCG interview with investor 2017)
[187] (BCG interview with financial authority 2017)

The US PP market

The US private placement market is the most established PP market. For several decades it has provided a source of funding to US and non-US companies. It often serves as a "first capital market" when issuers need an alternative to bank debt.[188] As the US PP market is sometimes regarded as the benchmark PP market, it can complement the picture of private placement markets in Europe.

Definition of a US PP

US private placements (US PPs) are securities that are placed with a selected group of professional investors or a syndicate arranged by an investment bank referred to as an offering agent, pursuant to the private placement exemption under Section 4(a)(2) of the US Securities Act of 1933 (Regulation D).[189] The reason to exempt US PPs from a SEC registration is that investors have the economic clout to assess the investment and access professional advice and therefore do not need the protection provided by the SEC registration process.[190] US PPs are also exempt from public disclosure and reporting requirements.[191]

Issuers are not required to obtain a credit rating for such placements, so US PPs offer the simplest and hence least costly way of offering a bond to investors from an issuer's perspective. Most US PPs, however, are given a private rating by the Securities Valuation Office of the National Association of Insurance Commissioners (NAIC), explained in more detail below. Please note that US PPs do not include issuances to US investors under the exemption from registration pursuant to Rule 144A.

Private placement characteristics

The US private placement market is particularly suitable for companies seeking to raise unrated debt in smaller denominations than in the public bond market. An overview of some characteristics of US PPs is given in Figure 34.

Target companies	External rating	Listing	Format	Deal size	Typical years to maturity	Typical investor strategy
Revenue €150M–€5B	Not required, but NAIC rating	Listed or unlisted	Bond	Median size around €145M	9–15 years	Buy-and-hold

Figure 34: Characteristics of US PPs[192]

[188] (Hay 2015)
[189] (NAIC 2017)
[190] (NAIC 2017)
[191] (White & Case 2014)
[192] (Slaughter and May 2013); (Global Capital 2015); (BCG analysis based on Private Placement Monitor 2017)

Development of the US PP market

In 2016 the corporate US PP market had a volume of roughly €47B.[193] The numbers based on Private Placement Monitor data are even higher with record volumes 2016 of around €54B.[194] The differences might stem from slightly different definitions of US PPs as well as a different network coverage in terms of stakeholder data. In general, the US PP market is significantly larger than any European PP market.

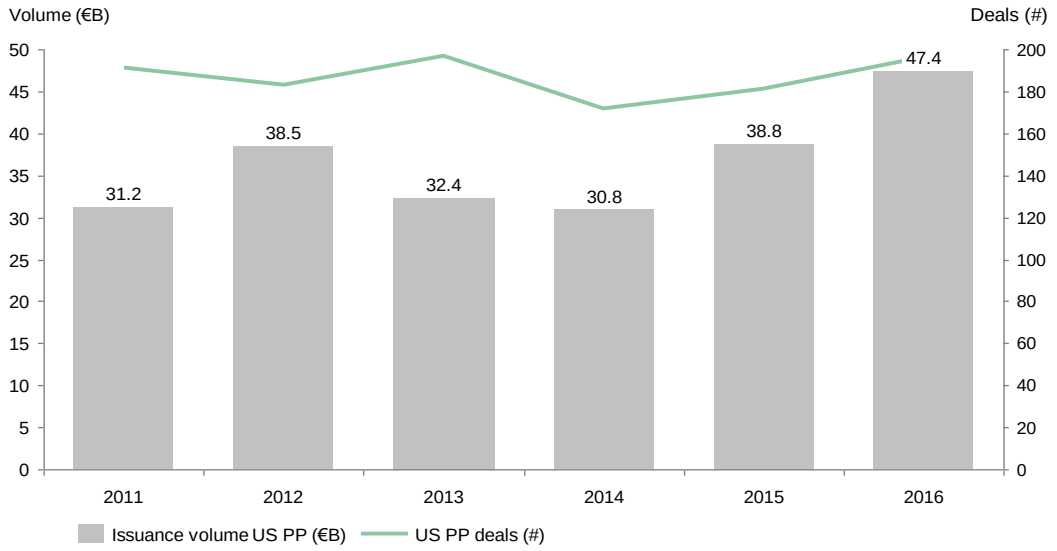

Figure 35: Development of the US PP market in terms of volume and number of deals[195]

The average and median deal size in the US PP market are larger than in both European markets, with an average deal size around €242M and a median deal size around €181M. Both numbers have remained rather stable until 2015 but seen a jump from 2015 to 2016, also due to significant increase in maximum deal size.

[193] (BCG analysis based on Thomson One 2017); only considering the corporate US PP market, i.e., excluding deals done by governmental, financial and educational organisations; all data originally in USD, conversion based on average annual conversion rates from the European Central Bank published by the Deutsche Bundesbank (Deutsche Bundesbank 2017). According to (BCG analysis based on Dealogic 2017), the market volume was €41B.

[194] (BCG analysis based on Private Placement Monitor 2017); only considering the corporate US PP market, i.e., excluding deals done by governmental, financial and educational organisations; the Private Placement Monitor published US$67.9M (€61.3BM) for 2016, US$60.6M (€54.6M) for 2015 and US$58.8M (€44.3M) for 2014.

[195] (BCG analysis based on Thomson One 2017); 2016 not displayed due to data quality

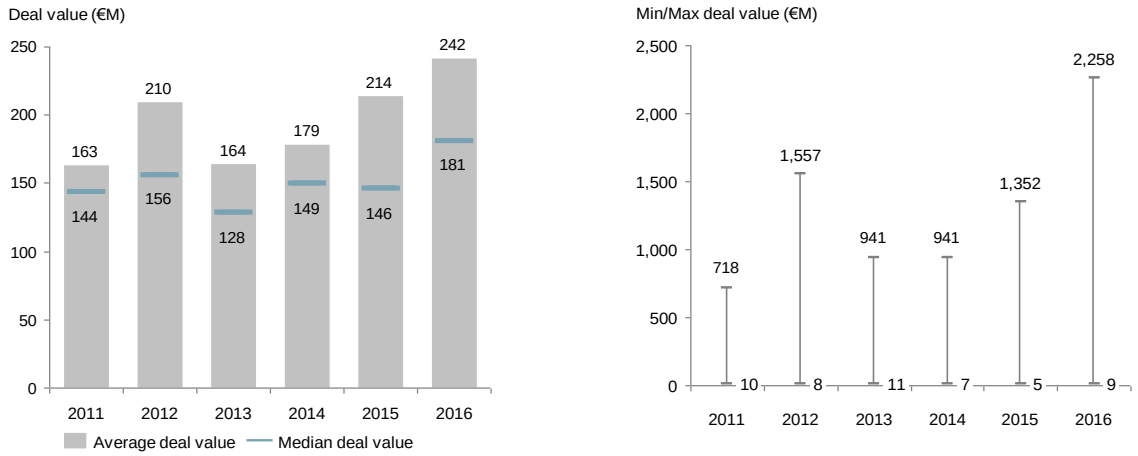

Figure 36: Development of US PP deal volumes[196]

The majority of deals have a median deal volume between €79M-238M. In 2015 around one quarter of deals were smaller than €79M, and only 2% of deals were smaller than €20M. The proportion of large deals between €238M-397M and of jumbo deals is significantly larger than in the European markets. One example of a jumbo deal is the record US PP transaction done by Mars Inc. with a volume of around €2.25B in 2016.[197]

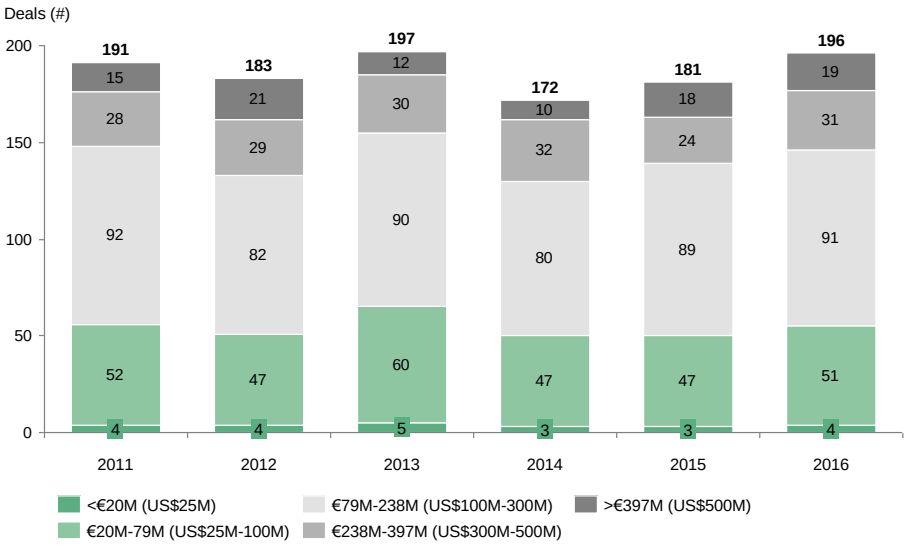

Figure 37: Development of US PP deals per size bracket[198]

US PP deals typically have longer maturities compared to European PPs. Only around 2% of deals have maturities that are shorter than six years and more than 80% of deals have maturities of nine years or longer. On the one hand, longer maturities are requested by issuers as many banks are uncomfortable offering such maturities.[199] On

[196] (BCG analysis based on Thomson One 2017)
[197] (BCG analysis based on Private Placement Monitor 2017)
[198] (BCG analysis based on Thomson One 2017)
[199] (White & Case 2014)

the other hand, these maturities are also demanded by the investor side, especially by life insurance companies that dominate the US PP market (see below).[200]

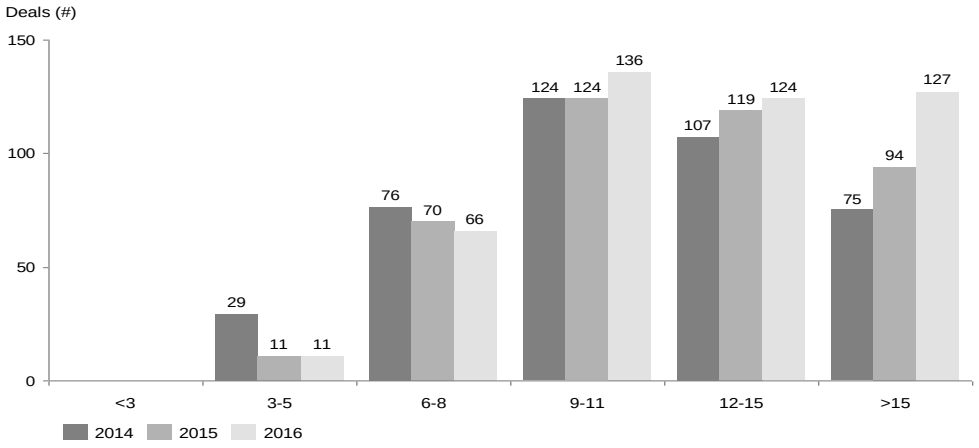

Figure 38: Distribution of tenors in US PP market[201]

Stakeholder groups

The issuance process for a US PP and the respective roles for the different stakeholders are similar to an SSD issuance (please refer to the relevant section on p.25 for further details). The process of issuing a US PP usually takes about 10-12 weeks.[202]

Issuer landscape

The US PP market is an established and mature market. The proportion of new issuers is relatively small at 10 to 15%; most issuers are repeat issuers with more than 85% of issuers having issued a private placement before. This is a comparatively higher number than in the SSD or Euro-PP market.

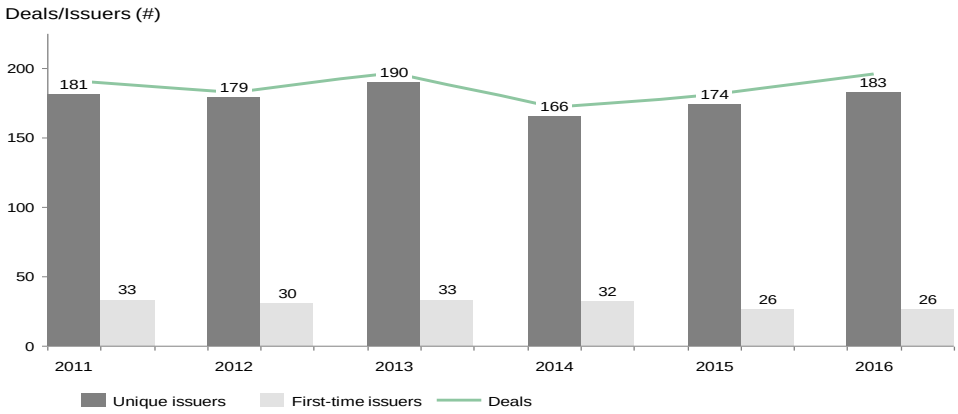

Figure 39: Development of number of issuers in US PP market[203]

[200] (EY 2016)
[201] (BCG analysis based on Thomson One 2017)
[202] (Hayter 2010); (NAIC 2017); (BayernLB 2017)
[203] (BCG analysis based on Thomson One 2017)

US PPs used to have strong international exposure, with traditionally more than 50% international issuers. In fact, most international issuers come from Europe, one study cites between 25% and 40% of the US PP market's annual deal flow.[204] In recent years, however, European issuers in the US PP have decreased due to the rise of the Euro-PP and the SSD market, in particular.

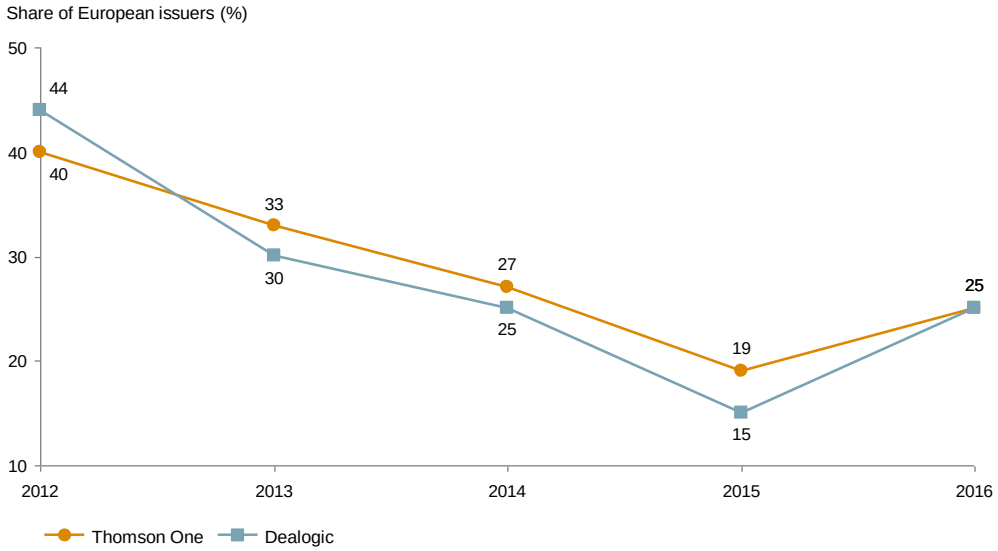

Figure 40: Development of share of European issuers in US PP market[205]

The trend of decreasing internationalisation is also observed for first-time issuers: In 2015 and 2016, the majority of first-time issuers were domestic, whereas from 2011 to 2014, the majority of first-time issuers were international.

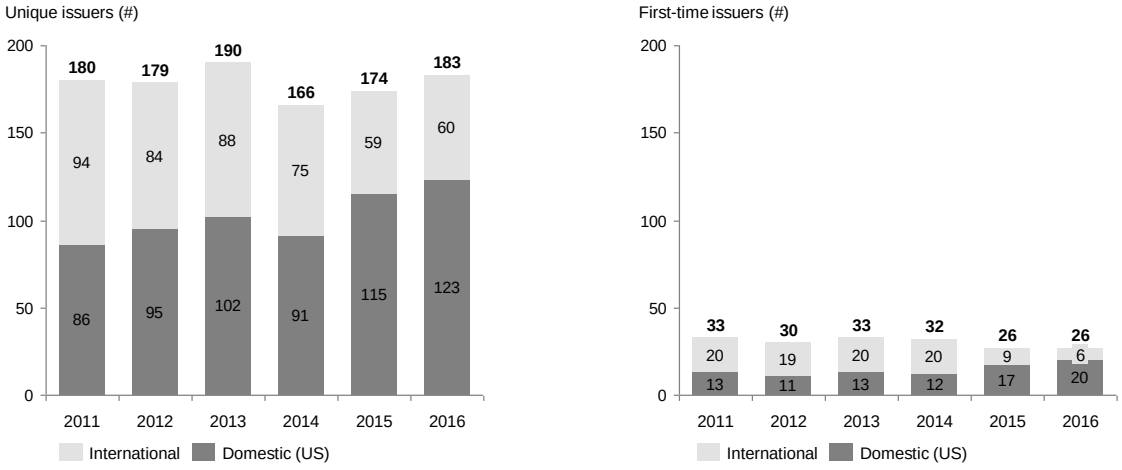

Figure 41: Nationality split of issuers in US PP market[206]

[204] (Hay 2015)
[205] (BCG analysis based on Thomson One 2017); (BCG analysis based on Dealogic 2017)
[206] (BCG analysis based on Thomson One 2017)

The majority of international issuers of US PPs are located in Europe, followed by Oceania. At a country-level, most international issuers are from the UK, Australia and Canada.

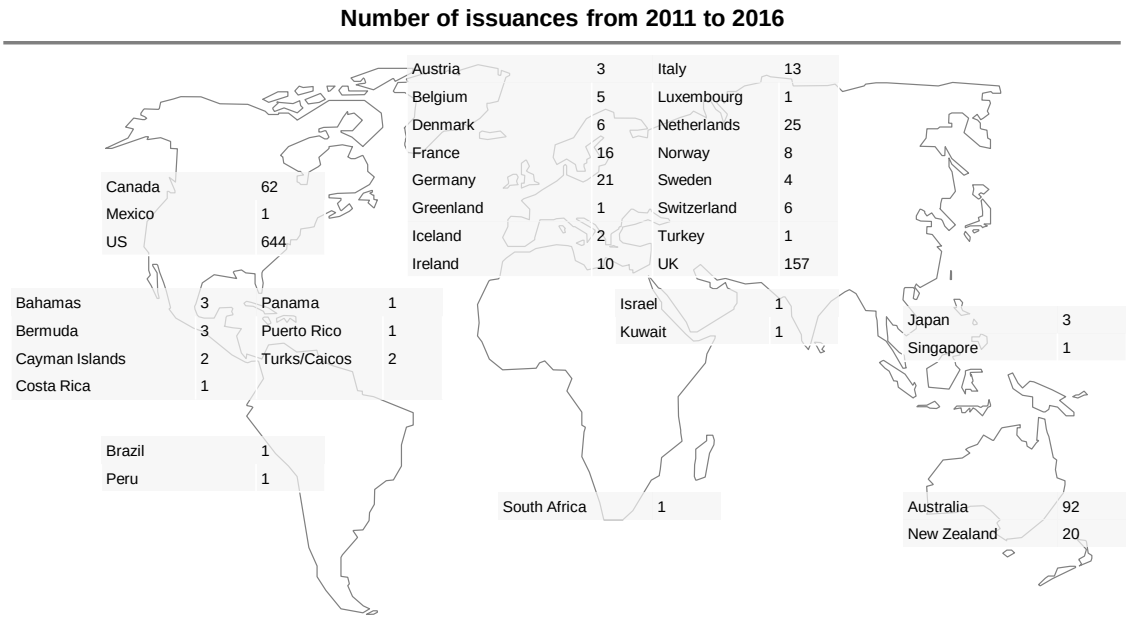

Figure 42: Regional split of issuers in US PP market[207]

The size of issuers in the US PP market is larger than in the Euro-PP market but comparable to the SSD market: around 45% of issuers generate annual revenues between €1B and €5B.

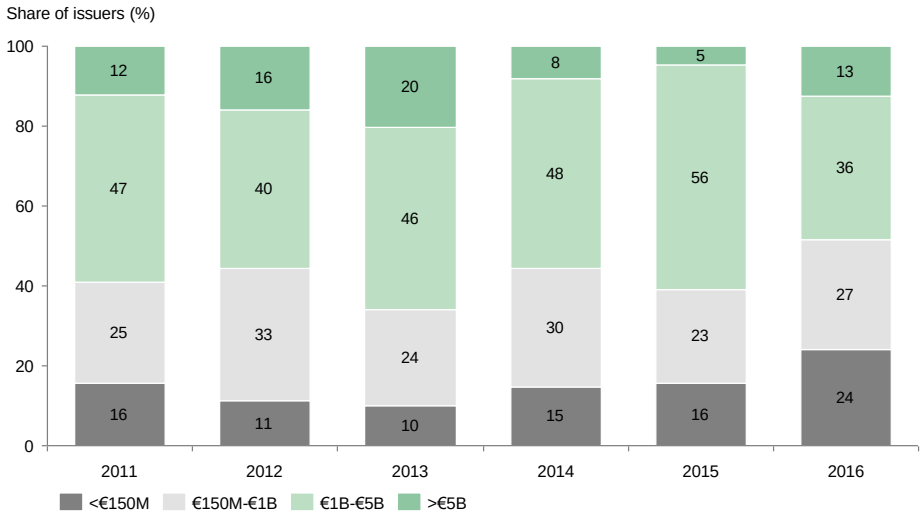

Figure 43: Revenue split of issuers in US PP market[208]

[207] (BCG analysis based on Thomson One 2017)
[208] (BCG analysis based on Thomson One 2017)

Historically around 70 to 80% of issuers in the US PP market were unlisted companies. In 2016, the share of listed issuers has increased to 33%.

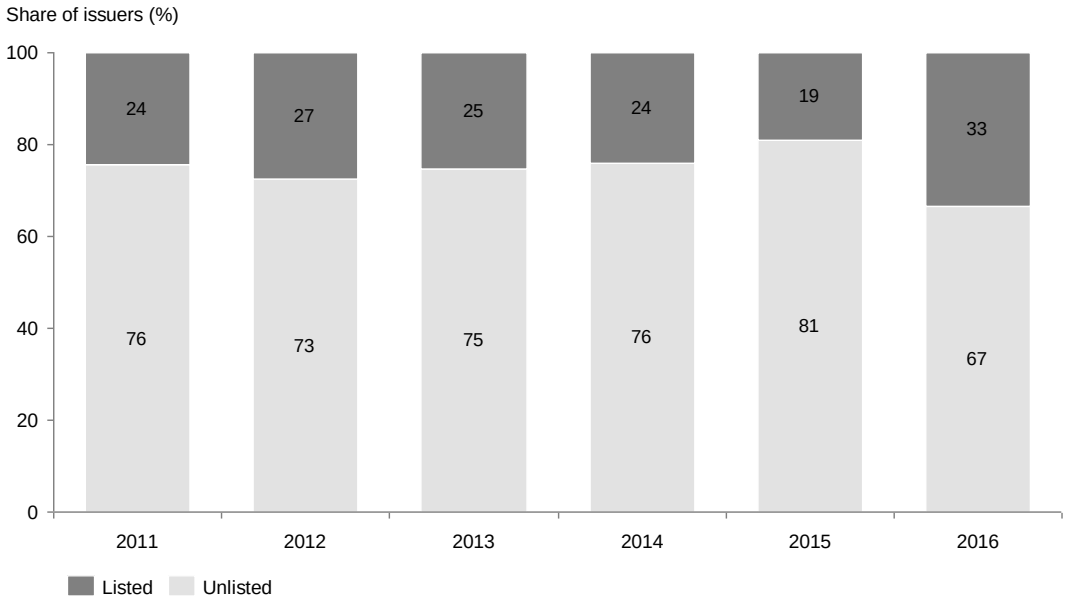

Figure 44: Share of listed and unlisted issuers in US PP market[209]

As in the SSD and Euro-PP markets, issuers of US PPs are present in all commercial sectors. However, a larger number of issuers is from the energy sector, driven by electric companies, as well as in real estate-related industries. The sector split of issuers has remained stable in recent years.

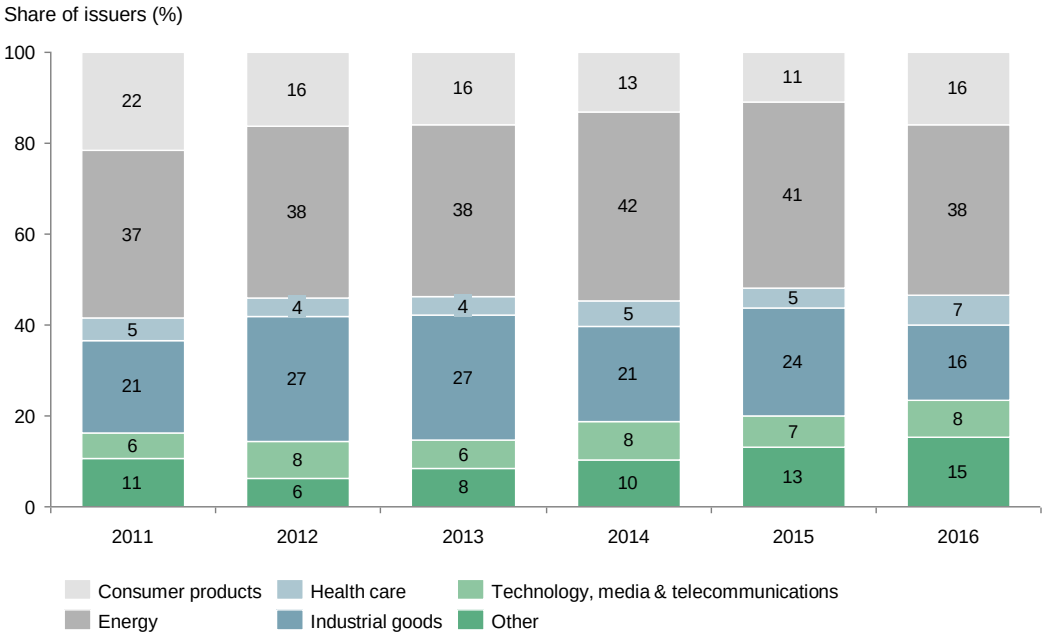

Figure 45: Sector split of issuers in US PP market[210]

[209] (BCG analysis based on Thomson One 2017)

More than 95% of the transactions in the US PP market have an investment-grade equivalent rating by the NAIC, i.e., NAIC-1 or NAIC-2.[211] This is comparable to the credit quality in the SSD market but differs significantly from the Euro-PP market. Compared with the public investment grade market in the US, the average US PP market quality rating is slightly lower, with Baa1/Baa2 compared to A3/Baa1.[212]

An external rating is not required for issuers of private placements. Nevertheless, for US PP investors that are US insurance companies, it is required by law that the issuer receives a private credit designation by the Securities Valuation Office (SVO) of the NAIC.[213] As around 90% of US PPs are held by life insurers, almost all US PPs have an NAIC rating.[214] However, in contrast to public ratings from recognised organisations, the NAIC ratings are not designed to support the investment decision process of a potential investor and are suitable for NAIC members only.[215] These ratings are also used by state insurance regulators to establish reserve requirements, capital adequacy, and compliance with risk-based portfolio limitations.

Excursus: The NAIC rating process

The investor-sponsored rating process for quality assessment and valuation of securities is initiated by the insurance companies reporting the ownership of investment securities to the Capital Markets and Investment Analysis Office, which is part of the SVO. If there is more than one insurance company investing in the same private placement, the investor with the highest investment is responsible for filing the security. The lead investor submits the required documentation (audits, NPA, etc.) and in the next step, the NAIC's SVO conducts a thorough credit analysis, including an independent financial analysis on at least three years of historical audited financial information and a minimum of one year projected financial information. Those filings that are accompanied by unaudited or no financial statements can also be analysed by the SVO but require certified information from the reporting insurance company.[216] At the end of the credit assessment process, the SVO finally assigns a NAIC designation and/or unit price. In particular, NAIC defines six categories for the credit quality from NAIC-1 (highest quality/lowest risk of default) to NAIC-6 (lowest quality/in or near default).[217] Investors bear the risk of the ultimate NAIC rating as they are typically assigned after closing.[218] The entire process can take up to 12 months and pre-ratings are rarely seen, but are possible.[219]

[210] (BCG analysis based on Thomson One 2017)
[211] (BCG analysis based on Private Placement Monitor 2017); (Sakhrani, Ashton und Bates, Cross-Border Private Placement Market: Trends in 2017 2017)
[212] (Mendel 2013)
[213] (NAIC 2017)
[214] (Mendel 2013)
[215] (NAIC 2017)
[216] (NAIC 2016)
[217] (NAIC 2017)
[218] (BCG interview with arranger 2017)
[219] (AFP 2013)

Arranger landscape

The most active arrangers in the US PP market are the large commercial Anglo-American banks; led by Bank of America Merrill Lynch, and by JP Morgan over the past two years and H1 2017.[220]

2015

Rank	Arranger	Share (%)
1	Bank of America Merrill Lynch	23.4
2	JP Morgan	13.5
3	Wells Fargo Securities	8.4
4	Barclays	8.3
5	Citi	5.9
6	Morgan Stanley	5.4
7	NatWest Markets	4.3
8	Mitsubishi UFJ Financial Group	4.1
9	Commonwealth Bank of Australia	3.4
10	National Australia Bank	3.2

2016

Rank	Arranger	Share (%)
1	Bank of America Merrill Lynch	16.9
2	JP Morgan	12.3
3	Barclays	7.6
4	Citi	6.2
5	NatWest	5.7
6	Mitsubishi UFJ Financial Group	4.2
7	Wells Fargo Securities	3.9
8	Morgan Stanley	3.6
9	Goldman Sachs	3.4
10	National Australia Bank	3.0

H1 2017

Rank	Arranger	Share (%)
1	Bank of America Merrill Lynch	20.0
2	JP Morgan	10.2
3	Barclays	9.4
4	Mitsubishi UFJ Financial Group	7.6
5	Citi	6.7
6	Morgan Stanley	5.5
7	Wells Fargo Securities	5.1
8	Goldman Sachs	4.0
9	Lloyds Banking Group	4.0
10	NatWest Markets	3.3

Figure 46: US PP arranger league tables[221]

Investor landscape

Overall, it is estimated that there are around 50-70 active investors in the US PP market[222] with institutional investors accounting for the majority of investors as in the Euro-PP market. More specifically, the most active investors are life insurers with an estimated share exceeding 90%.[223] Other investors are non-life-insurance companies, asset managers, pension funds, and banks. According to the NAIC, in 2015 around 20% of insurance companies' total bond portfolio was invested in PPs.[224]

The largest appetite is for senior unsecured note structures that are pari-passu with bank debt; demand for subordinated notes, on the other hand, is rather limited. Investors remain focused on ensuring they receive adequate covenant packages. The financial covenants are mostly maintenance-based covenants and usually aligned with the covenant package in the issuer's existing debt documentation.[225] For a detailed analysis of the financial covenants used in private placement documentation, see section *III. Analysis of Most Common Risk-Mitigation Clauses in Private Placement Transactions*, in the *Legal part* (pp.185ff). The usual bid size ranges from €5-150M.[226]

[220] (BCG analysis based on Private Placement Monitor 2017)
[221] (BCG analysis based on Dealogic 2017)
[222] (Hayter 2010); (BCG interview with issuer 2017)
[223] (Mendel 2013)
[224] (NAIC 2017)
[225] (BCG interview with arranger 2017)
[226] (BCG interview with arranger 2017)

Key lessons learned from the US PP market

The US PP market – being the most established PP market – is a suitable benchmark to use when seeking best practices.

Unified (capital) market	**Common taxation rules, accounting procedures, insolvency laws** and other unified relevant rules and regulations
Common legal framework	Common framework to assess PP deals within the 'safe harbour' of **SEC exemption under Regulation D**, increased security for investors regarding the treatment of investments
NAIC rating	NAIC rating for the US PP markets post-transaction, complimentary assessment for investors
Standardised documentation	**Standardised template** for the US PP market transaction documentation (Model X Forms), includes 'housekeeping' covenants, allows for financial covenants, already adopted by other PP markets

Figure 47: Best practice examples from US PP market

First, in contrast to the EU, with separate capital markets across Member States, the US is a *unified (capital) market* which results in common taxation rules, accounting procedures, insolvency laws and other unified relevant rules and regulations.[227] Furthermore, the size of capital markets differs as well: in 2014, the level of stock market capitalisation was around 52% of GDP in the EU and 151% in the US.[228]

In the US there is a *common legal framework* for assessing and applying PP deals within the 'safe harbour' of SEC exemption under Regulation D.[229] This provides investors with additional security about the treatment of their investments.[230]

In addition, most PP deals have an *NAIC rating* through the Securities Valuation Office[231], which again gives institutional investors access to a third-party opinion post-transaction. This, in turn, validates their own credit analysis and seems to encourage investment in private placements.[232]

Lastly, the US PP market offers a *standardised template* in the form of its Model X Note Purchase Agreement. The Model X Forms include some 'housekeeping' covenants and ensure a pari-passu ranking of notes and any guarantees.[233] The best practice of

[227] (Basu und Dupont-Barton 2015)
[228] (The World Bank 2017)
[229] Despite some differences in the language used, there is essentially no difference between the 'safe harbour' in the US legislation and the PP exemptions under the prospectus directive. For more information, please refer to pp.142ff.
[230] (AFME und BCG 2015)
[231] (NAIC 2017); US PPs held by insurance companies are required to receive an NAIC rating
[232] (AFME und BCG 2015)
[233] (Sakhrani, Ashton and Bates, Cross-border private placement market: trends in 2016 2016)

standardisation has been adapted in other markets already, for example when building the Euro-PP market.[234]

[234] See section *III. Analysis of Most Common Risk-Mitigation Clauses in Private Placement Transactions* (pp.178ff) of the *Legal part* for a more detailed analysis of the treatment of financial covenants in private placement documentation.

II. Cost-benefit analysis

This section covers advantages and disadvantages of private placements and also includes an analysis of costs for the issuance of and investment in private placements. In general, PPs are designed to complement other funding instruments and are one element in the overall funding mix of companies. Various experts have confirmed that PP instruments can take – or have already taken – a complementary role to other financing sources, such as corporate bonds or bank financing, as they offer distinct advantages for both issuers and investors.[235] These advantages and also potential drawbacks are explored in the following.

Private placement markets as complementary to other financing channels

Compared to the US, Europe is still considered to be over-reliant on bank funding and its capital markets are significantly underdeveloped with only about two-thirds of investable assets.[236] Reducing over-reliance on bank funding has therefore been a pronounced objective of various authorities, especially after the financial crisis in 2008/09. Although it has been reduced over the years, market participants still view bank funding as the dominant source of funding in many EU Member States.[237]

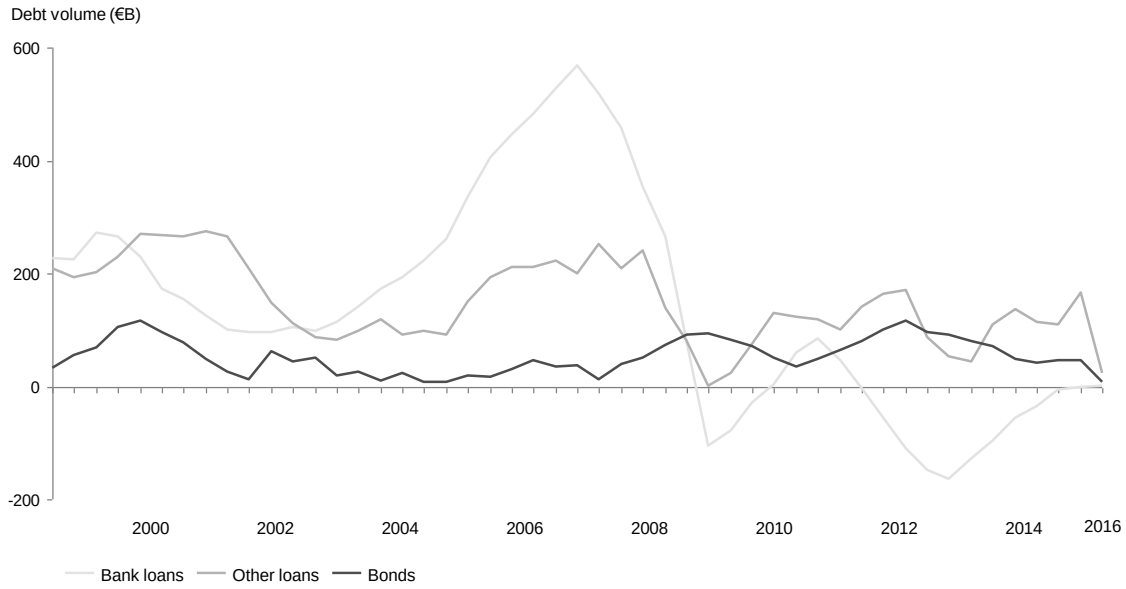

Figure 48: Dynamics in non-financial companies' sources of debt funding (liabilities) in the Euro area[238]

Diversified funding of companies also supports and stabilises national economies in times of economic turmoil.[239] The Schuldschein in particular, has proven to be rather resilient in volatile times. In 2008/09, for example, the SSD provided a source of

[235] (BCG interview with arranger 2017); (BCG interview with investor 2017); (BCG interview with issuer 2017)
[236] (AFME und BCG 2015)
[237] (Schuldschein Forum 2017); (BCG interview with financial expert 2017)
[238] (Schuldschein Forum 2017); (ECB, Eurostat und Commission 2017)
[239] (BCG interview with financial authority 2017)

liquidity while the bond market suffered from capital market fluctuations[240] and availability of bank funding was limited[241]. Again in recent years, the SSD market seemed to be unaffected by political instabilities:[242] despite the European sovereign debt crisis in 2015, Brexit, or the US elections in 2016, the SSD market reached record volumes.[243] The interest in SSDs in volatile times is also supported by the fact that it can be accounted for on an accrual accounting basis. This is preferable for investors especially in volatile environments.

Apart from reducing reliance on bank funding and thereby supporting financial stability during economic crises, private placements occupy a 'sweet spot' between bank financing and corporate bonds, offering market participants an additional financing option. Depending on their needs, companies can choose the most appropriate funding source in terms of time-to-maturity, minimum issuance size, rating requirements or others. Having a full-fledged option space increases companies' funding independence from economic cycles, enabling companies to adapt their funding to their respective needs independently of the liquidity in the banking sector or capital market.[244]

The table in Figure 49 illustrates the different characteristics of various debt financing instruments and how each one offers certain benefits – depending on the respective issuers' and investors' needs.

	Corporate loan	Syndicated loan	SSD	Euro-PP	Corporate bond
Format	Loan	Loan	Loan	Loan or bond	Bond
Uses	Working capital, funding bridge	Working capital, funding bridge	Working capital, funding bridge, acquisition	Working capital, funding bridge, acquisition	Working capital, funding bridge, acquisition, investment
Typical tenor	Wide range	2-10 years	3-5 years	6-8 years	Long term
Volume	n/a	Starting from ~€25M	Starting from ~€10M	Starting from ~€10M	Starting from ~€100M
Coupon	Fixed or floating	Fixed or floating	Fixed or floating	Fixed or floating	Mostly fixed
Rating	Not required	Not required	Not required	Not required	Required
Publicity	No public disclosure requirements[1]	No public disclosure requirements[1]	No public disclosure requirements[1]	No public disclosure requirements[1]	Prospectus and capital market communication
Transaction process	2-6 weeks	10-16 weeks	4-8 weeks	4-8 weeks	10-16 weeks
Primary investors	Banks	Banks	Mostly banks	Institutional investors	Institutional investors

Figure 49: Comparison of debt financing instruments[245]

Advantages and disadvantages of PPs over other financing instruments

To generate a comprehensive picture, the following section will shed light PPs from different angles, including different issuer perspectives (small/mid-sized firm vs. large firm) as well as investor perspectives (institutional investor vs. bank investor).

The table in Figure 50 provides an overview of advantages of private placements for the different stakeholders while potential disadvantages of PPs are given in Figure 51.

[240] (LBBW 2016)
[241] (BCG interview with issuer 2017)
[242] (BCG interview with arranger 2017)
[243] (Dealogic 2017)
[244] (BCG interview with financial authority 2017)
[245] (Association for Financial Professionals 2013); (BayernLB 2017); (BCG analysis 2017)

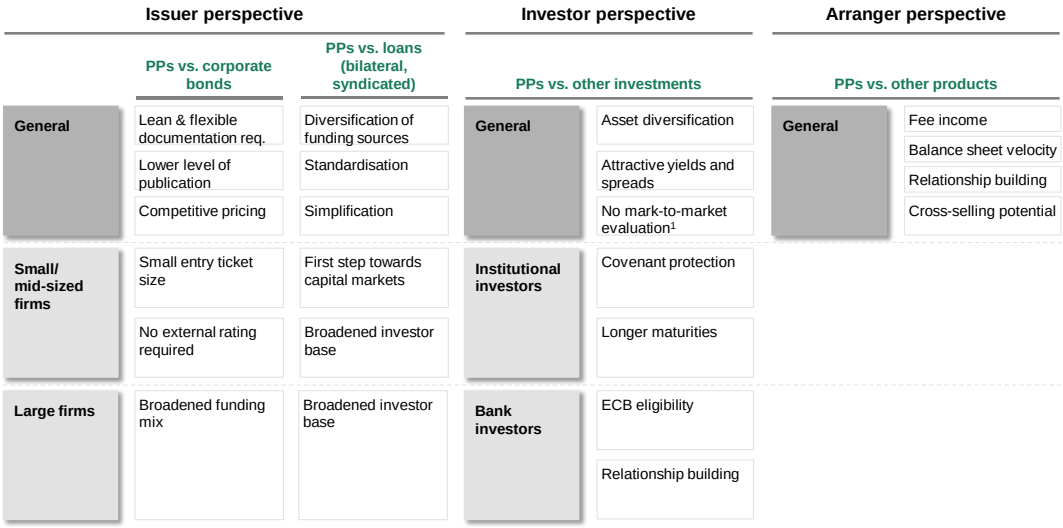

Figure 50: Advantages of private placements[246]

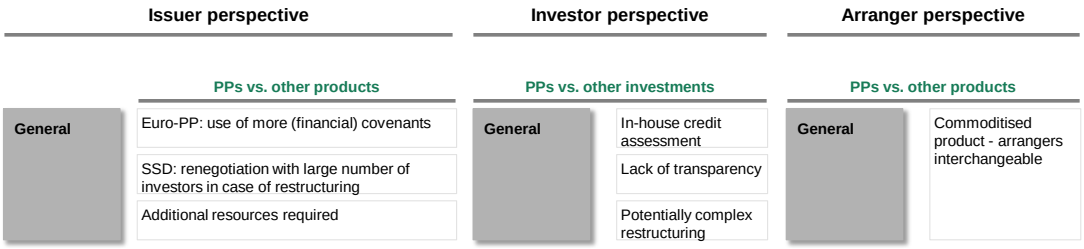

Figure 51: Disadvantages of private placements

Issuer perspective

Advantages of PPs over corporate bonds

Private placements can offer three general advantages over corporate bonds, independent of the issuer's size:[247]

- *Lean & flexible documentation requirements*: Typically, documentation is simpler, and consequently incurs less cost than for bond issuances. In particular, the Schuldschein offers very lean documentation: often only around 20 pages. Nevertheless, documentation is flexible and open for negotiation and customisation to cater to specific needs of issuers and investors.
- *Lower level of publication*: Contrary to a corporate bond issuances, PPs are negotiated directly, or with the help of an arranger between issuers and investors. This allows business-sensitive information to be contained in a limited space as it does not have to be made public, in contrast to a public offering. This confidentiality is often perceived as a major advantage of PPs – especially for privately owned

[246] Footnote 1: Please refer to the *Legal part* (pp.111ff) for specific information on accounting treatment of private placements.
[247] (BCG interview with issuer 2017); (BCG interview with legal advisor 2017); (VÖB 2015); (Basu und Dupont-Barton 2015); (LBBW 2016); (Association for Financial Professionals 2013)

companies – as they combine capital market orientation with the confidentiality levels of loans.

- *Competitive pricing*: Given the current market environment, most issuers are satisfied with the pricing they receive in PP markets and appraise it to be on a competitive level with the pricing on the bond market.[248] Many issuers in PP markets do not have an external rating and, since it is not required, costs related to the rating process are not relevant.[249] For large investment-grade companies with external rating, however, the bond market is still accessible at lower costs, not least because the European Central Bank's current quantitative easing policy has caused bond yields to decrease.[250]

In addition to the general advantages of PPs for issuers, there are some advantages that depend on the size of the issuers. For small and mid-sized firms the following aspects are relevant:

- *Small entry ticket size*: There is no formal minimum issue or tranche size which gives small- or mid-sized firms the possibility to issue smaller ticket sizes. However, arrangers and authorities emphasise that a minimum deal size of around €20M is preferable due to economies of scale.[251]
- *No external rating required*: In contrast to the bond market, private placements allow companies that do not have – or do not want to have – an external rating to access the capital market. This is especially attractive for small and mid-sized firms that do not bring up the necessary funds or documents to receive an external rating or want to eliminate size bias. For some larger firms, it can also be beneficial to not have a rating as it potentially affects pricing in case of a change of the rating.[252] In fact, most issuers in the SSD and Euro-PP market do not have an external rating (see *I. Stock-taking*, pp.17ff).

For **large firms**, there are also some additional benefits of PPs:

- *Broadened funding mix*: PPs are an attractive financing instrument in volatile times, also for large companies. At the beginning of the year 2016, for example, the German bond market was not working to its full extent which made some issuers tap the SSD market instead.[253] In addition, issuers pointed out that the bond market and the associated prices are largely influenced by macroeconomic factors, and thus often volatile, whereas the PP pricing and valuation focuses on the risk of the issuing party itself.

Advantages of PPs over bank financing (bank loans, syndicated loans)

Private placements also offer some advantages over traditional bank financing, i.e., corporate bank loans and syndicated loans:

- *Diversification of financing sources*: Private placement markets provide issuers with an alternative funding source to bank financing. In fact, this was the most

[248] (BCG interview with issuer 2017)
[249] (BCG interview with issuer 2017)
[250] (BCG interview with issuer 2017)
[251] (BCG interview with arranger 2017)
[252] (BCG interview with issuer 2017)
[253] (BCG interview with issuer 2017)

frequently given reason for issuing PPs and is also backed up by several reports.[254] Having different financing sources also helps with liquidity planning.

- *Standardisation*: In general, any standardisation reduces the time and effort spent on documentation by both issuers and investors. Both European PP markets have adopted standardisation best practices, such as the standardisation templates, and some initiatives from the ECPP working group or the LMA aim at promoting PP standardisation even further.
- *Simplification*: Adding more standardised debt products to the funding mix can also reduce a company's effort spent on sourcing funding. Streamlined channels of debt financing can free-up resources in the corporate finance department of an issuer as there is less time spent with banks negotiating traditional bank loans.

For **small and mid-sized firms**, PPs offer the following advantages:

- *First step towards capital markets*: Issuing a PP can be the starting point of a gradual movement towards capital markets as firms position themselves in the extended capital market space. Arrangers also often sell PPs as the first capital-market-related product to their clients.[255]
- *Broadened investor base*: Corporate loans and syndicated loans are a relationship business – as are PPs – and are thus predominantly accompanied by the issuer's core bank. By issuing PPs, on the other hand, smaller issuers get access to a broader investor base beyond their traditional core banks. This enlarges the pool of available debt capital and extends the funding base to a passive group of investors that is not necessarily looking for ancillary business.[256]

In addition to the general advantages listed above, **large corporates** may choose private placements over bank financing to broaden their investment base. Furthermore, they may also favour to issue PPs given the conditions they can obtain are more attractive than through bank financing.[257]

Disadvantages of PPs

Notwithstanding the above, the study identifies three potential drawbacks for issuers of private placements.

First, as raised by some issuers of the Euro-PP, the *use of financial covenants* constitutes one disadvantage of the Euro-PP. In economically difficult times it can be challenging to meet covenants, and covenant packages typically leave issuers with less entrepreneurial freedom to manoeuvre through the difficulties.[258] Nevertheless, as syndicated loans and public bonds also have covenant packages which are often quite similar to those of the Euro-PP, this is no disadvantage limited to Euro-PPs but also relevant for other instruments.

Second, a specific disadvantage of a Schuldschein is the potentially complex *restructuring process*. Large number of investors might result in challenging discussions and result in difficult renegotiation of the SSD's features with all investors

[254] (BCG interview with issuer 2017); (BCG interview with legal advisor 2017); (VÖB 2015); (Basu und Dupont-Barton 2015); (LBBW 2016); (Association for Financial Professionals 2013)
[255] (BCG interview with arranger 2017)
[256] (BCG interview with arranger 2017)
[257] (BCG interview with financial expert 2017)
[258] (BCG interview with issuer 2017); (BCG interview with arranger 2017)

(see below).[259] Third and finally, issuers need to allocate additional internal resources to provide the necessary information for the credit and risk assessment by potential investors. For first-time issuers this may be a particularly relevant aspect. [260]

Investor perspective

The following section outlines specific elements of PPs with relevance for institutional and bank investors.

Advantages of PPs

PPs offer three major advantages:

- *Portfolio diversification*: Investors can diversify their assets by accessing a broad set of issuers through private placements. This set of issuers includes companies to which investors may not have access, such as private or family-owned companies, niche business sector firms or foreign-based companies. For bank investors, this may in particular also include issuers without an existing client relationship to the bank.
- *Attractive yields and spreads*: Private placements often offer attractive yields and relatively stable spreads for the given risk profile. One of the reasons is an illiquidity premium paid for holding a relatively illiquid asset.[261] In the US PP as well as the Schuldschein market, however, spreads are increasingly tight due to a high demand on the investors' side, causing some concerns among investors.[262]
- *No mark-to-market valuation*: Typically, investors can include private placements with their nominal value in their balance on an accrual accounting basis, i.e., there is no mark-to-market valuation of private placements.[263] Thus the value of the assets is not adjusted to market prices, making the investment more resilient to market volatilities. Under IFRS 9, which will come into effect in 2018 and replace the current IAS regulation, investors need to decide whether they will hold their investment assets until maturity or not. If they are held to collect contractual flows until maturity and not intended to be sold, which is the usual case for PPs, under IFRS 9, private placements can be classified at amortised cost. Otherwise, the asset is measured at fair value. [264]

For **institutional investors** PPs have two more aspects that make them an attractive investment:

- *Covenant protection*: For institutional investors in the Euro-PP market, financial covenants provide a certain protection as they act as early warning signs of declining performance. In the US PP market, according to the NAIC, the use of covenants and other contractual protections to manage deteriorating credit quality has resulted in lower default rates for US PPs compared to public bonds.[265] SSDs,

[259] (BCG interview with investor 2017); (BCG interview with arranger 2017)
[260] (BCG interview with arranger 2017)
[261] (BCG interview with investor 2017)
[262] (BCG interview with investor 2017)
[263] (Moody's 2017); (BCG interview with arranger 2017)
[264] (EY 2016); (PWC 2017); (BCG interview with arranger 2017). Please refer to the *Legal part* (pp.111ff) for more information.
[265] (NAIC 2017)

however, are typically rather 'covenant-light', especially SSDs from German issuers. SSD issuances by international issuers increasingly offer covenants.[266]

- *Longer maturities*: PPs – or more specifically US PPs and Euro-PPs – offer long maturities that match investors' long-term liabilities[267] as well as their investment strategy to hold until maturity. In the future, maturities may be expanded as there is a significant interest by issuers who would also be willing to pay higher coupons for longer maturities.[268]

For **bank investors**, which are mainly active in the SSD market, the Schuldschein offers the following additional advantages:

- *ECB eligibility*: SSDs that fulfil certain conditions can be pledged as ECB collateral[269] which allows banks to refinance themselves at lower costs[270.] To be eligible, among other criteria, SSDs need to Euro-denominated, feature a credit assessment conforming to the ECB's minimum requirements and be issued by a non-financial or public-sector entity within the Eurozone.[271]
- *Relationship-building*: Building on access to a broader issuer base, bank investors – in particular non-European ones – also value PPs as an additional channel to establish new relationships with issuers.[272] This, however, is rather a secondary benefit as market participants claim that there might be more effective ways to build a relationship than lending.[273]

Disadvantages of PPs[274]

Private placements incur two specific drawbacks that are especially relevant for **institutional investors**:

- *In-house credit assessment*: Unlike the bond market, where institutional investors mostly examine external ratings and public information, PP markets require institutional investors to conduct an internal credit analysis which requires i) necessary capabilities and skills, and ii) sufficient resources and time as it involves examining the financial statements of several past years, sector specifics (there can be significant differences between different sectors, e.g., technology vs. real estate), review of the business model and operations, and assessment of financial ratios, among other activities. This makes PP investments more challenging, especially for smaller institutional investors which might not have the necessary in-house credit analysis skills.[275] There are, however, more and more asset managers

[266] (BCG interview with arranger 2017)
[267] (Basu und Dupont-Barton 2015)
[268] (BCG interview with arranger 2017); (BCG interview with issuer 2017)
[269] This is set out in the guideline (EU) 2015/510 of the European Central Bank of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (ECB/2014/60). Schuldscheine are expressly mentioned in Art. 2 (Definitions) (13) as credit claims. Credit claims are in Title III, Chapter 1, Section 1 Art. 89 seq. set out as eligible type of asset. This has not changed based on the Guideline (ECB) 2015/27 and the guideline of 2 November 2016.
[270] (BCG interview with arranger 2017)
[271] (UniCredit 2011) (European Central Bank 2011)
[272] (BCG interview with investor 2017)
[273] (BCG interview with arranger 2017)
[274] (BCG interview with legal advisor 2017)
[275] (BCG interview with arranger 2017)

with dedicated corporate debt financing teams who already have or are building up these skills.

- *Lack of internal knowledge*: There is still a lack of knowledge (and awareness) regarding PPs, especially beyond the German Schuldschein or the US PP. First and most importantly, the Euro-PP is still relatively new. Second, for international, non-European investors, it might be challenging to receive investment approvals from internal credit committees for PPs if they are based on different law systems, e.g., on German or French law. Additionally, international investors may not have the local market expertise and, even more generally, PPs are less known outside of Europe and North America.[276] However, this might change in the near future as European issuers and arrangers increasingly hold roadshows in Asian hubs, such as Singapore, to raise awareness and gain trust from international investors for PP instruments.

Both of these disadvantages can be counteracted by having a dedicated and skilled team in-house. Building such a team, however, again requires certain set-up costs and time.

Two potential drawbacks that seem to be not as relevant are the *lack of an external rating* and the *lack of a liquid* secondary market. The lack of an external rating is often mentioned as a drawback of PPs for institutional investors. According to market experts, however, investors consider a rating as a nice-to-have, but not essential – ultimately, an investment decision is always based on an investor's own assessment.[277] This point of view seems to be even more prominent in the SSD market: at the Schuldschein Forum 2017 in Frankfurt, for example, 90% of the participants stated that they deemed an official rating unnecessary.[278]

Regarding the lack of a liquid secondary market, this especially applies to European PP markets which are rather illiquid. This could represent a serious limitation for investors, many investors, however, do not consider it to be a major hurdle. They consider PPs as illiquid instruments from their investment decision on and want to hold them to maturity. On the contrary, if an investor chooses to sell the private placement, this can be rather perceived as a sign of distress.[279] In addition, investors appreciate the premium paid for holding an illiquid asset.[280]

In the Schuldschein market, the lack of transparency is perceived as another disadvantage. Lack of transparency can occur in at least two situations: on the one hand, investors often have no insight into how allocations are decided upon. On the other hand, for SSDs with a large number of investors, an individual investor has little information about the development of the issuance as they typically receive only one to two annual updates. This can be considered as a disadvantage, especially by international bank investors.[281]

Arranger perspective

Advantages and disadvantages can also be assessed from the arranger's perspective.

[276] (BCG interview with investor 2017)
[277] (BCG interview with investor 2017)
[278] (Schuldschein Forum 2017)
[279] (BCG interview with investor 2017)
[280] (BCG interview with investor 2017)
[281] (BCG interview with arranger 2017)

Advantages of PPs

Private placements constitute attractive instruments also for arrangers. For one, PPs in a loan format offer arrangers fee *income* without necessarily binding capital. Following the principle of "originate-to-distribute", arrangers keep the fees for the transaction but eliminate the assets from their balance sheet. The application of this principle, in contrast to "originate-to-hold", increases the *balance sheet velocity* and is easier to leverage for private placements than for traditional loans. Some arranger banks will hold on to a part of the PP, thus keeping some proverbial skin in the game (especially for SSDs), but still bind less capital and balance sheet than in a "buy-and-hold" model.[282]

Offering PPs might also be an important addition in an arranger's product portfolio, and might set an arranger bank apart from a 'second-tier' bank by offering the whole range of debt capital market products.[283] As a consequence, it also adds to the *relationship-building* aspect, i.e., banks getting in contact with new or existent clients through PPs. Lastly, offering PPs might lead to some cross-selling potential in case of the PP serving as the anchor product for related products, such as currency or interest rate swaps.

Disadvantages of PPs

Some industry experts claim that it is mostly traditional loans that act as 'anchor products' and constitute the core of a customer's relationship with a bank, especially in Germany.[284] Private placements, on the other hand, seem to become increasingly *commoditised products*. This might diminish the relationship factor mentioned above, which in turn would lead to arranger banks being somewhat interchangeable. For complex PPs with large volumes, however, this is less applicable.

Including PPs in a product portfolio also entails having a dedicated team to deal with PP-related questions and tasks. Thus, certain set-up costs are required to develop such a team. Arranger banks therefore need to build a track record in the PP space to attract issuance volume to justify the initial set-up costs.[285]

General remarks on the use of private placements

In spite of the advantages laid out above, it should be stressed that private placements constitute no universal remedy for every company and situation and are therefore not necessarily a suitable financing source. As originally intended, PPs should be regarded and used as complementing financing instrument to diversify a company's financing sources. PPs, as for all other financing instruments, should not be the only source of financing and any over-reliance on private placements should be critically assessed.[286]

The increasing use of PPs for jumbo deals – especially for SSDs – needs to be closely monitored: Potentially, the documentation and publication requirements of PPs are not sufficient for such large volumes.[287] While the issuance of SSDs is still a relationship-driven business, large deals are increasingly complex and the use of funds is also not

[282] (BCG interview with arranger 2017)
[283] (BCG interview with arranger 2017)
[284] (BCG interview with arranger 2017)
[285] (BCG interview with arranger 2017)
[286] (BCG interview with arranger 2017)
[287] (BCG interview with rating agency 2017)

always made transparent; thus, lean documentation might not always be the most adequate.[288]

Assessment of issuing costs of PPs compared to other financing sources

The main cost buckets for issuing a private placement are considered to be *arranger fees, legal fees, costs related to the provision of information* to potential investors and the *coupon* paid. Costs may vary depending on the chosen PP format (Euro-PP vs. SSD, rated vs. unrated, etc.) and the issuer profile. Nonetheless, overall, private placements offer lower issuance costs, especially compared to public markets.

PPs vs. corporate bonds

Overall, the issuance costs of private placements are estimated to be lower than for corporate bonds. First, there are *lower documentation* costs as there is usually no need to create extensive documentation such as a prospectus for investors, exchanges or bank supervision which reduces costs for auditors, among others. Second, there are *no registration or rating agency fees*.[289] Third, *legal fees* are lower due to lower complexity.

Interview partners have frequently stated that the lower issuance cost of private placement instruments is the single most important factor when it comes to choosing between corporate bonds and PPs – despite many other relevant aspects, such as time-to-maturity or documentation requirements.[290]

Experts estimate that the costs for issuing a Schuldschein are about 0.5-1% of the nominal value and generally tend to the lower bound for larger issuances as certain costs, for instance the cost of involving legal advice, are fixed rather than variable.

However, these legal costs may vary substantially depending on negotiations with investors, whether the issuer is already listed and if the bonds are listed on a regulated market, an MTF or unlisted. For illustrative purposes, in the case of a first time issuer, legal fees will be raised by 20% compared to a repeat deal.

The cost of involving legal advice for a simple unsecured bilateral Schuldschein structure will be around €10,000 to €20,000. For a more complicated secured structure, about €25,000 to €50,000. Any protracted negotiations or specific issues can lead to an increase in such costs. Legal fees for a Euro PP issuance may then vary between €40,000 and €90,000.[291]

A banking expert from a US commercial bank estimated total issuance expenses for PPs to be around €200,000 to €250,000; that is including fees for a road-show, legal advice and other expenses.[292] In turn, issuance costs of corporate bonds rather range between 3-5% of the nominal value, although this might lessen significantly for large companies and also if the company is a frequent issuer.[293]

[288] (BCG interview with arranger 2017); (BCG interview with legal advisor 2017)
[289] (LBBW 2016)
[290] (BCG interview with issuer 2017); (BCG interview with arranger 2017); (BCG interview with financial authority 2017)
[291] (BCG analysis based on Linklaters 2017)
[292] (BCG interview with arranger 2017)
[293] (BCG interview with arranger 2017)

PPs vs. bank financing

According to market experts, there is no major difference in the total cost for syndicated loans compared to PPs. Again, it depends instead on the complexity of the individual transaction.[294]

A major cost item for loans are legal fees that need to be invested independently from the risk profile of the loan. Nevertheless, the required effort and ultimately the costs vary. "Plain vanilla" syndicated loans are likely to be very large and will require drafting legal documentation spanning across multiple credit lines, geographies and large investor pools. High yield loans are likely to be complex and to leverage collateral. Only simple bilateral loans incur lower legal costs as they are typically issued with the house bank; the long-standing relationship between issuer and bank helps to minimise risk and due diligence efforts and cost.

The table in Figure 52 provides a more detailed overview on the different costs per debt financing instrument. Please note that this is an indicative expert assessment.

		SSD	Euro-PP loan	Euro-PP bond	Corporate bond	Bilateral loan	Syndicated loan
Pre-origination	Financial statement information	(x)	(x)	(x)	x	(x)	(x)
	Due diligence	(x)	(x)	(x)	x	-	-/(x)
Structuring & origination	Stock exchange admission	-	-	(x)	(x)	-	-
	Capital market compliant rating (external rating)	(-)	(-)	(-)	x	-	-
	Legal fees	x	x	x	x	-	x
Distribution	Documentation needs	(x)	(x)	(x)	x	(x)	(x)
	Marketing expenses	(x)	(x)	(x)	x	-	(-)/(x)
	Prospectus/Memorandum	-	(-)	(-)	x	-	(x)
	Road show	(-)	(-)	(-)	x	-	(x)
	Registrar fees	(-)	(-)	(-)	x	-	-
	Structuring & arranger fees	x	(x)	(x)	x	(-)	(x)
Post-origination	Auditing fees	(x)	(x)	(x)	x	-	(x)
	Public exchange membership fees	-	-	(x)	(x)	-	-
	Internal costs to provide in-depth financials	(x)	(x)	(x)	x	(-)/(x)	(x)
	Ongoing reporting obligations	(x)	(x)	(x)	x	(-)/(x)	(x)

Legend
x = applies (x) = applies to a lesser extent (-) = almost not applicable - = not applicable

Figure 52: Issuance costs compared across debt financing instruments[295]

Assessment of investment costs of a PP compared to other investments

For investors, there are two main cost categories that characterise investing in private placements compared to public instruments, such as corporate bonds: *in-house credit analysis and monitoring of financial performance* after the deal is closed.

In the Euro-PP market in particular, there are many first time issuers who might not know how to tell a credit story or which financial information is needed. One

[294] (BCG interview with legal advisor 2017)
[295] (BCG analysis 2017)

institutional investor shared that one transaction with a family-owned company took about nine months from the first meeting until the PP was issued. This, however, is an exception: most transactions take 4-8 weeks.[296] Nonetheless, it requires a significant amount of time and resources to perform a diligent credit analysis and to prepare the right legal package that reflects the credit quality adequately for internal decision making.

Nevertheless, there is no strong indication for a significant difference in the cost structure and amount between private placements and corporate bonds. While additional expertise may be required to conduct specialised credit assessments, there is no indication that this differs to usual corporate bond requirements.[297]

In addition to the pre-transaction costs there are post-transaction costs. Once the transaction is completed there is a great need for close monitoring to exercise any rights of investors when needed.[298] This is especially relevant when holding private placements as there is no liquid secondary market. Another relevant factor when assessing the costs of investing in a PP compared to other investment opportunities are the capital requirements of PPs that come along. For insurers, the capital requirements for assets are determined under Solvency II.

Excursus: Solvency II

Directive 2009/138/EC – as amended by Directive 2014/51/EU (Omnibus II) – ("**Solvency II**") replaced fourteen existing directives in the insurance sector commonly referred to as 'Solvency I'. Solvency II has three pillars: i) quantitative requirements, ii) governance and risk management, and iii) disclosure and transparency requirements. The quantitative requirements of pillar i) require all insurers subject to Solvency II to have at all times eligible own funds of at least the level of the Solvency Capital Requirement ("**SCR**"). Under the standard formula[299] as set out in article 103 et seqq. of Solvency II (and further specified in delegated acts) the SCR shall be calculated as the sum of the Basic SCR ("**BSCR**"), which is relevant in terms of investments of insurers, the capital requirement for operational risk, and the adjustment for the loss-absorbing capacity of technical provisions and deferred taxes. The BSCR comprises individual risk modules, inter alia, the market risk module and the counterparty default risk module (inter alia, insurance-specific risk modules). For the purposes of the calculation, the investments of an insurer, such as private placements, are (depending on the type of risk exposure) to be assigned to the sub-modules of the market risk module: i.e., the interest rate risk sub-module, the equity risk sub-module, the property risk sub-module, the spread risk sub-module, the market risk concentrations sub-module, and the currency risk sub-module. It should be noted that the risk (sub-) modules are not mutually exclusive and an asset may be subject to different risk modules at once (e.g., the spread risk and the interest rate risk sub-module).

Private placements fall under the market risk module and therein, as a matter of principle, under the spread risk sub-module and the interest rate risk sub-module (further sub-modules could apply depending on the features of the private placement).

[296] (BCG interview with investor 2017)
[297] (BCG interview with financial expert 2017)
[298] (BCG interview with investor 2017)
[299] Solvency II provides a range of methods to calculate the SCR which allows undertakings to choose a method that is proportionate to the nature, scale and complexity of the risks that are measured (the standard formula or, with approval of the competent regulatory authority, a full internal model or a partial internal model).

Often it is stated that financial assets handled in the market risk module and spread risk sub-module require more solvency capital than comparable assets handled in the counterparty risk module (e.g., certain mortgage loans). Under the spread risk sub-module, unrated transactions are treated similarly to assets with an external rating of BBB or BB, with corresponding charges attached (depending on the modified duration of the instrument).

Experts criticise several aspects: firstly, private placements are usually not subject to risk from market volatility, as they are typically held to maturity.[300,301] Therefore, risk charges reflecting market volatility could be too excessive for private placements. Secondly, capital charges that apply to US PPs under NAIC-rules are more favourable compared to Solvency II, especially for PPs with longer maturities, as the capital requirements do not consider the duration of a PP.[302,303]

Other experts, however, argue that the treatment of PPs under Solvency II is not really a barrier as the stricter treatment of PPs leads to higher returns; in other words, investors looking for better return 'need' some risk.[304] One insurer also noted regarding the treatment of PPs that "*it could be worse, it could be better*"[305.]

Taking the different perspectives into consideration, it is certainly helpful that the European Commission revisits the current calibrations of Solvency II and considers a potential recalibration, although Solvency II does not seem to be a significant hurdle for institutional investors when investing in PPs.

[300] (BCG interview with arranger 2017)
[301] (BCG interview with investor 2017)
[302] (BCG interview with rating agency 2017)
[303] (BCG interview with arranger 2017)
[304] (BCG interview with arranger 2017)
[305] (BCG interview with investor 2017)

III. Growth potential

A key component of this study is to identify EU Member States with potential to grow the funding channel of private placement for corporates. This section assesses the potential number of issuers across the EU based on key characteristics of existing markets and evaluates the investor landscape in selected Member States. It furthermore highlights PP markets outside SSD and Euro-PP and cross-border activities across the EU and evaluates potential economic barriers to further development. Legal and regulatory barriers for growth of private placement across the EU are analysed in the *Legal part* (pp.117ff) of the study.

This study identifies mid-sized companies with revenues between €75M and €5B as the most relevant issuers for privately placed debt instruments from an economic perspective. In order to constitute a proper domestic market for PP, both demand from investors and supply in form of issuers for whom a PP issuance is economically feasible is required. In the French Euro-PP and German SSD market, investor appetite is strong due to long tenors, attractive yields and due to access to debt of privately owned companies. Moreover, a relatively small number of professional investors with appetite for the type of issuer and instrument is already sufficient to "start" a PP market. France, for example, started its PP market in 2012 with only around 10 initial investors.[306] In addition, the investors' appetite is not restricted to issuers from their own domestic markets.[307]

Therefore, development of potential PP markets across the EU is less demand- than supply-driven. A key indicator for the potential supply is the **number of potential issuers** with the right characteristics described below.

If the issuer base of a Member State is below a certain threshold, issuers are more likely to (continue) to engage in cross-border activities and the development of a tailored domestic PP product is less likely and feasible from an economic perspective. Based on that reasoning, EU Member States can be allocated to the following two categories:

i. *Potential domestic markets*: EU Member States with relatively high potential to develop and grow a national PP market in the near future, based on their issuer and investor base; the prevalence of an existing domestic PP initiative is a second important factor;

ii. *Cross-border markets*: Member States with smaller national issuer base, lower investment capacity or other constraints to develop a domestic PP market in the short term; however, there are already a significant number of issuers that issue in cross-border PP markets or which have a significant potential to do so in the future.[308]

In order to assess the growth potential and to allocate potential EU Member States to these categories, a quantitative and qualitative assessment with insights from market

[306] (BCG interview with association 2017); (BCG interview with investor 2017)
[307] (BCG interview with financial authority 2017)

[308] In general, companies from all EU Member States can issue private placements in the existing markets; nevertheless, this analysis will focus on those countries that have a significant cross-border potential in terms of the potential issuer base.

experts are combined. For details on the mature markets in Germany and France, please refer to section *I. Stock-taking* (pp.17ff).

Quantitative assessment of potential number of issuers

To identify EU Member States with the potential for developing either a domestic market or a significant number of cross-border transactions, the potential base of issuers in each EU Member State is taken into account. Based on findings from the section *I. Stock-taking* (pp.17ff) as well as expert opinions, this study expects companies with annual revenues between €75M and €5B to be the most relevant potential PP issuers for economic reasons.[309] In Figure 53, the number of active companies with this range of annual revenues size are given for every EU Member State.

Country	# of active companies with revenue btw. €75M-€5B
Austria	1561
Belgium	1831
Bulgaria	187
Croatia	136
Cyprus	101
Czech Republic	690
Denmark	1195
Estonia	77
Finland	817
France	5725
Germany	9469
Greece	320
Hungary	445
Ireland	911
Italy	4755
Latvia	94
Lithuania	120
Luxembourg	351
Malta	83
Netherlands	2973
Poland	1397
Portugal	587
Romania	328
Slovakia	292
Slovenia	142
Spain	2881
Sweden	1975
United Kingdom	9730

Figure 53: Number of active companies between €75M-€5B[310]

In principle, every Member State can develop or further scale a private placement market, if there is interest and market participants have an economic need. The establishment of such a market, however, is associated with certain set-up costs for investors, issuers and arrangers. Markets with a larger number of potential issuers are more likely to develop a critical mass of transactions in order to justify set-up costs, e.g., specialised credit analysts.

[309] (BCG interview with arranger 2017); (BCG interview with financial authority 2017)
[310] (Orbis 2017); Despite certain shortcomings, Orbis is considered to cover the market most comprehensively in all Member States, including both public and private companies.

In France, financial authorities assumed that 1,000-2,000 potential issuers are necessary to generate a sufficient number of transactions to form a domestic PP market.[311] Building on this example, the study sets the required minimum number of issuers to constitute a domestic market at 1,000 companies. Although it is likely that not all potential issuers will enter the PP market immediately, it is crucial to have a sufficiently large pool of potential issuers to generate growth. In France, there were only 20 issuers in 2012 and 26 in 2013, accounting for less than 1% of potential issuers (5.725).[312] Based on this logic and in addition to the countries with larger existing markets, i.e., Germany and France, the following countries have a potential issuer base large enough to enable growth of private placement markets: Austria, Belgium, Denmark, Italy, Ireland, the Netherlands, Poland, Spain, Sweden and the UK.

Quantitative assessment of potential number of investors and investment capacity

To match the supply side and to create a functioning private placement market, there needs to be sufficient demand, i.e., a minimum number of investors and enough investment capacity. However, the investor side is not the critical factor for a private placement market; a relatively low number of investors is already sufficient to generate sufficient demand to start a market.[313] Therefore, the following information about the number of potential investors and investment capacity in the countries under consideration is not decisive for the categorization but rather to complete the market picture.

In line with the ICMA definition and the focus of this study, the main target group for future PP markets are institutional investors. According to market experts across Europe, demand from this investor group in this specific type of instrument is generally high due to the various advantages PPs offer to institutional investors (see section *II. Cost-benefit analysis*, pp.64ff).[314]

Figure 54 displays the number of pension funds, insurance companies and asset management companies in EU Member States that have a high number of potential issuers.

[311] (BCG interview with financial authority 2017)
[312] (BCG analysis based on Dealogic 2017)
[313] (BCG interview with association 2017); (BCG interview with investor 2017)
[314] (BCG interview with arranger 2017); (BCG interview with investor 2017)

Country	# of pension funds[1]	# of insurance companies	# of asset management companies[2]
Austria	13	138	29
Belgium	196	123	82
Denmark	20	153	16
France	n/a	301	613
Germany	171	375	313
Ireland	67,840[4]	259	431[5]
Italy	283	220	280
The Netherlands	320	186	188
Poland	25	61	n/a
Spain	1,688	241	96
Sweden	830[3]	207	78
United Kingdom	43,690	454	197

Figure 54: Number of institutional investors per group in selected EU Member States[315]

An estimation of the investment capacities of pension funds and insurance companies in the selected countries is shown in Figure 55. Although pension funds and insurance funds do not comprise 100% of the investment community, they are the largest investor pools as well as the target investors for PPs (with the exception of bank investors in Germany), and can thus be used as a reliable proxy for the total investment capacity in the respective countries.[316]

[315] Footnotes refer to: 1. OECD data from 2015; 2. EFAMA data from 2013; 3. Swedish Pensions Agency; 4. OECD Reviews of Pension Systems - Ireland and the Irish Pensions Authority's Annual Reports; around 57,000 out of the 68,000 Irish pension schemes have only 1 member and would not be required to be registered in certain other countries; 5. End 2012 data.
(BCG analysis based on OECD 2015); (EFAMA 2017)

[316] The investment data includes all investments by pension and insurance funds (equities, bills & bonds, cash & deposits, others), whether in-house or via third-party asset managers.

Country	Pension fund investments (€B)	Insurance company investments (€B)	Sum (€B)
Austria	24	83	107
Belgium	24	231	255
Denmark	554	268	822
France	210	1,706	1,916
Germany	202	1,454	1,656
Ireland	122	54	176
Italy	144	567	711
The Netherlands	1,220	490	1,710
Poland	37	25	62
Spain	156	268	424
Sweden	346	303	649
United Kingdom	2,490	1,205	3,695

Figure 55: Investment capacities of institutional investors in selected EU Member States[317]

Qualitative assessment

The findings of the previous quantitative approach are completed by expert assessments regarding the growth potential of PP markets in EU Member States. Overall, market participants from well-established markets are somewhat sceptical about the scale potential of domestic PP markets in other EU Member States. Their concerns are based on different factors, such as country size overall, maturity of domestic capital markets, and lack of domestic investment capacity.[318]

There is however a common understanding that in order to constitute a domestic market for PP transactions, there needs to be a sizeable supply by mid-sized companies and a demand for alternative financing instruments. This can be amplified, for instance, by a high dependency on bank loans or a rather illiquid banking, as it is the case in Spain or Italy.[319]

Another hypothesis mentioned by market participants is that countries with a local currency might have a greater need to develop a domestic PP market than countries with the Euro currency, as those can more easily engage in cross-border activities.[320] For instance, if multinational companies want to issue Euro-denominated private placement instruments, they might either choose the SSD or the Euro-PP market. The same holds true for investors from Euro-denominated countries, as they can easily invest in the well-established markets. In turn, for issuers and investors operating in a non-Euro-denominated country where a currency hedge may be expensive, a domestic market for private placements may be economically reasonable.[321] This reasoning, for instance, applies to non-Euro Scandinavian countries, which are frequently mentioned as potential domestic PP markets.[322] Along the same lines also Poland is mentioned,

[317] (BCG analysis based on OECD 2015); the Netherlands has the highest ratio of pension assets to GDP (2015: 184%) followed by the US (121%)
[318] (BCG interview with arranger 2017); (BCG interview with financial authority 2017); (BCG interview with investor 2017)
[319] (BCG interview with arranger 2017); (BCG interview with financial authority 2017)
[320] (BCG interview with arranger 2017); (BCG interview with investor 2017)
[321] (BCG interview with arranger 2017)
[322] (BCG interview with issuer 2017); (BCG interview with arranger 2017);

but it shows few signs of additional credit demand, mainly as a result of the fact that there is enough liquidity in the banking sector which leads to competitive pricing in the market.[323]

Notwithstanding the above, it should be noted that the local currency may only be a contributory factor in the creation of a domestic market. Consequently not every non-Euro-denominated country is per se a potential domestic private placement market in the EU. Moreover, from an investor perspective, many investors from Euro-denominated countries may not want to incur a currency risk or may be restricted to invest in Euro-denominated issuances.[324] Thus, a local currency may also imply a strong limitation on the investor base.

Cross-border markets are generally perceived as being more likely to develop than domestic markets. In general, companies from all EU Member States can issue private placements in the existing markets; it is predominantly a question of size and also credit quality whether an issuer can tap a market or not. Furthermore, both banks and institutional investors consider cross-border issuances and show a willingness to invest in foreign issuers if they fit into their portfolio. Market participants see a large potential for companies from Southern Europe, i.e., Spain or Italy, as well as from the Benelux countries, i.e., Belgium or the Netherlands.[325,326] In addition to existing cross-border activities of these countries in SSD and Euro-PP markets, some large international commercial banks have newly established 'SSD-teams', indicating an increasing interest in the German SSD market.[327]

Despite the perceived potential for cross-border activities, market experts have identified two challenges. First, the credit quality assessment of relatively unknown issuers from outside the main PP markets may be more difficult and thus linked to higher uncertainty. Such issuers will therefore most likely have to pay a premium to issue a PP.[328] Therefore, a non-German or non-French issuer will carefully consider advantages and disadvantages to diversify funding away from core banks in exchange for paying a premium.

Furthermore, some domestic investors have a preference for domestic issuers. For example, German Sparkassen and Volksbanken often have certain country limits that they need to respect.[329] Institutional investors in the French market also mentioned a preference for domestic issuers as they speak the same language, which – in their view – makes a diligent credit analysis and negotiations much easier.[330]

EU Member States with PP growth potential

Given the heterogeneous economies and industry landscapes across the EU, the financing needs of companies and thus the potential for private placements varies across the Member States. In particular, the disparity between old and new Member

[323] (BCG interview with arranger 2017)
[324] (BCG interview with financial expert 2017)
[325] (BCG & Linklaters 2017)
[326] Many European companies issue through Luxembourg vehicles. The number of potential issuers itself is rather small and Luxembourg is therefore not considered to be a relevant country for the analysis.
[327] (BCG interview with arranger 2017)
[328] (BCG interview with arranger 2017); (BCG interview with association 2017)
[329] (BCG interview with association 2017)
[330] (BCG interview with investor 2017)

States in terms of the current size of industries translates directly to the assessment of growth potential for private placements.

The study identifies three countries that exhibit large number of potential issuers and have already undertaken first steps towards creating a new domestic product tailored for the specific needs of the industry: **Italy, the Netherlands and Spain**. While Spain and Italy have already undertaken first steps and introduced mini-bond products, they are still at an early development stage. The Netherlands, in turn, are working on a home-market initiative to try to establish a pan-European private placement market similar to the Euro-PP.

Based on the number of potential issuers, the study expects substantial potential for cross-border activities for those countries with at least 1,000 potential issuers. This is the case for Italy, the Netherlands and Spain, and for **Austria, Belgium, Denmark, Ireland, Poland, Sweden** and **the United Kingdom**. Nevertheless, as stressed before, companies from all Member States can engage in cross-border activities and especially larger corporates from smaller countries may become important issuers in the future.

As elaborated in section *I. Stock-taking* (pp.17ff), the two existing markets differ in terms of the credit quality requirements of issuers. It should therefore be noted that not every potential issuer is suitable for a private placement in both the SSD and the Euro-PP market.

Figure 56: EU Member States in different growth potential categories[331]

The following section provides a brief overview of each of the specified countries for new domestic markets and cross-border markets.

Countries with potential for domestic markets

Italy

Overall, Italy shows many characteristics of a significant potential for growth of private placement activities and the creation of a new domestic market. First and most importantly, the study identifies 4,755 potential issuers that generate annual revenues in the target range of €75M to €5B.

Secondly, the financial crisis of 2008 and its aftermath put intense pressure on SMEs, and still, access to finance is seen as the single greatest challenge for SMEs in Italy.[332]

[331] Footnote 1: Companies from the United Kingdom are actively tapping the US PP market, primarily driven by cultural proximity between the two countries (see also Figure 42).
[332] (Deutsche Bank Research 2014)

In 2015, Italy's share of bank funding for domestic corporates was at 62%[333], which is lower than the EU average of roughly 70% but still significantly higher than in the US market, where bank funding accounts for only 30%.[334] In 2016, the domestic credit provided to the private sector by banks was 86% of GDP; in Germany this ratio was at only 77% and 53% in the US.[335] Moreover, Italy's nonperforming loans to total gross loans ratio is significantly higher than the EU average; in 2016 this ratio was at 17% compared to less than 5% on average in the EU.[336] Nevertheless, other experts see good preconditions for private placement growth given an established "bond-financing culture" in the Italian economy.[337]

To reduce the dependency on bank lending and to offer its large SME base an alternative funding source, Italy has undertaken several steps to support alternative financing instruments, in particular private placements. There are currently two existing initiatives to foster growth of a domestic private placement market.

On the one hand, Italy introduced legal changes (see the *Legal part*, pp.117ff, for further details) and standardized documentation to support its private placement instruments, launching the ExtraMOT PRO as a multilateral trading facility for corporate bonds, including also the Italian mini-bonds[338], in 2013.

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[333] (Banca d'Italia 2016)
[334] (AFME 2014)
[335] (The World Bank 2017)
[336] (The World Bank 2017)
[337] (BCG interview with financial expert 2017)
[338] Mini-bonds are general debt instruments especially designed for unlisted companies, but are not equivalent to private placements in the definition used by this study (see *Abstract*

Private placement of debt can play a key role in the financing of EU businesses. In line with the CMU Action Plan, this study identifies best practices in the well-functioning EU markets of private placements (mainly the German *Schuldschein* and the French Euro-PP) as well as potential barriers to their development. The study shows a considerable growth potential for private placements of debt in the EU as they create specific opportunities to issuers and investors alike. Most notably, private placements allow medium-sized firms to access new funding opportunities and reduce their reliance on bank funding. They allow investors to diversify their investment portfolio to unrated, private firms while earning an attractive return. Further, the risk-profile of private placement instruments is not substantially different from senior unsecured debt. No major regulatory barriers preventing further growth of private placements in the EU have been identified as requiring immediate attention. However, some steps could be taken at European and national level in order to foster the development of private placement markets.

Résumé court

Le placement privé de la dette peut jouer un rôle clé dans le financement des entreprises européennes. En ligne avec le Plan d'Action CMU, cette étude identifie les meilleures pratiques (best practices) dans les marchés de placements privés européens d'ores et déjà existants et les barrières potentielles à leur développement.

There was a high demand for this from the corporate sector and it was established following changes in the tax regime that allowed unlisted companies to issue bonds and to be treated almost equally to listed companies[339], therefore allowing Italian companies an easy and flexible access to capital markets[340]. The ExtraMOT PRO mini-bond does not require a minimum issue size. Average deal size amounts to €25-30M and maturity is typically between five to seven years.[341] An external rating is not required, and currently two thirds of the issuers are not rated.[342] Moreover, in April 2016, in order to foster the visibility of the issuers and their products listed on

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L'étude montre que les marchés de placements privés ont un potentiel de croissance important, car ils créent des opportunités spécifiques tant pour les émetteurs que pour les investisseurs. Plus particulièrement, les placements privés permettent à des entreprises de taille moyenne de diversifier leur financement et de réduire leur dépendance au financement bancaire. Ils permettent aux investisseurs de diversifier leurs investissements dans des entreprises privés et non notées par une agence de crédit, tout en obtenant un rendement attractif. De plus, le profil de risque des outils de placement privé n'est pas substantiellement différent de celui des dettes senior non garanties. Aucune barrière réglementaire significative empêchant la croissance des placements privés dans l'UE n'a été identifiée comme nécessitant une attention immédiate. Certaines mesures pourraient néanmoins être menées tant au niveau national qu'européen pour soutenir le développement des marchés de placements privés au sein de l'UE.

Zusammenfassung

Die Privatplatzierung von Schuldinstrumenten kann bei der Finanzierung von Unternehmen in Europa eine Schlüsselrolle spielen. Im Rahmen des Aktionsplans zur Schaffung einer Kapitalmarktunion (CMU Action Plan) stellt diese Studie die besten Praktiken von gut funktionierenden EU-Märkten für Privatplatzierungen (der deutsche *Schuldschein* und der französische *Euro-PP*) sowie die Rahmenbedingungen für die weitere Entwicklung der Märkte für Privatplatzierungen dar. Die Studie identifiziert Wachstumspotenziale für Privatplatzierungen von Verbindlichkeiten in der EU, die den Optionenraum für Finanzierungen bzw. Investitionen sowohl für Emittenten als auch für Investoren erweitern. Vor allem ermöglichen Privatplatzierungen es mittelgroßen Unternehmen, auf neue Finanzierungsinstrumente zuzugreifen und weniger von einer Finanzierung durch Banken abhängig zu sein. Investoren bieten Privatplatzierungen die Möglichkeit, ihr Investmentportfolio mit Schuldtiteln von nicht börsennotierten Unternehmen zu diversifizieren und dabei eine attraktive Rendite zu erzielen. Derzeit unterscheidet sich das Risikoprofil der untersuchten Privatplatzierungsinstrumente nicht wesentlich von nicht besicherten erstrangigen Verbindlichkeiten. Es wurden keine wesentlichen regulatorischen Hürden festgestellt, die weiteres Wachstum von Privatplatzierungen in der EU verhindern und sofortiges Handeln erfordern würden. Dennoch sollten auf europäischer und nationaler Ebene Maßnahmen ergriffen werden, um die Entwicklung von Privatplatzierungsmärkten zu fördern.

Background and objective, pp.8f)
[339] (Borsa Italiana 2016); (BCG interview with financial authority 2017)
[340] (BCG interview with stock exchange 2017)
[341] (Afme 2015)
[342] (Afme 2015)

ExtraMOT, Borsa Italiana launched ExtraMOT PROLinK, a website fully dedicated to issuers and relevant instruments listed on ExtraMOT PRO, where relevant information is easily accessible to investors.

The mini-bond market explicitly targets medium-sized issuers[343], who usually enter the market with an advisor who supports new entrants in the emission phase[344]. It is restricted to professional investors, usually institutional.[345] Until now, domestic investors have been funding the vast majority of the market. However, there is a growing number of international investors active, particularly foreign insurance companies and asset managers from the UK, the Nordics or Benelux.[346] As of December 2016, the Italian mini-bond market had issued 165 mini-bonds for a total value of €9.0B.[347] The Italian government has been very active in growing the market, e.g., by investing €250M in the launch of a mini-bond fund in 2014.[348]

On the other hand, in 2012 Italy initiated the ELITE program, which is a digital platform that offers special training and consultancy services for selected companies – especially SMEs – to help them to acquire new funding sources. Moreover, the ELITE venture aims to establish strong links between companies, advisers, investors and all relevant stakeholders, creating the right conditions for a resilient funding environment, tailored to the needs of companies seeking funds. It was initially open to Italian companies only, today they account for about 60% of the enrolled companies. 40% of all companies have annual revenues above €50M and are therefore close to or within the target range of potential issuers.[349]

Subsequently, in 2016, the platform was extended to allow these companies to also directly raise capital on a digital FCA regulated private placement platform, in so called 'ELITE Club Deals'. Like the ExtraMOT PRO, it is limited to professional investors only. The deals require only limited standardized information and a set of predefined documentation; deal sizes currently average between €10-25M.[350] Also for ELITE companies, a recently introduced "ELITE Basket Bond" offers the possibility to receive funding from investors with smaller issuances as well, as the bonds issued by the companies are collateralized through a special purpose vehicle in a single note, offered to institutional and professional investors.[351]

This positive development, however, is countered by strong competition from the banking sector, as the bank loan market is currently highly liquid and cheaply priced.[352] In addition, market experts claim that the mini-bond market is still too complex and too costly for a large share of small to medium-sized companies.[353]

As well as the domestic PP activity, Italian issuers also show some activity in cross-border transactions. There were at least four issuances in the SSD market, one in

[343] (Allianz Bond Market Contact Group 2015)
[344] (BCG interview with stock exchange 2017)
[345] (Borsa Italiana 2016); (BCG interview with stock exchange 2017)
[346] (Whittaker 2015)
[347] (Borsa Italiana 2016); other databases with different definitions of mini-bonds publish different data, for example, (Politecnico di Milano – Dipartimento di Ingegneria Gestionale 2017) calculated €6.2B for the total issuance value until the end of 2016
[348] (Bottiglia and Pichler 2016)
[349] (ELITE 2017)
[350] (BCG interview with platform provider 2017)
[351] (BCG interview with platform provider 2017)
[352] (Whittaker 2015); (Banca d'Italia 2016)
[353] (BCG interview with financial expert 2017)

2008 and 3 in 2012. The issuers were all large companies with annual revenues above €5B.[354] Smaller or mid-sized firms were more active in the Euro-PP market; in 2014, there were 8 issuances by Italian firms, and in 2015 a total of 13.[355]

According to some market experts, there are still fundamental challenges to private placements in Italy: i) complex and (too) costly preparation of information packages, ii) little or no domestic origination network for investors to access smaller companies, iii) lack of standardised processes for rating smaller companies, and iv) enforcement of debt repayment.[356] Notwithstanding the above, market participants see positive developments and first steps in the right direction thanks to initiatives aimed at the provision of assistance and the build-up of specific financial expertise, with the ultimate goal to ensure trust both on the side of the issuer and of the investor.[357]

The Netherlands

In the past, bank financing has been the dominant funding source for Dutch corporates.[358] This leads to a high dependency on the banking sector: in 2015, around 77% of corporate funding originated from 203 banks.[359] In terms of GDP, in 2016 the domestic credit provided to the private sector by banks was equivalent to 111% of GDP – 15% above the average in the EU, and significantly above France (97%) and Germany (77%).[360]

Regarding privately placed debt, most market participants refer to privately placed bonds, dominated by issuances from municipalities or other public institutions.[361] However demand for corporate private placements increased after the financial crisis. Dutch companies tried to access funding alternatives in order to reduce their dependency on the banking.[362]

As a result of this, cross-border activity into other corporate PP markets increased. Since 2008, there have been 18 issuances of Dutch issuers into the SSD market, thereof 3 in 2016, and 4 issuances into the Euro-PP market.[363] There were even more issuances into the US PP market: 80% of the total outstanding amount of private placements are denominated in US$. Growth of the PP market is also driven by institutional investors, e.g., banks and insurers, who are increasingly active in the market.[364] Additionally, there is a broad Dutch initiative, spearheaded by banks and especially insurance companies in particular, which is currently working on a home-market initiative trying to establish a pan-European private placement market very

[354] (BCG analysis based on LoanConnector 2017)
[355] (BCG analysis based on Dealogic 2017)
[356] (BCG interview with financial expert 2017)
[357] (BCG interview with stock exchange 2017)
[358] (Dijk 2014)
[359] (European Central Bank 2016); this compares to 69% in France and 79% in Germany.
[360] (The World Bank 2017)
[361] (Aegon 2016)
[362] (De Nederlandsche Bank 2015)
[363] (BCG analysis based on Dealogic 2017)
[364] (BCG interview with financial expert 2017) (BCG interview with association 2017) (De Nederlandsche Bank 2016)

similar to the Euro-PP.[365] Finally, with 2,973 potential issuers generating annual revenues in the target range of €75M to €5B, the Netherlands show a positive growth potential.

Spain

In Spain there are strong indications that there is a significant potential for growing private placement activities. The potential issuer base is strong with 2,881 companies generating annual revenues in the target range from €75M to €5B.

Secondly, the Spanish economy is still highly dependent on bank financing; 80% of funding for non-financial corporates originates from over 200 credit institutions and foreign branches – therefore 10% above the EU average.[366] Even more notably, in 2016 the domestic credit provided to the private sector by banks was equivalent to 111% of GDP; which compares to 97% in France and 77% in Germany, and an EU average of 96%.[367]

In recent years, however, there has been a structural shift in financing sources towards capital markets. Larger Spanish corporates and multinationals are reducing their reliance on bank financing, while smaller companies, although still highly dependent on traditional sources in most cases, have begun assessing capital markets as a potential new source of funding. The growth in corporate debt issuance has mainly been driven by the downward trend in benchmark rates, the drop in the Spanish risk premium, and the improved financial health of non-financial corporate issuers.[368]

To create an additional funding source for medium-sized companies, mini-bonds were also introduced in Spain. The mini-bond market in Spain is carried through the *Mercado Alternativo de Renta Fija* (MARF). MARF was established in 2013 and is targeted at mid-sized companies to diversify their funding and at professional institutional investors to diversify their investment portfolios.[369] To ensure a certain level of stability, MARF included quantitative and qualitative limitations in the asset allocation of insurers.[370]

On the issuer side, MARF targets SMEs in particular, with preferred issuance volumes of €20-100M.[371] Owing to the strict regulations in the market, EBITDA levels and leverage ratios are limited. Furthermore, each issuance requires a thorough description of the issuer and the debt securities and a list of the most relevant risk factors.

The introduction of MARF was accompanied by significant changes in the Spanish regulation, concerning corporate laws, securitization and company financing laws.

[365] (Dijk 2014); (BCG interview with arranger 2017); (BCG interview with association 2017)
[366] (European Central Bank 2016)
[367] (The World Bank 2017)
[368] (Guijarro, Gaya und Pardo 2015)
[369] (Viscsillas 2013)
[370] (Allianz Bond Market Contact Group 2015)
[371] (BCG interview with stock exchange 2017)

Moreover, MARF offers advantages concerning documentation, publication requirements and others that continuously attract more issuers.[372]

MARF has registered a total issuance volume of €6.2B[373] since it was created in 2013. Among the issuers are 50-60 companies that have never operated on the capital market before and this positive trend is expected to continue in the future.[374]

In terms of a domestic PP market, MARF can be considered as a substantial first step. Best practices with other PP initiatives should be shared to further improve growth.[375] Some market experts, however, consider Spain to be too small to establish a significant domestic market. Nevertheless, the recent experience with MARF shows that there is a new appetite amongst investors and the majority of placements are actually investor-driven.[376]

In terms of cross-border activity in the SSD and Euro-PP markets, Spanish issuers have historically been less active. Between 2008 and 2016, there were only four issuances by one utility company in the SSD market (in 2008, 2010, 2012 and 2016)[377]. By contrast, the German market has most recently registered a re-appearing interest from southern European countries in the SSD[378] and there was also some activity in the Euro-PP market with four issuances in 2015 and three issuances in 2016. The larger activities in the Euro-PP market compared to the SSD market indicates that the profile of the Euro-PP market seems to be more suitable to the needs of Spanish issuers.

Countries with potential for cross-border markets

Austria

Austrian corporates receive 89% of their financing through bank lending.[379] This figure is among the highest in Europe and suggests a very strong dependency. The Austrian capital market is very small, on both the equity and the bond side. Larger corporates regularly access the German stock exchange.[380]

Thus, there is demand for funding diversification, particularly for the 1,561 companies in the €75M-€5B revenue bracket. These companies are very similar to German "Mittelstand" (medium-sized) companies.

In fact, Austrian companies are already active issuers in the German SSD market. Between 2008 and 2016 alone, they issued 64 SSDs, with constantly double-digit number of issuances since 2014 (14 in 2014, 11 in 2015 and 10 in 2016).[381] The issuer mix is broad across industries, whereas in terms of size issuers are medium to large companies, as typically seen in the SSD market.

[372] (BCG interview with stock exchange 2017)
[373] This figure includes both mini-bonds and commercial papers issued in MARF.
[374] (BCG interview with stock exchange 2017)
[375] (BCG interview with stock exchange 2017)
[376] (BCG interview with stock exchange 2017)
[377] (BCG analysis based on LoanConnector 2017)
[378] (BayernLB 2017)
[379] (European Central Bank 2016)
[380] (BCG interview with financial expert 2017)
[381] (BCG analysis based on LoanConnector 2017)

There have not been any reported issuances in the Euro-PP market.[382] This might be attributed to the proximity of Germany and Austria, in terms of business culture, language and financial and economic system.[383] Similar corporate laws in Germany and Austria also support cross-border transactions into the SSD market.[384]

Owing to the proximity between the two countries, it is easier for Austrian companies and investors to tap the well-established SSD market than to create a domestic market. As a matter of fact, also Austrian investors can invest in Austrian companies based on the SSD documentation. Growth, however, is also limited as the banking sector is characterised by a high liquidity and regulatory obstacles, such as the legal framework given by the Austrian Pension Fund law, prevent investors from engaging in SSDs to a larger extent.[385]

Belgium

Compared to other EU countries, Belgium has a relatively low share of bank funding for domestic corporates with around 50%.[386] The shift towards alternative funding instruments has notably increased over the last years. Following the financial crises, this was influenced by the low interest rate environment and an increased investor demand for higher-yielding assets.

Belgian issuers, including some of the 1,831 companies with revenues of €75M-€5B, are already active in the PP markets through cross-border transactions. In the last five years, seven Belgian issuances were made in the SSD market, and a total of 19 issuances in the Euro-PP market.[387] The higher number of Euro-PP issuances can be explained through proximity thanks to a common language and a similar legal framework. Larger, investment-grade issuers from Belgium are also active in the US PP market.[388]

As most of the current PP activity is cross-border, there is no Belgian specific legal framework or standard documentation.[389] To foster cross-border activities still further, some remaining legal challenges, such as taxation for international investors, could be removed. For more details, please refer to the *Legal part* (pp.117ff) of this study.

Denmark

Traditionally, Danish companies have been highly dependent on bank lending: in 2016 domestic credit to private sector by banks was at 170% of GDP.[390] The financial crisis,

[382] (BCG analysis based on Dealogic 2017)
[383] (BCG interview with financial expert 2017)
[384] (BCG interview with financial expert 2017)
[385] (BCG interview with financial expert 2017)
[386] (European Central Bank 2016)
[387] (BCG analysis based on Thomson One 2017); (BCG analysis based on Dealogic 2017)
[388] (BCG analysis based on Thomson One 2017)
[389] (BCG interview with legal advisor 2017)
[390] (World Bank 2017)

however, as well as the subsequently increasing pressure on banks sparked considerations of whether issuance of bonds by companies might be a useful addition to financing sources.[391]

Despite these considerations, the bond market today is almost non-existent. Only a few top Danish companies issue bonds.[392] As for SMEs, the Danish government stated that "SMEs in Denmark do not make use of corporate bonds as a source of funding"[393]. Costs for issuing a bond, including the need for an external rating, are seen as the major hurdle. Nonetheless, with the "Corporate and other bonds" segment, Nasdaq Copenhagen actually already has a special market for corporate bonds.[394]

The Danish government sees standardisation, easier access to a credit as well as increased abilities of investors to quantify the associated credit risk, e.g., through official ratings, as important factors in promoting liquidity in the corporate bond market.[395]

Utilizing a PP instrument might therefore be an interesting option to diversify funding for smaller companies. In total, the study identifies 1,195 potential issuers. Current demand, however, seems limited as bank liquidity is comparably high and the Nordic banking sector is in a stable condition. In addition, there has so far been no reported cross-border activity, neither into the SSD nor the Euro-PP market.[396]

Ireland

In comparison to other EU Member States, Ireland seems to have diversified away from bank funding. Its share of bank funding for non-financial companies currently at only 32%, compared to 69% in the French market and 79% in the German market.[397] Thus, there is already a significant share of other financing instruments but so far only a low volume of private placement activities. Nevertheless, the study identifies a potential issuer base of 911 companies.

There is already an Irish PP market for financial institutions that use it as an alternative source of wholesale funding. According to a recent report published by the Central Bank of Ireland, the market peaked at €121B in 2007, but it fell significantly to €29B in 2014.[398] After the financial crisis, the downgrading of banks' credit ratings and an associated decrease in investor confidence reduced the appetite for new issuances. Since then, demand has remained low with reduced loan-to-deposit ratios.[399]

In terms of the investor landscape, in the past the market was dominated by Irish-domestic banks and IFSC banks (i.e., international banks operating in Ireland). This, however, shifted towards non-bank financial institutions: in 2014, 62% of these

[391] (Galbo und Rosenbaum 2013)
[392] (BCG interview with financial expert 2017)
[393] (Ministry of Business and Growth Denmark 2015), p.7
[394] (Nasdaq 2011)
[395] (Ministry of Business and Growth Denmark 2015)
[396] (BCG analysis based on LoanConnector 2017); (BCG analysis based on Dealogic 2017)
[397] (European Central Bank 2016)
[398] (Coates und Dooley 2016)
[399] (BCG Interview with Irish expert 2017)

private placements were held by investment funds and money market funds.[400] A private placement market for financial institutions might serve as an indicator that a corporate private placement market could find investors.

Currently, cross-border activities in the SSD and the Euro-PP market are rather limited. There were two issuances in the SSD market in 2016 and one into the Euro-PP market in 2016.

Overall, the outlook for Ireland from a private placement perspective seems mixed. Reliance on bank funding is not as prevalent as in other EU Member States, which appears to have dampened the demand for PPs, including cross-border transactions.

Poland

Poland has a comparably low share of bank funding for domestic corporates with around 51%.[401] The share of corporate loans in the Polish banking sector's assets is one of the lowest in the EU.[402] While Poland has a high number of 673 banks[403], around 600 of these are cooperative banks, each of which is registered as a single, independent entity, and only 36 commercial banks operate in Poland.[404] With regards to assets, 70% of the market are covered by the top 10 banks.[405]

Therefore, there is a strong need for further development of capital markets, and in particular, to diversify funding for mid-sized companies. For the latter, private placements are a potential financing option and this study identifies 1,397 companies who could be potential issuers of private placements.

Poland's main corporate bond market, Catalyst, is still relatively small compared to other European countries, particularly in terms of liquidity and transparency.[406] In 2016, there were only 19 companies issuing corporate bonds with an average issue size of €20M. The companies' average revenue was €50-75M and therefore slightly below the target bracket for substantial private placement activities.

Catalyst also offers a segment for private placements but these are more or less corporate bonds for which private placement techniques are used. In fact, only 20% of corporate bond issues were made public while the remainder was privately placed. This private market accounted for a total volume of outstanding debt of €18B by 2016.[407]

An important challenge to the further development of a domestic capital market is the relatively small institutional investor base with currently below 100 potential investors. Furthermore, institutional investors have a rather short term orientation as they seem to be concerned with longer maturities and therefore potentially higher risks.[408]

[400] (Coates und Dooley 2016)
[401] (BCG analysis based on data from Narodowy Bank Polski 2017)
[402] (Raiser 2015)
[403] (Narodowy Bank Polski 2017)
[404] (BCG interview with financial expert 2017)
[405] (BCG interview with financial expert 2017)
[406] (BCG interview with financial expert 2017)
[407] (BCG interview with financial expert 2017)
[408] (Raiser 2015)

To encourage institutional investors to be more active in capital markets, the Polish bank association Związek Banków Polskich (ZBP) supports the Commission's CMU Action Plan, and highlights the importance of removing any obstacles for institutional investors when investing in capital markets, e.g., investment limits.[409] With regards to further development of private placements, the ZBP observes PP used as a legal tool for financing transactions within one capital group or other similar business ventures in the Polish market.[410]

Engaging in existing private placement markets through cross-border activity can also yield opportunities in enlarging the investor pool. So far, however, there are no reported cross-border transactions in the SSD market and none in the Euro-PP market.[411]

Sweden

Swedish corporates largely rely on equity capital and bank lending as financing sources; 80% of non-financial corporates' financing needs are still funded by around 160 banks.[412] Bilateral loans are particularly important for smaller companies, whereas syndicated loans are more common among larger companies.[413] The study identifies 1,975 potential issuers of private placements.

The capital market is relatively small in Sweden; bonds, for example, are issued by government and mortgage institutions, with respective 25% and 40% of the total volume of bonds in Swedish kronor.[414] There is, however, increasing interest in the corporate bond market. It was started by a few large Swedish firms (among others, Volvo and Ericsson) and has now around 150 active borrowers.[415]

Banks are trying to bring more mid-sized companies to the capital markets, but the main challenge remains the lack of an external rating. Investors typically do not have the internal capacities to cover the less known companies in-depth; the previous shadow rating of banks can no longer be used for credit assessment by investors.[416]

Potential measures to address these challenges could be a simplified legal framework, one market standard for documentation, a streamlined and cost-efficient rating, and potentially the introduction of a trustee function for restructurings as it is done in Norway.[417]

So far, it appears as if the private placement market in Sweden is a market where only PP techniques are used for a bond issuance. For example, several Swedish companies, such as Nexam Chemical Holding AB or Vicore Pharma, have privately placed corporate bonds.[418]

There is also already some cross-border activity in the SSD and the Euro-PP market: there was one issuance each in the SSD market in 2013, 2015 and 2016, and one in

[409] (Związek Banków Polskich 2015)
[410] (Związek Banków Polskich 2015)
[411] (BCG analysis based on LoanConnector 2017); (BCG analysis based on Dealogic 2017)
[412] (Sveriges Riksbank 2017)
[413] (Sveriges Riksbank 2011)
[414] (Sveriges Riksbank 2016)
[415] (BCG interview with financial expert 2017)
[416] (BCG interview with financial expert 2017)
[417] (BCG interview with financial expert 2017)
[418] (Nexam Chemical 2016); (Vicore Pharma 2017)

the Euro-PP market in 2015.[419] According to legal experts, Swedish issuers are even more active on the US PP market.[420] However, as there are no specific regulatory barriers for preventing a Swedish company from issuing a Schuldschein or a Euro-PP, cross-border activities might increase in the future.

[419] (BCG analysis based on LoanConnector 2017); (BCG analysis based on Dealogic 2017)
[420] (BCG interview with legal advisor 2017)

IV. Risk analytics

This section focuses on understanding and assessing risks of private placement transactions in the German SSD market, the French Euro-PP market and the US PP market. The risk-assessment is separated into the following four categories:

- Credit risk
- Market risk
- Liquidity risk
- Regulatory and legal risk

To assess these risk categories in the context of private placement instruments, this study combines relevant quantitative data – where available – and qualitative risk evaluations based on interviews with investors, issuers, arrangers, state authorities and risk experts. The objective of this section is to address key risk parameters that investors take into account when generating a holistic risk-return profile.[421] For specific information on risk mitigation strategies for PPs regarding documentation and legal frameworks, including commonly used covenants, please refer to the *Legal part* (pp.117ff) of this study for a detailed discussion.

Overview of risk categories

Credit risk

Credit risk in the form of *issuer default risk* is the risk that the borrower may not repay at all, not in time or not in full. In such a case the investor would lose the principal and/or the interest associated with it, resulting in a disruption of cash flow and increased collection cost.[422] For privately placed debt instruments, this risk is the most material category as investors almost exclusively follow a buy-and-hold strategy.[423]

In addition to issuer default risk, counterparty credit risk is a second, minor factor in the context of PP transactions. Counterparty credit risk is defined as the risk of default, delay of payment or only partial payment of any counterparty of the issuer (i.e., arranger and investor).[424] The nature of the contractual relationship of PP instruments means that there is no exposure to any material counterparty risk. Except for the risk of investor default between the conclusion of the contract and payment of the principal, the contractual relationship does not fundamentally change if the counterparty (i.e., arranger or investor) defaults. The issuers would still be able to use the private placement funding until the end of maturity and then repay the principal to the insolvency assets of the defaulted investor.

Another form of counterparty risk exists for derivatives that are cross-sold in some PP transactions to investors and issuers.[425] A default, delay or only partial payment of the

[421] (BCG & Linklaters 2017)

[422] (The Association of German Public Banks 2015); (Sveriges Riksbank 2014); (Bank of International Settlements 2000)

[423] For information on the key financial ratios of issuers of selected deals, please refer to the *Appendix* (pp.228ff).

[424] (Sveriges Riksbank 2014)

[425] According to interview insights, this is particularly true for any cross-border issuances outside the eurozone

counterparty of the derivative could pose a risk for these issuers and investors.[426] However, since these derivatives are usually not part of the contractual agreement of the private placements, they are not the focus of this study.

Market risk

Market risk includes all risk sub-categories that originate from external market factors such as changes in interest rates, political events, or others.[427] Private placement instruments are exposed to external market factors in the same way as other financing instruments.

Based on the European IAS regulation, adopted in 2002, all European companies that are listed on an EU securities market (including banks and insurance companies), have been required to follow IFRS accounting standards since 2005.[428] As a financial asset, according to IAS 39 — Financial Instruments: Recognition and Measurement, as well as IFRS 9, which will replace IAS 39 as of 1 January, 2018, private placement instruments can be classified at amortised cost if they are held to collect contractual flows until maturity and not intended to be sold.[429] If held to maturity, from an accounting perspective private placements are therefore not adapted and exposed to market price.

Liquidity risk

Liquidity risk covers the financial risk that an investment cannot be bought or sold quickly enough without incurring a loss. Therefore, liquidity risk in the context of private placement of debt is strongly related to the presence and liquidity of a secondary market. Investors should theoretically be able to dispose of their assets, for example, in the event that they require liquidity or if the risk-return-profile of an investment is no longer adequate from their perspective.

The level of activity on the *secondary market* can serve as an indicator of how material the liquidity risk of an asset is. In addition to the total volume traded, the spread between ask and bid prices also indicates liquidity: the higher the spread, the lower the market liquidity.

Since almost all private placement investors follow a buy-and-hold strategy, a liquid secondary market is currently not established. Nevertheless, during special circumstances such as during a crisis or times of financial distress, even long-term investors might have to liquidate assets. In these situations, liquidity risk becomes material and needs to be accounted for. In general, though, investors appreciate the illiquidity premium that is factored into most PP transactions.

Regulatory and legal risk

The most relevant *regulatory risk* in Europe concerns capital requirements. Potential changes to capital requirement regulations (in the context of PP mainly CRR and Solvency II) can have significant effects on the capital requirements of investors, e.g., capital and leverage ratios.[430] *Legal risk* concerns the risk of errors in documentation

[426] (Fath und Stanley 2011)
[427] (Federal Reserve 2017)
[428] (Deloitte 2017)
[429] (EY 2016)
[430] (BCG interview with financial expert 2017)

and management of covenants, as well as the risk of differences in legislation between countries (geographic risk).

Please refer to the *Legal part* (pp.117ff) of this study for a more detailed discussion of regulatory and legal risk.

Risk categories compared across different debt instruments

The following section assesses the risk profile of different debt instruments for the risk categories described above. An overview of the separate risk assessments in this section can be found in Figure 57.

Credit risk		Market risk		Liquidity risk		Regulatory and legal risk
Private placements	Traditional instruments	Private placements	Traditional instruments	Private placements	Traditional instruments	
• SSD	• Corporate bond	• SSD	• Corporate bond		• Corporate bond	*See legal part*
• Euro-PP	• Corporate loan	• Euro-PP	• Corporate loan		• Corporate loan	
• US PP		• US PP				

Figure 57: Overview of risk categories compared across different debt financing instruments

Credit risk

Schuldschein

The corporate Schuldschein market has traditionally been a market for issuers with investment-grade ratings, this reputation is acknowledged by all market participants[431]. Nevertheless there are some market participants who claim that there are signs of a side market developing, with an increasing number of sub-investment grade companies issuing SSDs.[432] Some of these issuers have previously been active on the German 'Mittelstandsanleihen' market which has seen an extraordinarily high default rates with more than 20% (see pp.106f for details). However, this side market is expected to remain small, and the overall SSD market is expected to remain a strong investment-grade market[433].

As a result, there have been very **few cases of default** in the SSD market in recent years.[434] To derive a theoretical approximation for the issuer default rate in this market, the weighted average default rate can be calculated based on the average rating of a SSD issuer and a rating agency's experience value of default for each rating class[435]. Based on this theoretical approach, in 2015, this risk was 0.188%, which implies that on average every 532nd issuer would, on average, default that year[436]. With a total of 104 SSDs issued in 2015, this suggests that only 0.2 issuers would have defaulted[437].

[431] Please refer to the section *I. Stock-Taking* (pp.12ff) for more details
[432] (BCG interview with arranger 2017); (Scope Ratings 2016)
[433] (BCG interview with arranger 2017); (BCG interview with investor 2017); (BCG interview with financial authority 2017)
[434] (BCG interview with arranger 2017)
[435] (S&P Global 2016)
[436] (BCG analysis based on S&P and LBBW data 2016)
[437] (LBBW 2016)

The very low default rate is confirmed by a recent report by the Association of German Public Banks (VÖB): between 2008 and 2016, the default rate for all transactions arranged by member banks was 0.08%.[438] As VÖB member banks have a combined market share of over 80%[439], this reflects the investment grade nature of the SSD market.

Even though there have been only few credit events, the process of **restructuring** is important. According to market participants, there have been very few cases of restructuring overall; and two recent cases of SSD that needed restructuring were handled successfully[440].

Generally, the need for credit restructuring can be caused by covenant breaches. This does not necessarily need to be a Schuldschein covenant, but can also be a breach of another one of the issuer's debt facilities triggering the restructuring of the issuer's total debt.

This restructuring can prove difficult for the following two reasons:

1. In the case of a credit event that triggers restructuring, the issuer needs to **communicate and negotiate with each investor individually**.[441] As the SSD is a loan construct there are no majority voting clauses or similar as with corporate bonds. Thus, each individual investor can decide whether to terminate the loan, restructure the transaction or waive any rights received during covenants breach. This could ultimately lead to a termination of the entire restructuring process due to one investor entity.[442,443]

2. The **lead arranger is expected to actively participate** during the restructuring process. However, this does not exclude the actual investors from the process since they have the obligation to participate. In addition, the lead investor is often the issuer's house bank that might be expected to help out.

Overall, the restructuring process of a Schuldschein can be complex, in particular due to the number of investors typically involved in an SSD deal. According to market experts, most investors pay particular attention to the house bank and/or to the main arranging bank as a point of reference during the restructuring process.[444]

Another aspect is a potential moral hazard that might occur when smaller investors are involved in larger SSD transactions – if those investors prefer a quick exit they can put pressure on the other creditors as mutual agreement on restructuring proceeding is needed.[445]

To prevent the default of a Schuldschein at first hand, many SSD contracts include certain clauses to help the issuer through challenging times while still being rewarded for taking additional risk. One example is the inclusion of a coupon step-up-clause

[438] (VÖB 2017)
[439] (VÖB 2017)
[440] (BCG interview with arranger 2017); (BCG interview with issuer 2017)
[441] (Koller 2014)
[442] (Hesslinger und Theiselmann 2010)
[443] Please refer to the section *Regulatory Obstacles to the Further Development of the Schuldschein* (pp.147ff) in the *Legal part* for further details
[444] (BCG interview with arranger 2017)
[445] (BCG interview with arranger 2017)

instead of a termination clause.[446] For further examples and more detailed information on the context, please refer to the *Legal part* (pp.117ff).

Euro-PP

As discussed in the section *The French Euro-PP market* (pp.38ff), the issuer profile of the Euro-PP is different compared to other PP instruments.[447] Euro-PP instruments are often used by comparably smaller issuers and most Euro-PP issuers do not have an external rating that could have been used as an indicator of underlying risk. Nevertheless, issuers are assessed for credit risk during the internal assessment process of institutional investors.[448]

Euro-PP investors typically conduct their own risk assessment. This implies a proper due diligence including an analysis of the issuer's financials and business plan.[449] Additionally, the regular process involves face-to-face meetings with the management as well as conference calls and background checks in order to qualify the deal as a potential investment candidate in addition to a pure paper based evaluation. Furthermore, in order to mitigate the higher risk of smaller and/or unrated issuers, investors almost always demand a set of financial covenants.[450] Risk mitigation strategies are further discussed in the *Legal part* (pp.117ff) of this study.

Thus far this due diligence process seems to have been effective. According to market participants, to date there has been only one default of a Euro-PP instrument which, furthermore, was not related to the private placement structure of the transaction itself but was due to fraud.[451] However, as the Euro-PP market is still relatively young, it has to prove its long-term stability once it has lived through an entire credit and economic cycle.[452]

Furthermore, there have been some transactions where (financial) covenants were breached and the issuer's debt needed **restructuring**.[453] The investor community, however, is currently not concerned about these individual cases of restructuring as they have been handled well.[454]

Regarding the process of restructuring there are some differences between a Euro-PP in loan format and a Euro-PP in bond format. Euro-PP loans are very similar to a standard syndicated loan facility in terms of documentation.[455] Thus, restructuring a Euro PP loan is similar to restructuring a syndicated loan facility. The documentation specifies which provisions require unanimous investors' consent and which require only a majority investors' consent in order to be amended or waived. A restructuring does not require a general meeting of the investors to be convened. The investors are requested to respond to the waiver or amendment request by simply informing the

[446] (BCG interview with arranger 2017)
[447] (Dealogic 2016)
[448] (Dealogic 2016)
[449] (BCG interview with investor 2017)
[450] (BCG interview with investor 2017); (BCG interview with association 2017)
[451] (BCG interview with financial authority 2017); (BCG interview with investor 2017)
[452] Credit cycle is defined as the entire cycle of the credit process, from the issuance to the repayment of the principal at the end of maturity; economic cycle is defined as the entire cycle of macroeconomic factors, from high liquidity and low-interest-rate environment to a contraction in the availability of funds and high interest rates.
[453] (BCG interview with arranger 2017); (BCG interview with investor 2017)
[454] (BCG interview with investor 2017)
[455] (BCG interview with legal advisor 2017)

facility agent of their position. All the investors of record are usually known to the facility agent which therefore makes communication much easier.

The restructuring of a *Euro-PP bond* is more challenging as any modification needed during the life of the bond needs to be cleared and voted upon by a general meeting of the bondholders. As one exception to this rule, the issuer can also present a proof of unanimous consent among bondholders representing 100% of the outstanding principal amount of the series. Such a unanimous consent, however, is more difficult to obtain and the issuer might never be completely sure of the identity of all bondholders as bonds are negotiable and transferrable instruments.[456]

The Sapin II law changed this restrictive regime and allows, in some cases, complete freedom as to the organisation of bondholders' representation.[457] Two requirements must be fulfilled in order to benefit from this new contractual freedom:

- The terms and conditions of the bond must include arrangements for bondholders' representation and also provide for the convening of bondholder meetings, the making of bondholder decisions and set out quorum requirements and voting majorities applicable to such decisions; and
- the nominal value of the bond or the minimum amount that may be acquired by a bondholder per transaction must amount to at least €100,000 or its equivalent in any foreign currency.

The implementing ordinance is not fully in place yet as some additional decrees need to be published.[458] Consequently, it may take some time to be fully implemented and applicable for Euro-PP bonds. If the two conditions mentioned above are not met, the general rules of the French "Code de commerce" regarding representation of bondholders apply.

The restructuring of a Euro-PP, both bond and loan, is assumed to be less complex on average than a SSD transaction as there are fewer investors.[459] This not only renders communication and negotiation much easier thanks to the small number of individual threads, but might also give each investor a stronger sense of commitment.[460]

US PP

The US PP market is a market of high credit quality. In 2015, for example, there were less than 1% sub-investment grade issuances.[461] This high rating standard can be explained by the following:

a. The **internal guidelines** of institutional investors are relevant to the dynamics of the market.[462] Many institutional investors, especially life insurers, prefer lower credit risk and therefore higher rated issuers.

[456] (BCG interview with financial authority 2017)
[457] Implementing ordinance n°2017-970 from May 10, 2017 (the "Ordinance"); for more information on Sapin II law please refer to the *Legal part* of the study (pp.112ff)
[458] As of May 2017
[459] (BCG interview with issuer 2017); (BCG interview with arranger 2017)
[460] For details on the modification of Bondholders' representatives for Euro-PP in a bond format under Law Sapin II please see French ordinance of 10 May 2017: Modernisation of bondholders' representation
[461] (Advantus 2016)

b. The **regulatory guidelines** for US insurance companies strongly incentivise private placement instruments with investment grade ratings. The risk capital requirements above investment grade are between 0.4% and 1.3%, while sub-investment grade US PPs cost between 4.6% and 10%.[463]

A unique aspect of the US PP's credit risk is the National Association of Insurance Commissioners (NAIC): "*The NAIC is the U.S. standard-setting and regulatory support organization. […] Through the NAIC, state insurance regulators establish standards and coordinate regulatory oversight*"[464]. As such, the NAIC rates US PP issuers and assigns ratings based on their credit risk. Consequently, the issuer's rating is much more consistent and transparent for investors (see p.60 for details). In addition, in-house credit research capabilities of institutional investors are usually sophisticated and investors are able to assess credit risks independently, without using any major third-party provider.[465]

The NAIC uses its own rating terminology, which is not as detailed as other rating classifications – nevertheless, it provides a good overview of the market. In view of the fact that sub-investment grade US PPs are practically non-existent, the market has a low issuer default risk. Regarding the default rate, US PP issuers appear to have a similar loss history similar to that associated with publicly-issued bonds.[466] The analysis of the expected default rate derived from the issuer credit rating and probability of default for each rating class[467] yields an average default probability of 0.142% – even below the Schuldschein default rate of 0.188%.

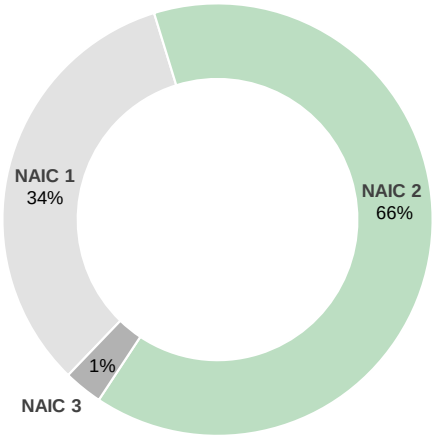

Figure 58: US PP issuer rating[468]

Concerning the recovery rate of US PPs, an extensive study by the Society of Actuaries states that "*senior unsecured private placement loss severity has the strongest and most statistically reliable advantage compared to public bonds, 37% versus 56%*"[469],

[462] (BCG interview with issuer 2017)
[463] (Global Capital 2015)
[464] (National Association of Insurance Comissioners 2017)
[465] (BCG interview with arranger 2017)
[466] (Society of Actuaries 2016)
[467] Using the same methodology as for the Schuldschein
[468] Definition: NAIC 1: AAA until A-; NAIC 2: BBB+ until BBB-; NAIC 3:BB+ and below; (Advantus 2016); (Standard & Poor's 2015); (Quad Capital 2016)
[469] (Society of Actuaries 2016)

i.e., recovery rates of 63% for US PPs and 44% for corporate bonds. The higher recovery rate of US PPs consequently reduces the loss in case of default.

The same study also acknowledges the different issuer qualities of the two financing instruments. However, it concludes that even when controlling for the quality standards, the US PP has a clear economic advantage over the corporate bond in terms of economic loss.

Regarding restructuring, US PPs typically have only few investors per transaction. As a result of this small number of investors, all investors 'sit at the table', i.e., they are involved regarding the negotiation of amendments to the original documentation and moral hazard situation as depicted in some Schuldschein transaction setting are unlikely.[470]

Corporate bond

Credit risk of senior unsecured corporate bonds is typically similar to private placement instruments. Hence, there are equal recovery rights in cases of default.

Most public corporate bonds have an external rating, although it is not a regulatory requirement, but rather an implicit commercial requirement in order to attract a sufficient number of investors. The external rating enables the investor to rely on the fact that the issuer and the bond have already been analysed and assessed in terms of underlying risk. Additionally, it enhances the transparency of the issuer, the debt instrument and the market itself. An external rating is a good indicator for the investor for his own economic assessment. Conversely, approximately 75% of all Schuldschein issuers are not externally rated before issuance.[471] For the French Euro-PP, between 2008 and 2016, 84% of issuers were unrated.[472] In turn, for the US PP, thanks to the NAIC ratings (see p.60), more than 90% of US PPs have a rating.[473]

All situations that require a decision by the investors are described and structured in the initial legal documentation agreement. Typically, each decision needs to be approved by the majority (usually 50%, sometimes 66%) except so-called 'reserved matters'. Reserved matters require a higher majority; the most typical ones are: i) cash payment (i.e., delayed interest payment or principal payment), ii) term postponement (i.e., timing of repayments), and iii) security released (i.e., any collateral to be released).[474]

The restructuring process is often driven by large investors or investors who originated/structured the transaction. They lead the effort to negotiate with the issuer before presenting it to the whole investor pool for a vote. Negotiations can be handled privately with some level of resolution agreement or simply fall apart and lead into formal bankruptcy proceedings.[475]

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[470] (Mendel 2013)
[471] (Scope Ratings 2015)
[472] (Thomson Reuters 2017); (Capital IQ 2017); (BCG analysis 2017)
[473] As elaborated in section *I. Stock-taking* (pp.46ff), around 90% of the investors in the US PP are life insurers. For US PP investors that are US insurance companies, it is required by law that the issuer receives a private credit designation by the Securities Valuation Office (SVO) of the NAIC.
[474] (BCG interview with arranger 2017); (BCG interview with legal advisor 2017)
[475] (BCG interview with arranger 2017)

Compared to PP issuances, public corporate bond emissions often have a more diverse and larger set of investors, meaning that the issuer has to deal with a large number of investors on average.

Corporate loans (bilateral and syndicated)

The credit risk of corporate loans, both bilateral and syndicated loans, largely depends on the issuer's credit quality. The restructuring of a *bilateral loan* is typically straightforward as there is a one on one relationship between borrower and lender. If further instruments are affected and insolvency proceedings opened this will add complexity and other stakeholders to negotiate with i.e. on rankings of the different creditors positions.

For *syndicated loans*, the loan agreement usually includes provisions that render negotiations about ranking within the syndicate obsolete. As the design of a syndicated loan is based on the 'pari passu'-clause all lenders are treated equally: losses are split evenly between lenders in the case of a liquidation or haircut in case of a restructuring. When there are several classes of creditors, there is a specific legal document, the 'intercreditor-agreement', to organize the process between differently ranked debt lenders. Such an agreement is always signed and validated by every single creditor, which can be very time-consuming to complete depending on the number of investors.[476]

Market risk

Schuldschein

As there is no material secondary market for corporate Schuldschein instruments, direct impact of market movements i.e. the impact of changes in interested rates on the market value of SSD cannot be observed. Therefore, the volume of issuances will be regarded as potential indicator in the following.

The SSD market has demonstrated resilience to external shocks in the past, for example to the slowdown of the Chinese economy around September 2015[477], Brexit or the Italian referendum in 2016[478]. Also in the past, notably during the financial crisis in 2008, the Schuldschein proved quite resilient while the corporate bond market in Germany slowed down significantly.[479] This has led large companies such as HeidelbergCement AG to issue a Schuldschein rather than a corporate bond.[480,481]

Regarding market risk associated with changes in interest rates, the investor structure of the Schuldschein market has to be taken into account. An important driver for the growing demand of investors in the past few years has been the liquidity of the banks, which have historically been the largest group of investors in the SSD market.[482]

[476] If other instruments than the syndicated loan are affected and insolvency proceedings opened, the same situation as described in the paragraph about corporate loans might occur.
[477] (Scope Ratings 2016)
[478] (LBBW 2016)
[479] (UniCredit 2011)
[480] (Backhaus, DerTreasurer 2016)
[481] (Debevoise & Plimpton 2015)
[482] (BCG interview with arranger 2017)

An increase in interest rates and therefore potential decrease in banks' demand for that asset class might result in higher yields. This in turn could attract more institutional investors to the market as they could then meet their internal return thresholds. In this case, the decrease in bank demand would be partially offset by new institutional investors entering the market.

Euro-PP

Given that the Euro-PP market was established in 2012 after the financial crisis, no substantial external macro events influenced the Euro-PP market until today. The low interest rate environment in Europe had been there since the foundation of the market. In addition, the drop in Euro-PP emissions in 2016 was due to increased liquidity in the French banking sector and thus more competition from bank lending as discussed earlier.[483]

US PP

The US PP market exists for several decades and is considered to be the most mature private placement market.[484] By going through the typical credit life cycle for numerous times, the market has demonstrated the ability to withstand major macroeconomic and political shocks. Additionally, the fact that 40% of all issuances are cross-border reduces the market risk exposure to the US market by diversifying a substantial part of market risk globally.[485]

Traditional debt instruments

As corporate bank loans are mostly held to maturity instruments and accounted for as such, impact of market movements i.e., from interest rate changes, are not visible.

Corporate bonds reflect the impact of market movements directly, as they are traded on public exchanges and are accounted for mark-to-market[486].

Liquidity risk

Private placements are illiquid instruments by nature, many investors seek the illiquidity premium of this instrument as discussed before.[487] Therefore, secondary markets for PP instruments rarely exist and are rather illiquid, that implies a higher liquidity risk for all three instruments. However, most investors follow a buy-and-hold strategy.[488] Buy-and-hold investors accept the level of illiquidity since they are being compensated through an illiquidity premium. Nonetheless, private placement

[483] See section *I. Stock-taking* (pp.12ff) for more details
[484] (Macquarie 2016)
[485] (Macquarie 2016)
[486] (Backhaus, DerTreasurer 2016); (BCG interview with arranger 2017)
[487] See section *II. Cost-benefit analysis* (pp.56ff) for more details
[488] (BCG interview with investor 2017); (BCG interview with arranger 2017); (Mendel 2013)

instruments are tradable at least from a technical perspective. Most trading (around 98%) occurs OTC and not via listed secondary markets.[489]

According to Euronext information, the average daily trading volume (ADTV) for Euro-***PP bonds*** in 2016 was €11M compared to €6.5B for all corporate bonds, and for the YTD 2017, it was €7.5M compared to €2B for all bonds. Bid ask spreads of Euro-PP bonds, however, remain attractive to trading, with a bid ask spread of €0.063 in 2016, and of €0.041 YTD 2017 (as of June 2017).[490]

There are also attempts at present to create a secondary market through platforms.[491,492] As of April 2017 there have not yet been any corporate SSD transactions in the latest attempt in Germany.

Corporate bank loans have a similar liquidity risk as private placements. However, there are specialised distressed debt investors that buy usually portfolios of distressed debt at a haircut. Portfolios could include both corporate loans and private placement instruments.

Corporate bonds incur lower liquidity risk due to existing secondary market in most segments.

Regulatory and legal risk

The most relevant operational risk for private placement transactions is regulatory risk. Regulatory guidelines can have a big impact on the investment decisions of banks and insurance companies. Consequently, changes concerning capital requirements (i.e., Basel IV) and liquidity requirements (i.e., Solvency II) significantly impact the balance sheet costs of assets such as Schuldschein or Euro-PP. For more information on the dynamics of the regulatory landscape and the effects on the private placement instruments, please refer to the *Legal part* (pp.117ff) of the study.

Coupon development of private placements compared to corporate bonds

The subsequent analysis focuses on comparing the coupon rate of different debt instruments rather than analysing each instrument individually.

It is necessary to take into account that the coupon is not the only indicator for risk and thus cannot be used as a general measurement for risk associated with the transaction. The change can also be influenced by factors like tenor or issuance date at the overall interest rate levels. The following analysis can be used as a very rough indication for an estimation of the magnitude of risk only.[493]

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[489] (BCG interview with stock exchange 2017)
[490] (BCG interview with stock exchange 2017)
[491] One example is the 'Schuldscheinbörse Deutschland', i.e., an exchange platform for SSDs, which was launched in March 2017 and tries to bring together buyers and sellers of a Schuldschein. However, according to the exchange committee, though, there have not yet been any transactions as of April 2017
[492] (Schuldscheinbörse Deutschland 2017)
[493] Due to limited publicly available data these other factors are not included in this analysis; nonetheless, the analysis is considered to be informative as long as the underlying data for bonds and PPs is treated equally.

The bases for the analysis of the German market consisted of 37 and 527 transactions for the SSD and German corporate bond market, respectively. The French market offered 208 and 201 data points for the Euro-PP and French corporate bond market, respectively, the US market consisted of 1,145 and 561 transactions for the US PP and US corporate bond market, respectively.[494] To reflect changing interest rate levels the analysis focusses on investments in the same year.

The German debt market has experienced declining yields over the last few years, similar to the development in German government bond yields. Both the Schuldschein and the German corporate bond have seen decreasing coupons since 2007.[495] The Schuldschein market had an average coupon at the time of issuance of 5.5% and even 6% in 2008. This compares to roughly 4% for German corporate bonds. Since then, however, the Schuldschein coupon has declined significantly and is now at approximately 2%, similar to German corporate bonds.

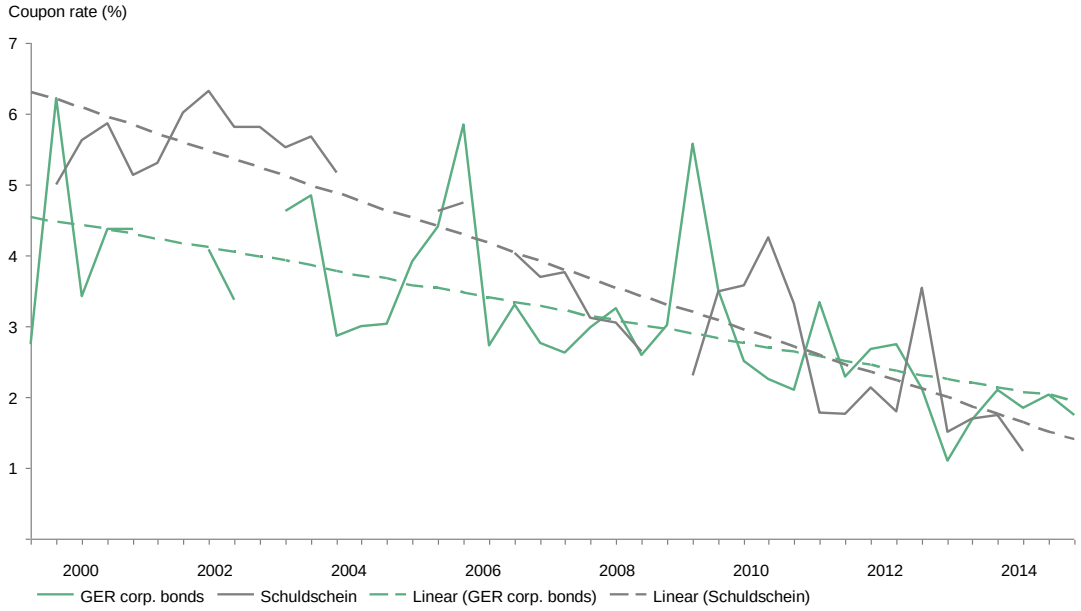

Figure 59: Coupon development of German debt market[496]

The French debt market has experienced a difficult development. At the launch of the Euro-PP market in 2012, corporate bonds and Euro-PPs were issued at similar coupon rates of 4.0-4.5%. Since then, however, the corporate bond market has declined to coupon rates of roughly 1.5% in 2017 while the Euro-PP market has stagnated at approximately 4% coupon. This supports the hypothesis of market participants that in

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Also issuances are not always issued at par, meaning that yield can be different even when having the same coupon. As it is a time-series, market rates are expected to move in the same direction as coupon over time, regardless of discounts/premiums.

[494] Data was extracted from EIKON and Bloomberg and government-related issuers and other debt products were excluded.

[495] The data points comprise individual corporate SSD issuances and corporate bonds rather than an index. On the one hand, this enables exclusion of potential government-related and financial firms. On the other hand, it allowed certain bond products such as zero-coupon, convertible, secured or subordinate bonds to be eliminated.

[496] (BCG analysis based on Eikon 2017); (BCG analysis based on Bloomberg 2017)

recent years Euro-PPs have increasingly opened up to issuers that incur higher credit risks and therefore have to pay higher coupon rates.

Figure 60: Coupon development of French debt market[497]

There are only slight differences in the US PP and corporate bond markets. In 2014, US PPs had an average coupon rate of more than 4%, while the corporate bond market was issuing at approximately 3.7%. Since then, both markets have come together and by the end of 2016, there was no significant difference between the coupon rates of the two markets.

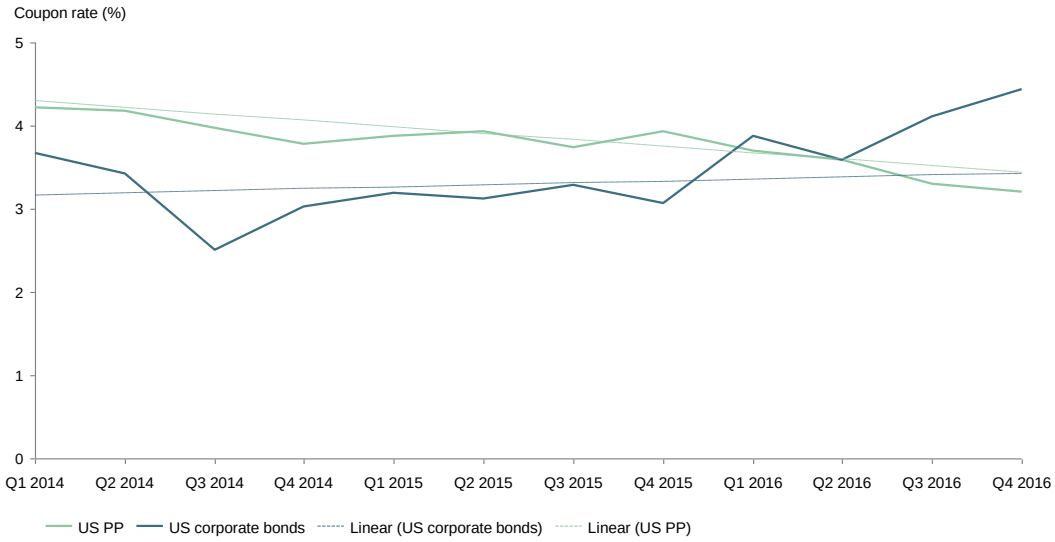

Figure 61: Coupon development of US debt market[498]

[497] (BCG analysis based on Eikon 2017); (BCG analysis based on Bloomberg 2017)
[498] (BCG analysis based on Eikon 2017); (BCG analysis based on Bloomberg 2017)

Comparative case studies

The last part of the risk section briefly compares the risk associated with mini-bond markets in Italy and Germany to PP markets.

Mini-bond market in Italy

As explained in section *III. Growth potential* (pp.77ff), Italy established a mini-bond, ExtraMOT PRO, in 2013 targeted at SMEs and open to professional investors only.[499] As it is designed for smaller companies, the credit risk is considered to be higher. Most issuers are not.[500] Since the market is still very new, there are not yet any data regarding default and recovery rates nor long term default statistics.[501] However, it appears that 40% of prospective issuers and almost 20% of actual issuers are sub-investment grade.[502]

A study published on the official Borsa Italiana website has taken an alternative approach to assess the default probability of the ExtraMOT PRO.[503] Similarly to the risk assessment for the Schuldschein and the US PP market used in this study, they analysed the default rate of potential issuers, i.e., Italian SMEs. The study concludes that the historic default rate of potential Italian mini-bond issuers was 3.6%, thus significantly higher than the default probability of both the Schuldschein and the US PP market. The study states that "*some defaults in the [Italian] Minibond market are natural, expected and acceptable in a portfolio context*".[504] Thus, it appears that even though the ExtraMOT PRO has solid regulatory guidelines, the associated credit risk is still higher than for other PP markets.

Mini-bond market (Mittelstandsanleihe) in Germany

The German mini-bond market was established in 2010 by the Börse Stuttgart to make it easier for German SMEs to access new debt instruments and diversify their investor base. The typical issuance volume in this market ranges between €15 and €150M.[505] In February 2017, the market volume was roughly €9.3B from more than 200 bonds.

Until February 2017, the default rate has been above 20% - an extraordinarily high figure even for high-yield bonds.[506] Defaults arose among issuers from different industries: internet-based travel portals (Travel24), cruise liners (MS Deutschland),

[499] (Borsa Italiana 2016)
[500] (Afme 2015)
[501] (Altman, Sabato und Esentato 2016)
[502] (Altman, Esentato und Sabato 2016); (Borsa Italiana 2016); (Firpo 2014); (Borsa Italiana 2016)
[503] (Altman, Sabato und Esentato 2016)
[504] (Altman, Sabato und Esentato 2016)
[505] (Bond Guide 2016)
[506] (Scope Ratings 2017)

and fashion companies (Strenesse). However, although these defaults indicate a very risky market, it is important to note that 57% of all defaults were linked to renewable energies.[507] As the German renewable energy sector, especially the solar industry, is currently experiencing structural difficulties and non-competitive cost structures, the market is particularly exposed to defaults.[508] Examples for this are Solar Millenium, Q-Cell and most notably Solarworld.

The comparably poor credit quality of issuers and the lack of credit protection through covenants or other regulatory features fostered the high default rate. These factors were amplified by a large portion of retail investors that were attracted to the market because of high yield expectations but did not have the means to conduct a professional due diligence or negotiate proper credit protection. Private investors were not only attracted by high yields, but also fully trusted the "Mittelstand" label: German SMEs generally have a strong reputation for reliability and stability amongst the German population.

In an attempt to tighten regulatory standards and increase credit quality, the German Exchange (Deutsche Börse) launched the 'Scale All Share Index' in March 2017. All mini-bonds bonds currently listed on the most common 'Entry Standard' will either move to the Scale All Share Index or, if rejected, will have to transition to the open-market segment. New candidates for the Scale All Share Index have to fulfil certain criteria, e.g., minimum levels of publication requirements, collaboration with a capital market partner who assesses the candidate's eligibility and offers support, as well as a mandatory research report.[509]

This initiative indicates efforts to ensure stability and increase trust among investors. Additionally, investors will have to satisfy more stringent requirements which are designed to shift the investor base from retail to institutional investors.[510] However, the market will still be accessible for retail investors that meet these investor requirements.

In general, the high share of retail investors and inverse distribution of issuer industries indicates that the German mini-bond market and the SSD and Euro-PP market only have a few features in common. It does therefore not set a suitable example for other PP markets that are currently developing.

[507] (Scope Ratings 2015)
[508] (Frankfurter Allgemeine Zeitung 2017)
[509] (Deutsche Börse 2017)
[510] (Scope Ratings 2017)

V. Mapping of innovation

This section highlights recent innovations related to private placements and assesses their potential contribution to a further development of private placement markets. For example, some of the innovations directly target current challenges of the market such as limited transparency in order to reduce barriers to.

Innovation and technological change massively influence the financial industry in recent years, disrupting some traditional banking business models, e.g., in the consumer lending space.[511] Similar trends are expected to occur or have already started in the private placement markets and have the potential to change their path forward.

Innovation mapping approach

A list of relevant innovations for the context of private placements was collected through various sources; amongst others press research, information from the BCG FinTech Control Tower database and expert interviews. This resulted in an overview of innovations that will be described in abstract terms to avoid highlighting specific organisations. Please also note that this section only includes a selection of case studies and does not claim to be exhaustive.

Classification and examples of innovations in private placements

The identified innovations in the private placement area were classified into four categories using the 4Ps of innovation – product, platform, process and policy innovation:

- *Product innovations*: are directly related to the characteristics and features of a product or instrument, e.g., multi-tranche PPs.
- *Process innovations*: change or support the process of the transaction, e.g., alter the speed in which a transaction is completed. This type of innovation is certainly closely connected to platform innovations as they can provide a basis for efficient processes.
- *Platform innovations*: affect the market place and in particular the way of arranging a transaction, i.e., how investors find issuers and vice versa. Examples from the fintech industry include peer-to-peer lending platforms or other web-based portals that facilitate the search for and interaction between investors and issuers.
- *Policy innovations*: facilitate or foster private placement transactions by improving legal and regulatory conditions.

[511] (Nash and Beardsley 2015)

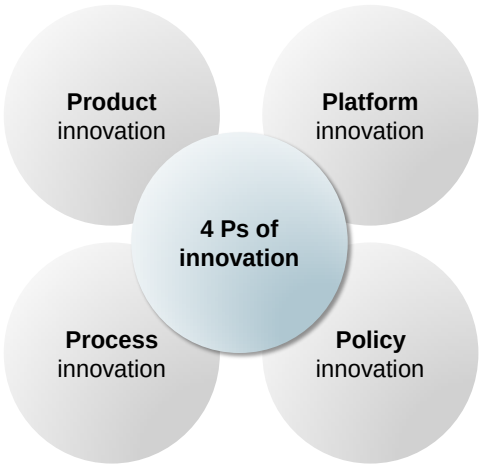

Figure 62: 4Ps of innovation[512]

Innovations can change and shape a market. With regards to private placements, most initiatives are designed to shape three aspects. First, initiatives enhance standardisation in the form of documentation[513] and in the form of standardised processes, as for example the process of issuing a PP or performing a credit analysis. Second, different innovations try to increase transparency in various aspects, such as market prices and issuance cost. Furthermore, they conduct general analyses with regards to market demand and supply in the market. Third, increased access for market participants is necessary for a continuous growth of private placement markets. Therefore, both the investor and the issuer base in particular need to be enlarged.

Overview of innovations

Most innovations identified in this context with relevance to private placement markets can be considered as incremental steps in the general development of the markets and only few show a disruptive approach.

Key product innovations

- *Private placement funds*: Funds which invest primarily in private placements have been launched by banks in several PP markets. These funds usually invest in around 15 to 25 different PP transactions. They can facilitate the market entry for smaller issuers but also new investors, as the credit analysis is carried out by the issuing bank[514] and the minimum investment is comparatively low. Furthermore, risk is distributed across several transactions. However, some investors prefer to know the specific issuances they are investing in and see PP funds as a niche product.[515]
- *Green private placements*: Green PPs have been issued in both the SSD and in the Euro-PP market.[516] These issuances must adhere to sustainability standards that have to be certified by a third party. Moreover, the issuer needs to regularly

[512] (BCG analysis 2017)
[513] (Euro PP Working Group 2014)
[514] (De Bailliencourt 2013); (Kögler, LBBW legt Schuldscheinfonds auf 2016)
[515] (BCG interview with arranger 2017); (BCG interview with investor 2017)
[516] (Kögler, Nordex begibt einen "Green Schuldschein" 2016); (Nordex SE 2016); (TenneT 2016); (Option Finance 2015)

demonstrate that the proceeds from the promissory note are used for sustainable projects. Green PPs increase access to private placements as they open the investor base to ESG investors. So far, all green issuances have experienced strong demand and exceeded expectations.[517] It is important to add, however, that SSDs and Euro-PPs in general have experienced strong demand in the past and Green PPs tend to be perceived as niche products.[518]

Key process innovations

- *PP ratings by rating agencies*: some institutional investors do not have own credit assessment teams, making it more challenging to invest in unrated issuers. Several rating agencies have reacted to this barrier to entry and have launched a PP rating[519], which rates the credit quality of a company and its private placement instruments over their respective maturities. It is a service that is offered to, and paid by, issuers who voluntarily provide the necessary data and information to carry out the credit analysis in a standardized procedure comparable to published ratings. Usually, the information is made available only to interested investors, at the issuer's discretion, sometimes via an electronic platform.[520] Such ratings can increase the access to PPs for investors who do not have their own credit research capacities and also open the market to companies without external rating.
- *Standardised documentation*: As elaborated in section *I. Stock-taking*, standardised documentation has been developed to support the growth of existing PP markets.[521,522] The standardised documentation produced by the Euro-PP working group and the International Capital Market Association (ICMA) is a prominent example for the Euro-PP market. The most recent edition of the 'European corporate Debt and Private Placement Market Guide' also covers the German SSD and promotes the standardised documentation produced by the Loan Market Association and the Euro-PP working group. The documentation consists of a recommended form of facility agreement (LMA PP Facility Agreement), a recommended form of subscription agreement (LMA PP Subscription Agreement), a recommended form of term sheet and a confidentiality agreement. Documentation is now available in English, French and Italian.[523] These standardised documentation templates facilitate the entry of new market participants by increasing trust and reducing the work and effort required when issuing. Making the documentation available in several languages also facilitates the entry of international market participants.

Key policy innovations

- *Private placement withholding tax exemptions*: Several countries, for example Italy and the UK, have introduced withholding tax exemptions for private placements. The exemption applies to qualified investors who are not resident in the country, given that they are located in 'white listed countries' (Italy)[524] or come from states with a double taxation treaty (UK)[525]. Thus, it mirrors the benefits given to corporate bonds and enables direct lending from other countries. These laws

[517] (Nordex SE 2016)
[518] (BCG interview with issuer 2017)
[519] (Scope Ratings 2014)
[520] (Moody's Investors Service 2012)
[521] (BCG interview with arranger 2017)
[522] (BCG interview with financial authority 2017)
[523] (Euro PP Working Group 2014); (Loan Market Association 2016)
[524] (Quaglia und Sbisá 2014); (Vestini und Marino 2014)
[525] (Allen & Overy 2016); (Norton Rose Fulbright 2016)

simplify the process and reduce costs for issuers and investors, therefore ultimately increasing overall efficiency. For a more detailed discussion of the UK withholding tax exemption for private placements, see the *Legal part* (pp.117ff).

- *Representation of bondholder's regime reform*: The représentation de la masse is currently being modernised in France under Sapin II. The reform is necessary as the representation of bondholders regime is quite stringent under French law. If the bond issue is not considered 'international', the issuer has to strictly follow the rules of the code de commerce (French commercial code). This includes strict rules concerning meetings, including the requirement for a majority representation of the bondholders to negotiate. An ordinance changed these strict rules to allow issuers and investors to contractually negotiate and organise the representation of bondholders if the bonds have a denomination of more than €100,000. This has led to much greater flexibility and increased efficiency in the Euro-PP market, especially when terms and conditions have to be renegotiated.[526]

Key platform innovations

In line with the trend of new market places and general end-to-end digital processes, platform innovations constitute innovations which potentially might impact the most going forward. In recent years, several online platforms for PP transactions have been launched; either general trading platforms which include PPs as well as other products or platforms that specialise in PP transactions. Platforms can provide both a primary and a secondary market for PP instruments.

- Private placement platforms: PP platforms provide online access to private placement transactions. These platforms are usually only accessible to professional market participants and some platforms have even limited their services to a selected group of companies[527]. Others require an entry credit approval by a third party as a quality check before being allowed to issue on the platform.[528] Platforms enable the user to profit from advantages of digitised processes, including:
  - automated search, filter and match options,[529]
  - automated calculations,
  - anonymously sharing and collection of information,[530]
  - limiting access to information to a specific group of people/institutions,
  - online negotiation of deals in real time,[531]
  - online access to term sheets and standardised documentation, often in several languages.

  Some platforms also offer additional features and services, such as:
  - support with the issuance process,[532]
  - professional risk analysis,[533]
  - comparison of borrowing curves with peers.[534]

[526] (BCG interview with financial authority 2017)
[527] (ELITE - London Stock Exchange Group 2017)
[528] (European Private Placement Facility 2017); (ELITE - London Stock Exchange Group 2017)
[529] (ACE Portal 2017); (ELITE - London Stock Exchange Group 2017); (Habdank 2016)
[530] (Origin 2017); (European Private Placement Facility 2017)
[531] (Firstwire GmbH 2017)
[532] (Firstwire GmbH 2017)
[533] (Firstwire GmbH 2017)
[534] (Origin 2017)

Overall, platforms claim to provide larger and more international networks[535] which make it easier to match potential business partners without previous relationships. Facilitating the process of looking for business partners increases access to and the efficiency of PP transactions. In addition, most platforms are transparent regarding their fees and charge lower transaction costs than those charged for the standard transactions that include an arranger bank.

These platforms follow different business models, also in regards to partnering with or without banks as traditional arrangers. There are three general models:

1. The platform provides an option to connect issuers and arrangers or investors, but the different parties are responsible for all operational and legal details.[536] The business model may therefore involve a subscription fee, but could also be a fee based on the size of the transaction.
2. The platform arranges the deals and the deals are settled with a partner bank.[537] In this model the platform usually charges an arranger fee, but this is expected to be lower than those associated with traditional arrangers.
3. The platform disintermediates banks as arrangers entirely. The platform also charges an arranger fee, but can offer very competitive pricing.

The progress and increasing number of platforms is closely monitored by banks.[538] Most arrangers do not see current platforms as a significant threat, but they acknowledge that they do offer many advantages[539] and may lead to increased transparency in the market. Some platforms, in turn, admit that first-time issuers are recommended to seek support from their house banks.[540] This may also be true for complicated issuances.

There are two major obstacles that have so far kept platforms from disintermediating arrangers completely: i) the inability to be the settlement counterparty, and ii) the lack of a large distribution network that usually takes years to build.[541] Consequently, the study expects there to be a mixture of platforms and arrangers in the PP transaction process in the future.

Overall, **increased competition** may lower transaction costs and increase the efficiency of the market. Banks may have to react to lower fees by also lowering their fees or withdrawing from the market if it becomes unprofitable. However, the success of any of these platforms has yet to be evaluated as most have only been established only recently.

- *Platforms with focus on a secondary market of PPs*: Platforms for secondary markets focus on bringing together buyer and sellers of private placements.[542] Secondary market platforms aim to facilitate the difficult process of selling a PP instrument before maturity.

  The two main advantages of such platforms are increased transparency and potentially lower costs. Market participants, however, are still sceptical about the development of a secondary market for PPs. Some participants are convinced that a

[535] (BCG interview with issuer 2017); (ACE Portal 2017); (Origin 2017)
[536] (BCG interview with arranger 2017)
[537] (European Private Placement Facility 2017)
[538] (BCG interview with arranger 2017)
[539] (BCG interview with arranger 2017)
[540] (BCG interview with arranger 2017)
[541] (Origin 2017)
[542] (BÖAG Börsen AG 2017)

secondary market is needed in case the valuation of PPs would be changed from the regulatory side, or that it will develop automatically as PP markets grow and the interest rate environment changes. Others, however, believe that it is unlikely to develop as most PP holders are buy-and-hold investors.[543] Many investors stressed that it is a strategic decision to invest long term and to obtain an illiquidity premium in return and this would be reduced if a relevant secondary market were to be established.[544]

Finally, the study identifies one potentially disruptive innovation that may fundamentally challenge current market procedures: **blockchain**.[545] A recent use case for private placements is discussed below.

Daimler AG and Landesbank Baden-Württemberg (LBBW) recently tested the use of blockchain technology for SSDs and were able to carry out a complete SSD transaction. Blockchain allows for transparent, safe and decentralised storage of all information, from all contractual measures of the €100 million loan agreement to the confirmation of repayment and interest payments. Here, information is stored in data blocks that are connected to each other in a chain. As each block contains a piece of the previous block's information, each connection between two blocks is unique. While all parties involved in the SSD deal, Daimler, LBBW and several German savings banks, have access to all information stored in the blockchain, data manipulation is virtually impossible because the connections between data blocks communicate and are able to detect any inconsistencies in relation to the data that was originally created.[546]

[543] (BCG interview with financial authority 2017); (BCG interview with arranger 2017)
[544] (BCG interview with investor 2017)
[545] For more information on blockchain see "Thinking outside the blocks" (Evans 2016) or "Fintech in capital markets: a land of opportunity" (Morel, et al. 2016)
[546] (LBBW 2017)

Conclusion of the economic part

Privately placed debt instruments have become a more and more relevant source of company funding over the past years. In the EU there are several variants of privately placed debt instruments across different Member States, but the study identifies the **German Schuldschein (SSD)** market and the **French Euro-PP market** as the dominant private placement markets. For comparison, the study also analyses the **US PP market** as the most established private placement market. The study reveals that the three markets differ with respect to size and credit quality of the issuer, size and structure of the deals, and the general investor landscape.

In general, private placements **allow companies to diversify their funding**. Private placements are a financing instrument, classed between bank financing and corporate bonds, which **enables companies to choose the most appropriate funding source** in terms of maturity, minimum issuance size, rating requirements and others. Serving as an additional option for funding, it can **reduce reliance on bank funding** – supporting the pronounced objective of many authorities after the financial crisis in 2008/09. Furthermore, private placements – specifically the SSD - have been observed to be rather **resilient in times of economic crisis**. SSD have remained a viable source of company funding during the financial crisis, even reaching record volumes.

In comparison to corporate bonds, **documentation for private placements is, in general, simpler and more flexible**. In contrast to direct bank funding, private placements are more standardised on average and can therefore simplify the process of debt financing. In addition, as private placement transactions are **typically negotiated directly**, at least in the case of unlisted private placement instruments the disclosure of business-sensitive information can be kept to a minimum. Overall, overall, **private placements offer lower issuance costs**, especially compared to public markets.

For SMEs, private placement can serve as a **first step towards capital markets** and also to **attract new investor groups**. Larger companies use private placements mainly to diversify their funding. Furthermore, private placements offer a stable financing option that has proven to be decoupled from other market developments.

In general, there are two types of investors in private placement markets in Europe, with banks on the one hand and institutional investors such as insurances, pension funds and asset managers on the other. Private placements provide all investors the possibility to **diversify their assets** to unrated, private companies while offering **attractive yields**. In addition, most investors are investing into private placements until maturity and thus can use **accrual accounting basis**, i.e., there is **no mark-to-market valuation** limiting volatility. This constitutes a substantial advantage over other securities.

Private placements – specifically US PPs and Euro-PPs – offer **longer maturities** that match institutional investors' long-term liabilities as well as their investment strategy to hold until maturity. Also for institutional investors of US PPs and Euro-PPs, **financial covenant protection** makes private placements an attractive investment opportunity.

The study reveals that for the private placement markets in focus, there have been **very few cases of default so far**. Two driving factors can be linked to this observation: First, both European markets as they exist today, especially the French Euro-PP market, are relatively young and still have to prove their long-term stability

through an entire credit and economic cycle. Second, the high credit quality of issuer's in the US PP and German SSD market implies a low level of credit risk.

A specific drawback of private placements compared to bonds can be the comparably **complex restructuring process,** in particular when a large number of investors is involved. This applies particularly to SSD which, as a loan construct, has no majority voting clauses or similar rules. For the Euro-PP there are typically fewer investors, which simplifies communication and negotiation and also enhances the investors' sense of commitment. Furthermore, the introduction of the Sapin 2 law increased the freedom as to the organisation of bondholders' representation.

The two existing domestic private placement markets in the EU are expected to grow further. For the SSD market, the study identifies **internationalisation** and institutional investor's **substantial liquidity** as the main driver for further growth. For the Euro-PP market, given that it was only established in 2012, the study expects **increased awareness** of the instrument and its benefits will attract more issuers and investors, both nationally and internationally to drive the development of the market.

As an additional growth driver of private placements in the EU, the study evaluates the establishment of new domestic markets. To establish a new domestic private placement market, the crucial factor is a **sufficient number of potential issuers**. The study identifies potential issuers of private placements as medium-sized companies with revenues between €75M to €5B. The study also finds that a relatively low number of investors is already sufficient to establish a market.

The study identifies three countries that exhibit a large number of potential issuers and have already undertaken first steps to create a new domestic market for private placements: Spain, Italy and the Netherlands. These countries are therefore classified as having the highest short-term **potential to build a new domestic market** for private placements.

Based on the analysis of the existing markets, best practices for market design and regulation were derived that help new markets flourish. The study identifies a **collaborative market design** effort of all market participants and a **standardised private placement documentation** to be the most relevant factors. Furthermore, it is essential to adjust regulation to facilitate the **engagement of institutional investors** in the private placement market. Countries can also take regulatory measures, including modifications to corporate laws, to further facilitate the growth of the market by removing restrictive provisions and creating a more private placement friendly regulatory framework. Finally, a further supportive element for a successful market may be a centralised credit assessment by a public authority, which fosters a safe and regulated market environment and incentivises investors.

Besides the growth of domestic markets, the study also identifies **significant potential for cross-border activities in the EU**. In general, companies from all EU Member States can issue private placements in the existing markets. Given the experience from previous placements on the two existing markets, the study characterises companies with a €75M–€5B revenue and a strong credit rating as potential issuers. For companies that satisfy these criteria, SSDs or Euro-PPs may serve as an attractive source of company funding to match its strategic goals. As the market is mainly supply driven, with demand for private placements having historically exceeded supply, there is significant potential for increased cross-border issuances. Furthermore, both banks and institutional investors are open to cross-border issuances and show a willingness to invest in foreign issuers.

Given the heterogeneous economies across the EU, the corporate landscape and therefore the potential for private placements differs across the Member States. Based on the number of potential issuers across the EU, the study expects substantial potential for cross-border activities for those countries with at least 1,000 potential issuers. This criterion is currently satisfied for **Italy, Spain, the Netherlands, Belgium, Austria, Denmark, Ireland, Sweden, Poland and the United Kingdom**.

In addition to general policy innovations, the study identifies **four areas of innovation in the private placement market** that can contribute to the development of private placements in the EU. In general, there have been many innovations in the financial industry in recent years – driven by new technologies, processes and business models. The combination of big data analytics and new distribution channels allowed technology start-ups to challenge traditional bank business models. Similar trends can be seen in the private placement markets.

First, the market has seen several **online platforms for private placement transactions**. Different platforms follow different business model strategies and it is unclear which will succeed and which not, but they are all likely to increase transparency in the market and constitute strong competition for established arrangers.

Second, to meet investors' needs and expectations and to further expand the investor base, two **product innovations** have been introduced: **Private placement funds** have been launched by several banks to facilitate the entry to the market and further increase the investor base. Additionally, so called **green private placements** have been issued on the SSD and Euro-PP market that adhere to sustainability standards certified by a third party.

Third, the study identifies two relevant **process innovations**: (i) **standardised documentation** has been published to facilitate the entrance of new market participants by increasing trust and streamlining the issuance process, and (ii) rating agencies have started to offer **private placement ratings** to support institutional investors that lack their own credit assessment teams.

Fourth, the study introduces two policy innovations: (i) **Private placement withholding tax exemptions** i.e. for qualified investors from states with double taxation treaties and (ii) **Reform of bondholder's representation regime** that is currently modernised in France under Sapin II and allows issuers and investors to contractually negotiate and organise the representation of bondholders if the bonds have a denomination of more than €100,000.

Legal part

Introduction

Objective

The European Commission has contracted Linklaters LLP ("**Linklaters**") to conduct the legal part of the study on "Identifying the regulatory and market obstacles to the development of private placement of debt in the EU". The objective of the legal part of this study is to identify best practices for and barriers to the development of private placement markets in order to find ways to further develop the private placement markets for debt in the EU.

Key Issues

The legal part of the study focusses on:

a. the identification of regulatory best practice in the well-functioning private placement markets;

b. the identification of regulatory obstacles to the development of private placement markets across the EU; and

c. analysis of the most common risk mitigation provisions in private placement documentation.

Definition of Private Placement

As already set out in the Economic Part (see *Economic Part I Stock-Taking*) private placements are not uniformly defined and different jurisdictions might have a different understanding of what constitutes a private placement.

The term "private placement" does not generally have a legal definition. Therefore, for the purposes of this study, we have defined a private placement as a medium or long-term debt financing transaction between a listed or unlisted company and a small number of institutional investors, based on deal-specific documentation negotiated between the issuer/borrower and the investor(s)/lenders generally, but not necessarily, with the participation of one or more bank intermediaries as arranger (see *Economic Part I Stock-Taking*).

In Germany, the private placement instrument is primarily the Schuldscheindarlehen (as well as Namenschuldverschreibungen)[547]. In France, the private placement instrument is primarily Euro PP and can either take the form of a bond or a loan. In the US, the private placement instrument is primarily US PP and in the form of bonds.

Although instruments such as equities, covered bonds and securitization products are often privately placed, they are not specifically private placement instrument and, as such, are outside the scope of the study.

[547] See "Regulatory Obstacles to the Further Development of the Schuldschein Market – Termination Right after Ten Years" for an explanation of the distinction between the Schuldscheindarlehen and the Namenschuldverschreibungen.

I. Regulatory Best Practice in the Well-Functioning Private Placement Markets

This section analyses the legal environment for private placements in the jurisdictions where private placement as a funding tool has been most successful, namely:

i. the Schuldschein market in Germany;

ii. the Euro PP market in France; and

iii. the US PP market in the United States.

In particular, this section describes the legal and regulatory framework applicable to private placements at a national level in such jurisdictions and any soft law measures aimed at facilitating the issuance of privately placed debt in such jurisdictions. This section also identifies any areas in which the regulatory framework applicable to private placements in such jurisdictions could be improved.

Schuldschein Market

What is a Schuldschein?

In a finance or capital markets context, the term "Schuldschein" more narrowly refers to a form of debt certificate, which evidences the lender's rights under the underlying bilateral loan agreement (the "**Schuldschein Loan**") and is usually signed by the borrower alone.

A Schuldschein Loan is a loan governed by German law (named "Schuldscheindarlehen" in the related loan documentation) and which may, but is not mandatorily, evidenced by a Schuldschein (certificate of indebtedness). The definition is of importance *inter alia* in cross default clauses provided for in bonds and notes referring to capital markets indebtedness, often including Schuldscheindarlehen.

A Schuldschein and the related Schuldschein Loan needs to be governed by German law so that the terms and conditions of the Schuldschein correspond to the expectations of market participants and so that such market participants can rely on the statutory provisions of the German Civil Code (*Bürgerliches Gesetzbuch* – "**German Civil Code**" or "**BGB**")[548].

A Schuldschein (certificate of indebtedness) is a document issued by an obligor, constituting or confirming any kind of obligation of one person vis-à-vis another person. In court proceedings, the Schuldschein (certificate of indebtedness) serves as proof of the existence of the constituted or evidenced obligation. If the corresponding claim (i.e. the Schuldschein Loan) of the creditor is assigned to a third party, legal title to the Schuldschein (certificate of indebtedness) is transferred by operation of law[549]. Upon discharge of the obligation (i.e. the Schuldschein Loan), the obligor is entitled to have the Schuldschein (certificate of indebtedness) returned to him[550]. As long as the Schuldschein (certificate of indebtedness) has not been returned, there is a

548 §§ 488 seq. German Civil Code (*Bürgerliches Gesetzbuch* – BGB). This section of the German Civil Code applies to the Schuldscheindarlehen, but not to Namensschuldverschreibungen.

549 § 952 German Civil Code (*Bürgerliches Gesetzbuch – BGB*).

550 § 371 German Civil Code (*Bürgerliches Gesetzbuch* – BGB).

presumption that the obligation still exists. If the creditor claims that the Schuldschein (certificate of indebtedness) is stolen, lost or destroyed, the obligor is entitled to obtain a certified acknowledgment from the obligor that the obligation has been discharged[551].

Why use a Schuldschein Loan from a legal perspective?

There are a range of legal reasons for using a Schuldschein:

i. the lender can assign the claims evidenced by a Schuldschein (certificate of indebtedness) without consent of the borrower (the title to the Schuldschein passes by operation of law) facilitating easy trading of the payment claims in relation to the Schuldschein Loan;[552]

ii. the lender does not need to hold the Schuldschein to enforce rights under the loan, i.e. the claim is merely evidenced by the Schuldschein;[553]

iii. some regulated lenders invest in Schuldschein for regulatory reasons (e.g. Versorgungswerke, pension funds);

iv. as the Schuldschein is a loan, it may have balance sheet advantages (e.g. nominal value versus market-to-market value); and

v. enforcement of claims under a Schuldschein may be accelerated via a fast track civil procedure (the so-called certificate process (Urkundsprozess)) under German civil proceedings law.

Regulatory Framework applicable to Schuldschein

a. German Civil Code

The German Civil Code provides a full statutory body of law addressing loans and certificates of indebtedness. This has resulted in loan documentation governed by German law traditionally being leaner than that governed by English law where the contract is the law.

i. German Civil Code

Plain vanilla Schuldschein documentation used in Germany is typically a few pages long and contains the essential commercial terms of the loan agreement (see *Legal Part III* (*Overview of Schuldschein Documentation*) below for further details). Many of the important legal conditions (e.g. business day convention, termination rights of the lender or the borrower, etc.) are codified in the German Civil Code and apply by operation of law.[554]

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551 § 371 German Civil Code (*Bürgerliches Gesetzbuch* – BGB).

552 § 952 BGB.

553 Given that the Schuldschein is an evidentiary document (§ 416 German Civil Procedure Code (Zivilprozessordnung – ZPO)), it will, however, enhance the procedural position of the creditor. The Schuldschein must be returned to the borrower upon repayment of the loan (§ 371 BGB).

554 The Schuldschein (certificate of indebtedness) is only mentioned once in the German statutory law in § 372 of the BGB stating that if a certificate of indebtedness has been issued relating to the claim, the obligor may, besides demanding the receipt, also demand return of the certificate of indebtedness. If the obligee claims to be unable to return it, the obligor may demand an officially certified acknowledgement that the debt is extinguished.

ii. Loan Contract, §§ 488 ff. BGB

The general provisions of a loan contract are included in §§ 488 seq. BGB which sets out the typical contractual duties in a loan contract:

"The loan contract obliges the lender to make available to the borrower a sum of money in the agreed amount. The borrower is obliged to pay interest owed and, at the due date, to repay the loan made available."[555]

§ 488 and § 489 BGB provide for termination rights of a loan contract.

iii. Interest and Business Day Convention

Typically, Schuldschein documentation contains essential commercial terms, such as the agreed interest rate. In the rare cases where the parties do not specify the interest rate in the documentation, German law provides for statutory interest rate in § 246 BGB and § 352 of the German Commercial Code (Handelsgesetzbuch – "**HGB**"). The statutory default interest rate is regulated in § 288 BGB.

Conditions regarding periods of time and fixed dates (e.g. business day convention) are codified in §§ 186 seq. BGB.

iv. Statutory Termination Rights

Schuldschein Loans are to be repaid at maturity unless previously repaid. The repayment will usually be in form of a bullet payment.

Schuldschein Loans may provide for various events of default, but there are also statutory grounds for termination, which are in some cases mandatory, but in other cases, can be waived.

§ 489 para. 1 BGB provides for an ordinary termination right of the borrower in the case of a loan agreement under which a periodically fixed (pegged) interest rate has been agreed.[556] § 489 para. 2 BGB is applicable to loan agreements with a variable interest rate.[557] Both the borrower's rights of termination cannot be excluded or rendered more difficult by an agreement.

Pursuant to § 490 para. 1 BGB (an extraordinary termination right) the lender may give notice of termination of the loan agreement with immediate effect if there is or threatens to be a substantial deterioration in the financial

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555 § 488 para. 1 BGB.

556 § 489 para. 1 BGB: "The borrower may terminate a loan contract with a pegged lending rate, in whole or in part (1) if the pegging of the lending rate ends prior to the time determined for repayment and no new agreement is reached on the lending rate, observing a notice period of one month to end at the earliest at the end of the day on which the pegging of the lending rate ends; if an adjustment of the lending rate is agreed at certain intervals of up to one year, the borrower may only give notice to end at the end of the day on which the pegging of the lending rate ends; (2) in any case at the end of ten years after complete receipt, observing a notice period of six months; if, after the loan is received, a new agreement is reached on the repayment period or the lending rate, the date of this agreement replaces the date of receipt."

557 § 489 para. 2 BGB: "The borrower may terminate a loan contract with a variable rate of interest at any time, giving three months' notice of termination."

circumstances of the borrower or in the value of a security given for the loan as a result of which the repayment of the loan is jeopardised even if the security is realised. This right can be expressly excluded by contract.

Pursuant to § 314 BGB (termination for good cause) which applies in all cases, each party may terminate a contract for the performance of a continuing obligation (Dauerschuldverhältnis) for a compelling reason[558] without a notice period. However, the termination is only permitted within a reasonable period from the moment of time the good cause/compelling reason becomes known. As this termination right cannot be excluded by contract, Schuldschein Loans usually provide for typical examples of such compelling reason (however, such list of examples is not exhaustive and does not restrict the rights of an extraordinary termination pursuant to § 314 BGB).

v. Transfer

The Schuldschein Loan is transferable under German law by way of assignment (*Abtretung*) or by way of assumption of contract (*Vertragsübernahme*). §§ 398 seq. BGB governs the transfer of a loan by way of assignment. Assumption of contract is not governed by German statutory law but has been found to be admissible by case law and legal theory[559]. This method allows the transfer of rights and obligations.

b. Documentation

As with regular loan agreements, a Schuldschein Loan may contain more extensive clauses such as negative pledge, borrower undertakings, tax gross-up, increased costs clause, representations and warranties, events of default and status clauses (see Legal Part III (Key Risk Mitigation Provisions in Schuldschein Documentation) below for more detail). Schuldschein documentation may also be used to evidence highly structured and complex loan agreements containing intricate interest rate, repayment and prepayment conditions, limited recourse and ring fencing clauses.

Although Schuldschein documentation is standardised to a large extent, no pro forma documentation exists in the market equivalent to the Euro PP or LMA private placement documentation.

c. Form

Where both parties to the Schuldschein are professionals, there are no requirements on the form of the Schuldschein Loan under German civil law.[560] However, regulatory, tax and accounting rules may require some form of written documentation. The Schuldschein Loan can be in writing (this is the standard practice) or oral, evidenced only by the Schuldschein (certificate of indebtedness) which itself sets out the terms and conditions of the underlying Schuldschein Loan.

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558 Pursuant to § 314 para. 1 sent. 2 BGB, there is a compelling reason if the terminating party, taking into account all the circumstances of the specific case and weighing the interests of both parties, cannot reasonably be expected to continue the contractual relationship until the agreed end or until the expiry of a notice period.

559 BGH 142, 23 seq.; Münchener Kommentar zum BGB, § 491 BGB Rdnr. 31 seq.

560 § 350 German Commercial Code (*Handelsgesetzbuch – HGB*)

d. Commercial and Legal Classification of a Schuldschein

The Schuldschein Loan, although legally a loan, is commercially a hybrid between a bond and loan. However, the Schuldschein Loan and the Schuldschein (certificate of indebtedness) do not constitute a security (*Wertpapier*) for the purposes of the German Civil Act or German Securities Prospectus Act (WpPG) or other laws or regulations referring to securities (*Wertpapiere*). Neither do they fall within the ambit of the Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse ("**Market Abuse Regulation**" or "**MAR**") or Markets in Financial Instruments Directive (2004/39/EC) ("**MiFID**") since they do not qualify as transferable securities.

The Hamburg/Hannover stock exchange has established a platform to bring together Schuldschein demand and supply of institutional investors and thereby establish a secondary market. However, this does not change the above analysis. A Schuldschein Loan is still to be qualified as a loan and the Hamburg/Hannover platform does not change the nature of the Schuldschein Loan (i.e. it is still not a negotiable instrument) since the assignment procedure can still only be settled after a demand and a supply have been matched. Further, a customarily structured Schuldschein Loan marketed to institutional investors should (subject to a case-by-case analysis) not fall within the ambit of the US Securities Laws (see Legal Part I (Regulatory Obstacles to the Further Development of the Schuldschein Market) (iv)).

e. Soft-Law Measures

The Schuldschein market benefits from the following market practices:

i. Eligible Asset for certain Insurance Companies

The German Investment Regulation (*Anlageverordnung*) expressly mentions loans to corporates subject to certain conditions as eligible assets for small insurance companies within the meaning of Section 211 of the German Insurance Supervision Act (*Versicherungsaufsichtsgesetz* – the "**VAG**"), pension schemes (*Pensionskassen*) and burial schemes (Sterbekassen)[561]; the same applies for pension funds (*Pensionsfonds*)[562] and professional pension schemes for liberal professions (Versorgungswerke)[563]. The "Principles for the Granting of Loans to Companies by Insurers" as of June 2013 (5th revised edition) by the German Insurance Association (Gesamtverband der Deutschen Versicherungswirtschaft e.V.) (the "**Principles**") further explicitly refer to Schuldschein Loans. These Principles have been issued in consultation with the German financial authority (the "**BaFin**"). BaFin itself refers to these Principles in its BaFin circular 4/2011

[561] Section 2 (1) no. 4 a) of the German Investment Regulation (*Anlageverordnung*).

[562] Section 17 (1) no. 4 a) of the German Regulation on the Supervision of Pension Funds (*Pensionsfonds-Aufsichtsverordnung*).

[563] *Versorgungswerke* are, due to internal regulations or state law, subject to the German Investment Regulation.

(VA) (the "**Circular**") and in its guidance notes on BaFin Circular 4/2011 (VA 54-I 3201-2013/0002).

Solvency II introduced in its article 133 the "freedom of investment" for insurance companies. According to this article, member states of the European Union (which are obliged to implement the Solvency II-Directive into national law (i.e. the VAG in Germany) shall neither require insurance companies to invest in particular categories of asset, nor subject the investment decisions of an insurance company to any kind of prior approval or systematic notification requirements. Accordingly, as of 1 January 2016 the VAG was replaced by a new VAG – which does not provide for a catalogue of eligible investments or quotas governing the permissible composition of the insurance company's portfolio. In addition, the German Investment Regulation (*Anlageverordnung*) was revoked with a view to the insurance companies regulated by Solvency II.

However, the Principles continue to apply for insurance companies falling outside Solvency II (i.e. small insurance companies within the meaning of Section 211 VAG) as well as pension funds, pensions schemes, burial schemes and professional pension schemes for liberal professions. In practice, many insurance companies regulated by Solvency II still continue to apply the Principles in their internal investment policy in order to assess compliance with the prudent person principle.564 Furthermore, the internal investment policy of insurance companies regulated by Solvency II regularly reflects the long-standing administrative practice by BaFin (*inter alia* set out in the Circular).

The Principles serve to check whether the granting of a loan meets the requirements of the investment guidelines set by the relevant entity by reference to Sections 1 and 2 of the German Investment Regulation (*Anlageverordnung*) and thus is eligible as an investment for the guarantee assets (*Sicherungsvermögen*) of such entity.

The guidelines set out in the Circular and the Principles provide two options to assess the credit quality of prospective borrowers:

i. assessment based on a long-term rating by a recognised rating agency that is at least investment grade quality when the loan is granted (issuer rating); or

ii. assessment based on the company's ratios stated in the Principles, which must comply with the minimum requirements set forth therein.

The Principles are mainly applied to companies which have not been rated by recognised rating agencies and for which the insurers have to carry out the credit assessment themselves as a result. The Principles specify the minimum requirements for the assessment of such companies and provide respective criteria for the eligibility of loans to companies as an investment of guarantee assets.

The respective criteria are based on the ratios that the rating agencies consider necessary to maintain an investment grade rating so that an analogy is established to the approval of external investment grade ratings

564 Reference is made to an interview with a German insurance company conducted in April 2017.

as a prerequisite for making a loan eligible. The aim is that criteria for assessing credit quality should be equally strict for both assessment options.

The guidance notes on BaFin Circular 4/2011 are to be updated due to, inter alia, the new regulatory measures of Solvency II. The recent draft of the BaFin circular "Guidance Notes on the Investment of Guarantee Assets of Insurance Undertakings" 16/2016 is still referring to these principles[565].

However, the investment of insurance companies into loans of corporates (including Schuldschein Loans) are subject to certain restrictions. See Legal Part I (*Regulatory Obstacles to the Further Development of the Schuldschein Markt*) (ii) (a) below for further details.

ii. Accounting standards

The relevant accounting standard for balancing Schuldschein Loans is flexible. The parties to a Schuldschein Loan can either make use of the IAS/IRFS accounting standard or the HGB accounting standard. This gives flexibility to parties which do not have any IAS/IFRS model implemented. This is further a convenience in comparison with listed bonds where accounting must follow the international IFRS accounting standard. Applying local accounting standards like HGB instead of IAS/IRFS is likely to reduce costs for Investors in Schuldschein Loans.

Both HGB as well as IAS/IFRS accounting provide for favourable accounting of Schuldschein Loans at investor level because Schuldschein Loans can usually be accounted at their nominal amount upon issuance.

The accounting of Schuldschein Loans for IAS/IFRS purposes is currently subject to IAS 39 until 31 December 2017. An investor can account for a Schuldschein Loan at its nominal amount under IAS 39 if it falls within the category "Loans and Receivables" for purposes of IAS 39, which should typically be the case due to its legal nature as a bilateral loan agreement. Exceptionally a Schuldschein Loan may also be qualified as "held to maturity" under IAS 39 due to the rather illiquid secondary markets for Schuldschein Loans. However, the categorisation of a Schuldschein Loan for purposes of IAS 39 as "held to maturity" should not result in a different accounting treatment.

In contract to listed bonds or other securities, Schuldschein Loans are therefore not subject to market-to-market valuation, i.e. IAS 39 accounting does not require an annual re-valuation of Schuldschein Loans based on current fair market values. Changes to the fair market value of Schuldschein Loans are therefore also not P&L effective under IAS 39.

With effect as 1 January 2018, IAS 39 will be replaced with IFRS 9 as the relevant accounting standard for Schuldschein Loans. However, it is not expected that the application of IFRS 9 as the new accounting standard will result in material changes with respect to the accounting of Schuldschein Loans, i.e. for purposes of IFRS 9 it is expected that Schuldschein Loans will typically be accounted for at their nominal value upon issuance.

Under IFRS 9 financial instruments must be accounted for at amortised costs if (i) the relevant business model of which a financial instrument forms a

565 See section B 4.3 d of the draft of the BaFin circular.

part at investor level is the collection of payments which are contractually provided for under the financial instrument, and (ii) the specific financial instrument only provides for payments of principal and interest on contractually defined dates. This should typically also be the case for Schuldschein Loans.

A different valuation regime applies (i.e. valuation at fair value) if the business model for a Schuldschein Loan at investor level exceptionally provides for a generation of income from a sale of the Schuldschein Loan.

iii. Short documentation

The documentation of a typical and market standard Schuldschein Loan is generally quite short, being about 10 to 20 pages long. There are even shorter versions of Schuldschein Loans available, such as the templates used by the German Federal States (Bundesländer) which are about 2 pages long. As discussed above, the key reason for such slim documentation is that German (statutory) law provides for a substantial amount of the rules required by market participants. In addition, given that Schuldschein Loans are typically issued by entities with an investment-grade rating, the lengthy provisions customary in the finance documentation of sub-investment-grade issuers is not generally deemed necessary.

iv. No disclosure documentation

Schuldschein Loans are not considered security/financial instruments according to the German securities prospectus act (*Wertpapierprospektgesetz*), the German securities trading act (*Wertpapierhandelsgesetz*) or the Markets in Financial Instruments Directive (2004/39/EC). Consequently, Schuldschein Loans are not subject to any prospectus obligation, any key information document obligation (be it national or European key information documents) or any other disclosure obligation.

v. Bilingual documentation

Even though the Schuldschein is a German law governed instrument, it is currently market practice to draft the Schuldschein Loan in both German and English in order to attract international investors. German is usually the binding language. As such, there is no significant language barrier in the Schuldschein market[566].

vi. Schuldschein-Loans as ECB collateral

Guideline (EU) 2015/510 of the European Central Bank of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (ECB/2014/60) (the "**Guideline**") provides that Schuldschein Loans are qualified as credit claims[567]. Credit claims again are set out as eligible type of asset for ECB collateral[568], subject to certain strict conditions. The ECB

566 Interview with an arranger conducted in May 2017.
567 Art. 2 (*Definitions*) (13).
568 See Title III, Chapter 1, Section 1 Art. 89 seq. of the Guideline.

guideline (ECB) 2015/27 and the guideline of 2 November 2016 do not change this qualification.

vii. Deposit Protection Fund of German Banks (*Einlagensicherungsfonds deutscher Banken*)

The Deposit Protection Fund of German Banks (*Einlagensicherungsfonds deutscher Banken* – "**Fund**") is operated by the Association of German Banks (*Bundesverband deutscher Banken* – "**Banking Association**") which members are private commercial banks in Germany. Save for certain exemptions, all banks which are members of the Banking Association are required to participate in the Fund.[569]

According to its by-laws, "the purpose of the Fund is to give assistance, in the interest of depositors, in the event of imminent or actual financial difficulties of banks, particularly when the suspension of payments is imminent, in order to prevent the impairment of public confidence in private banks".[570]

Protected are all credit balances, including time deposits and savings deposits, which result from amounts left in an account or from temporary situations deriving from banking transactions and which the bank is required to repay under the legal and contractual conditions applicable (deposits). The deposits have to be deposits of natural persons (also where they are acting in the exercise of their commercial or self-employed professional activity) and foundations with legal capacity under German law or foundations under foreign law that are comparable to foundations with legal capacity under German law.[571] The protection extends to, among other things (such as time and savings deposits), Schuldschein Loans issued by banks. Thus, the obligation of bank obligors to pay interest owed and to repay the loan made available are covered by the Fund for the protection of the creditor (investors). The amount of protection for each creditor is subject to certain protection ceilings of the bank's own funds within the meaning of Article 72 of Regulation (EU) No. 575/2013 used for deposit protection purposes.

The Fund only covers deposits and depositors if and to the extent that they are not already covered by the mandatory deposit protection fund. It is at the discretion of each bank to join the Fund. No bank is legally obliged to participate in the Fund and to offer the associated protection to its customers.

viii. LMA Schuldschein Guide and VÖB Guide on Private Placements

The LMA has published a Schuldschein guide which sets out the key aspects and characteristics of a Schuldschein and provides current market perspectives and considerations, outlines the legal framework and

569 § 2a of By-laws of the Deposit Protection Fund of the Association of German Banks, dated October 2017.

570 § 2 of By-laws of the Deposit Protection Fund of the Association of German Banks, dated October 2017.

571 § 6 of By-laws of the Deposit Protection Fund of the Association of German Banks, dated October 2017.

summarises legal nuances particular to Schuldschein. The guide is aimed at persons less familiar with Schuldschein, in particular international lenders and investors, and aims to raise awareness thereof.

Additional best practice recommendations are provided in the guide "Schuldscheindarlehen (Private Placements) - Best practice for European Capital Markets Union" from the Association of German Public Banks (*Bundesverband Öffentlicher Banken Deutschlands*), a leading industry association in the German banking industry.

ix. Internal Rating by Arranger

Most Schuldschein Loans are implemented with the participation of an arranger which typically provides a credit assessment of the issuer to the borrower.[572] The arranging banks usually have internal rating opinions on the creditworthiness of various market players. This internal rating opinion might be provided upon request via a confidentiality agreement between the arranger and the borrower.

Since the internal rating opinion is only disclosed to a limited number of users, such an internal rating provided to the borrower constitutes a private rating according to the Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (the "**Credit Rating Regulation**"). However, the Credit Rating Regulation only applies to so-called public ratings, which are credit ratings issued by credit rating agencies and disclosed publicly or distributed by subscription (see Art. 2 of the Credit Rating Regulation).

Regulatory Obstacles to the Further Development of the Schuldschein Market

Notwithstanding the success of the Schuldschein market, the following have been identified as areas in which the regulatory framework applicable to Schuldschein could be improved.

i. Banking Licence Requirements

a. Borrower

The acceptance of monies under a loan agreement, including a Schuldschein Loan, may in certain circumstances constitute banking business and hence a regulated activity.

Pursuant to Section 32 (1) sentence 1 of the German Banking Act (*Kreditwesengesetz* – "**Banking Act**" or "**KWG**") anyone wishing to conduct banking business requires a written authorisation by BaFin.

Deposit taking business qualifies as acceptance of funds from others as deposits or of other unconditionally repayable funds from the public, unless the claim to repayment is securitised in the form of bearer or order notes, irrespective of whether or not interest is paid (deposit business). This means that the borrower of a Schuldschein Loan will be qualified to conduct deposit business, if (i) its acceptance of the Schuldschein Loan is to be considered as the acceptance of funds from the public and (ii) if it is conducting this activity commercially or on a scale that requires a commercially organised

572 Interview with an arranging bank conducted in April 2017.

business undertaking. Condition (ii) must be analysed on a case-by-case basis.

The acceptance of a Schuldschein Loan is not to be considered acceptance of funds from the public if the Schuldschein Loan is, for instance, provided by a credit institution or another regulated institution. In this case, no authorisation would be required for the borrower.

The BaFin may only grant authorisation if, *inter alia*, the following requirements are met:

- The applicant must bring evidence that it has the resources needed for the intended business.

  For example, investment advisers, investment brokers, contract brokers, asset managers and portfolio managers, operators of multilateral trading systems or undertakings engaging in placement business who, in providing financial services, are not authorised to obtain ownership or possession of funds or securities of customers and who do not trade in financial instruments for their own account must prove that they have a minimum capital of at least EUR 50,000.

  Other financial services institutions which do not trade in financial instruments for their own account must prove that they have a minimum capital of at least EUR 125,000.

  For securities trading banks, the minimum capital required is at least EUR 730,000, while for deposit-taking credit institutions it is at least EUR 5m.

  The applicant further must provide information on its trustworthiness, the senior managers, their professional knowledge, skills and experience and information required to assess whether the senior managers have sufficient time to dedicate to the performance of their tasks. BaFin consults the Federal Central Criminal Register (*Bundeszentralregister*) and the Central Trade and Industry Register (*Gewerbezentralregister*) in order to verify that they are reliable persons.
- The application must contain a viable business plan setting out the types of business envisaged, the structural organisation and the planned internal control mechanisms of the institution. BaFin may refuse the application if the institution is not prepared or in a position to make the organisational arrangements necessary for the proper operation of the business for which it is seeking authorisation.
- Where any significant holdings are held in the institution, the applicant must also provide information on these holdings and the holders of these holdings including information required to assess their trustworthiness or, where no significant holdings are held in the institution, the names of the up to 20 biggest shareholders.
- In addition, the applicant must provide information indicating a close link between the institution and other natural persons or other undertakings, as well as the names of the members of the supervisory body, along with the information required to assess their trustworthiness and expertise as well as the information required to assess whether they can commit sufficient time to the performance of their function.

b. Lender

The granting of monies under a loan agreement (including a Schuldschein Loan) may constitute banking business and hence a regulated activity.

The granting of monies under a Schuldschein Loan would therefore require a written authorisation by BaFin.

The granting of money loans and acceptance credits (lending business) requires a license, if this activity is conducted commercially or on a scale that requires a commercially organised business undertaking. The transfer of a fully paid Schuldschein Loan, such as via an assumption of contract or an assignment of the rights, does not qualify as "granting of money" since taking over a loan is to be regarded as an acquisition of a debt in return for payment.

A banking license is not required if the Schuldschein Loan is provided by a credit institution or another regulated institution.

Non-German borrowers are not subject to the above restrictions since they are not subject to regulation under German banking law. However, any license issues need to be looked at on a case-by-case basis, as certain exemptions therefrom may be available.

ii. Credit / Solvency Capital Requirements

German credit institutions and financial institutions are not subject to restrictions concerning the purchase or granting of or borrowing under Schuldschein Loans. They must, however, consider capital adequacy pursuant to the Capital Requirements Regulation (EU) No. 575/2013 for the Schuldschein Loan, which is the same as for similar debt instruments.

Certain German institutional investors in the insurance sector are subject to investment restrictions with respect to Schuldschein Loans (see Legal Part I *(Regulatory Framework applicable to Schuldschein)* e. i. above for more detail). While insurance companies regulated by Solvency II have more flexibility in investing their assets, given that these insurers benefit from the "freedom of investment" of Solvency II, they must back their investments with own funds. Based on the Solvency II standard formula to calculate the Solvency Capital Requirement ("**SCR**"), which is applied by the vast majority of the German insurance companies, the investments of an insurer must be assigned (depending on the type of risk exposure) to the risk (sub-) modules described in articles 164 et seqq.[573] of the Commission Delegated Regulation (EU) 2015/35 ("**Solvency II-Regulation**"). As a matter of principle, Schuldschein Loans are allocated to the spread risk sub-module on bonds and loans[574]. The SCR under this spread risk sub-module depends on the "credit quality step" (based on a credit assessment/rating of a regulated external credit assessment institution ("**ECAI**")) and the modified duration of the Schuldschein Loan. Alternatively, if a credit assessment of an ECAI is not available, the SCR solely depends on the duration. In simplified terms, the longer the duration and the lower the external rating of the Schuldschein Loan, the higher the SCR under the spread risk sub-module on bonds and loans.

iii. German Notification Requirements

573 Title 1, Chapter V, Sections 5 and 6.

574 Article 176 Solvency II-Regulation

Certain German institutional investors, including German credit institutions, financial institutions and insurance undertakings, have to observe the requirements of the German Banking Act (*Kreditwesengesetz*) regarding quarterly reporting of large loans (*Millionenkreditmeldewesen*). As a result, Schuldschein Loans with a nominal above €1 million must be reported to the German Central Bank (*Deutsche Bundesbank*) on a quarterly basis.

iv. Complexity of Secured Structures

Schuldschein Loans are occasionally used to finance the acquisition of assets (e.g. real property or aircraft) of projects. Documentation will then provide for clauses typical for these types of transaction (e.g. loan to value ratios and other financial covenants) and will be secured. The latter implies the appointment of a security agent and documentation must, given the individual acceleration right of each creditor, provide that security may only be enforced by the security agent and only if the conditions for enforcement apply to a quorum of lenders. These clauses change the typical / market standard Schuldschein documentation and make it substantially longer and therefore mitigate the benefit of a relatively short documentation.

v. Classification of Schuldschein

Under German law a Schuldschein Loan constitutes a loan and not a security (see Legal Part I (*Regulatory Framework applicable to Schuldschein*) (c) for further details).

Depending on the specific structure of the loan, a Schuldschein Loan could constitute a "security" or a loan under US law. This is important for determining whether disclosure obligations apply in connection with a Schuldschein loan provided by a U.S. entity or to a U.S. investor. If a Schuldschein Loan were to be found to be a "security" for the purposes of the U.S. Securities Act of 1933 ("**Securities Act**"), an exemption would need to be found or the borrower would be required to provide substantial additional disclosure with relation to itself and the Schuldschein Loan. However, when applying the relevant "4 points" test[575], there are good arguments that a typical Schuldschein Loan would not be classified as a "security" under the Securities Act. Even if a particular Schuldschein Loan did constitute a "security," there are a number of potentially available exemptions from the Securities Act. Schuldschein Loan forms vary, and any given loan would need to be analysed by legal counsel to fully assess whether it would constitute a "security", have any exemptions available to it under the Securities Act, or trigger any filing or disclosure requirements.

vi. Bail in of Schuldschein Loans

Section 46f (5) of the KWG stipulates that, if a bank becomes insolvent (CRR credit institution), claims under certain unsecured debt instruments will be subordinated to general senior unsecured liabilities. This includes Schuldschein Loans as long as they do not qualify as covered or eligible deposits under Section 46f (4) KWG. This means that if the borrower of a Schuldschein Loan is a bank there will be a mandatory subordination in case of the borrower's insolvency, which in turn means the creditors concerned will bear losses as compared to

575 Reves. vs. Ernst&Young, 494 U.S. 56 (1990)

others whose claims currently rank *pari passu*. The bail-in tool will be applied to these unsecured debt instruments before other senior unsecured liabilities.

vii. Restructuring of Schuldschein

Generally, each lender can terminate a loan regarding its part of the Schuldschein if the termination right (one of the ancillary rights (*Nebenrechte*)) has been assigned to the assignee. If the borrower wishes to amend the Schuldschein documentation, each lender including the assignor has to agree to the same change (except in case of an assumption of contract (*Vertragsübernahme*) where the assignor's consent is not required). This can be a quite tedious process.

There is no unanimity exception providing for optional creditor majority provisions pursuant to the German Bond Act (*SchVG*) because the German Bond Act (*SchVG*) is not applicable to Schuldschein Loans. It is possible to try to simplify the unanimity process by providing for creditor majority provisions in Schuldschein documentation. However, although such clauses are legally possible, they are not market standard and would change the simple nature of Schuldschein documentation.

viii. Termination Right after ten years

In relation to unsecured debt, it is common in Germany to issue a Schuldschein for maturities below ten years and a Namensschuldverschreibung[576] for longer maturities. This is because Schuldschein (being loans for the purpose of the German Civil Code) are subject to a mandatory termination right of the borrower after ten years if the interest rate is fixed. The German Civil Code provides that "the borrower may terminate a loan contract with a pegged lending rate, in whole or in part, in any case at the end of ten years after complete receipt, observing a notice period of six months; if, after the loan is received, a new agreement is reached on the repayment period or the lending rate, the date of this agreement replaces the date of receipt".[577]

ix. No Standard Documentation

There is no standardised pro forma Schuldschein Loan documentation equivalent to the Euro PP, US PP Model X or LMA private placement documentation. However, many clauses of a Schuldschein Loan are highly standardised and can be found in the documentation used by market participants.

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576 A Namensschuldverschreibung which can be described as German registered bond, is a security under German law, which is set out in the name of the investor. The Namensschuldverschreibung consists of a certificate and the relevant terms and conditions. It is not a contract. The investor has no obligations under the Namensschuldverschreibung. A Namensschuldverschreibung, in contrast to bearer bonds, can only be transferred via assignment and not by transfer of title. The Namensschuldverschreibung will in general be handed out physically to the investor and there is in general one exclusive Namensschuldverschreibung for one (the relevant) investor. In case of transfer the investor has the right to request the Namensschuldverschreibung to be amended so that its name appears on the certificate and not the name of the transferor.

577 § 489 para. 1 No. 2 German Civil Code (*Bürgerliches Gesetzbuch* – BGB).

Euro PP Market

Overview

There is no definition of Euro PP in French law. However, in accordance with the Charter for Euro private placements (the "**Charter**") and the European Corporate Debt Private Placement Market Guide (the "**ECPP Guide**"), a Euro PP may be defined as a medium or long-term debt financing transaction between a listed or unlisted company and a limited number of institutional investors, based on deal-specific documentation negotiated between the issuer and investors, generally with the participation of an arranger.

The target issuers of Euro PP are primarily medium-sized European companies who may be looking to diversify from the bank loan market or for an alternative to the established European debt capital markets. The target investors in Euro PP are primarily institutional investors (insurance companies, fund managers and asset management companies). An arranger will act as a facilitator between an issuer and an investor, but most of the time, not as an underwriter of the debt being issued.

A Euro PP may take two forms: a bond issue or a loan, and is usually unrated. It is a buy-and-hold investment. Bonds are generally held by the investors until maturity due to limited liquidity on the secondary market.

As explained in the Charter, in terms of financial disclosure and legal and economic protection, the Euro PP draws its inspiration from the disclosure and protections that the relevant issuer would provide to its banks in the context of bilateral or syndicated loans, as the case may be.

The Euro PP working group (a French financial industry initiative bringing together corporate issuers, investors and intermediaries (the "**Euro PP Working Group**")) differentiates Euro PP transactions from the following:

i. a private placement under an EMTN or other programme for the issuance of negotiable debt instruments - such debt issuance programmes on international markets enable active issuers with market recognition to carry out syndicated issues or opportunistic funding deals with investors seeking an appropriate investment with a specific term or structure on a private placement basis. Issuers with such programmes are mostly rated companies;

ii. a public offering of bonds to retail and institutional investors; and

iii. a loan from a bank or syndicate, where the bank or syndicate may be seeking ancillary business from the issuer.

Regulatory Framework applicable to Euro PP

i. Opening of Euro PP market to insurance companies, mutual insurers and employee benefit institutions

   Prior to its reform in 2013, the French *Code des assurances* did not provide the possibility for insurance companies to subscribe for unlisted bonds issued by commercial companies. In fact, the only bonds that could be bought by insurance companies then were bonds traded on a regulated market in the European Union or the OECD.

Reform of the French *Code des assurances*[578] in 2013 allowed insurance companies to directly subscribe for unlisted bonds issued by commercial companies. This reform enabled insurers to invest up to 5% of policy-holders' savings in private debt, either in the form of direct loans or through dedicated funds. This reform was a crucial step for Euro PPs as it allowed for insurance companies to invest in unlisted transactions such as Euro PPs.

Following the 2013 reform, a decree[579] extended the authorisation to mutual insurers and employee benefit institutions, allowing them to invest up to 5% of assets in companies, including unlisted small and medium sized firms, through a special credit fund called "fonds de prêts à l'économie".

This package of regulations gave investors the opportunity to access a new asset class and to ensure the diversification of their portfolios, enabling the development of the Euro PP market.

While the 2013 reform remains applicable to insurance companies which are subject to the Directive (2002/13/EC) ("**Solvency I**") prudential regime[580], insurance companies governed by the Solvency II prudential regime are no longer subject to the rules set up by the reform. However, this statement should be qualified, as Solvency II is not intended to limit the development of the Euro PP market. In fact, the insurance companies investing in these instruments are required to assess how it will have an impact on their prudential requirements, following in any event the principles of a prudent person[581] and freedom of investment. These principles therefore require insurance companies which are subject to the Solvency II regime to be able to properly identify, measure, monitor, control and report the risks associated with Euro PP operations[582].

Therefore, the principles applicable under the new prudential regime force insurers to take appropriate measures to realise their investments in optimal conditions and always in the interest of their insured.

In practice, and given the fact that investors participating in the Euro PP market appear to be sufficiently substantial and well-organised, these principles do not seem to have a material adverse effect in the development of the Euro PPs.

578 Decree n°2013-717 of 2 August 2013 (amending article R. 332-2 of the French *Code des assurances*).

579 Decree n°2014-1530 of 17 December 2014 (article L. 212-1 of the French Code de la mutualité).

580 Section 2 of the Solvency II Directive has established exclusions of some insurance companies from its scope. Thus, the Directive Solvency I is applicable to insurance companies whose undertakings fulfill all the size conditions set up by the Article 4 of the Solvency II Directive (for example insurance companies whose undertaking's annual gross written income does not exceed EUR 5 million and the total of the undertaking's technical provisions does not exceed EUR 25 million). Non-life organisations, life insurance organisations and reinsurance organisations are also subject to the Directive Solvency I under some conditions (Articles 5 to 11).

581 Article 132 of the Solvency II Directive

582 Article R. 353-1, I. of the French Insurance Code

ii. Necessity of specific documentation for Euro PPs

The Euro PP market appeared in France during the second half of 2012 with the first listed Euro PP in bond format. At that point, there was no documentation providing a framework for Euro PPs. In order to develop the Euro PP market and to facilitate the access of mid-sized companies to this market, it became necessary to standardise the instrument and to provide a market framework. Since 2014, an initiative has been undertaken to develop a specific documentation and framework for the Euro PP.

Charter of Euro Private Placements

The Euro PP Working Group established the Charter, benefiting from the support of the Banque de France and the French Direction Générale du Trésor participating in an observer capacity.

The Charter is intended to provide a non-binding and specific execution framework of credit market best practices that are essential for the development of Euro PPs with a view to establishing the Euro PP market a reference market in France and internationally. The Charter is further intended for instructional purposes and to set out roles and missions of all key participants.

The Charter includes in its appendixes non-binding model documents which can be adapted to the parties' needs. These include:

- an information memorandum with the framework of how the issuers should be described;
- a template of the terms and conditions for the bond format which details for each clause the points to which issuers and investors must pay particular attention;
- a form of non-disclosure agreement to control the transmission of the information by the issuer to investors in order to guarantee confidentiality; and
- a form of arranger's due diligence questionnaire.

Model private placement agreements

The Euro PP Working Group released two model private placement agreements in January 2015. These contracts were established for use on the Euro PP market to respond to the needs of both investors and issuers of any size, French and international alike.

These agreements are governed by French law and are available for bond and bank loan markets, covering the entirety of the Euro PP market while preserving the particularities of each segment. They were translated into the English and Italian languages with the wish to broaden the use of the Euro PP market by foreign issuers and investors.

By providing these model agreements to market participants, the goal was to promote the development of new funding tools through the emergence of a more efficient and integrated Euro PP market via standardisation of the contractual documentation.

The contracts are negotiated by the parties, based on the market conditions, the profile of the issuer and the characteristics of the transaction. The clauses can also be adjusted. This flexibility leaves full discretion to issuers and investors when they negotiate the documentation, allowing them to use these contracts for a variety of different credit ratings or situations.

The Charter, the template documentation and the market information are available on http://www.euro-privateplacement.com/. This website aims at centralising all the work carried out by the Euro PP steering committee and is a reference to obtain all the information concerning the market evolutions.

ECPP Guide

The initiatives described above have been taken at European level. In addition, an ECPP Guide has been established by the European Corporate Debt Private Placement Joint Committee (the "ECPP JC") in coordination with ICMA, which builds on existing practices in the bond and bank loan markets, as well as practices in other international private placement markets.

The ECPP Guide is in line with the Charter and the work of the Euro PP Working Group, defining best practices and the roles of parties, whilst also providing standard summary terms for discussion between issuers and investors.

First published in February 2015, the ECPP Guide has become an important contributing factor in the development of the market. The ECPP Guide was updated in October 2016 to reflect the evolutions in the Euro PP market and to cover the Schuldschein market.

The rules set out in the ECPP Guide are not mandatory and are established for information purposes only. A survey showed that most of the investors (76%) and more than half of the corporates (53%) were aware of this initiative in 2016. A significant number of the investors and corporates used the ECPP Guide (20% of the investors and 11% of the corporates) and the available standardised documentation (8% of the investors and 7% of the corporates)[583].

LMA Documentation

In January 2015, the LMA produced four standard form documents to assist in creating a more unified and efficient Euro PP market:

- a form of facility agreement;
- a form of subscription agreement;
- a form of term sheet for use with the above mentioned agreements; and
- a confidentiality agreement for use with the above mentioned agreements.

In addition, the LMA issued a user guide providing guidance on the key terms of the standard form documents.

The standard form documents are governed by English law but have been drafted in such a way as to be easily adaptable to other jurisdictions. They are available on the LMA's website (which is accessible to the LMA's members). See Part III (*Analysis of Most Common Risk-Mitigation Clauses in Private Placement Transactions*) for details of the provisions of the LMA private placement documents.

583 "*Funding European business: Strengthening alternatives*" by Allen & Overy, http://www.allenovery.com/publications/en-gb/FundingEuropeanBusiness/Documents/2016/2016-Funding_European_business_Strengthening_alternatives.pdf

AMAFI's Code of best practice for Euro PP arrangers

Most Euro PP transactions are implemented with the role of an arranger. In January 2016, AMAFI (*Association française des marchés financiers*), which participates in cross-market work aimed at promoting the development of the Euro PP market, published a Code of best practice for Euro PP arrangers setting out best business practices for arrangers and underlining their key role in the Euro PP market (the "**AMAFI Code**").

The AMAFI Code details tasks, services and due diligence that an arranger may perform at each stage of a Euro PP transaction and assures high-calibre professional services from arrangers, giving added security to issuers and investors. The AMAFI Code complement that Charter and aims to detail in the most complete way the role of arrangers, particularly in their role of advising and analysing the credit of the issuer.

i. Opening of MTF for Euro PP transactions

The listing of Euro PPs in the form of bonds is not an obligation. The choice to list a Euro PP transaction depends on several factors relating particularly to issuing constraints.

For example, the wide application of the provisions of the Market Abuse Regulation[584] ("**MAR**") may inform the issuers' decision as to whether to list their Euro PPs or not. Indeed, many issuers that do not already have instruments listed would normally favour a non-listed Euro PP for a first-time issuance in order to remain outside the scope of MAR. On the other hand, an issuer who already has instruments listed may find the MAR obligations less burdensome if they already apply by virtue of its already having securities listed.

Issuers may also prefer to list their Euro PPs on a traditional regulated market exchange or on a MTF to allow the development of a certain liquidity, even if these transactions are intended as a buy-and-hold investment (i.e. to be held by the investors until the maturity of the Euro PP).

Furthermore, one of the general criteria established by the ECB for eligibility of assets as collateral is the admission on acceptable markets for marketable assets[585] (for further explanation, see "Euro PP as ECB collateral" below). As the traditional regulated markets and the MTF markets are considered as acceptable markets for assets as collateral for Eurosystem monetary policy operations, some companies may prefer to list their Euro PPs. However, they need to comply with all the eligibility rules established by the ECB (including the rating criteria, which is rarely the case for Euro PP transactions given that they are usually unrated) in order for their Euro PPs to be accepted as collateral by the Eurosystem.

However, the listing on a regulated market led to burdensome information requirements for small and medium-sized companies, including the requirement to produce a prospectus for the purposes of obtaining admission to listing, periodic and ongoing disclosure obligations during the instrument's life and the obligation to publish audited consolidated financial statements for two years

584 Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC.

585 Article 68 of the Guideline (EU) 2015/510 of the ECB of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (ECB/2014/60).

(according to international IFRS or French accounting standards) and the related statutory auditors' reports.

In view of these constraints on the regulated market, Euronext decided to encourage the development of Euro PP transactions by launching a new product in March 2015: Euronext Private Placement Bonds[586].

This initiative gives issuers of Euro PP easier access to Euronext MTFs[587], thus expanding their investor base. Issuers can now list Euro PP issues on Euronext Growth or Euronext Access using a fast, simple and standardised procedure that is also attractive in terms of cost. Further, the information requirements are much lighter as there is no need to prepare a prospectus (within the meaning of Directive (2003/71/EC) (the "**Prospectus Directive**")), to disclose information periodically or to appoint a listing sponsor[588].

Despite these considerations, many non-listed companies have increasingly, over time, issued non-listed Euro PPs demonstrating that the listing of the issuer or of its bonds is no longer a determining criterion or an absolute barrier for investors. Of the Euro PPs listed between May 2012 and June 2017, approximately 55% of Euro PP transactions were listed on a regulated market and 45% were listed on a MTF.[589]

ii. A need for a simplification of provisions relating to bond issues and representation of bondholders

The legal framework set out in the French Code de commerce relating to representation of bondholders (the "**Masse**") for French law governed bond issues is considered to be constraining as this is a "one size fits all" legal regime, which cannot be contractually modified in the terms and conditions of the bonds. One exception was provided for by the French Code de commerce where the bond issue could be categorised as "international" or "issued outside France" (L.228-90 of the French Code de commerce).

In the latter case – i.e. where an international component to the transaction can be demonstrated (if for instance 50% or more of the investors are domiciled abroad) – the terms and conditions can disapply certain provisions of the law and set out contractually the rules applicable to the representation of bondholders.

However, small and medium-sized companies issuing Euro PPs in France do not easily benefit from the contractual flexibility because their bonds are considered to be issued in France in most cases.

In the Sapin II law which was passed on 9 December 2016 ("**Sapin II**"), the legislator showed his intention to "favour the bond issues' development, in particular by simplifying and modernising the provisions relating to these issues

586 https://www.euronext.com/fr/actualite/euronext-renforce-son-offre-de-cotation-des-placements-prives-obligataires

587 Euronext Growth (formerly known as Alternext) and Euronext Access (formerly known as Free Market).

588 Euronext Growth Markets Rule Book into force as of 19 June 2017 and Euronext Access Rule Book into force as of 19 June 2017.

589 Approximate figures based on Linklaters' analysis of the Euro PPs issued between May 2012 to June 2017.

and the representation of bondholders, as well as repealing the provisions that were not appropriate and bringing French law in line with European law".

Sapin II entered into force on 11 December 2016. However, the Government had to adopt legislative measures by ordinance within ten months from the enactment of the law. These draft ordinances and decrees have been presented for public consultation by the French Direction Générale du Trésor (reporting to the French Ministry of Foreign Affairs and the French Ministry of Economy and Finance).

Ordinance n°2017-970 of 10 May 2017 (Modernisation of bondholders' representation), which aims to foster the development of bond issuances, was published on 11 May 2017 and completed by the implementing decree dated 12 July 2017 (the "**Ordinance**"). The main purpose of the Ordinance is to simplify the degree of formality involved in bond issuances and to modernise the representation of bondholders. The Ordinance should assist in promoting the development of Euro PP as well as simplify bondholder meetings, which remain excessively formalistic and may be regarded by issuers as burdensome and costly.

The reforms implemented by the Ordinance have resulted in the role of the parties being enhanced, as expressed in the terms and conditions of the bonds.

- The Ordinance allows, pursuant to a new Article L.213-6-3 of the French Monetary and Financial Code (the "**Monetary and Financial Code**"), in some cases, complete freedom as to the organisation of bondholders' representation.

  As mentioned above, prior to the Ordinance, only two options were available in the event of a plurality of bondholders, depending on whether or not the issuance was considered to be outside France:

  a. full application of the Monetary and Financial Code's provisions to the group of bondholders (*masse*) (referred to as "full *masse* (*masse complète*)"); or

  b. partial application of such provisions (referred to as "contractual masse (*masse contractuelle*)" or "streamlined masse (*masse allégée*)"), in which case a limited list of provisions may not apply, as provided for in Article L.228-90 of the Monetary and Financial Code.

  The Ordinance draws a new distinction, in addition to that already in force: bond issuances with an individual denomination of at least EUR 100,000 on the one hand and other issuances on the other.

  The Ordinance now allows for:

  a. full disapplication of the provisions of the Monetary and Financial Code relating to the masse, the masse's representatives and bondholder meetings; and

  b. a combination of varying degrees of contractual freedom and the application of certain provisions relating to the masse (without relying on the limitations set out in Article L.228-90 of the Monetary and Financial Code).

  Two requirements must be fulfilled in order to benefit from this new contractual freedom:

a. the terms and conditions of the bonds must make arrangements for bondholder representation, provide for the convening of bondholder meetings, provide for the making of bondholder decisions and set out quorum requirements and voting majorities applicable to such decisions; and

b. the nominal value of the bonds or the minimum amount that may be acquired by a bondholder per transaction must amount to at least EUR 100,000 or its equivalent in any foreign currency.

- The fact that the terms and conditions of the bonds are now the source of rules dictating bondholder representation arrangements is further reflected in amendments made by the Ordinance to certain provisions of the Monetary and Financial Code:

  a. a new Article L.228-46-1 of the Monetary and Financial Code provides for the written consultation of the bondholders, which may be completed electronically. Physical meetings of bondholders are no longer a prerequisite for their decisions to be considered. The option to consult bondholders in this way, as well as the timing and forms of the consultation, are to be provided for in the terms and conditions of the bonds;

  b. in the context of an offer to the public, it is mandatory to appoint an initial *masse* representative in the terms and conditions of the bonds (Article L.228-51 of the Monetary and Financial Code) while it is only a possibility in case of private placements;

  c. the convening of bondholders' general meetings need not conform to the formal rules laid down in relation to shareholders' general meetings provided that the terms and conditions set out the timing and forms of the consultation (Article L.228-59 of the Monetary and Financial Code);

  d. Article L.228-61 of the Monetary and Financial Code permits bondholders attending meetings via videoconferencing or other means of telecommunication to be considered to count towards the quorum or voting majority calculation purposes, as long as the articles of association or the terms and conditions of the bonds provide for such possibility;

  e. the terms and conditions may provide for instances where bondholders can vote together with other creditors, subject to the prior consent of such creditors (Article L.213-6-3 II of the Monetary and Financial Code); and

  f. the terms and conditions may also provide bondholders with the option to appoint an agent in charge of the representation and the submission of claims should the issuer become subject to any of the proceedings referred to in Book VI of the Monetary and Financial Code (i.e. preventive proceedings (*prévention*), safeguard procedure (*sauvegarde*), judicial reorganisation (*redressement judiciaire*) or judicial winding-up (*liquidation judiciaire*)) (Article L.213-6-3 IV of the Monetary and Financial Code).

- The Ordinance further provides for issuers to correct clerical errors in the terms and conditions of the bonds without consulting or gathering the bondholders.

It will be interesting in the coming months to evaluate the use of the contractual freedom provided for by the Ordinance among different kinds of issuers and issuances (wholesale bond issuances versus Euro PP for instance). Admittedly, the *masse* system provided for in the Monetary and Financial Code and used since the very first French-law governed issuances remains, for many bondholders, a cornerstone of their protection. However, the streamlining of issuance formalities and the costs-effectiveness improvements relating to the convening, consulting and publication of bondholder decisions will not only be welcomed by issuers but also bondholders, given that they will now be consulted in a more straightforward, and consequently, a more frequent manner.

Market participants interviewed as part of this study are unanimously satisfied with this new reform.

iii. No specific tax obstacles

- No stamp duty or registration duty is due upon the issuance, the transfer or repayment of Euro PPs (structured either under the bond or the loan format).
- The withholding tax regime applicable to Euro PPs follows the legal regime of the format being used (i.e. loan or bond)[590].

a. Euro PP issued under a bond format

If Euro PP is issued under a bond format, payments of interest and other revenues made by the issuer with respect to bonds will not be subject to withholding tax unless such payments are made outside France in a non-cooperative State or territory (*Etat ou territoire non-coopératif*)[591] (a "**Non-Cooperative State**"). If such payments under the bonds are made in a Non-Cooperative State, a 75% withholding tax will be applicable[592].

Furthermore, interest and other revenues paid on bonds may not be deductible from the taxable income of this issuer if they are paid or accrued to persons established or domiciled in a Non-Cooperative State or paid in such a Non-Cooperative State (the "**Deductibility Exclusion**")[593]. Under certain conditions, any such non-deductible interest and other revenues may be recharacterised as constructive dividends[594], in which case such non-deductible interest and other revenues may be subject to a withholding tax[595], at a rate of 30% or 75%, subject to the more favourable provisions of any applicable double tax treaty.

Notwithstanding the foregoing, neither the 75% withholding tax[596] nor, to the extent the relevant interest or other revenues relate to genuine transactions and are not in an abnormal or exaggerated amount, the Deductibility Exclusion, will apply in respect of a particular issue of bonds if

590 Assuming that the bondholders/lenders are unrelated to the borrower.
591 Article 238-0 A of the French *Code général des impôts*
592 Article 125 A III of the French *Code général des impôts* – Application of the withholding tax is subject to certain exceptions and to the more favourable provisions of any applicable double tax treaty.
593 Article 238 A of the French *Code general des impôts*
594 Article 109 et seq. of the French *Code général des impôts*
595 Article 119 bis 2 of the French *Code général des impôts*
596 Article 125 A III of the French *Code général des impôts*

the issuer can prove that the principal purpose and effect of such issue of bonds were not that of allowing the payments of interest or other revenues to be made in a Non-Cooperative State (the "**Exception**"). Pursuant to the French tax administrative guidelines[597], an issue of bonds will benefit from the Exception without the issuer having to provide any proof of the purpose and effect of such issue of bonds, if such bonds are:

i. offered by means of a public offer within the meaning of Article L.411.1 of the Monetary and Financial Code; or

ii. admitted to trading on a regulated market or on a French or foreign MTF provided that such market or system is not located in a Non-Cooperative State, and the operation of such market is carried out by a market operator or an investment services provider, or by such other similar foreign entity, provided further that such market operator, investment services provider or entity is not located in a Non-Cooperative State; or

iii. admitted, at the time of their issue, to the operations of a central depositary or of a securities clearing and delivery and payments systems operator within the meaning of Article L.561-2 of the Monetary and Financial Code, or of one or more similar foreign depositaries or operators provided that such depositary or operator is not located in a Non-Cooperative State.

Euro PPs issued under the bond format should therefore benefit from this Exception as the bonds are either listed on a regulated market or a MTF which is not located in a Non-Cooperative State or admitted to the operations of a central depositary recognised by French law (Euroclear France / Euroclear – Clearstream).

b. Euro PP issued under a loan format

If Euro PP is issued under a loan format, payments of interest and other revenues made by the borrower with respect to a loan will follow the same rules as those applicable to the Euro PP issued under a bond format.

Furthermore, interest and other revenues paid on such loan may not be deductible from the taxable income of the borrower if they are paid or accrued to persons established or domiciled in a Non-Cooperative State or paid in such a Non-Cooperative State (Deductibility Exclusion) and, under certain conditions, any such non-deductible interest and other revenues may be recharacterised as constructive dividends[598].

Notwithstanding the foregoing, neither the 75% withholding tax nor, to the extent the relevant interest or other revenues relate to genuine transactions and are not in an abnormal or exaggerated amount, the Deductibility Exclusion, will apply in respect of a particular loan if the borrower can prove that the principal purpose[599] and effect[600] of such loan were not that of

[597] BOI-INT-DG-20-50-20140211 n°550 and 990, BOI-RPPM-RCM-30-10-20-40-20140211 n°70 and 80 and BOI-IR-DOMIC-10-20-20-60-20150320 n°10

[598] The regime applicable to the Euro PP issued under a bond format (as described above) also applies to the Euro PP issued under a loan format.

[599] The Borrower must prove that its intent was not that of locating sums in a Non-Cooperative State.

allowing the payments of interest or other revenues to be made in a Non-Cooperative State.

As a consequence, Euro PPs issued under a loan format should not be subject to the 75% withholding tax[601] or the Deductibility Exclusion in the two following cases:

i. the interest and other revenues paid on such loan shall not be made (a) to a person incorporated, domiciled, established or acting through an office located in a Non-Cooperative State and (b) on account held in a financial institution located in a Non-Cooperative State; or

ii. the borrower is able to demonstrate that the principal purpose and effect of such loan were not that of allowing the payments of interest or other revenues to be made in a Non-Cooperative State.

The market practice is for Euro PP lenders to be qualifying lenders so that the loan falls within the scope of item (i) above. The loan format thus does not offer to them blanket exemptions applicable to the bond format (see (I), (II) or (III) of paragraph (i) above).

iv. Euro PP as ECB collateral

The Eurosystem conducts credit operations with credit institutions and other market participants. Lending is based on adequate collateral.

The ECB has developed eligibility rules[602] for assets eligible as collateral. The Banque de France has taken over and implemented such rules[603].

In relation to whether Euro PPs are eligible as collateral as defined by the ECB, it should be noted that the eligibility criteria have been set up depending on whether the assets are marketable or non-marketable assets.

a. Marketable Assets

Marketable assets are defined as debt instruments that are admitted to trading on a regulated market[604] or on certain acceptable non-regulated markets, as defined in the Article 68 of the Guideline 2015/510. The ECB publishes an updated list of eligible marketable assets on its website every business day[605]. This list is also published on the Banque de France website.

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600 All factual and quantitative elements shall be taken into account in order to make an objective comparison between (i) the gain resulting from the tax advantages and (ii) the gain resulting from advantages other than tax in case payments are made in a Non-Cooperative State.

601 Article 125 A III of the French *Code général des impôts*

602 Guideline (EU) 2015/510 of the ECB of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (ECB/2014/60).

603 Decision of the Banque de France n°2015-01 of 22 April 2015.

604 As defined in Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments.

605 Article 61 of the Guideline 2015/510.

On the basis of research we have conducted into the database of the ECB website, we have not found Euro PP transactions in the list established by the ECB.

As some Euro PP operations were admitted to trading on regulated markets or MTFs, we have examined all criteria of eligibility in order to determine if Euro PPs could be assimilated to marketable assets.

Among the general criteria set up by the ECB[606] and on the basis of our inquiries, the vast majority of Euro PP transactions we examined fall within the scope of most of the criteria:

- a "fixed and unconditional principal amount";
- coupon structures compatible with in Article 63 of the Guideline 2015/510;
- Euro PPs do not give rise to rights to the principal and/or the interest that are subordinated to the rights of holders of other debt instruments;
- Euro PP operations are denominated in EUR;
- Euro PPs are issued within the euro area;
- Euro PP transactions are transferable in book-entry form;
- Some Euro PP operations are admitted on acceptable markets for marketable assets (such as Euronext Paris market); and
- Euro PPs are mainly issued by non-financial corporations established in the EEA.

However, concerning the criteria set out in Article 71 of the Guideline 2015/510, the assets shall meet the credit quality requirements provided by one accepted external credit assessment institution (ECAI)[607]. These assets must have a credit assessment in compliance with credit quality step 3[608].

Eurosystem harmonised rating scale for ECAIs

ECAI credit assessment		Credit quality step (CQS) CQS 1	CQS 2	CQS 3
Short-term	DBRS		R-1H, R-1M	R-1L, R-2H, R-2M, R2-L
	Fitch Ratings		F1+, F1	F2
	Moody's		P-1	P-2
	Standard & Poor's		A-1+, A-1	A-2
Long-term	DBRS	AAA/AAH/AA/AAL	AH/A/AL	BBBH/BBB/BBBL
	Fitch Ratings	AAA/AA+/AA/AA-	A+/A/A-	BBB+/BBB/BBB-
	Moody's	Aaa/Aa1/Aa2/Aa3	A1/A2/A3	Baa1/Baa2/Baa3
	Standard & Poor's	AAA/AA+/AA/AA-	A+/A/A-	BBB+/BBB/BBB-

Source: Eurosystem Credit Assessment Framework for Monetary Policy Operations[609]

606 Part IV, Title II, Chapter I, Section I of the Guideline 2015/510 (Articles 62 to 71 of the Guideline 2015/510).

607 ECAIs are DBRS, FitchRatings, Moody's and Standard & Poor's.

608 Credit quality step 3 is considered equivalent to a maximum probability of default over a one-year horizon of 0.40% (Article 59, 3 of the Guideline 2015/510)

609 https://www.ecb.europa.eu/pub/pdf/other/mb201404_focus03.en.pdf?1c85f104bb2b99d2c2ffc17d3ff9fc64

b. Non-Marketable Assets

As regards non-marketable assets, there are three types of assets that are eligible as collateral: fixed-term deposits from eligible counterparties, credit claims and non-marketable retail mortgage-backed debt instruments.

Euro PP transactions may fall within the scope of eligibility criteria for credit claims[610]. A credit claim is considered as a claim for the repayment of money, which constitutes a debt obligation of a debtor vis-a-vis a counterparty.

Among the criteria established by the ECB611, Euro PP transactions comply with:

- the principal amount and coupons criteria;
- the non-subordination criteria;
- the obligation of a minimum size ((i) for domestic use, the Banque de France does not require any minimum amount612 and (ii) for cross-border use, the minimum size of EUR 500,000 shall apply); and
- the governing law - the Euro PPs are issued under the law of a EU Member State.

The issuer has its registered office in the euro area and the currency of the denomination is EUR. One of the types of debtors for credit claims (i.e. non-financial corporations) is those who are authorized to issue Euro PPs. Euro PPs also comply with the additional legal requirements for credit claims.

However, concerning the credit standards of credit claims, the debtor must meet high credit standards[613] from one of the four credit assessment sources accepted by the Eurosystem[614].

The credit quality of marketable assets and non-marketable assets is the criteria which represents the main issue as regard to the eligibility of Euro PPs as ECB collateral. As specified in the Charter, Euro PPs are usually unrated. These operations are consequently excluded from the scope of ECB collateral. For those Euro PPs that are rated, which is rarely the case, they must have a credit assessment in compliance with credit quality step 3.

Thus, it is not possible to determine whether Euro PP operations are automatically eligible as ECB collateral. The analysis must be made on a case-by-case basis taking into account whether the Euro PP in question is rated or not and whether it meets the minimum credit assessment. Therefore, given the characteristics of Euro PP and that it is rarely rated, the assumption is that the Euro PP's eligibility as ECB collateral is not of central importance. However, if all criteria are met, there is nothing to prevent Euro PP from being accepted as collateral by the Eurosystem.

In relation to Euro PPs in the form of loans, it should be noted that both the standard form document prepared by the LMA and the standard form document prepared by the Euro PP Working Group includes provisions allowing the lenders to pledge, assign as

610 Part IV, Title III, Chapter I, Section I of the Guideline 2015/510

611 Articles 89 to 105 of the Guideline 2015/510.

612 Article 93 of the Decision of the Banque de France n°2015-01 of 22 April 2015.

613 Articles 109 to 111 of the Guideline 2015/510.

614 The four credit assessment sources are ECAIs, the Banque de France's in-house credit assessment system, counterparties' internal ratings-based systems and third-party providers' rating tools.

guarantee or give a security encumbering all or some of their receivables so as to guarantee their obligations, including, in particular, any pledge, any assignment as guarantee or other security guaranteeing their obligations vis-a-vis a federal reserve, the ECB, the Bank of France, or any central bank or financial institution.

Regulatory Obstacle to the Further Development of the Euro PP Market

Through the development of the Euro PP market, regulatory barriers have, in general, been addressed as they have been identified. As such, market participants have agreed that there are currently very few, if any, significant regulatory obstacles to the further development of the Euro PP market. The only potential area currently identified by market participants in which the regulatory framework applicable to Euro PP could be improved is as regards the market sounding regime under the Market Abuse Regulation.

Market Abuse Regulation – Market sounding

Directive 2003/6/EC of 28 January 2003 on insider dealing and market manipulation (the "**Market Abuse Directive**" or "**MAD**") did not include any provision concerning market soundings. Initially, market soundings were mainly a feature of the equity markets. However, because of the lack of liquidity on bond markets and the considerable volatility which was caused by the 2007 financial crisis, market sounding practices have developed for bond transactions.

In France, former article 216-1 of the *Autorité des marchés financiers* General Regulation ("**RG AMF**") regulated market soundings for both equity and bond markets. This article referred to the AMAFI Code of conduct dated 4 March 2014 (the "**Code of Conduct**") as a professional set of rules to be observed. Under this regime, discussions with potential investors for the purpose of negotiating the terms and conditions of their participations to a Euro PP transaction were considered not to fall within the definition of market sounding rules. As MAR is of direct application in EU Member States, national market abuse regulations such as the one embedded in former article 216-1 of the RG AMF were technically repealed on MAR taking effect, which in turn automatically lead to the repeal of the Code of Conduct.

The Market Abuse Regulation took effect on 3 July 2016 and applies to financial instruments that are admitted to regulated markets, MTFs and (from 3 January 2018) OTF. As with the previous regime, the jurisdiction of incorporation of an issuer, guarantor or bookrunner will not be relevant to whether the entity is subject to MAR. If an issuer has any securities (debt or equity) which are admitted to trading (or for which a request for admission to trading has been made) on a relevant trading venue, it must ensure compliance with the new regime. The scope of MAR is wider than the previous regime under MAD in that issuers with securities admitted to trading on MTFs will also be subject to the provisions of MAR[615].

MAR has introduced new provisions for market soundings, and in particular its Article 11 which defines this concept and provides for the subsequent obligations. A market sounding comprises "the communication of information, prior to the announcement of a transaction, in order to gauge the interest of potential investors in a possible transaction and the conditions relating to it such as its potential size or pricing, to one or more potential investors by (a) an issuer; (b) a secondary offeror of

[615] Note this may not represent a significant change for certain issuers with securities admitted to trading on certain of the MTFs as they may have their own market abuse regime already.

a financial instrument in such quantity of value that the transaction is distinct from ordinary trading and involves a selling method based on the prior assessment of potential investors; (c) an emission allowance market participant; or (d) a third party acting on behalf or on the account of a person referred to in point (a), (b) or (c)".

There are no specific provisions as to whether private placements fall within the scope of MAR. The general view is that Article 11 only applies to discussions regarding transactions in Article 2.1 of MAR, which provides that MAR applies to "(a) financial instruments admitted to trading on a regulated market or for which a request for admission to trading on a regulated market has been made, (b) financial instruments traded on an MTF, admitted to trading on an MTF or for which a request for admission to trading on an MTF has been made, (c) financial instruments traded on an OTF and (d) financial instruments not covered by point (a), (b) or (c), the price or value of which depends on or has an effect on the price or value of a financial instrument referred to in those points, including, but not limited to, credit default swaps and contracts for difference".

As a result, the only certainty is that unlisted Euro PPs issued by companies whose shares are not admitted to trading on regulated markets, MTFs and OTFs are excluded from the scope of RG AMF. In other cases, there is room for interpretation and in particular whether or not Article 2.1.d. implies that private placements issued by companies which have their shares listed on a regulated market fall within the scope of the market sounding provisions.

In the definition of a market sounding, the purpose is to gauge the interest of potential investors in a possible transaction and the conditions relating to it (size, pricing etc.). In the case of Euro PP transactions, information is indeed communicated "prior to the announcement of a transaction" but this is not done in order to clarify the conditions relating to the transactions (size, price).

When a Euro PP[616] is prepared, the goal is not to contact a few selected investors to identify certain specific terms of a transaction with a view to maximising its chances of success with the many other investors to which it is to be offered, but rather to identify potential investors with whom all the terms of the Euro PP transaction (including contractual terms) will be negotiated. The involvement of investors is key in the preparation and structuring of the transaction. In fact, the negotiation of contractual terms and conditions between the borrower and the investors is the most important feature of a Euro PP. This distinguishes a Euro PP from public bond issues, where investors subscribe to an issue without usually being involved in these negotiations. [617]

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[616] Defined in the European Corporate Debt Private Placement Market Guide (October 2016) as "a medium or long-term debt financing transaction between a listed or unlisted company and a small number of institutional investors, based on deal-specific documentation negotiated between the borrower (the "Borrower") and the investor(s) (the "Investor(s)") generally, but not necessarily, with the participation of one or more bank intermediaries as arranger (the "Arranger") usually acting in an agency capacity (i.e. as a facilitator between the Borrower and the Investor, but not as an underwriter of the debt)" (http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Primary-Markets/primary-market-products/private-placements/the-european-corporate-debt-private-placement-market-guide/)

[617] The following elements in the definition of a Euro PP transaction in the European Corporate Debt Private Placement Market Guide (October 2016) confirm this analysis:

This analysis is shared by the majority of the market participants and was set out in AMAFI's guidance on MAR[618] leading to the same conclusion as before the entry into force of MAR, i.e. that Euro PP transactions should be excluded from the scope of market soundings.

However, MAR in respect to market sounding rules needs to be clarified at EU level to confirm that Euro PP transactions (i.e. not a public or syndicated bond issue and not an EMTN) do not fall within the scope of article 11 and therefore that market soundings provisions do not apply to Euro PP transactions. Ultimately, market participants would like this issue to be addressed by a specific new piece of legislation.

This clarification is needed to be sure that the market sounding regime does not impede prospective investors to participate in the structuring of Euro PP transactions that can take several weeks or months to structure. There are other more appropriate risk mitigators that are applicable to Euro PPs to achieve the same goal: inside information (which may be communicated to potential investors during the negotiation of a Euro PP transactions) remains subject to MAR. What is more, Euro PP requires a formal non-disclosure agreement to manage any confidential and/or inside information shared previously to any exchange.

"Negotiation of contractual terms and conditions between the Borrower and the Investors is an important feature of an ECPP, with the whole process more closely resembling that of the bank loan market. This distinguishes an ECPP from public bond issues, where Investors subscribe to an issue without usually being involved in these negotiations, and from a SSD transaction, where the Arranger negotiates the majority of the contractual terms and conditions in advance of them being presented to the Investors", as more fully described in Section 7.

618 AMAFI – 17/13 – MAR Framework – FAQ on implementation and interpretation – Question 2.5 – 9 February 2017

US PP Market

Overview

The US PP market is a US private bond market which is available to both US and non-US companies. One of the principal attractions of this market is that it provides an alternative source of liquidity from the traditional bank market without the need for a formal credit rating and reporting requirements which are a pre-requisite of the public bond markets.

One of the main attractions from an investor's perspective is that US PP's usually come with covenants similar to those in a company's bank credit facilities. Further, the US PP market has proved to be resilient in recent years and was largely open throughout the period of financial turmoil in 2008/2009.

Regulatory Framework

The basic rule relating to securities offerings in the United States is that all offers and sales of securities must either be registered with the SEC or exempt from registration. The private placement exemption from registration is contained in Section 4(a)(2) of the Securities Act, which exempts from registration non-public offerings. The rationale for the private placement exemption is that the extensive regulation applicable to public offerings is not required for offerings made to a limited number of investors that due to their resources or sophistication, can protect themselves and evaluate the merits of private securities offerings.

However, the statute itself does not set forth guidance for determining whether an offering meets its requirements. Accordingly, prior to the adoption of Regulation D by the US SEC in 1982, issuers and their advisors had to rely on judicial and administrative interpretations of the private placement exemption for guidance. Regulation D is a "safe harbor" from registration with more objective standards for determining whether the private placement exemption is available. It is a non-exclusive safe harbor from registration, so an issuer that fails to satisfy the objective criteria of Regulation D may still rely on the broader Section 4(a)(2) private placement exemption.

Most private placements carried out under the Regulation D rely on a rule which provides an exemption for offers and sales to an unlimited number of "accredited investors." In general terms, accredited investors are institutional investors of a certain size and individuals defined as wealthy at the time of the sale. Any private placement conducted under Regulation D to "accredited investors" must also meet general conditions relating to integration, limitation on the manner of offering and limitations on resale that apply to all exempt offers and sales conducted pursuant to Regulation D.

Like Article 3(2)(a) of the Prospectus Directive, which allows PPs to be placed with an unlimited number of "qualified investors," Section 4(a)(2) (including the Regulation D safe harbour) allows for offerings to an unlimited number of investors (provided that they are accredited investors). This means that functionally, the US PP market and the Euro PP market are open to similarly situated investors. The following table compares the key provisions of US and Euro PP regulation:

US exemptions from registration	EU exemptions from a prospectus (Prospectus Directive)	EU exemptions from a prospectus (Prospectus Regulation fully applicable from 21 July 2019)
Small issuance size exemption		
▪ Rule 504 exempts offerings with an aggregate price of up to USD 1 million (EUR 0.9 million619) in any 12 month period with no limits on the type or number of investors.	▪ Article 1(2)(h) of the Prospectus Directive exempts offers of securities with a total consideration in the EU below EUR 5 million. The limit shall be calculated over a period of 12 months. However, MS are free to have national rules for issuances with a total consideration between EUR 100 000 and EUR 5 million.	▪ Article 1 (3) of the Prospectus Regulation exempts offers of securities to the public with a total consideration in the Union of less than EUR 1 million, which shall be calculated over a period of 12 months. However, MS are free to have national rules for issuances with a total consideration between EUR 1 million and EUR 8 million.
▪ Rule 505 exempts offerings with an aggregate price of up to USD 5 million (approx. EUR 4.5 million) in any 12 month period which can be offered to an unlimited to an unlimited number of accredited investors and up to 35 non-accredited investors.		

619 Conversion based on average annual conversion rates published by Deutsche Bundesbank (2016)

"Qualified" investor exemption		
▪ Rule 506 (b) exempts offerings without any limit on the size of the offering but the securities can only be offered to an unlimited number of accredited investors and up to 35 sophisticated investors.	▪ Article 3 (2) (c) and (d) of the Prospectus Directive exempts from a prospectus requirement offers of securities whose denomination per unit is equal to or above EUR 100,000, or where investors are subject to a minimum individual investment equal to or above this value.	▪ Article 1 (4) (c) and (d) of the Prospectus Regulation exempts from a prospectus requirement offers of securities whose denomination per unit is equal to or above EUR 100,000, or where investors are subject to a minimum individual investment equal to or above this value.
▪ Rule 506 (c) exempts offerings without any limit on the size of the offering but restrict the offering to accredited investors only. Non-accredited investors are prohibited from participated in the offering.	▪ Article 3 (2) (a) of the Prospectus Directive exempts from a prospectus requirement offers of securities which are only addressed to (an unlimited number of) "qualified investors" (i.e. "professional investors" under MIFID).	▪ Article 1 (4) (a) of the Prospectus Regulation exempts from a prospectus requirement offers of securities which are only addressed to (an unlimited number of) "qualified investors" (i.e. "professional investors" under MIFID).
Limited number of investors exemption		
	▪ Article 3(2) (b) of the Prospectus Directive exempts from a prospectus requirement offers of securities addressed to less than 150 natural or legal persons per Member State, other than qualified investors.	▪ Article 1 (4) (b) of the Prospectus Regulation exempts from a prospectus requirement offers of securities addressed to less than 150 natural or legal persons per Member State, other than qualified investors.

Though it is common for private placements in the US to be marketed with a disclosure document called a private placement memorandum, the lack of legal requirement provides flexibility around disclosure for issuers depending on the circumstances of a particular issuance. Because the private placement market in the United States exists by way of an exemption to the otherwise applicable legislative regime, there are essentially no offering restrictions once the terms of the relevant safe harbour have been met. However, as discussed further below, the US PP market has developed certain standards and best practices despite the absence of regulatory requirements to do so.

Best Practices

The following have been identified as the most significant best practices in the US PP market:

a. Preparation of a quality disclosure document.

   Though not strictly required when selling securities to accredited investors, issuers often prepare and distribute to investors a private placement memorandum. This market practice has evolved for a number of reasons, the primary of which relates to issuer liability concerns, investor demand and the issuer's marketing objectives. If the issuer is a reporting company, much of the information will be available from the issuer's public company reports. The issuer disclosure provided in connection with any private placement is not subject to the US Securities and Exchange Commission ("**SEC**")'s review or comment.

b. Adequate handling of and prompt responses to investors questions and information needs; making management available for due diligence.

   In the US PP market, it is common for offerees to be invited to meet with representatives of the issuer, and to make an independent investigation into the matters disclosed in the private placement memorandum. Again, this market practice has evolved primarily due to issuer liability concerns and investor demand. Historically, challenges to US PP offerings have hinged on whether sufficient information has been provided to investors, which goes beyond the private placement memorandum to include responses to investor questions and management due diligence.

c. Selection of strong and experienced placement agent and investor counsel.

   Because private placements are typically sold to investors of significant means, issuers typically rely on professional placement agents, and investors are typically represented by legal counsel.

   Private placement agents introduce issuers to potential investors, and help issuers understand and target appropriate investor groups for their securities. The private placement safe harbour can be revoked if a US PP transaction involves a placement agent who is deemed a "bad actor" under SEC rules. As such, issuers are encouraged to engage only with known, reputable placement agents.

   In order to take advantage of the ability to make an independent investigation of the matters disclosed by the issuer, and to negotiate purchase terms and the terms of the offered securities, investors are typically represented by legal counsel designated by the issuer.

d. Use of form documents developed by industry bodies with which investors will be familiar and documentation that addresses the issues likely to be raised by investors.

   For several decades, parties in the US PP debt financing market have relied on model form note purchase agreements ("**NPAs**") developed by the American College of Investment Counsel (the "**ACIC**") in coordination with other market participants. NPAs are the agreements by which investors agree to subscribe to

debt security issuances, and contain the structural and economic terms of the notes to be issued, representations, warranties, default remedies and miscellaneous provisions. The standard ACIC form NPA for non-US issuers is called the "Model Form X" and has variants for investment-grade and non-investment-grade issuers. The Model Form X is comparable to the form bank facilities published by the LMA in its scope and robust representations, warranties and undertakings.

Standardization of documents in the US PP market has facilitated the efficient negotiation, issuance and trading of US PP notes.

Summary - Regulatory Best Practice in the Well-Functioning Private Placement Markets

There is no specific regulatory framework established for private placements in the European jurisdictions where private placement as a funding tool has been most successful, namely the Schuldschein market in Germany and the Euro PP market in France. Instead, the legal framework applicable to such private placement instruments is, in general, the same as that which applies to other forms of debt financing, such as corporate bonds and syndicated loans.

The development of the Schuldschein market and Euro PP market, in particular, has been characterised by the identification of potential and actual obstacles, regulatory or otherwise, at an early stage, with subsequent regulatory adjustments or the development of best practices in order to address or mitigate such obstacles. For example, in the Euro PP market, restrictive French law provisions relating to bond issues and representation of bondholders were addressed with the passing of SAPIN II.

In both the Schuldschein and Euro PP markets, a number of best practices have developed which have helped underpin the success of such markets. In particular, in each of the Schuldschein and Euro PP markets, the role of the arranger is of central importance, both in terms of guiding the transaction and ensuring that market standards are maintained. The prominent role of the arranging bank is a feature which the Schuldschein and Euro PP market share with the successful US PP market. In each jurisdiction, the role of arrangers and best practices applicable thereto have been formalised in publications by the relevant working groups and associations.

Market participants agree that there are no significant regulatory obstacles to the development of these established private placements markets requiring immediate attention[620]. Rather, in each of the Schuldschein and Euro PP markets there a number of lesser issues, some of which have arisen as a result of such private placement markets operating within the same regulatory framework other forms of debt financing. For example, in the Schuldschein market, the applicability of banking licence requirements, the clarification of the legal classification of a Schuldschein and difficulties around the restructuring of Schuldschein are, amongst other, areas where the regulatory framework might be addressed in order to facilitate further growth. In the Euro PP market, the key area identified as requiring clarification is the application of the MAR market sounding regime to Euro PP transactions.

In terms of regulatory framework, the key message from market participants is that they are generally content with the current regulatory environment and have indicated

620 This view has been confirmed by interviews with arrangers and issuers conducted in April/May 2017.

that, to the extent possible, they would like to limit further regulatory changes affecting these markets.

II. Regulatory Obstacles to the Development of Private Placement Markets Across the EU

This section identifies regulatory obstacles to the development of private placement markets across the EU. This section will first discuss potential impediments on a pan-European level stemming from EU law before examining the specific regulatory frameworks of the EU Member States where the private placement market remains underdeveloped and where economic analysis indicates a potential for growth.

Regulatory Obstacles to the Development of Private Placement Markets at an EU Level

In general, market participants have confirmed that there are no significant regulatory obstacles affecting the development of private placement markets across the EU. Notwithstanding this, we have identified below certain regulations at a pan-European level with a potential to impact the development of such private placement markets.

Solvency II

Although Solvency II has not been identified as a primary concern for European private placement market participants, ICMA has stressed the importance of creating a level playing field for investment in private placements by institutional investors throughout the EU Member States[621].

ICMA states that one area where discrepancies remain in terms of investment profiles as between bank investors and insurance investors lies in the capital charges under Solvency II. The ECPP JC has previously demonstrated existing inconsistencies between the Solvency II capital charges for banks under Basel III rules, as well as for insurers under the rules of the National Association of Insurance Commissioners ("**NAIC**") in US PP, both of which are lower than for insurers in Europe and in all cases with comparable maturity and risk profiles.

Smaller insurers may find it difficult to assess this market or those for whom private placement is a new asset class. In addition, the Solvency II capital requirements are often cited by insurance investors as a significant investment disincentive.[622] ICMA considers that improving the calibration of the current Solvency II charge may remove the disincentives to investment in this market.

The calibrations for capital charges currently assume that investors trade in private placements and are fully exposed to their market volatility. In reality, for buy-to-hold investors, such as insurers acquiring private placements to match their long-term liabilities, the exposure is not to market volatility of the private placement, but to counterparty default risk, which is not appropriately recognised in Solvency II and should, in ICMA's view, be the subject of further investigative work. Please see the Economic Part I, Stock-taking (*Definition of a Schuldschein*) stating that most investors follow a buy-and-hold strategy.

The Solvency II working group, a sub-group which feeds into the ECPP JC, is investigating suggestions that default rates are lower, and recovery rates higher, on private placement than for comparable corporate transactions, with comparability

621 ICMA response to CMU Mid-Term Review.

622 Interview with a German insurance company conducted in April 2017.

being based on implied ratings. This may also affect the level at which the capital charges are ultimately set.

ICMA suggest that a readjustment of the current long-term calibrations may incentivise investment in private placement.

Market Abuse Regulation

Neither Schuldschein nor Euro PP in loan format fall within the ambit of the Market Abuse Regulation as they do not qualify as transferable securities. Although Euro PP in bond format which is admitted to regulated markets, MTFs and (from 3 January 2018) OTFs do typically fall within the ambit of the Market Abuse Regulation, the primary concern of market participants in respect of the Market Abuse Regulation is whether the market sounding regime thereunder is applicable to Euro PP in bond format (see "*Regulatory Obstacle to the Further Development of the Euro PP Market*" above for further details).

Regulatory Obstacles to the Development of Private Placement Markets at a National Level

The Economic Part of this study has identified certain EU jurisdictions where the private placement market remains underdeveloped and where economic analysis indicates a potential for growth (see Economic Part, Part III Growth potential). Such jurisdictions may be grouped as follows:

- *Mature private placement markets*: existing private placement markets that are most advanced in relative terms, e.g. through their size, maturity level or awareness across the EU.
- *Domestic private placement markets*: EU Member States with potential to grow a national private placement market based on their issuer and investor base; mostly, these countries already have some kind of domestic private placement initiative.
- *Cross-border private placement markets*: EU Member States with lower national investment capacity or other constraints to develop a domestic private placement market; there is, however, already a significant number of domestic issuers that issue into non-domestic private placement markets or a large potential to do so in the future.

This section identifies potential impediments to the development of certain domestic private placement markets and the cross-border markets as a result of national laws.

The mature private placement markets in the EU comprise of the Schuldschein (as well as Namensschuldverschreibungen) market in Germany and the Euro PP market in France. The regulatory framework for these markets is discussed in Legal Part, Part I (*Regulatory Framework applicable to Schuldschein and Regulatory Framework applicable to Euro PP*).

Domestic Private Placement Markets

The Economic Part of this study has identified Italy, the Netherlands and Spain as jurisdictions with the potential to grow a national private placement market based on their issuer and investor base (see Economic Part, Part III Growth potential). To a certain extent, each of these jurisdictions already has a form of domestic private placement initiative.

This section (i) provides an overview of private placement markets in such jurisdictions, (ii) details the specific regulatory frameworks implemented for private placements in such jurisdictions, (iii) identifies and analyses the regulatory obstacles to further development of such markets and (iv) describes certain best practices particular to such markets.

Italy

a. Overview of private placements in Italy

The Italian bond market has changed in recent years due principally to changes in the tax regime, which in substance lifted the restrictions on unlisted companies to issue bonds. This new wave of bond issues is often referred to as "mini-bonds", but this is a term of art and has no specific legal meaning.

The fact that a much broader range of companies are now able to access the bond markets has also meant a growth in private placements, which in Italy are generally understood as being bond issues without a roadshow to multiple investors and without the sort of bookbuilding activity that would be seen on benchmark bond issues of large corporates. Essentially a financial intermediary, usually an investment bank, will put investors and companies in contact and the investor(s) is/are involved in negotiating specific terms of the bonds – there will generally be a single investor or a limited number of investors.

b. Regulatory framework of private placements in Italy

There is no specific legal or regulatory framework that refers only to so-called "mini-bonds". As for the German Schuldschein market and French Euro PP market, the applicable framework for "mini-bonds" is the framework for bond issues by Italian companies generally.

The Italian civil code contains provisions relating to bonds[623] that apply generally to Italian companies (other than certain types of companies such as banks or securitisation vehicles which are exempt from certain of these provisions).

There are three principal practical aspects to be considered, subject to any additional restrictions that may be in a company's by-laws:

1. an Italian company may authorise a bond issue by passing a resolution that needs to be notarised and deposited with the relevant companies' register prior to the issue date[624];

2. an Italian company may not issue bonds in a nominal amount that exceeds twice its share capital and reserves, unless (i) the bonds are subscribed by professional investors that are regulated entities, or (ii) the bonds are listed on a regulated market or MTF[625]; and

623 Art. 2410 et seq. Italian Civil Code.
624 Art. 2410(2) Italian Civil Code.
625 Art. 2412 Italian Civil Code.

3. any changes to the terms and conditions of a bond issued by an Italian company may only be made at a bondholder meeting, and the by-laws of the company or the Italian civil code will dictate the relevant notice periods for calling such a meeting, as well as the constitutive and voting quorums for passing any resolution[626].

In addition, Italian and European securities laws apply to any offering or placement of bonds in Italy, which vary depending on the characteristics of the securities (such as denomination, listing, etc.) and of the investors. As such, the usual considerations will apply relating to market abuse and, if a regulated market listing is chosen, prospectuses, transparency, etc.

c. Italian tax considerations - changes to the Italian tax regime of "mini-bonds"

In lieu of the ordinary 26% interest withholding tax, a substitutive tax regime is provided for securities falling within the category of bonds (*obbligazioni*) or debentures similar to bonds (*titoli similari alle obbligazioni*) which embed the unconditional obligation of the issuer to fully repay the principal invested upon redemption. The application of the substitutive tax regime does not carry a substantial benefit (in terms of effective taxation) to certain Italian resident investors (such as Italian resident individuals, etc.), being the substitutive tax levied at a rate equal to the ordinary interest withholding tax rate (i.e. 26%). By contrast, the substitutive tax regime entails, *inter alia*, that (i) certain Italian resident entities (such as companies, investment funds, etc.) receive interest without triggering any taxation at source and (ii) certain categories of foreign investors (such as those resident/established in "white-list countries") receive interest free of any taxation at source.

In particular, the substitutive tax regime applies where the securities are issued by:

i. banks or companies whose shares are traded on a regulated market or MTFs of an EU Member State or of States belonging to the EEA and included in the "white-list countries" ("Qualified Regulated Market" or "Qualified MTF");

ii. unlisted companies, if the securities are listed in a Qualified Regulated Market or Qualified MTF, regardless of the nature of the bondholders; and

iii. unlisted companies, where the bonds are also not listed, provided that they are held by "investitori qualificati" ("Qualified Investors") pursuant to Article 100 of Legislative Decree No. 58/1998 (the "Italian Financial Act").

Interest arising from unlisted bonds and similar securities issued by unlisted companies and held by investors other than Qualified Investors under letter (c) above, remain subject to the ordinary 26% interest withholding tax.

In recent years, the Italian government approved a number of legal provisions[627] in order to remove certain unfavourable tax rules which hindered the issue of bonds by companies whose equity shares were not listed on regulated markets or MTFs within the EU (so called "mini-bonds").

626 Art. 2415 Italian Civil Code.

627 In the so called "Decreto Crescita" in 2012, "Decreto Destinazione Italia" in 2013, "Decreto Crescita e Competitività" in 2014 and "Decreto Internazionalizzazione" in 2015.

The key changes resulting from such new tax measures are as follows:

i. Deductibility of interest for the issuer

Mini-bonds are now more efficient instruments in terms of interest tax deductibility. As of 2016, issuers of mini-bonds are no longer subject to any interest deductibility limitations and may deduct passive interest under the general interest barrier rule provided for corporate income tax ("**CIT**") purposes, according to which passive interest exceeding the active interest accrued are deductible up to 30% of EBITDA.

ii. Tax treatment of interest received by the bondholder

The subscription of mini-bonds has also been made more appealing to investors. As described above, the substitutive tax regime (provided by Decree No. 239/1996) applicable to bonds issued by banks or companies whose shares are traded on a Qualified Regulated Market or a Qualified MTF has been extended to mini-bonds, provided that they are either:

i. listed in a Qualified Regulated Market or a Qualified MTF; or

ii. in the case of unlisted mini-bonds, held by Qualified Investors.

As a result of the substitutive tax regime now applicable to mini-bonds also, (a) Italian institutional investors (including banks and insurance companies) receive interest without triggering any taxation at source; and (b) non-Italian investors established in "white-list countries" may receive interest free of any taxation, subject to certain procedural requirements and fulfilments.

To ensure payment of interest without the application of the substitutive tax, the bondholders indicated above must (a) be the beneficial owners of payments of interest on the mini-bonds and (b) timely deposit the mini-bonds directly or indirectly with an intermediary. In addition, non-Italian resident investors established in "white-list countries" must also timely file with the relevant depository a self-assessment (*autocertificazione*) stating, *inter alia*, that it is resident, for tax purposes, in a country which recognises the Italian fiscal authorities' right to an adequate exchange of information. Such self-assessment (*autocertificazione*) is valid until withdrawn or revoked and need not be submitted where a certificate, declaration or other similar document meant for equivalent uses was previously submitted to the same depository. The self-assessment (*autocertificazione*) is not requested for non-Italian resident investors that are international entities and organisations established in accordance with international agreements ratified in Italy and Central Banks or entities which manage, *inter alia*, the official reserves of a foreign state.

iii. Deductibility for CIT purposes of the issue costs

All costs related to the issue of mini-bonds are deductible by the issuer, for CIT purposes, in the tax return relating to the tax year during which they have been incurred.

d. Regulatory obstacles to the development of private placements in Italy

Subject to very limited exceptions, lending in Italy is a regulated activity as provided under the Italian Banking Act[628] and Decree no. 53 of 2015. As such the entities that are able to lend to Italian companies are limited and any investor falling outside this category must ensure that its investment cannot be seen to fall within the regulated activity of lending, which essentially requires a banking license. Investments by such entities can be carried out through purchasing bonds issued by the relevant company, and this is one of the reasons why the documentation for mini-bonds and private placements in Italy is substantially the same as the documentation for a public bond issue, and not similar to the more simplified documentation which could be compared to a loan. As such, an Italian company is generally unable to issue a private placement in loan format unless the investor/lender is a regulated entity authorised to carry out lending activities in Italy.

In addition to the tax considerations above, article 2412 of the Italian civil code restricts the amount of unlisted bonds that an Italian company can issue to double the amount of the issuer's share capital and certain reserves. Such restriction does not apply if the bonds are then listed[629]. For this reason, bonds will generally be listed on a regulated market or MTF in an EU Member State. Connected to this, bonds will therefore follow the same format as a public bond issue since the stock exchanges/competent authorities/clearing systems are familiar with this.

As in most cases mini-bonds are listed, a broad range of regulation applies to the companies issuing listed mini-bonds which can be overly burdensome. For example, MAR applies generally, which can be difficult for a small private company to deal with both at the time of issue (for example, there would be an obligation on the issuer to publish all price sensitive information at the time of listing: the company would need to ascertain what information it provided to investors in the negotiation phase is price sensitive and be required to publish it, which is something certain companies might be reluctant to do) and during the life of the mini-bond (for example the issuer would be obliged to disclose price sensitive information during the life of the Mini-Bond and would also need to comply with regulations if it wanted to restructure or request waivers in relation to the terms of the Mini-Bond).

From an interview with a representative of Borsa Italiana, they share this concern and explained that the cost of having personnel and internal procedures in place in order to identify and manage price sensitive information is excessively burdensome for small and medium sized companies. CONSOB has indicated that it intends to publish guidelines aimed at simplifying procedures relating to price sensitive information for, *inter alia*, Mini-Bond issuers[630].

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628 Legislative Decree no. 385 of 1 September 1993, as amended from time to time, artt. 10, 106 e ss.

629 The Italian government with Law Decree no. 83 of 22 June 2012 (converted into Law no.134 of 7 August 2012) indeed amended article 2412 to allow companies to issue bonds in an amount higher than twice their share capital and reserves if the relevant bonds are listed, to facilitate issuance of mini-bonds by SMEs so enhancing the financing opportunities available to them.

630 Paper dated 13 October 2017, entitled "*Relazione illustrativa degli esiti della consultazione, delle conseguenze sulla regolamentazione, sull'attività delle imprese e degli operatori e sugli interessi degli investitori e dei risparmiatori*".

Finally, article 2415 of the Italian civil code also needs to be complied with in terms of bondholder meeting provisions (i.e. in the event that any amendments/waivers are required during the life of the bond). This often creates unnecessary complexity due to the fact that quorums and majorities cannot be freely negotiated, and necessary formalities need to be followed in order to pass a resolution for an amendment/waiver. This is particularly burdensome and frustrating when there are only one or two investors, and all parties agree with the amendment/waiver.

e. Regulatory obstacles to the further development of cross-border private placement markets

To the extent that the private placement instrument concerned is a bond (and not a loan), there are no significant regulatory obstacles to investors purchasing such instruments from Italian companies. Further, there are no significant regulatory obstacles to Italian investors purchasing such private placement instruments, whether in loan or bond form, from non-Italian companies provided that it is permitted in the jurisdiction of the borrower.

f. Best practices in respect of private placements in Italy

The following have been identified as the most significant best practices in respect of private placements in Italy where, in general, such privately placed bonds would be listed:

i. It is market practice to use standard English law eurobond structure for larger deals/investors given the potential for the involvement of international investors.

ii. A parallel market for bonds with a value of approximately 1-10 million Euros is generally governed by Italian law and listed on the Italian stock exchange.

iii. The ExtraMOT Pro was introduced on 11 February 2014 as the new Professional Segment of ExtraMOT market (which is dedicated to listing of bonds, commercial paper, project bonds etc.). It shares the same structure as the ExtraMOT, but it is specifically designed for professional investors, and only professional investors may trade on this market.

The new segment was born to offer to companies and, in particular to SMEs, a national flexible and cost effective market to take advantage of the tax benefits arising from the new regulatory framework[631].

The regulatory infrastructure of the new segment provides companies with a first access to capital markets in a simple and convenient way. The only listing requirements are publishing the annual financial statements for the past two years, the last of which should be audited and providing an admission document in Italian or in English with some essential information. A listing prospectus in accordance with the Prospectus Directive is not required. Following admission to listing, audited annual financial statements need to be published, if a public rating is assigned such rating needs to be disclosed, and information should be published concerning any changes in the bond holders' rights, and any technical information related to the characteristics of the bonds (e.g. payment dates, interest coupons, sinking schedule).

631 Decree-Law No. 83/2012.

The Netherlands

a. Overview of private placements in the Netherlands

In the current low interest environment, with little cost differential between loan and bond, bank loan financing remains attractive. However, corporates and financial institutions consider the private placement market as a useful source to diversify their financing structure and spread the maturity of their debt. In the Netherlands, the largest investors in private bonds are De Nederlandse Waterschapsbank (NWB), the Dutch Municipal Bank (BNG) and a few large institutional investors. Issuers are mainly investment-grade businesses or municipalities. Recently, more capital-intensive businesses (such as wind turbine farms, aviation, and shipping companies) have increasingly been using private placement bonds to raise capital.[632]

The Dutch debt private placement market is not as developed as the German Schuldschein market and the French Euro PP market and there is no specific Dutch private placement instrument equivalent to the Schuldschein or Euro PP. However, there are no specific regulatory barriers for preventing a Dutch company from issuing a Schuldschein or a Euro PP. In fact, there are companies that have issued such instruments. For example, the Dutch utility company TenneT Holding B.V. issued a German law governed Green Schuldschein loan in the amount of EUR 500,000,000 on 12 May 2016.[633] It should, however, be noted that from our experience, Dutch issuers are more active on the US PP market.

Dutch corporate bond documentation is mainly based on either an issuer's or investor's own standardised documentation or that of the intermediary or arranging bank involved. The fixed templates and standard documentation developed by the ICMA and the LMA are also often used. We are not aware of any initiative from the Dutch Central Bank or any other Dutch (governmental) authority to develop standardised documentation for the Dutch private placement market. The Dutch Central Bank does recognise the increasing use of private placements by Dutch companies and acknowledges the importance of structural improvements in making the market more accessible to both borrowers and lenders.[634]

b. Regulatory framework of private placements in the Netherlands

The regulatory framework for private placements of bonds in the Netherlands (whether by Dutch or non-Dutch issuers) is the same as that for eurobonds (typically, EMTN programmes also allow for notes issued thereunder to be privately placed). Dutch including European securities laws apply to any offering of bonds in the Netherlands, with requirements varying depending on the characteristics of the securities (such as denomination, listing, etc.) and of the investors (such as number of offerees and type of investor, in particular whether institutional or retail). As such, the usual considerations will apply as regards

632 https://www.aegonassetmanagement.com/nl/Nederland/Nieuws-en-inzichten/Inzichten/2016/Private-placement-bonds-and-the-illiquidity-premium/

633 http://www.tennet.eu/company/investor-relations/green-schuldschein/

634 https://www.dnb.nl/en/news/news-and-archive/dnbulletin-2015/dnb323578.jsp

prospectuses, transparency and market abuse, etc. The Dutch civil code does not contain specific provisions relating to privately placed bonds.

c. Regulatory obstacles to the development of private placements in the Netherlands

There are currently no significant regulatory obstacles to the development of private placements in the Netherlands. From the issuer perspective, see "Regulatory framework of private placement in the Netherlands". As for the investor/lender (whether Dutch or non-Dutch), from a Dutch legal perspective lending as such is not a regulated activity in the Netherlands that would require a licence (except if lending to consumers). No licence is therefore required for primary or secondary lending activities to Dutch corporates (such as direct lending to corporates or the purchase of corporate debt). Of course, other activities that the lender may be engaged in, whether or not in conjunction with its lending activities (e.g. accepting deposits and/or other repayable funds from the public), may require a licence (e.g. based on EU bank or investment regulations).

d. Best practices in respect of private placement in the Netherlands

In the absence of a vibrant Dutch private placement market, current best practice would be to use industry standard documentation such as that developed by ICMA and the LMA.

e. Tax aspects in respect of private placement in the Netherlands

No specific tax regime applies in the Netherlands in relation to the private placement of debt or an investment in debt that is privately placed. The ordinary Netherlands tax regime applies to the issuer/borrower and the investor/lender.

There are no Netherlands issue, stamp, transfer or similar taxes due in relation to issuing and investing in privately placed debt or later transfers thereof. Similarly, no Netherlands VAT is due in relation to issuing and investing in privately placed debt or later transfers thereof.

The Netherlands does not levy a withholding tax on interest (see below for potential application of dividend withholding tax).

Interest, as well as costs, are generally deductible for Dutch corporate income tax (standard rate 25%) purposes by the issuer/borrower, subject to various interest deduction limitation provisions that apply to debt financing generally, i.e. not specifically in relation to privately placed debt. Application of one of these provisions, art. 10, paragraph 1, letter d Dutch Corporate Income Tax Act ("**CITA**"), not only results in non-deductible interest for Dutch corporate income tax purposes, but interest would also become subject to Dutch dividend withholding tax (standard rate 15%).

Article 10-1-d CITA provides that the remuneration on a loan is not deductible if the loan is granted under such circumstances that the loan in fact functions as equity (a hybrid loan). Whether a loan is considered to function as equity should be determined based on case law.

Interest received by an investor in/lender of privately placed debt is taxed on the basis of the ordinary Dutch tax regime. Investors/lenders that are corporate income taxpayers for CITA purposes are subject to Dutch corporate income tax (standard rate 25%) with respect to interest received. Certain institutional

investors may benefit from a specific tax treatment, e.g. Dutch pension funds are generally exempt from CITA and interest they receive on privately placed debt would thus not be subject to Dutch corporate income tax.

f. Regulatory obstacles to the further development of cross-border private placement markets

There are currently no significant regulatory obstacles to the further development of a cross-border private placement market from a Netherlands point of view. As for offers of privately placed debt into the Netherlands by non-Dutch issuers see "Regulatory framework of private placement in the Netherlands" above. As for non-Dutch investors in/lenders of Dutch corporate debt, see "Regulatory obstacles to the development of private placement in the Netherlands" above. Whether Dutch issuers offering privately placed debt abroad, or Dutch lenders to corporate borrowers abroad, need to meet regulatory requirements (such as requiring a bank licence) is a matter of the law of the country where the bonds of the Dutch issuer are offered or the borrower of the Dutch lender is located.

Spain

a. Overview of private placements in Spain

The private placement market in Spain is carried through the Alternative Fixed Income Market or MARF (*Mercado Alternativo de Renta Fija*) which, as explained in the Economic Part, carries out the mini-bond market in Spain. MARF came into operation on 2013 and was created as a result of the requirements of the memorandum of understanding governing the financial assistance programme requested in 2012 by the Spanish government from the European Stability Mechanism, with the aim to improve the performance of Spain's financial system as a whole.

MARF adopts the legal structure of a MTF, under the terms provided for in Articles 317 et seq. of the Spanish Securities Market Act.

Given that it is a MTF, access requirements are more flexible than those imposed by official secondary markets and provide greater speed in processing the issues. For this reason, companies using MARF are able to benefit from process simplification and lower costs.

MARF is aimed at institutional investors that wish to diversify their portfolios with fixed-income securities from medium-sized companies that are usually not listed and with good business prospects.

The initial incorporation of securities to MARF shall be requested by the issuer or any member of the market.

Each issuance has to be registered by means of an information memorandum (*documento informativo de incorporación*), which sets out, among other things, a description of the issuer and the debt securities and a list of the most relevant risk factors.

Following unofficial conversations with its directors, the MARF is eager to promote and enhance growth of private placement transactions within its platform.

b. Regulatory framework of private placements in Spain

There is no specific legal or regulatory framework that refers only to so-called "mini-bonds". The applicable framework is the framework for bond issues by Spanish companies generally. The technical legal provisions are the same as those governing the eurobond market.

These are some practical aspects to be considered by Spanish companies when issuing bonds, subject to additional restrictions that may apply:

1. Spanish issuer's board of directors are now generally entitled to authorise the issuance and listing of notes as well as the granting of guarantees except if (i) the issuer's by-laws provide otherwise; or (ii) the notes to be issued are debt securities convertible into shares or notes that grant holders a participation in the company's profits (in which case the general shareholders meeting will be the competent body).
2. Spanish issuers are obliged to grant a public deed of issue in Spain and file it with the Spanish Commercial Registry when listing their bonds in non-Spanish exchange markets or MTFs.
3. Bondholders' syndicate and commissioner (comisario) needed in certain scenarios.
4. Spanish companies are authorised to issue notes (including convertible notes) or other debt instruments abroad.
5. The general rules on ranking of claims set out under the Spanish Insolvency Act will apply in an insolvency scenario.
6. Statutory auditor's responsibility for damage caused when the auditor carries out its duties without the required diligence.

In addition, in line with other European countries, Spanish and European securities laws apply to any offering or placement of bonds in Spain, which vary depending on the characteristics of the securities (such as denomination, listing, etc.) and of the investors.

c. Regulatory obstacles to the development of private placements in Spain

Although MARF regulations do not establish a minimum amount per issuance, since 2013 there have been only two issuances for an amount of less than EUR 10 million (EUR 8 million and EUR 2 million, respectively) out of almost 30 issuances.

The application for the initial incorporation of securities to MARF must include a solvency report issued by a rating agency and the issuer's audited annual accounts for the last two financial years in accordance with the applicable Spanish corporate requirements.[635] It is worth mentioning that external rating is not required by other European markets such as the Schuldschein market or the Euro PP market.

Issuers are also required to provide certain periodical information through the life of the issuance, such as relevant modifications in the issuer's legal structure

635 In accordance with Spanish applicable laws, the obligation to have an audit committee relates only to Spanish listed companies or Spanish companies which securities are admitted to listing on a secondary market. Therefore, issuers with securities admitted to listing in MARF are not required to have an audit committee.

or other relevant milestones regarding the management of the company, as well as any modification affecting the securities. Potential investors in bonds listed on MARF do not need to comply with any reporting obligations. Only issuers are obliged.

There are no tax barriers under Spanish legislation preventing the development of the private placement market within the MARF. Generally speaking interest payments under securities listed in the MARF to Corporate Income Tax taxpayers, non resident entities acting through a permanent establishment in Spain and individuals and legal entities non resident in Spain would be exempt from withholding taxes in case that some procedures are duly fulfilled.

d. Regulatory obstacles to the further development of cross-border private placement markets

There are no significant obstacles or limits on Spanish entities either issuing through or investing in Schuldschein from a Spanish law perspective.

In the case of Euro PP to be utilised in Spain, a distinction has to be made between Euro PP in loan format and Euro PP in bond format. As regards Euro PP in loan format, there are no limits for Spanish entities who intend to act both as borrowers or creditors under a loan from a Spanish law perspective, and as such, there should be no significant regulatory obstacle for Spanish entities issuing through or investing in Euro PP loans. As regards Euro PP in bond format, article 405 of the Spanish Companies Law establishes that the Spanish law shall determine the capacity of the Spanish entities to issue bonds or other debt instruments. In this context, article 401 of the abovementioned law sets out certain limits affecting Spanish limited liability partnerships (*sociedades de responsabilidad limitada*) aiming to issue bonds. Specifically, the issuances made by this type of companies shall not amount to more than twice its net wealth. This limit does not apply to Spanish public limited companies (*sociedades anónimas*). There are no limits or obstacles for Spanish entities investing in Euro PP loans from a Spanish law perspective.

e. Best practices in respect of private placements in Spain

Limited liability partnerships (*sociedad de responsabilidad limitada*) are allowed to issue or guarantee bonds as a consequence of the improvements in relation to the access to capital markets introduced by Law 5/2015, of 27 April, for the development of business financing ("**Law 5/2015**"). Most medium-sized companies in Spain are limited liability partnerships, and therefore the MARF could be a good instrument to attract more companies willing to issue bonds under this domestic regime. Prior to Law 5/2015, Spanish limited liability partnerships had to be converted into public limited liability companies (*sociedad anónima*) to act as issuers or guarantors in debt issuances, with the implicit consequences on costs and time. The issuance and guarantee limit amounts to twice the company's own funds, unless the issuance is guaranteed by a mortgage, a pledge of securities, a public guarantee or a joint and several guarantee by credit entities.

Law 5/2015 has also removed the limits for public limited companies (*sociedades anónimas*) in relation to the issuance of bonds. Before Law 5/2015, only public limited companies were allowed to issue debt securities, subject to several restrictions (the amount of debt available to a public limited liability company was capped at the amount of its share capital plus its reserves in accordance with the company's last approved balance sheet, subject to certain exceptions).

Limited liability partnerships (*sociedades de responsabilidad limitada*) were not allowed to issue debt securities.

Law 5/2015 removed all restrictions to public limited companies in terms of debt issuances amounts (by virtue of Article 45 of Law 5/2015) and allowed limited liability partnerships to issue debt securities. Therefore, since 2015 the two main types of companies in Spain are allowed to issue debt securities.

In addition, the debt securities to be admitted onto the MARF should be exclusively aimed at qualified investors and have a minimum denomination of EUR 100,000. Circular 3/2014, of 29 October relating to the incorporation and exclusion of securities in the MARF expressly includes this requirement for securities to be listed in MARF. As far as we are aware, MARF's minimum denomination will be maintained in EUR 100,000.

Cross-Border Private Placement Markets

The Economic Part of this study has identified Austria, Belgium, Denmark, Ireland Poland and Sweden, together with certain other Eastern European states, as jurisdictions with insufficient national investment capacity or other constraints preventing the development of an own domestic private placement market but with a significant number of domestic issuers that issue into non-domestic private placement markets or a significant potential to do so in the future.

This section identifies and analyses the regulatory obstacles to further development of such cross-border private placement markets.

Austria[636]

a. Overview of Austrian cross-border private placement activity

In general, private placements of bonds (including Schuldschein Loans (*Schuldscheindarlehen*)) by Austrian corporations are mostly carried out with the assistance of (international) credit institutions providing expertise on the type of security to be issued, its terms and conditions and placement services. In 2017, there has been a notable number of placements of Schuldschein Loans (*Schuldscheindarlehen*) by Austrian issuers. Most of these transactions are governed by German law and purchased by investors (mostly banks and insurance companies) located in the EEA (with a majority of investors from Austria and Germany). US private placements (based on the US law governed model forms) are rare and mostly done by Austrian entities having a US exposure or relationship.

Except for certain mandatory provisions (in particular the notification obligation and the mandatory venue for consumers), there are no specific regulatory barriers for Austrian companies to issue a Schuldschein, Euro PP or US PP. No licence is required for primary or secondary issuances such as direct placements unless the company offers and/or provides any regulated banking or investment services in Austria, including, accepting deposits or other repayable funds from the public.

636 Binder Grösswang Rechtsanwälte GmbH

b. Potential corporate law restrictions

In accordance with EU Regulation 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (the "Rome I Regulation"), the choice of foreign law would be recognised as a valid choice of law under Austrian law, provided that such choice of law would not prejudice the application of (i) mandatory provisions of the law of a country other than the country the law of which has been chosen, if all elements relevant to the situation at the time of the choice are located in that other country, (ii) mandatory provisions of Community law, if all elements relevant to the situation at the time of the choice are located in one or more EU member states and (iii) overriding mandatory provisions (as defined in the Rome I Regulation) of the law of the country where the obligations arising out of the agreement in question have to be or have been performed, in so far as those overriding mandatory provisions render the performance of the agreement in question unlawful. Furthermore, Austrian courts may refuse the application of a rule of the chosen law, if such application is manifestly incompatible with Austrian public policy (*ordre public*).

Pursuant to mandatory Austrian law, offers of securities in Austria – by way of public offers or private placements – need to be notified to the Austrian Control Bank (*Oesterreichische Kontrollbank Aktiengesellschaft*) prior to the commencement of the offer. The notification needs to contain certain statistical data of the offer, for instance volume, interest rate and offer period. The notification obligation is not a prerequisite for the validity of the offer, however, failure to duly notify is punishable with an administrative fine of up to EUR 100,000.

Under Austrian banking regulatory law, the granting of loans (which would include Schuldschein Loans (*Schuldscheindarlehen*)) or other forms of private placements if not made in the form of a bond) may constitute banking business under the Austrian Banking Act (*Bankwesengesetz*), if carried out on a commercial basis (*gewerblich*) in Austria.

According to the leading authority dealings are carried out on a commercial basis, if they occur (i) repeatedly (*wiederholt*) or with the intention to be repeated (*mit Wiederholungsabsicht*) and (ii) are aimed at the realisation of proceeds (*Einnahmenerzielungsabsicht*). Whether dealings are deemed to be carried out in Austria is to be determined on a case by case basis. For example, facts such as the place of (i) the initiation of the business relationship, (ii) the signing of the relevant documentation, (iii) the performance under the relevant agreements and (iv) the use of the loan proceeds are relevant for such determination.

Activities constituting banking business under the Austrian Banking Act either (i) require an Austrian banking license or (ii) are to be carried out by a branch in Austria or by way of provision of services under an EU-passport (i.e. a valid banking license in the home member state that was notified in accordance with CRD IV[637].

637 Directive 2013/36/EC of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC)

c. Potential consumer protection law restrictions

In our experience, neither issuers nor investors in a typical private placement transaction would qualify as consumers under Austrian law. Therefore, consumer protection rules seem to be of lesser importance in these transactions.

The Regulation on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters may impose a potential obstacle on issuers in case of contractual disputes with investors in cross-border matters. Pursuant to said Regulation issuers are restricted in their choice of the potential court of jurisdiction, when investors are regarded as consumers: Issuers must proceed against investors before the courts of the Member State in which the investor is domiciled, whereas investors may proceed against issuers in the courts of their domicile.

d. Potential restrictions relating to security interests

While we have seen the overwhelming majority of private placement transactions to be made on an unsecured basis, Austrian corporate law restricts the ability of up- or side-stream security: Austrian companies with limited liability (*Gesellschaft mit beschränkter Haftung*), Austrian stock corporations (*Aktiengesellschaft*) and Austrian partnerships (*Personengesellschaft*) where no natural person is an unlimited partner (e.g. GmbH & Co KG) (collectively, a "Company") are subject to strict capital maintenance principles ("Capital Maintenance Rules").

e. Potential restrictions from a tax perspective

From an Austrian tax perspective, restrictions on private placement activities could result from the potential tax consequences of investments made into private placement instruments, which may depend on the tax qualification of the concerned instruments as well as on certain other aspects.

In particular, the Austrian tax treatment may depend on whether the concerned institutional investor is for Austrian tax purposes qualified as separate taxable entity, e.g. as corporation, or as tax transparent entity, e.g. as limited or general partnership. In case of a qualification as tax transparent entity, the investors (shareholders/partners) of such institutional investor would for Austrian tax purposes be considered as having directly derived the income from the private placement instruments. In case of an individual as shareholder/partner of such institutional investor, the Austrian tax treatment for income derived by individuals would then apply whereas in case of a corporation as shareholder/partner, the tax treatment for income derived by corporations would be relevant.

Generally, for securities which qualify as debt instruments and which are for Austrian tax purposes considered to be held by individuals as private assets, income arising from such securities qualifies as investment income (*Einkünfte aus Kapitalvermögen*) that may arise in the following types: (i) income from the provision of capital (*Überlassung von Kapital*) including interest payments on the securities (*Zinserträge*), (ii) realized capital gains (*Einkünfte aus realisierten Wertsteigerungen*) derived from assets that generate income from the provision of capital, including income of zero coupon bonds and accrued interest, and (iii) income from derivatives including cash settlements, premiums, or realization amounts.

Investment income from such securities is typically subject to a special income tax rate of 27.5%. If the investment income is paid out by an Austrian paying agent or custodian, it is subject to withholding tax at the rate of 27.5%. The withholding tax deduction generally results in final income taxation if it is for Austrian tax purposes considered that an individual investor holds the securities as private assets.

However, there are some exemptions from the special income tax rate of 27.5% and from the respective withholding tax. Income derived from securities that are not legally and factually offered to an indefinite number of persons are not subject to withholding tax. In such case, the income is treated in the same way as an ordinary loan and is subject to the regular individual income tax rate applicable the investor with a progressive rate of up to 55% (for income exceeding € 1 million per year) and has to be declared in the annual income tax return of the investor.

These principles are generally also applicable to securities which are for Austrian tax purposes considered to be held by individuals as business assets, however with the difference that income from realized capital gains, even when paid out through an Austrian paying agent or custodian, is not subject to final taxation and thus has to be included in the annual income tax return of the investor.

Income as described above which is derived by Austrian resident corporations (i.e. whose seat or place of management is located in Austria) is generally subject to Austrian corporate income tax at the general rate of 25%, except for income from equity-like participation rights which may be exempt from corporate income tax subject to certain conditions. Corporations deriving business income may avoid the application of Austrian withholding tax by filing a declaration of exemption (*Befreiungserklärung*) with the Austrian withholding tax agent, which has to be forwarded to the tax office in charge. If no declaration of exemption was filed, the withholding tax might be credited as prepayment to the corporate income tax and refunded with the amount exceeding corporate income tax. There is, inter alia, a special tax regime for qualifying private foundations established under Austrian law (*Privatstiftungen*; interim tax of 25%, no withholding tax). Where Austrian withholding tax is levied on payments to corporations, the applicable rate is 25%.

Interest income from securities which is for Austrian tax purposes considered to be derived by non-resident individuals (i.e. individuals who have neither a domicile nor their habitual abode in Austria) is, in principle, taxable in Austria if the issuer has its seat or its place of management in Austria or issues the securities through an Austrian branch being the debtor of the securities and if withholding tax has to be levied by an Austrian paying agent or custodian (as described above). However, no taxation of interest income applies to individuals who are residents in a country with which Austria has agreed on an automatic exchange of information as well as to non-resident corporate investors, if an appropriate proof is provided by the investor. Moreover, foreign investors have the possibility to seek relief from any withheld withholding tax in a refund procedure with the Austrian tax office.

If non-resident investors receive income from private placement instruments as part of business income of an Austrian permanent establishment, they are to a large extent subject to the same tax treatment as resident investors.

It can be noted that Austria's right to tax income in connection with private placements may be restricted by double taxation treaties both in case of unlimited and limited income tax liability.

Denmark[638]

a. Overview of Danish cross-border private placement activity

Large Danish non-financial companies generally fund themselves through a mix of bank lending and issuance of corporate bonds, whereas smaller non-financial companies (SMEs) generally rely on funding through bank lending.

From May 2015 to May 2016 Danish banks[639] increased their lending by DKK 13 billion to Danish non-financial companies. In the same period there was a decrease in the issuance of corporate bonds by the same amount, leaving the issued amount of corporate bonds totalling DKK 178 billion[640].

In a 2014 working paper[641] from the National Bank of Denmark it was estimated that 98% of all corporate bonds registered at VP Securities[642] were listed bonds, leaving only 2% of the corporate bonds registered at VP Securities unlisted[643]. The issuing of unlisted corporate bonds has been very limited and on a much smaller scale than, for example, in Sweden. However, there has been an increase of issuances in the Danish market in Q3 and Q4 of 2017.

Traditionally, Danish companies have not to a large extend used private placements as an alternative source of funding to bank loans and, for the larger companies, the issuance of corporate bonds. However, a few larger companies have used the US private placement market to obtain funding, and some SMEs have also issued bonds through private placements on the Danish, Swedish and Norwegian market. 0.4% of the total market volume of bonds issued by Danish companies in 2015 were issued on the US private placement market[644]. The market for private placements in Denmark is therefore limited. Costs for issuing bonds, including a need for an external rating, are considered the major hurdle especially for SMEs. However, over the last few years there has been a growth on the Danish corporate bonds market largely due to Danish pension funds seeking out alternative investments to achieve a higher return. Danish pension and venture funds have always, to a certain extent, been active on the private placement market through either direct or indirect lending, but the funds have increased their lending to companies during the last couple of years. In 2015, Danish pension funds granted loans totalling DKK 85 billion - a figure that increased to DKK 106 billion in 2016, an increase of 25%[645]. Further, it is noted

638 Kromann Reumert.

639 We have found no statistics on the amount of funding from non-Danish banks.

640 https://www.nationalbanken.dk/da/statistik/find_statistik/Sider/2017/Danske-virksomheder-udsteder-faerre-obligationer.aspx

641 http://www.nationalbanken.dk/da/publikationer/Documents/2014/12/WP_91.pdf

642 The Danish central securities depository.

643 Ibid.

644 https://cbcm.commerzbank.com/media/documents_11/paid_articles_1/jan_1/Global_Capital_private_debt_report.pdf (page 9) (2015 number)

645 https://www.finanstilsynet.dk/~/media/Tal-og-fakta/2017/Markedsudvikling-for-livsforsikringsselskaber-og-tvrgende-pensionskasser-i-2016-v1.pdf?la=da (Unfortunately, these figures also comprised loans to non-Danish companies.)

that with the segment "Corporate and other bonds", Nasdaq Copenhagen actually already has a special market for corporate bonds[646].

The Danish Minister for Business and Growth has acknowledged that having a well-functioning market for private placements is important and that the market could benefit from having standardised documentation for private placements with a focus on a market-led standardised documentation. Factors such as easier access to credit as well as improvements of the investors' ability to quantify the credit risk are mentioned as important for promoting liquidity in the corporate bond market especially in terms of SMEs.

There is currently no standardised documentation for private placements in Denmark, but inspiration could be sought from Danish corporate bond documentation or international private placement documentation. As such, there are no common risk mitigation provisions and no best practice in place.

The small market for private placements in Denmark is partly a result of the other ways of obtaining funding. Both large and smaller companies can fund themselves through loans issued by mortgage credit institutions (against mortgages on real property) which are often on terms more favourable to the company. These can to a large extent be relied upon instead of issuing bonds themselves[647].

b. Regulatory obstacles to further development of cross-border private placement markets

Generally, there are no specific regulatory obstacles preventing Danish non-financial companies from issuing Euro PPs or Schuldscheins on a cross-border basis, and nor are there any obstacles preventing a Danish investor from participating in such a transaction.

However, the following potential restrictions may be taken into account.

c. Lending by non-bank entities

A lender is not required to obtain a banking license, unless the lender offers and/or provides any other regulated banking services in Denmark, including receiving deposits or other repayable funds from the public.

d. Potential Danish consumer protection law restrictions to cross-border issuance of or investment in Schuldscheins / Euro PPs

The issuer is not, nor is any investor in Schuldscheins or Euro PPs generally considered a consumer. Accordingly, Danish consumer protection law will not restrict the issuance of or investment in Schuldscheins and Euro PPs.

e. Potential Danish corporate law restrictions to cross-border issuance of or investment in Schuldscheins / Euro PP

646 http://www.nasdaqomxnordic.com/bonds/denmark?languageId=1&Instrument=null

647 http://www.nationalbanken.dk/da/publikationer/Documents/2014/12/WP_91.pdf

In general, Danish corporate law does not contain barriers for issuance of or investment in Schuldscheins / Euro PPs.

f. Potential Danish restrictions related to security interests to cross-border issuance of or investment in Schuldscheins / Euro PPs

In general, there are no Danish regulatory requirements or restrictions in terms of issuing Schuldschein or Euro PP on a secured or unsecured basis. Further, receivables under a Schuldschein or Euro PP can generally be the subject of a security interest, e.g. by way of assignment, unless the applicable contractual provisions stipulate the opposite.

g. Potential Danish restrictions from a tax perspective to cross-border issuance of or investment in Schuldscheins / Euro PPs

From a tax perspective, Danish law does not contain restrictions potentially hindering the cross border issuance of or investment in Schuldscheins, Euro PPs, or similar. However, issuers and investors should be aware that they can become subject to taxation on interest rates or capital gains. Whether investors or issuers will be subject to tax depends on the instrument itself or the structure of issuance or investment. Further, intra group loans would also be subject to tax regulations.

Further, double taxation treaties may limit or exclude Denmark from the right to taxation.

i. Taxation at source

Under existing Danish tax law, no withholding tax is levied on payments of interest or principal or other amounts due on bonds to the owner of such payment, except if the owner is a corporate entity that is "related to" the issuer under the Danish Tax Control Act. If the owner is related to the issuer, then a withholding tax may in certain circumstances apply (22 % withholding tax).

ii. Resident holders of bonds

Private individuals and companies, funds and other entities that are considered separate taxable entities for Danish tax purposes and who are domiciled in Denmark for tax purposes, are (save for certain exceptions) liable to pay tax on capital gains and payments on interest on bonds.

iii. Non-resident holders of bonds

Payments of interest or principal amounts to any non-resident holders of bonds are not subject to taxation in Denmark. No withholding tax will be payable with respect to such payments, and any capital gain realised upon the sale, exchange or retirement of a bond will not be subject to taxation in Denmark, except as set out under Taxation at source above.

This tax treatment applies solely to holders of bonds who are not subject to full tax liability in Denmark or included in a Danish joint taxation scheme and do not carry on business in Denmark through a permanent establishment.

Ireland[648]

a. Overview of Irish private placement activity

Issuances of private placement securities by Irish companies are usually carried out with the assistance of an investment firm or a bank acting as arranger. The arranger will advise on likely investor demand, and on terms such as maturity and pricing.

Most Irish issuances of PP securities are made into the US market. Investors are generally insurance companies and pension entities.

b. Potential corporate law restrictions

Under Irish company law, an Irish private or public company may issue debt securities, including private placement securities. Some restrictions apply in respect of companies formed as private companies. A company formed as private company limited by shares ("**CLS**") may issue debt securities subject to the condition that:

i. the securities qualify for an exemption from the requirement to issue a prospectus under EU prospectus law (EU PD Law); and

ii. the securities are not listed.

If a security is to be listed, the company issuing the security must be formed as a designated activity company ("**DAC**") or a public company. If the security is to be offered to retail investors in denominations below the EU PD Law minimum (€100,000), the issuing company must be formed as a public company.

These corporate law requirements are not seen as unduly restricting private placement issuance by Irish companies.

c. Potential securities laws restrictions

Issuing debt securities of any tenor technically constitutes banking business under Irish law. "Banking business" is defined to include receiving money on the person's own account from members of the public, as a deposit or as repayable funds. "Carrying on" banking business requires a banking licence. Accordingly, an issuer of private placement securities would, absent exemptions, require a banking licence. The Central Bank of Ireland has issued an exemption from the requirement to hold a banking licence in respect of issuances of securities having maturities of one year or more. This would be sufficient to cover most private placement securities. Securities which have an original maturity of less than one year may also be exempt from the banking licence requirement, subject to fulfilment of certain conditions.

Other than as set out above and under b. "Potential corporate law restrictions", and other than as provided for in the securities law of the investor jurisdictions (principally the EU and the USA), there are no specific securities law restrictions on issuance of private placement securities by Irish companies.

d. Potential restrictions from a tax perspective

[648] A&L Goodbody

In general, interest and other revenue expenses incurred by an issuer of private placement securities should be deductible as a trade expense for corporation tax computation purposes.

Issuers may pay interest on private placement securities free of Irish withholding tax, provided that certain tax exemptions are complied with. The principal exemptions available are that:

i. the interest on the security is paid to a company that is beneficially entitled to the interest, is tax resident in an EU Member State or a country with which Ireland has a double taxation treaty, that jurisdiction generally imposes a tax on interest receivable in that jurisdiction by companies from foreign sources, and the security holder is not providing its commitment through an Irish branch or agency; or

ii. the interest is paid on a security that has a maturity of less than 2 years, and the security holder (a) is beneficially entitled to the interest, is Irish tax resident, and has provided the Irish issuer with its Irish tax reference number, or (b) is not Irish tax resident and has provided the Irish issuer with a completed Irish Revenue prescribed declaration, declaring that it is beneficially entitled to the interest and is not tax resident in Ireland.

Sweden

a. Overview of private placements in Sweden

Generally, non-financial companies' borrowing on the fixed-income market has increased in recent years and constitutes approximately one-fifth of non-financial companies' loan-based funding.[649] Most of their funding is still made up of borrowing from credit institutions, while the remainder comes from intra-group loans. Large, investment-grade Swedish companies account for most of the issue volumes on the bond market. However, in recent years, the number of companies choosing to issue bonds has increased significantly. Smaller high-yield companies have also begun to turn to the bond market. Consequently, there has been a substantial increase in the proportion of issues by companies that do not have a credit rating.

In addition to corporate issues aimed at large groups of investors, there is also a small Swedish market for private placements. These often involve bonds/loans that are issued in their entirety to one or a small number of investors. The terms are subject to negotiation and the issues are largely designed to meet the wishes of the investors. The Swedish debt private placement market is not as developed as the Schuldschein market and the Euro PP market. There is a push to standardise the corporate bond documentation. Both the Swedish Securities Dealers Association and Nordic Trustee have published forms of terms of conditions for Swedish law governed bonds. The ambition is that the harmonised

649 Sveriges Riksbank, *Den svenska finansmarknaden 2016*, http://www.riksbank.se/Documents/Rapporter/Finansmarknaden/2016/rap_finansm_160831_sve.pdf.

documentation, by providing an established and balanced point of reference, will contribute to a standardisation of the market. The standardised bond documentation is drafted for plain corporate bonds and would need to be adjusted when drafting Swedish private placement instruments.

Currently, there is no standardised documentation specifically for private placements. Guidance could be sought from the harmonised Swedish corporate bond documentation or other international fixed templates and standard documentation such as those developed by the ICMA and the LMA.

There are limited regulatory barriers in the Swedish debt private placement market. No licence is required for primary or secondary lending activities such as direct lending or purchase of debt unless the lender accepts deposits and/or other repayable funds from the public.

The Swedish regulators welcome market initiatives such as the ECPP Guide and believe that such private initiatives are sufficient to identify best practice and to standardise structures and documentation. The increased interest in corporate bonds has recently led to the opening of a new marketplace for these securities, the First North Bond Market. Private placement bonds can be listed on the wholesale segment of the regulated market Nasdaq Stockholm or on the multilateral trading facility First North Bond Market and be structured in a way which enables issuers to be exempted from the Swedish prospectus requirements. The Swedish regulators considers standardised credit information as an important part of a well-functioning private placement market and points out that initiatives have already been taken where the demand exists for e.g. S&Ps Mid-Market Evaluation scale launched solely in Europe in June 2013[650].

b. Potential corporate law restrictions

There are only limited corporate law restrictions on the issuance of private placement instruments. However, a private limited company (*Sw. privat aktiebolag*) or a shareholder in such a company may not, through advertising, attempt to sell, inter alia, debt securities issued by the company[651]. Nor may a private company otherwise attempt to sell securities by offering such securities for subscription or sale to more than 200 persons (retail or institutional investors). The aforesaid shall not, however, apply where the offer is directed solely to a group of persons who have previously given notice of interest in such offers and where no more than 200 securities are offered. The prohibition will not apply to offers which relate to transfers to no more than ten purchasers. This restriction does not apply to public limited companies (Sw. *publika aktiebolag*). However, a private limited company can be converted to a public limited company subject to an increase of its share capital to a minimum of SEK 500,000. Also, a public limited company must have a board of directors consisting of at least three elected board members and must appoint a managing director. The conversion of a private limited company to a public limited company takes approximately two to four weeks depending on the balances at the Swedish Companies Registration Office.

650 Ministry of Finance, Finansinspektionen and Sveriges Riksbank, "*The Swedish Government and the Swedish authorities' common answer to the Commission Green Paper on building a Capital Markets Union".*

651 Chapter 1 Section 6 and 7 of the Swedish Companies Act (Sw. *Aktiebolagslag (2005:551)*).

c. Potential consumer protection law restrictions

Neither issuers nor investors in a typical private placement transaction should qualify as consumers under Swedish law. Therefore, consumer protection rules seem to be of lesser importance in these transactions.

d. Potential restrictions relating to security interests

There are no specific restrictions in a private placement context other than the general restrictions under Swedish law relating to security interest such as rules regarding financial assistance, corporate benefit and thin capitalisation. Security can be taken over nearly every type of asset and in various forms. If security is to be provided over assets situated in Sweden, it is important to have the security created and perfected in accordance with Swedish law. For the preservation of a perfected pledge, the pledgor needs to be effectively deprived of its right to deal with or dispose of the pledged assets, which could restrain the effectiveness of taking security in Sweden. The effect of this principle is that under Swedish law a granted pledge over assets such as receivables and operating bank accounts will not be perfected until the pledgor is effectively deprived of its right to deal with the pledged assets.

It should be noted that security that has not been perfected without delay (i.e. security that remains unperfected until a specific trigger event) may be set aside (Sw. *återvinning*) in the pledgor's bankruptcy if such security is granted or perfected within a statutory hardening period prior to the date of the filing of the bankruptcy petition. The applicable hardening period is generally three months in relation to third parties and two years in relation to the pledgor's affiliates or related parties. The receiver may file an application with the competent District Court to set such transaction conducted during the hardening period aside, in which case the relevant security assets must be returned to the bankruptcy estate for distribution between creditors generally.

e. Potential restrictions from a tax perspective

There are limited tax issues and no relevant exchange controls. There is currently no Swedish withholding tax on interest payments by a Swedish borrower (corporate entity) or guarantor to a foreign lender. However, there are some reporting requirements according to which cross border payments into or out of Sweden exceeding SEK 150,000 (per payment or aggregate over the calendar year) must be reported to the Swedish Tax Agency by the bank effecting the transfers.

f. Regulatory obstacles to the further development of cross-border private placement markets

There are no significant regulatory barriers preventing a Swedish company from issuing a Schuldschein or a Euro PP on a cross border basis or preventing a Swedish investor from investing in a Schuldschein or a Euro PP on a cross border basis. In fact, there are companies that have issued such instruments. For example, the Swedish company Saab AB issued a German law governed Schuldschein Loan in the amount of EUR 100,000,000 on 21 December 2015.[652]

652 http://saabgroup.com/Media/news-press/news/2015-12/saab-issues-schuldschein-loan-agreements-amounting-to-meur-100/.

Investment research on corporate bonds in the Nordics has developed as an important tool enabling medium and smaller sized corporates to gain access to funding in the capital markets. Investment research on corporate bonds, including the assessment of credit quality by reference to a rating scale (often referred to in the market as shadow rating), has provided a basis for investors to compare bonds and take a view on the appropriate risk premium. However, ESMA has signalled that they considered that the Nordic model of lighter ratings should only be allowed to be provided by licensed entities. Following ESMA's attention to the practise, Nordic banks have ceased with the practice. There is a concern that the discontinuation of using shadow ratings would impede the liquidity in the Nordic bond market since SME's usually do not meet the requirements for obtaining official ratings. Given that a majority of the issuers of private placement high yield instruments are not rated, investors that used to rely on shadow ratings may no longer have the same ability to assess the credit risk of an investment in a private placement context.

ESMA's investigation created a need for the establishment of a regulated Nordic credit rating agency in order to promote further development of the Swedish bond market. For this purpose, the rating agency Nordic Credit Rating, established by several key Nordic market participants, is in the process of being set up. The rating operations are expected to start in Q2 2018 in Stockholm and Oslo.

Belgium

a. Overview of Belgian cross-border private placement activity

Generally, most Belgian corporates are still heavily relying on credit institutions in the more traditional corporate lending market to satisfy their financing needs. However, in recent years, there has been a notable increase in activity in the private placement markets by Belgian corporates through cross-border transactions, especially in the Euro PP and Schuldschein market. The majority of issuers comprises large, investment-grade Belgian corporates which already have (significant) experience in the international capital markets.

Except for certain mandatory provisions of Belgian law (including, amongst others, corporate law provisions relating to the form of the notes and meetings of bondholders), there are no specific regulatory barriers for preventing a Belgian company from issuing a Schuldschein, Euro PP or US PP. As a result, Belgian corporates have raised and continue to raise debt in more developed private placement markets such the Schuldschein, Euro PP and US PP markets. No licence is required for primary or secondary lending activities such as direct lending or purchase of debt unless the lender offers and/or provides any regulated banking or investment services in Belgium, including, amongst others, accepting deposits or other repayable funds from the public.

b. Potential corporate law restrictions

Pursuant to Belgian corporate law, a Belgian company can only issue securities in registered or dematerialised form (or, if the security is governed by foreign law or exclusively offered abroad, in the form of a global note in bearer form). A Schuldschein is considered as a loan from a Belgian law perspective and not as a

security. However, a Euro PP (in bond format) or a US PP is considered as a security and therefore subject to these restrictions.

Furthermore, Belgian corporate law may impose certain restrictions on the terms and conditions of debt instruments issued in the private placement markets. For example, change of control provisions included in debt instruments need to be approved by the shareholders of the Belgian company and filed with the clerk's office of the competent Commercial Court in order for these provisions to be enforceable vis-à-vis the company. In the framework of the reform and simplification of the Belgian Companies Code on which the Belgian legislator is currently working, it is contemplated that this requirement would disappear.

Lastly, Belgian corporate law prescribes the procedure for the organisation (including quorum and voting requirements and, in certain circumstances, validation by a Belgian court) of a bondholders' meeting by a Belgian issuer which makes the decision-making process in circumstances such as, for example, a restructuring/amendment process, inflexible and slow. These provisions are considered to constitute mandatory law provisions and would therefore apply notwithstanding the governing law of the relevant debt instrument. One should note that in the framework of the reform and simplification of the Belgian Companies Code, it is contemplated that these provisions will be amended and would no longer be of mandatory law.

c. Potential consumer protection law restrictions

Another potential obstacle relates to the application of the provisions of the Belgian Code of Economic Law (the "**ELC**") providing for a prohibition of unfair terms in consumer contracts, including investment instruments (such as shares and notes) placed with or offered to, consumers in Belgium and, in the view of the Belgian Financial Services and Markets Authority (the "**FSMA**"), irrespective of whether such offer was made by way of a private placement on a cross-border basis and whether or not such offer was governed by Belgian law or the laws of any other EU Member State or third country.

Book VI of the ELC sets out a number of terms which are by their very nature deemed to be unfair (the so called "black terms") in all cases and therefore unlawful. This list of black terms is supplemented by a general principle that any term which creates a "significant imbalance" in the parties' rights and obligations under the contract to the detriment of the consumer should be considered as unfair and thus unlawful. The definition of "consumer" in the ELC is quite broad and includes every physical person acting for purposes which are outside his trade, business, craft or profession. On 6 February 2017 the FSMA published a non-binding communication (the "**Communication**") relating to its position on the application of the Belgian rules on unfair contract terms in the framework of an offering of investment instruments to consumers in Belgium. However, the legal basis of the Communication is uncertain and a source of much debate at the moment. The solutions set forth in the Communication are however untested in the international capital markets and may give rise to legal uncertainty.

Important to note is that the prohibition on unfair contract terms should, in principle, have less impact on cross-border transactions such as Schuldschein, Euro PP or US PP given that the investment base for these type of debt instruments would typically not qualify as a "consumer". Indeed, given that the terms and conditions of these instruments usually form the subject of negotiations between the issuer and the investors willing to subscribe to these instruments, such investors are typically legal entities such as credit institutions,

pension funds and insurance undertakings and do not include physical persons which are acting for purposes outside their trade, business, craft or profession. However, it cannot be excluded that certain high net-worth individuals investing in these type of debt instruments could still fall within the scope of application of these restrictions.

d. Potential restrictions relating to security interests

In the case of more complex issuances which involve secured structures for issuers below investment grade or issuer-SPVs in the framework of a project bond, certain additional legal obstacles may arise, such as, amongst others, the requirement to include a parallel debt-covenant in the documentation as a security trustee or agent is not able to hold the benefit of security on behalf of a group of creditors. This is because Belgian law on the one hand does not recognise trusts and on the other hand, security is regarded as "accessory" in nature (meaning that the security interest must be granted to the creditor whose claim is secured, not to a person acting on behalf of the creditor or group of creditors).

In similar vein, limitations relating to statutory purpose, corporate purpose and corporate benefit apply to upstream and cross-stream guarantees provided by Belgian companies for the financial obligations of other (group) companies. As a result, any guarantee or security granted by a Belgian company for the obligations of another group company must be for the corporate benefit of the company itself. This is a question of fact and there is no specific test to be applied.

Corporate benefit is not a well-defined concept under Belgian law and its interpretation is left to the courts and legal authors. The corporate benefit rules and their application in the context of granting guarantees or security for the benefit of a group company are not clearly established under Belgian law and there is only limited case law on this issue.

The question of corporate benefit must be determined on a case-by-case basis by reference to the prevailing factual circumstances. Consideration has to be given to any direct and/or indirect benefit that the company would actually derive from the transaction and is particularly relevant for upstream or cross-stream guarantees and security. It is generally taught by legal scholars that such benefit should be proportionally greater than the risk for the company resulting from the granting and/or enforcement of the guarantee concerned. The financial support granted by the company should not exceed its financial capabilities. Belgian case law does not offer clear guidelines on when a group transaction is within the individual group member's corporate benefit and when aforementioned conditions are met.

Whether or not the corporate benefit requirement is met is a matter of fact to be assessed by the board of directors of the company granting the guarantee. The corporate benefit justification by the company's board of directors will be subject to only a ''marginal review'' by the courts; in insolvency situations, however, the courts can be expected to take a more critical view.

If the corporate benefit requirement is not met, the directors of the company may be held liable under civil law (i) by the company for negligence in the management of the company and (ii) by third parties in tort and under criminal law in certain specific circumstances (i.e., where the specific facts can be qualified as ''abuse of company goods'' (*misbruik van vennootschapsgoederen/abus de bien sociaux*)). Moreover, the guarantee or

security could be declared null and void. Alternatively, the guarantee or security could be reduced to an amount corresponding to the corporate benefit. These rules have been seldom tested under Belgian law, and there is only limited case law on this issue.

In order to enable Belgian subsidiaries to grant a guarantee and security to secure liabilities of a direct or indirect parent or sister company without the risk of violating Belgian rules on corporate benefit, it is standard market practice for financing agreements, terms and conditions, guarantees and/or security documents to contain "limitation language" in relation to subsidiaries incorporated or established in Belgium. Including such limitation language is, however, not conclusive in determining the corporate benefit.

The grant of a guarantee or security by a Belgian company must also be within or serve the corporate purpose and statutory purpose of the Belgian company as described in its articles of association, and the guarantee or security may not include any liability that would result in unlawful financial assistance within the meaning of the Belgian Companies Code.

e. Potential restrictions from a tax perspective

With respect to Belgian withholding taxes, interest payments are in principle subject to a 30% interest withholding tax. However, in practice issuers/investors rely upon several withholding tax exemptions (all of them have their specific advantages and disadvantages which are to be analysed on a case-by-case basis) in the framework of private placements by Belgian corporates.

In that respect, a potential obstacle can be that difficulties arise whether a private placement debt instrument should legally be qualified as a loan or as a security under the applicable law. Hence, this triggers uncertainty as to the applicable Belgian withholding tax rules. However, please note that whether a private placement debt instrument is governed by Belgian or foreign law is irrelevant in that respect, since such uncertainty could arise in both cases. The following is a high-level overview of the withholding tax exemptions typically relied upon by investors in such a context:

Ordinary loans: a withholding tax exemption is available for interest payments to (i) credit institutions (both domestic credit institutions as well as credit institutions which are resident for tax purposes in a country with which Belgium has entered into a double taxation agreement that is in force or in a country which is a member state of the EEA), (ii) Belgian corporations and (iii) investors benefitting from a Double Tax Treaty concluded by Belgium which provides for a full exemption from Belgian taxation on interest payments (subject to formalities);

Registered notes: a withholding tax exemption under Belgian domestic tax law is available for interest payments on registered bonds to non-resident savers (being basically non-resident investors/lenders), subject to the following (cumulative) conditions: (i) the investor is not a tax resident of Belgium, (ii) the investor does not use the notes for a professional activity in Belgium, (iii) the investor has been the beneficiary and legal owner (or usufructuary) of the notes during the entire period to which the interest pertains, (iv) the investor has been registered in the company's register as noteholder during the entire period to which the interest pertains and(v) if the investor is a corporation (or entity having a similar form), it is additionally required that it is either: (a) an investment company which has made a public call for savings or (b) a corporation that is subject in its country of residence to an income tax the provisions of which are not substantially more advantageous than in Belgium (a

so-called "subject to tax condition") or of which 50% or more of its shares are not held by Belgian individual residents (a so-called "look-through condition") and (vi) the investor has provided the company with a validly executed tax form; and

Notes in dematerialised form issued in the X/N settlement system: in principle, a Belgian withholding tax exemption is available for eligible investors such as non-resident investors having no connection with Belgium other than the holding of securities or companies subject to Belgian corporate income tax as well as foreign companies with a taxable establishment in Belgium.

Poland

a. Overview of Polish cross-border private placement activity

Although in the recent years there has been a significant increase in the issuances of debt instruments by Polish corporates, they still heavily rely on credit institutions in the more traditional corporate lending market or on foreign debt capital markets to satisfy their financial needs. However, there has been a notable increase in activity in the private placement markets by Polish blue chips through cross-border transactions aimed at foreign investors (due to insufficient demand in Poland), especially in the Euro PP and Schuldschein markets. Such Polish blue chips will typically use their foreign finance SPVs as issuers of the private placement addressed to foreign investors[653] for tax reasons.

The general rule under Polish international private law is that obligations resulting from securities fall under the law of the country in which such security was issued, therefore foreign law governed bonds issued by Polish entities are generally governed by the law of the country where they have been issued. Unlike bonds issued pursuant to and governed by Polish law, foreign law governed bonds may be subject to limitations on the maximum level of interest on receivables.

b. Regulatory Obstacles

In general, investments in debt products (including in private placement instruments as well granting loans and issuing debt securities) within EU, EEA and OECD Member States are not restricted and require no authorisation of Polish Authorities. Investments in debt products by entities from countries outside the European Union, the EEA and OECD, and investments by Polish entities in debt products of such entities are subject to certain restrictions. However, pursuant to the Regulation of the Minister of Finance, these restrictions have been waived in relation to countries with which Poland had signed the bilateral investment treaties ("**BIT**"), and therefore no authorisation is needed to acquire/issue bonds in these countries. Currently, Poland is bound by BIT agreements with around 60 countries, including the USA and China.

Moreover, lending activities in Poland are not restricted to licensed banks (credit institutions) as Polish regulations distinguish between a bank loan (Polish: *kredyt*) and a (general) loan (Polish: *pożyczka*). While the latter (i.e. a (general)

653 For example, in 2014 the Tauron Group issued German law governed Namensschuldverschreibung to the German market through its subsidiary Tauron Sweden Energy.

loan; Polish: *pożyczka*) can be granted by any entity[654] (including both banks and non-bank entities) and is regulated by provisions of the Polish Civil Code, a bank loan (Polish: *kredyt*) can only be granted by a licensed bank (or credit institution) and is regulated by provisions of the Polish Banking Law. Both banks and non-bank entities may also grant loans governed by foreign laws.

Polish law requires that foreign cash transfers and domestic foreign exchange settlements which value exceeds EUR 15,000 or its equivalent shall be made via licensed banks or payment institutions and electronic money institutions authorised to provide payment services. This requirement does not apply to settlements made with an authorised bank, domestic payment institution, branch of an EU payment institution, domestic electronic money institution, or a branch of a EU electronic money institution. [655]

Polish law also requires entities with their registered seat in Poland, who issue foreign private placement bonds or acquire private placement bonds on the foreign markets, to provide the National Bank of Poland with the necessary data required to prepare balance of payments and international investment position statistic. Such reporting obligation is fulfilled electronically, using relevant certificates issued by the National Bank of Poland. However, this requirement is not a restriction and is intended to enable ongoing market analysis.

In addition, some Polish institutional investors (such as in particular Polish pension funds and investment funds, including both UCITS funds and AIFs) are subject to regulatory investment limits which relate in particular to: (i) limited catalogue of classes of assets they may invest in and (ii) the maximum proportion of the aggregated value of the assets of a given class to the aggregate value of their (net) assets. E.g. a Polish closed-end investment fund may grant loans to third parties provided that: (i) the aggregated value of all loans granted by it does not exceed 50% of the aggregated value of its assets; (ii) the aggregated value of all loans granted by it to a single entity does not exceed 20% of the aggregated value of its assets; and (iii) the articles of association of the fund provide for the possibility of granting loans and set forth the criteria a borrower needs to fulfil (including in particular in relation to a collateral that shall secure the repayment of a loan). On the other hand, Polish pension funds must not grant loans and may only invest in a limited number of classes of assets, such as specific types of bonds (being transferable securities) including in particular corporate bonds that generally are secured, offered in a public offering and/or issued by a listed company.

c. Tax Obstacles

i. Taxation of foreign investors. Withholding tax on Polish issuances

Foreign corporate investors in private placement bonds issued in the EU markets by Polish issuers are, as a rule, subject to the 20% withholding tax on interest and discount income derived from such private placement bonds. Such income is deemed to be obtained in Poland based on the circumstance that the interest and discount payment comes from the entity which is a Polish tax resident issuer.

654 Please, however, note that some institutional entities are prohibited from granting loans. Moreover, the catalogue of classes of assets they may invest in is restricted.

655 Article 25 of the Polish Foreign Exchange Law.

The tax obligations of foreign investors are additionally regulated by respective double taxation avoidance treaties. Depending on certain double taxation avoidance treaties concluded by Poland, there can be a withholding tax on interest and discount income obtained in Poland (usually at the rate of 5 or 10%) or such income can be exempted.

Application of the tax rate resulting from a relevant double taxation avoidance treaty or non-collection of the tax pursuant to such treaty is possible provided that the location of the taxpayer's seat for taxation purposes is documented by a certificate of residence obtained from the taxpayer.

There should be no tax arising in Poland on the sale by foreign investors of privately placed bonds issued by the Polish issuers in the EU markets.

ii. Taxation of foreign investors. Withholding tax on foreign issuances

The main tax impediment to cross-border private placement activity of Polish issuers is the withholding tax together with the obligations connected to its remittance borne by the Polish issuers. This is due to the fact that, even though it is the bondholders who are the taxpayers in the case of bonds issued by the Polish issuers, the economic cost of such tax is usually borne by the Polish issuer as a result of its gross up obligation.

In order to avoid withholding tax and the exposure to the tax gross-up risk, Polish issuers would rather conduct an indirect issue through a SPV set up in another EU country (in the past Sweden was usually chosen by Polish issuers). In such a case, the SPV issues bonds to investors (bondholders), and the proceeds of the issue are transferred to a Polish entity, usually by means of bonds issued by the Polish entity and subscribed for by the SPV or by means of a loan contracted from the SPV by the Polish entity.

In a case of a direct issue by the Polish issuers to foreign investors, in order to apply a withholding tax rate on interest and discount income obtained in Poland or its exemption stemming from certain double taxation avoidance treaty concluded by Poland, the Polish issuers need to obtain tax residence certificates from foreign investors. In such a case, the conditions of the bond should provide that the bondholders are obliged to deliver to the Polish issuer tax residence certificates. Lack of tax residence certificate of foreign corporate investor results in remitting the 20% withholding tax by the Polish issuer. It should be noted that sometimes the delivery of an original tax residence certificate or its certified copy by the foreign investor could pose a practical problem.

iii. Taxation of Polish investors

Capital gains derived by Polish investors investing in private placement bonds issued by foreign issuers in the EU generally are subject to the 19% income tax rate (the same rate of 19% and rules apply to natural persons and corporate entities). Foreign tax paid on foreign-source income may be credited against Polish tax on the same profits, but the credit is limited to the amount of Polish tax payable on the foreign income.

iv. Tax deductibility of issuance costs

As a general rule, the issuance costs should be tax deductible from the corporate tax base of Polish issuers.

Summary - Regulatory Obstacles to the Development of Private Placement Markets Across the EU

Aside from the Schuldschein market in Germany and the Euro PP market in France, no other EU Member State has a developed national private placement market. The Economic Part of this study has identified Italy, the Netherlands and Spain as jurisdictions with the potential to grow a national private placement market based on their issuer and investor base. Although each of these jurisdictions does, to a certain extent, already have a form of domestic private placement initiative, such private placement instruments are not technically a separate class of instrument such as the Schuldschein or Euro PP. In both Italy and Spain, the relatively recent wave of new private placements is often referred to as "mini-bonds", but this is a term of art and has no specific legal meaning.

As is the case in Germany and France, neither Italy, the Netherlands nor Spain has a specific legal or regulatory framework for private placement instruments. As such, the applicable legal and regulatory framework for private placement instruments in such jurisdictions is the framework for bond issues by companies in such jurisdictions generally. However, such jurisdictions have made certain adjustments to their national regulatory frameworks as they apply to private placements in order to facilitate the issuance of private placement instruments by corporates and encourage investment in private placement instruments as an asset class. For example, in Italy certain unfavourable tax rules which hindered the issue of mini-bonds have been removed and, in Spain, the MARF was established for the purposes of carrying out the Spanish mini-bond market.

Overall, market participants do not see any significant regulatory obstacles specific to the development of the private placement markets in such jurisdictions. Rather, the obstacles that are typically identified are those which also affect the bond markets as a whole. However, such obstacles can comprise a bigger challenge for small and medium size enterprises looking to tap such markets. For example, in Italy, due to the regulation of lending activity and civil code restrictions on the amounts of unlisted bonds which can be issued by an Italian company, most bonds will generally be listed on a regulated market or MTF in an EU Member State. As a result, a broad range of regulation (such as MAR) applies to such companies which can be particularly burdensome for smaller private companies.

The Economic Part of this study has further identified Austria, Belgium, Denmark, Ireland, Poland and Sweden, together with certain other Eastern European states, as jurisdictions with insufficient national investment capacity or other constraints preventing the development of a domestic private placement market but with a significant number of domestic issuers that issue into non-domestic private placement markets or a significant potential to do so in the future. Only certain of these jurisdictions have a meaningful amount of cross border transactions into the more developed Schuldschein and Euro PP markets. As with the other European jurisdictions discussed in this study, the legal and regulatory framework applicable to such cross-border transactions is the framework that applies to cross border bond issues generally. As such, market participants indicate they do not see any significant regulatory obstacles to cross-border transactions involving the more established private placement instruments of Schuldschein and Euro PP. Instead, there are a number of minor concerns relating more to reconciling the different national legal, tax

and regulatory systems as they apply to such instruments, e.g. the local classification of a Schuldschein or the tax treatment of payments under such instruments as result of differing local tax laws.

III. Analysis of Most Common Risk-Mitigation Clauses in Private Placement Transactions

This section provides an overview of the typical form of documentation in each of the Schuldschein market and the Euro PP market. This section then analyses the most common risk mitigation provisions used in Schuldschein and Euro PP documentation to address the key risks associated with an investment in such private placement instruments. For comparison purposes, this section also analyses the equivalent risk mitigation provisions in the LMA's private placement documents and briefly touches on the American College of Investment Counsel ("**ACIC**") Model X form of private placement documentation.

Overview of Schuldschein Documentation

There is currently no standard form of Schuldschein documentation and no standard form precedent is expected in the short term. Important market players such as insurers, private banks and Landesbanken tend to use their own templates. The LMA has published a Schuldschein guide but this does not provide for a template.

All Schuldschein documentation provides for certain indispensable provisions such as currency and amount, purpose, conditions precedent for drawdown, interest (fixed or floating rate), repayment, tax gross-up, payments through the paying agent, default

interest, information, early termination, transferability and the typical boilerplate clauses and waiver of set off rights by the Borrower[656].

Traditionally risk mitigation provisions have been limited to a negative pledge, a *pari passu* provision and acceleration rights upon the occurrence of an event of default. However, in recent years there has been a tendency to migrate structural elements and documentation standards from the syndicated loan market to Schuldschein. One of the drivers for this trend is that Schuldschein are often issued in parallel to syndicated loans or as a substitute for these. In such situations, the banks participating in the syndicated loan often also act as lender under the Schuldschein and expect equivalent protection.

This trend and the increasing internationalisation of the Schuldschein through cross-border transactions has begun to result in recent years in Schuldschein documentation also providing for:

a. change of control (see "Change of Control" below for further details);
b. representations and warranties[657] (see "Representations and Warranties" below for further details);
c. financial covenants (see "Financial Covenants" below for further details);
d. information covenants (see "Information Covenants" below for further details);
e. expanded events of default, including material adverse change[658] and cross default (see "Events of Default" and "Material Adverse Change / Material Adverse Effect" below for further details); and
f. legal opinions[659] (see "Legal Opinions" below for further details).

Accordingly, Schuldschein documentation is becoming more structured than in the past. However, as always, the level of protection and structuring depends on the credit quality of the borrower. As a result, Schuldschein documentation can provide for very limited or extensive creditor protection. Although there generally is some convergence between syndicated loan and Schuldschein documentation standards there are, however, features which still discern the Schuldschein Loan clearly from syndicated loans, including:

i. Different roles for the agents

   An agent in a syndicated loan is responsible for administrating the syndicate which includes, among others, collecting payments from the borrower, calculating and determine how much of the payment each lender is entitled to and to distribute the payments to the lenders. Further it means coordinating changes of the lender and amendments of the syndicated loan. The so called "agent bank" is appointed by the lenders and their agent. In contrast, in a Schuldschein Loan the agent is acting on behalf of the borrower. The agent in a Schuldschein Loan is exclusively responsible for calculating and collecting the payment from the borrower and distributing the payments to the lenders, the agent does not have an administrating role in contrast to a syndicated loan.

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656 Such waiver is legally required to make the Schuldschein Loan eligible for the guarantee assets (*Sicherungsvermögen*) of insurers, Section 124, 125 and 130 of the German Insurance Supervisory Act (*Versicherungsaufsichtsgesetz*).

657 This applies, in particular, when the borrower and/or, as the case may be, the guarantor is a non-German entity.

658 In the absence of a contractual MAC the statutory MAC provided for in Section 490 of the German Civil Code will apply unless contractually disapplied.

659 External counsel being involved to a much larger extent than was customary in the past.

Consequently, Schuldschein Loans do not provide for an agent on the lenders' side. The interests of lenders are not centralised and bundled in an agent lender as no syndication applies to a Schuldschein.

ii. The right for each lender to accelerate its Schuldschein Loan upon an event of default

In a Schuldschein Loan with multiple lenders, each lender has a right to accelerate the Schuldschein upon the occurrence of an event of default. As such, there is no need for a certain percentage of the lenders or a majority lender to approve such acceleration, as usually is the case in syndicated loans. Again, Schuldschein Loans do not provide for syndication clauses bundling the interests of lenders.

iii. Higher fungibility / Liquidity of Schuldschein loan

Usually, prior consent from the borrower is needed before a lender in a syndicated loan can transfer its part in a loan to a new lender. In addition, there are usually restrictions with regards to which type of companies the lender may transfer its loan to. No such similar consents or restrictions exist for a lender in a Schuldschein Loan with multiple lenders to transfer its part of the Schuldschein Loan. The ability to transfer the Schuldschein without the prior consent of the borrower results in a higher liquidity. However, it has to be kept in mind that a Schuldschein Loan is transferable either via assignment or via assumption of contract which makes it itself less liquid than bearer bonds. Further, it should be noted that many Schuldschein Loans provide for restrictions as regards the type of transferees, e.g. transfer to institutional investors only, no transfer to competitors, transfer to regulated entities only, no transfer to entities outside the European Union etc.[660]

Overview of Euro PP Documentation

Since its inception in France in the second half of 2012, the Euro PP market has been the subject of private initiatives put in place in order to achieve a consensus on this new market. The Euro PP working group was created with the idea of developing specific documentation for Euro PPs in France. It was composed of several professionals (including issuers/borrowers, arrangers, investors, lawyers) under the supervision of the Banque de France, the French Treasury and the Paris IDF Chamber of Commerce and Industry.

Thus, the Charter was established to provide a non-binding framework of best practices for French and international Investors and to set up a common working basis for issuers, intermediaries and investors according to their respective needs. The Charter sets out good practices and guidelines, notably on the roles of the different participants and on the key phases of the transaction (preparation of the documentation, execution phase and management until maturity), in order to advise those involved in Euro PP transactions, who are not used to this type of instrument.

The Euro PP Working Group went further by releasing two model private placement agreements: a loan agreement and a bond agreement. The Euro PP model agreements were developed collectively, with active representation by all industry participants. These models provide examples of Euro PP legal documentation and constitute non-binding agreements. They are intended to be adapted as part of the Euro PP

660 Interview with an arranging Landesbank conducted in May 2017.

negotiations, based on the profile of the issuer, characteristics of the transaction and market conditions.

The ambition to develop the Euro PP market resulted in the organisation of the Euro PP first meeting in March 2015 in Paris by all the participants and the organisations which supported the Charter, in order to gather feedback and new trends from issuers, bankers and investors. This first meeting has led to the establishment of annual conferences permitting to exchange views and discuss about the Euro PPs (in March 2016 and in November this year).

The French initiative was taken up at a European level by the ECPP Guide, which was prepared under the supervision of ICMA and is in line with the Charter and the French model agreements. The ECPP Guide defines best practices and the role of the parties in a Euro PP transaction, provides a standard summary of terms of discussion between issuers and investors.

More details concerning the documentation are provided in the Legal Part II (Euro PP, Regulatory Framework) above.

Thanks to all these initiatives, France has succeeded in sufficiently standardising the Euro PP documentation and in removing all existing regulatory obstacles to establish a common market practice on the Euro PP market. According to the interviews that we conducted with arrangers, this documentation is not a barrier because, generally, participants were following the Charter closely. The interviewees considered that there is no need to go further in terms of standardisation.

The particularity of the Euro PP documentation is that it was modelled on bank loan documentation. In fact, investors sought contractual undertakings that were as similar as possible to those included in bank loan documentation, in particular those concerning the status of the bonds, which had to rank *pari passu* with lending banks. This has led to the emergence of specific clauses that are not usually found in public and syndicated bond issues.

The risk mitigation clauses that are most prevalent are:

a. negative pledge (see "Negative Pledge" below for further details);

b. step up: the interest rates payable on the bonds can be increased or decreased depending on the occurrence of certain events (such as non-compliance with ratios, non-compliance with an undertaking of the issuer such as the releasing of security interests);

c. events of default (see "Events of Default" below for further details);

d. expanded early redemption events: the bondholders will have the option to redeem their bonds following a change of control (see "Change of Control" below for further details), a breach of the financial ratios, a substantial disposal of the issuer's business, a dividend payment, an annual acquisition event);

e. information undertakings (see "Information Covenants" below for further details).

One relevant point is that, as per the interviews conducted with arrangers, the recent majority of the Euro PP transactions in the form of bonds are either unlisted or listed on MTF markets, which do not require the publication of a prospectus. Thus, the fact that the recent Euro PP transactions are not listed or are listed on an MTF market shows that Investors are no longer requiring necessarily a listing of the bonds and/or

a listing on a regulated market. Furthermore, the decision whether to list or not the bonds will primarily depend on the level of disclosure that the issuer wants to give to the market. Moreover, whether the transaction is on a regulated, MTF or unlisted market, has no impact on the contractual documentation of the bonds and on risk mitigation provisions that could be required by Investors. Risk mitigation provisions included in Euro PP documentation is primarily dependent on the specific circumstances of the issuer/borrower[661].

On this basis, the conclusion would seem to be that the existing standardisation of the documentation in France is sufficient. This can be explained by two main reasons. Firstly, investors are knowledgeable participants, having a strong knowledge of risk mitigation provisions, issuers' creditworthiness and issuers' profiles. Secondly, Euro PP documentation should remain negotiated on a case-by-case basis in order to allow investors to obtain a suitable protection in regard to their needs and to the capacity of the issuer to conduct its business, which would not be the case with an extended standardised documentation.

Overview of LMA Private Placement Documentation

The LMA private placement documents were created in response to demand from participants in the developing Pan-European private placement market, who felt that the lack of standardised documentation was one of the barriers to growth of the market[662].

The documentation accommodates both loans and notes, with the style of the documentation and the key commercial elements for both formats being as similar as possible. This enables investors and borrowers to select the most appropriate format for their individual transaction, based on structural rather than commercial preferences. The documentation is based on the LMA Recommended Form of Primary Documents, on the basis that these documents are already very well known across the market, particularly by corporate borrowers.

The LMA private placement documents currently consist of:

i. a confidentiality agreement;
ii. a term sheet;
iii. a term facility agreement (the "LMA Facility Agreement"); and
iv. a subscription agreement (the "LMA Subscription Agreement").

Although such documents need to be tailored to the specifics of a transaction, the documents are intended to provide a good starting point for the draftsman with a common framework and language for those involved in private placement transactions using the same basic structure and "boilerplate" as the LMA Recommended Forms of Primary Documents.

661 Based on Linklaters review of Euro PP transactions carried out between 2012 and 2016 comparing issuers' business sectors, listed/unlisted issuers, frequent issuers on the Euro PP market and issuers' size.

662 User Guide to the Form of Pan-European Private Placement Documents – April 2016.

Overview of US PP Documentation

A significant advantage of the US private placement market is its established and well-accepted standardised documentation. As with the Euro PP and LMA forms, although the detailed terms of each transaction will be negotiated by the borrower and investors, the templates create a framework for each deal. The primary template is the note purchase agreement ("**NPA**"), which documents the agreement by the investors to subscribe for the notes and contains the borrower representations, warranties and covenants. For cross-border transactions, non-US borrowers use the Model X Form, for which there are two versions depending on the credit of the borrower. Although these are governed by NY law, they are often amended so that they are governed by the laws of other jurisdictions.

The Model X Form contains some positive covenants requiring the issuer to perform certain actions. As with the Euro PP and LMA forms, there is a placeholder for financial covenants to be negotiated by the parties. The covenants in the US private placements are similar to those in the LMA bank facilities and vary depending on the credit quality of the issuer. For strong issuers, investors often accept lighter covenants. For some strong credits, the negotiated position might be no financial covenants and just a "most favoured lender" clause, which needs to be drafted as it is not included in the Model X Form. This provision entitles the investors under the NPA to the same or better terms and covenants as those of the borrower's other financings. Any favourable changes to those other financings would be deemed to be made to the NPA. This is often included as a means to ensure that the private placement lenders will benefit from the same terms as the senior lenders.

Risk Categories

In order to understand the risks associated with private placement instruments, the risk analytics section (pp.93ff) breaks down the overall risk-assessment into the following risk categories:

- Credit risk
- Market risk
- Liquidity risk
- Regulatory and legal risk

The following sections will analyse the most common contractual provisions included in Schuldschein, Euro PP and LMA documentation to mitigate such risks. Contractual risk mitigation provisions primarily address credit risk and legal risk and the following sections will therefore focus more on such risks. Market risk is typically priced into the purchase price of the private placement security. After issuance, any risk associated with, for example, changes in interest rates, political events, etc. will be borne by the investor. Liquidity risk is primarily determined by the type of instrument, whether and where is it listed / traded and any restrictions on its transferability.

Credit Risk

Credit risk in terms of issuer default risk is the risk that the borrower may not at all, not in time or not fully repay the debt. As a consequence, the investor would lose the principal and/or the interest associated with it, which would result in a disruption of cash flow and increased collection cost. In other words, it is the investor's risk associated with the default of the issuer. Please see the Economic Part IV, Risk analytics (*Overview of risk categories*) for more information.

The most common contractual provisions aimed at mitigating the credit risk of the issuer of a private placement instrument may be grouped as follows:

- financial covenants
- information covenants
- negative pledge
- events of default
- change of control

The following sections analyse each of these categories of risk-mitigation provision in turn.

Financial Covenants

Overview of Financial Covenants

Financial covenants in private placement documentation are undertakings towards the investors / lenders to comply with certain minimum and maximum financial ratios and/or values.

Financial covenants:

a. help investors / lenders to monitor the financial health of the issuer / issuer group during the lifetime of the financing;

b. provide them with a meaningful test of financial performance of the issuer / issuer group; and

c. provide realistic early warning signs that an issuer / borrower is in trouble.

Compliance is typically evidenced by the delivery of a compliance certificate (quarterly, semi-annually or annually). The aim in setting financial covenants is to balance "control" over the issuer / protection for the investors / lenders with flexibility for the issuer/ borrower.

A distinction may be made between maintenance covenants and incurrence covenants. Many typical bank finance covenants are maintenance covenants. That is, they affirmatively require the issuer / borrower to maintain certain standards. The issuer / borrower must be in compliance with these standards at all times, although in the case of financial covenants, effectively this can mean compliance each time a quarterly, semi-annual or annual test is carried out. Incurrence covenants, on the other hand, are not regularly tested and have minimal impact (if any) on the conduct of the issuer's / borrower's normal trading operations. However, the issuer / borrower must meet the standards imposed by the incurrence covenants if it wishes to take an action governed by a given covenant. These actions may include borrowing money, making investments or selling assets. Incurrence covenants are thus tested only at the time one of these specific events occurs and are therefore more borrower/issuer-friendly than maintenance covenants. Unless an issuer wants to take an action governed by a covenant, it need not worry about compliance.

Most Commonly Used Financial Covenants

The following are some of the most commonly used financial covenants in private placement documentation:

a. Debt / EBITDA ("**Leverage Ratio**")

   The Leverage Ratio test relates to the ratio of total debt (calculated on a gross or net basis) on the last day of a relevant period to EBITDA for that relevant period.

This test is intended to measure how the debt level of the issuer's group compares to its operating profit.

b. Cashflow / Cash Interest Expense and Principal Debt Repayments ("**Cashflow Cover Ratio**")

The Cashflow Cover Ratio is the ratio of cashflow to cash interest expense and principal debt repayments in relation to each relevant period. This test seeks to measure the ability of the issuer's group to generate sufficient cash in order to service its debts.

c. EBITDA / Cash Interest Cost ("**Interest Cover Ratio**")

The Interest Cover Ratio is the ratio of EBITDA to cash interest cost (calculated either on a gross or a net basis) in relation to each relevant period. It seeks to test the ability of the issuer's group to make enough operating profits to cover its interest costs.

d. Debt / Equity ("**Gearing Ratio**")

The Gearing Ratio is the ratio is of owner's equity (or capital) to funds borrowed by the issuer. Gearing is a measurement of the issuer's financial leverage, which demonstrates the degree to which the issuer's activities are funded by owner's funds versus creditor's funds. Higher calculations of a gearing ratio indicate a company has higher degree of leverage and is more susceptible to downturns in the economy and in the business cycle. This is because companies that have higher leverage have higher amounts of debt when compared to owner's equity. Therefore, entities with high gearing ratio findings have higher amounts of debt to service. Companies with lower gearing ratio calculations have more equity to rely upon as financing is needed.

e. Loan / Value of Asset Purchased ("**Loan to Value Ratio**")

The Loan to Value Ratio is a ratio of a loan to the value of an asset purchased. This ratio is commonly used to represent the ratio of the first mortgage line as a percentage of the total appraised value of real property. The higher the Loan to Value Ratio, the riskier the loan is for a lender.

f. Capital Expenditure ("**Capital Expenditure**")

The Capital Expenditure test limits the amount of capital expenditure that the issuer's group can make in each financial year.

Schuldschein

Generally, there are no financial covenants in Schuldschein Loans as long as the borrower is an investment grade rated entity. However, in cases where financial covenants are included, such financial covenants typically follow the borrower's existing financing documentation and reflects the current creditworthiness of the borrower. Therefore, the most "common" financial covenants in Schuldschein Loans for borrowers without rating or with a subinvestment grade rating are Leverage Ratio, Cashflow Cover Ratio, Interest Cover Ratio and Gearing Ratio[663].

663 Confirmed by an arranger in an interview conducted June 2017.

When comparing national and international Schuldschein transactions no distinct difference as regards financial covenants can be drawn. The type and scope of any financial covenants are typically based on the credit rating of the borrower, its business model and its existing financing as opposed to its jurisdiction of incorporation. The arranging banks typically aim to provide Schuldschein investors with the same protection as other creditors of the borrower.[664]

Euro PP

The template Euro PP in bond format contains the following placeholder for financial covenants:

"Financial covenants

[*Financial covenants (Financial Covenants, restrictions on investment and external growth transactions, etc.) to be determined between the issuer and the Subscriber[s]*]"[665]

The Euro PP in loan format contains the following placeholder for financial covenants:

"Financial Covenants

[*Financial Covenants (Financial Ratios, limitations of investments and acquisitions, etc.) to be determined between the Borrower, the Arranger and the Original Lender*]"[666]

The issuer undertakes to comply with certain ratios, where the definition of each component and frequency for calculating these ratios are given. These financial covenants are adapted to the issuer's profile. Investors are better informed and educated, so they are able to assess the credit risk in relation to the issuer's profile.

The Charter has provided undertakings for the issuer in the event that financial covenants have been inserted in the documentation. Then, the issuer/borrower has the obligation to write clear definitions of the ratios and should provide the frequency for their calculation.

The key financial covenants are:

a. Leverage Ratio;
b. Cashflow Cover Ratio;
c. Interest Cover Ratio;
d. Gearing Ratio;
e. Loan to Value Ratio;
f. Debt Coverage Ratio; and
g. Capital Expenditure.

664 Interview with an international arranging bank conducted in April 2017.
665 Article 4.1 (*Financial Covenants*) of Schedule 1 (*Terms and Conditions of the Notes*) to the Euro PP Subscription Agreement.
666 Article 15.2 (*Financial Covenants*) of the Euro PP Loan Agreement.

See above for a more detailed description of the operation of and rationale for such financial covenants.

The issuer/borrower is required to deliver a compliance certificate (quarterly, semi-annually or annually, so at least once a year) stating that all requirements in relation to the financial covenants have been fulfilled and that the ratios are validly calculated. This certificate has to be signed by both an authorised representative of the issuer and its statutory auditors (when calculations are made frequently, the issuer alone).

Based on analysis of the Euro PP transactions in bond format listed on regulated or MTF markets from May 2012 to May 2017, approximately half included a form of the Leverage Ratio and Gearing Ration financial covenants[667]. Given the limitations on the availability of documentation for Euro PPs listed on regulated or MTF markets, it is important to note that it is not possible to establish a clear comparison between the documentary provisions of bonds issued by a national issuer and those issued by an international issuer.

LMA

The LMA recognises that financial covenants will often be included in a private placement transaction but that it would be inappropriate to suggest which provisions should be included in a standard form[668]. As such, both the LMA Subscription Agreement and the LMA Facility Agreement contain placeholders for the insertion of financial covenants. The LMA has published a standalone guide to financial covenants that includes standard drafting that could be inserted into such documents depending on which provisions form part of the commercial deal.

US PP

The Model X Form contains some positive covenants requiring the issuer to perform certain actions. The negative covenants prohibiting issuers from taking certain actions are not included and are negotiated by the parties. The covenants in the US private placements are similar to those in the LMA bank facilities and will vary depending on the credit quality of the issuer. For strong issuers, investors often accept lighter covenants. For some strong credits, the negotiated position might be no financial covenants and just a "most favoured lender" clause, which needs to be drafted as it is not included in the Model X Form. This provision entitles the investors under the NPA to the same or better terms and covenants as those of the borrower's other financings. Any favourable changes to those other financings would be deemed to be made to the NPA. This is often included as a means to ensure that the private placement lenders will benefit from the same terms as the senior lenders.

Information Covenants

Overview of Information Covenants

Most private placement instruments typically include covenants requiring the issuer to provide investors with period financial information in respect of the issuer and its group. Such information allows the investors to monitor developments in the credit risk of the issuer by conducting ongoing financial due diligence on the issuer.

667 *Observatoire des Euro PP* by CMS Bureau Francis Lefebvre

668 User Guide to the Form of Pan-European Private Placement Documents – April 2016.

Schuldschein

Although there is no standard information covenant clause for Schuldschein, they usually contain an information undertaking provision whereby the borrower undertakes to provide the lender and the paying agent with information (such as unaudited and audited consolidated financial statements for each financial year, information for the lender to be able to comply with "know your customer" or other similar checks under all applicable laws and regulations and to notify the lender if any events of default have occurred. Since the arranging banks are typically structuring the Schuldschein transaction based on the existing finance arrangements of the borrower, Schuldschein investors are typically not worse off compared to other financing parties.[669]

Euro PP

Approximately 30% of Euro PPs in the bond format listed on regulated or MTF markets from May 2012 to May 2017 contain an information undertaking provision whereby the issuer undertakes to provide information to the investor (such as financial data including audited consolidated financial statements for at least the last two years, the related statutory auditors' reports and events affecting the issuer's indebtedness)[670]. Investors must have equivalent access to information in an easy, simple and secure manner. This means that investors/lenders will require similar information covenants regardless of the format of the Euro PP.

The Euro PP in bond format provides for a pro forma information covenant as a starting point for negotiation between the issuer and the subscribers (see Annex 1 – Paragraph 1 for details).

LMA

Both the LMA Subscription Agreement and the LMA Facility Agreement contain pro forma information undertakings as a starting point for negotiation between the company and the holder / lender requiring delivery of financial statements and other information (see Annex 2 – Paragraphs 1 and 2 for details).

Negative Pledge

Overview of Negative Pledge

A negative pledge is typically an undertaking on the part of an issuer and a guarantor (if there is one) limiting their right to give security (or, in many cases, to permit their subsidiaries to give security) in respect of their own indebtedness or that of others.

The drafting of a negative pledge requires a balance to be struck between achieving the desired purpose (see below) on the one hand and permitting the issuer to carry on its business in an efficient way as possible and in accordance with the norms of the markets within which it operates, on the other. For example, if the intended purpose of a negative pledge is to preserve as many of the assets of the issuer in an unsecured state for the benefit of unsecured creditors (which will include the relevant bondholders), then the provision should be widely drawn to include not just security, as the term is ordinarily understood, but "quasi security" such as sale-and-leaseback transactions. However, if the only way or the most economical way of obtaining

669 Interview with an international arranging bank conducted in April 2017.

670 *Observatoire des Euro PP* by CMS Bureau Francis Lefebvre

finance for the assets the issuer needs to operate its business is through such quasi secured methods, then it may be not only impracticable but also undesirable to prevent it from doing so.

The principal purposes of the negative pledge restrictions are:

a. to preserve the assets of the issuer for the group of creditors which includes the securityholder;

b. to ensure equality of treatment for creditors of the issuer of the same class;

c. to protect the market price of bonds[671];

d. to limit the debt/equity ratio of the issuer[672];

e. to ensure that all creditors of the issuer (or all of a given class) have similar interests if the issuer's financial position deteriorates;

f. to prevent creditors of the issuer who become creditors after the issue of the bonds being able to rank ahead of the bondholders in the winding-up of the issuer; and

g. to preserve the credit rating of the issuer.

Schuldschein

Schuldschein typically include a negative pledge provision generally setting out a restriction for the borrower (including its subsidiaries) to create, incur, assume or permit any type of security or encumbrance with respect of any of its assets or property or to in anyway dispose of any of its assets in circumstances where the arrangement or transaction is entered into primarily as a method of raising financial indebtedness for the financing of the acquisition of an asset, as long as any amount (principal or interest) under the loan is outstanding. The negative pledge provision also generally contains situations when the borrower will be able to create security over its assets (such as in order for the borrower to conduct its business). These situations are usually highly negotiated and tailored[673].

Euro PP

The negative pledge clause is highly negotiated in the Euro PP market compared to the eurobond issues, in particular concerning the scope of the relevant debt and the authorised security interests. Arrangers may want the scope of the relevant debt to be as large as possible (for instance, including bond issues, borrowings and debt with credit institutions, bank overdraft or other loans and borrowings and leasing agreements). By contrast, the issuer will seek to restrict the scope of the negative pledge and retain the greatest degree of flexibility on the authorised security interests.

671 The subsequent issue by the issuer of a secured bond, or the giving of a secured guarantee for a bond issued by a subsidiary, could affect the secondary market price of the bonds, because the security gives a better credit risk.

672 There may be a borrowing level above which the issuer cannot go without offering security.

673 Interview with a German arranger conducted in June 2017.

More than half of the Euro PPs' in bond format listed on regulated or MTF markets from May 2012 to May 2017 included a negative pledge clause covering both bank and bond debt[674].

The Euro PP in bond format provides for a pro forma negative pledge as a starting point for negotiation between the issuer and the subscribers (see Annex 1 – Paragraph 3 for details).

LMA

Both the LMA Subscription Agreement and the LMA Facility Agreement contain a pro forma negative pledge as a starting point for negotiation between the company and the holder / lender (see Annex 2 – Paragraphs 3 and 4 for details).

Events of Default

Overview of Events of Default

Most private placement financing transactions contain events of default, i.e. provisions entitling the holder to early repayment on the occurrence of certain events which have, or could have, a damaging effect on the issuer or on the guarantor (if there is one).

Most default provisions contain three distinct types of events:

a. Issue Specific Events

   Those which relate to breach by the issuer of terms of the bond or the Schuldschein, such as non-payment of principal or interest or the loss of governmental authorisations necessary to enable the issuer to perform its obligations under the bond (see paragraphs 1 – 4 below). The main purpose of such events is to provide a sanction (namely the threat of the bond becoming due prior to its normal maturity) in the event that the issuer fails to perform any part of its contract with the relevant investors.

   The following are examples of the typical issue specific events of default:

   1. Non Payment

      "**Non-Payment**: the issuer fails to pay the principal of, or any premium or interest on, any of the Bonds when due".

   2. Breach of Other Obligation

      "**Breach of Other Obligation**: the issuer defaults in performance or observance of or compliance with any of its other obligations set out in the Bonds".

   3. Authorisation and Consents

      "**Authorisation and Consents**: any action, condition or thing (including obtaining or effecting of any necessary consent, approval, authorisation, exemption, filing, licence, order, recording or registration) at any time required to be taken, fulfilled or done in order (a) to enable the issuer lawfully to enter into, exercise its rights and perform and comply with its

674 *Observatoire des Euro PP* by CMS Bureau Francis Lefebvre

obligations under the Bonds, (b) to ensure that those obligations are legally binding and enforceable and (c) to make the Bonds admissible in evidence in the courts of [•] is not taken, fulfilled or done".

4. Illegality

"**Illegality**: it is or will become unlawful for the issuer to perform or comply with any one or more of its obligations under any of the Bonds".

b. Issuer Specific Events

Those which relate specifically to the issuer, such as its insolvency or the expropriation of its assets by the state (see paragraphs 1 - 6 below). Issuer specific events are primarily designed to improve the investor's chances of recovering amounts due on the bonds in circumstances where the issuer's financial position is deteriorating, or is likely to deteriorate. They operate as an "early warning system" enabling the investor to take action to avoid an impending disaster. For example, the expropriation by a state of a material part of the business of the issuer may lead, after a period of time, to the insolvency of the issuer. The investor is more likely to recover amounts due under his security if he has an immediate right to repayment on the occurrence of the expropriation, rather than having to wait for the results of that event to occur.

Rating related events of default are rather unusual as a downgrade of a borrower would have significant consequences. In addition, many borrowers in the private placement market do not have a public available rating. Consequently, the market is relying on financial covenants replicating some of the methodology applied by rating agencies.[675]

The following are examples of the typical issuer specific events of default:

1. Cross default/Cross-acceleration

"**Cross Default**:

i. any other present or future indebtedness of the issuer for or in respect of borrowed moneys becomes (or becomes capable of being declared) due and payable prior to its stated maturity otherwise than at the option of the issuer; or

ii. any such indebtedness is not paid when due or, as the case may be, within any applicable grace period; or

iii. the issuer fails to pay when due or expressed to be due any amount payable or expressed to be payable by it under any present or future guarantee for any borrowed moneys."

2. Enforcement proceedings

"**Enforcement proceedings**: a distress, execution or other legal process is levied or enforced or sued out upon or against all or any of the property, assets or revenues of the Issuer".

3. Security enforceable/enforced

675 Interview with a German arranging bank in the Schuldschein market conducted in April 2017.

"**Security enforced**: any mortgage, charge, pledge, lien or other encumbrance, present or future, created or assumed by the issuer or any of its Subsidiaries becomes enforceable".

4. Insolvency

"**Insolvency**: the issuer [or any of its Subsidiaries] becomes insolvent or is unable to pay its debts as they mature or applies for or consents to or suffers the appointment of an administrator, liquidator or receiver of itself or the whole or any part of its undertaking, property, assets or revenues or takes any proceeding under any law for a readjustment or deferment of its obligations or any part of them or makes or enters into a general assignment or an arrangement or composition with or for the benefit of its creditors or stops or threatens to cease to carry on its business or any substantial part of its business."

5. Winding Up

"**Winding up**: an administrator is appointed, an order is made or an effective resolution passed for dissolving, winding up or liquidating or the issuer ceases or threatens to cease to carry on all or substantially all of its business or operations."

6. Moratorium or expropriation/nationalisation

"**Moratorium or expropriation**: a moratorium is agreed or declared in respect of any indebtedness of the issuer or any governmental authority or agency condemns, seizes, compulsorily purchases or expropriates all or a substantial part of the assets of the issuer."

c. Pari Passu Events

Those designed to ensure that the investors enjoy equal rights with other creditors, such as the default by the issuer in payment of other debts or the seizure of assets by another creditor (see paragraphs 1 – 3 above). Any creditor of the issuer who is entitled to accelerate his debt or to enforce any security is potentially in a better position than the investors. He may be able either to use the threat of acceleration to obtain concessions from the issuer (for example an improved repayment schedule or a higher rate of interest) or to recover his debt by exercising the right to accelerate and effectively "jumping the queue". The *pari passu* events are designed to put the bondholder on as similar a footing as possible as other creditors.

Paragraphs 1 -3 above are examples of the typical *pari passu* events of default.

Schuldschein

The following events of default are typically included in Schuldschein documentation:

i. Transaction specific events: Non-Payment and Breach of Other Obligations.

ii. Borrower specific events: Cross-Default, Insolvency and Winding Up.

See above for further details of such types of events of default.

Euro PP

Both the Euro PP in bond format[676] and the Euro PP in loan format[677] contain pro forma events of default as a starting point for negotiations between the parties.

The provisions that are very often included in Euro PPs in the bond format listed on regulated or MTF markets from May 2012 to May 2017 are:

i. Transaction specific events: Non-Payment and Breach of Other Obligations.

ii. Issuer specific events: Cross-Default, Insolvency and Winding Up.

See above for further details of such types of events of default.

LMA

Both the LMA Subscription Agreement[678] and the LMA Facility Agreement[679] contain pro forma events of default as a starting point for negotiation between the company and the holder / lender.

Change of Control

Overview of a Change of Control Clause

A typical change of control clause will provide that, on the occurrence of a takeover or merger leading to the acquisition of over 50% of the voting share capital of the issuer, a change of control will be deemed to have occurred. If this is then coupled with a rating downgrade (usually to below investment grade), withdrawal of rating or (if the bonds are not then rated) failure to obtain a rating, then the investors will have the right to put their bonds back to the issuer, normally at par although there are exceptions.

Schuldschein

It is usual for the Schuldschein Loan to contain a change of control provision obliging the borrower to inform the lender that a change of control has occurred and giving the lender a possibility to early terminate the Schuldschein Loan upon which the borrower is obliged to early repay the Schuldschein, usually, at the nominal amount plus accrual interest.

Euro PP

The majority of Euro PPs listed on regulated or MTF markets from May 2012 to May 2017 included an early redemption provision at the option of the Noteholders following a change of control. The definition of the change of control event varies from one issue to another, especially for family-owned companies for instance. Furthermore, as a Euro PP is usually unrated, the change of control provision is not linked to a rating event.

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676 Article 9 (*Events of Default*) of Schedule 1 (*Terms and Conditions of the Notes*) to the Euro PP Subscription Agreement.

677 Article 16 (*Events of Default*) of the Euro PP Loan Agreement.

678 Clause 22 (*Events of Default*) of the LMA Subscription Agreement.

679 Clause 22 (*Events of Default*) of the LMA Facility Agreement.

The Euro PP in bond format provides for a pro forma change of control put provision as a starting point for negotiation between the issuer and the subscribers (see Annex 1 – Paragraph 5 for details).

The Euro PP in loan format provides for a pro forma mandatory early repayment provision following a change of control as a starting point for negotiation between the borrower and the lenders (see Annex 1 – Paragraph 6 for details).

LMA

The LMA Subscription Agreement provides for a pro forma change of control put provision as a starting point for negotiation between the company and the holders (see Annex 2 – Paragraph 5 for details).

The LMA Facility Agreement provides for a pro forma mandatory early repayment provision following a change of control as a starting point for negotiation between the company and the lenders (see Annex 2 – Paragraph 6 for details).

Market Risk

Market risk includes all risk sub-categories that originate from external market factors such as movement of market prices through changes in interest rates, political events, or others. See the Economic Part IV, Risk analytics (*Overview of risk categories*) for further details.

In general, market risk is priced into the purchase price of the private placement security. After issuance, any risk associated with, for example, changes in interest rates, political events, etc. will be borne by the investor.

Material Adverse Change / Material Adverse Effect

The one exception to this is the protection afforded to investors by the "material adverse change" or "material adverse effect" provisions.

The term "material adverse effect" ("**MAE**") is somewhat different from the term "material adverse change" ("**MAC**"), as a MAC is used to describe a specific change or event while the concept of MAE describes the negative consequences of an event on the borrower's business and/or financial position. However, as the two terms are now often used relatively interchangeably in finance documents, this section will refer to the term MAC.

MAC clauses are used in a broad range of financial and commercial transactions although investment grade borrowers invariably insist on the removal of MAC clauses. In each case, the provision has a similar objective, namely to protect lenders where an unforeseen event (not provided for by any of the specific events of default) has had a significant negative impact on the borrower's/issuer's business and/or its ability to repay a loan/bond.

MAC clauses typically come under scrutiny following the occurrence of an unforeseen event which causes lenders to re-assess the risk which they are facing. This is particularly the case where the relevant event does not amount to an immediate event of default but is very likely to lead to a future payment default by the borrower or issuer.

In relation to bond issues, the subscription agreement would typically include a MAC representation given by the issuer to the arrangers/underwriters. This representation would normally be repeated on the closing date. If the issuer is unable to repeat such representation on the closing date the arrangers/underwriters/subscribers have the ability to walk away from the transaction, thus providing a level of protection to market risk between the signing and closing dates. This may also take the form of a termination right for the arrangers/underwriters if there has been a development between signing of the subscription agreement and closing which, in the view of the arrangers/underwriters, materially prejudices the success of the offering. The following is an example of such a termination right:

"Notwithstanding anything contained in this Agreement, the Managers may, by notice to the Issuer given at any time prior to payment of the net subscription moneys for the Bonds to the Issuer, terminate this Agreement in any of the following circumstances:

i. …

ii. if there shall have been in the Managers' opinion, since the date of this Agreement, any change, or any development involving a prospective change, in national or international monetary, financial, political or economic conditions or currency exchange rates or foreign exchange controls such as would in its view be likely to prejudice materially the success of the offering and distribution of the Bonds or dealings in the Bonds in the secondary market".

It very rare for MAC provisions to be included in bond documentation itself and so equivalent protection is not provided after issuance of the bond.

In a banking context, MAC clauses are generally found in facility agreements and commitment letters. The form of MAC clause may, however, be significantly different, as those contained in commitment letters are generally more widely drafted, having regard to market conditions as well as the specific borrower. MAC clauses contained in facility agreements tend to be more tightly drafted, focussing on the borrower and its business, rather than on wider market conditions.

Schuldschein

MAC/MAE provisions in Schuldschein are highly negotiated and tailored to the specific circumstances and business of the borrower. If a MAC/MAE provision is included it is usually included in other provisions, such as the provision of representations and warranties of the borrower, the borrower's information undertakings or in the event of default provision.

Euro PP

The Euro PP in bond format provides for the following pro forma MAE condition precedent as a starting point for negotiation between the issuer and the subscribers:

"CONDITIONS PRECEDENT

The undertaking by the Subscriber[s] [,acting severally and not jointly,] to subscribe and pay for the Notes on the Settlement Date is subject to the following conditions precedent:

a. (i) the absence, on the Settlement Date, of any event or change rendering any one of the undertakings made or any one of the representations made or warranties given, under the terms of Articles 3 and 5(A) of this Agreement untrue or incorrect, in the same terms as if they had been formulated, given or made on such Settlement Date, (ii) the absence, on the Settlement Date, of any event having or likely to have a Material Adverse Effect, and (iii) the performance by the issuer of all of its obligations under this Agreement up to and including the Settlement Date;"[680]

The Euro PP in bond format provides that the existence and scope of the definition of "Material Adverse Effect" are to be negotiated and modified based on the economics of the transaction and on the issuer's circumstances. The following is an example of such a definition:

"**Material Adverse Effect**" means any change or circumstance that has or is likely to have, individually or cumulatively, a material adverse effect on (i) the legal, financial or economic situation, the operating result, the assets, the activity, present or future, of the Issuer, or of the Issuer and its Material Subsidiaries taken as a whole, or (ii) the performance of this Agreement, the offering or the issue of the Bonds.

The Euro PP in loan format provides for the following pro forma MAE event of default as a starting point for negotiation between the borrower and the lenders:

The occurrence of any event or fact (other than those referred to above) having a Material Adverse Effect."[681]

The Euro PP in loan format provides that the existence and scope of the definition of "Material Adverse Effect" are to be negotiated and modified based on the economics of the transaction and on the borrower's circumstances.

In the event a MAE is negotiated, the following is an example provision that could serve as basis:

""**Material Adverse Effect**" means [in the reasonable opinion of the Majority Lenders] a material adverse effect on:

a. [the business, operations, property, condition (financial or otherwise) or prospects of the Group taken as a whole; [and/or]

b. [the ability of a Borrower to perform [its obligations under the Finance Documents]/[its payment obligations under the Finance Documents and/or its obligations under Clause 27.2 (Financial condition)]]/[the ability of the Borrower (taken as a whole) to perform [their obligations under the Finance Documents]/[their payment obligations under the Finance Documents] [and/or their obligations under Clause 27.2 (Financial condition)]]];

"**Material Adverse Change**" means any event or circumstance occurs which the Majority Lenders reasonably believe has or is reasonably likely to have a Material Adverse Effect".

680 Section 6 (*Conditions Precedent*) of the Euro PP Subscription Agreement.

681 Article 16.1.13 (*Events of Default*) of the Euro PP Loan Agreement.

LMA

Both the LMA Subscription Agreement and the LMA Facility Agreement contain a placeholder for a material adverse change event of default but do not suggest a pro forma provision.

Liquidity Risk

Liquidity risk is related to the presence and functioning of a secondary market. Investors should theoretically be able to dispose of their assets, for example in case they need liquidity or if the risk-return-ratio is no longer adequate. Please see the Economic Part IV, Risk analytics (*Overview of risk categories*) for further details.

Liquidity risk is primarily determined by the type of instrument, whether and where it is listed / traded and any restrictions on its transferability.

Listing / Stock Exchange

A listing of the instrument may reduce the liquidity risk in respect of such securities in several ways:

- listed debt securities must satisfy certain admissibility and disclosure standards and are, therefore, considered by investors to be an inherently safer investment than unlisted debt securities;
- a listing can also facilitate the marketing of the securities to specific categories of investors;
- institutional investors are often restricted or prohibited from investing in unlisted securities; and
- for other categories of investors, a listing will often mean that a security qualifies as an eligible security for investment purposes.

Schuldschein

There are no listing possibilities for Schuldschein. However, a new trading platform for Schuldschein Loan has been established by the Hamburg / Hannover stock exchange to bring together Schuldschein demand and supply of institutional investors and thereby establish a secondary market. Although the platform is a pure trading platform and not a regulatory market, it aims at providing liquidity to the Schuldschein market and enhance transparency.

Euro PP

Please refer to "Opening of MTF for Euro PP transactions" in the Regulatory Framework of the Euro PP overview section for further details.

LMA

The LMA Subscription Agreement is based on the LMA Facility Agreement and is intended to mirror as closely as possible the commercial terms made available under the LMA Facility Agreement. A number of the provisions included in the LMA Subscription Agreement are not typically seen in the public notes market. As such the

LMA Subscription Agreement is therefore unlikely to be suitable for use on a eurobond transaction, or where the notes are listed or held in a clearing system[682].

Transfer Restrictions

Contractual restrictions may prevent an investor from transferring a private placement instrument without the prior consent of the issuer or restrict the categories of persons to whom such private placement instrument may be transferred. From an issuer's perspective such restrictions may be for (i) legal or regulatory reasons (e.g. avoiding the transfer of such private placement instrument to a US person and thus potentially falling within the ambit of US securities laws) or (ii) commercial reasons (e.g. maintaining control over the identity of its creditors). Such contractual provisions reduce the free transferability of the relevant instrument and thus reduce its liquidity. From a risk mitigation perspective, limiting contractual restrictions to the extent feasible will help to minimise liquidity risk.

Schuldschein

Schuldschein Loans are generally freely transferable for the lender and may be transferred in whole or in part by way of assignment or assumption of contract. In connection with transfer in part, the Schuldschein might include restrictions with regards to minimum amounts which has to be transferred in order to proceed with the transfer. In addition, the borrower is often restricted to transfer its rights and obligations under the Schuldschein. In addition, Schuldschein Loans may have restrictions on (i) transfer to institutional investors only, (ii) no transfer to competitors, (iii) geographical scope, (iv) number of overall lenders or (v) limited number of transfers.[683]

Euro PP

Euro PP bonds are securities and should normally fall within the definition of "*obligation*" (article L213-5 of the French Monetary and Financial Code) under French law i.e. negotiable instruments which, for the same series notes, give the same rights of claim per denomination. They should not defer in terms of legal classification to any other bond issues and thus be freely transferable (subject to any applicable selling restrictions).

Euro PP loans are also generally transferrable under certain conditions and usually contains an "Assignments and transfers by the Lenders" clause, an example of which is as follows:

"Subject to this Article 18.1 (*Assignments and transfers by the Lenders*), a Lender (the "Existing Lender" and, after assignment of its rights or transfer of all or some of its rights and obligations under the Agreement, the '"Former Lender") can (i) assign certain of its rights or (ii) transfer all or some of its rights (including those relating to its Participation) and its obligations under the Agreement, to any credit institution, any financing company, any collective investment undertaking, insurance body (…) or any equivalent entity in the European Union (including any Fund linked to such entities), or, in general, to any entity, directly or indirectly authorised to grant loans, acquire or invest in loans, securities or other financial assets or in the case of a securitisation (the "New Lender")."

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682 User Guide to the Form of Pan-European Private Placement Documents – April 2016.

683 Interview with arranging bank conducted in April 2017.

LMA

Both the LMA Subscription Agreement[684] and the LMA Facility Agreement[685] contain options for transfers only with the consent of the company, transfers following consultation with the company, or for free transferability, to be agreed between the parties as appropriate.

Legal and Regulatory Risk

Legal risk generally comprises the risk of loss due to a defect in a transaction, a claim or event resulting in a liability, a failure to take certain actions required to protect assets or a change in law. The most relevant *regulatory risk* in Europe is around capital requirements.

The most common contractual provisions aimed at mitigating legal and regulatory risk may be grouped as follows:

- Representations and warranties
- Legal opinions
- Tax gross-up and tax call

The following sections analyse each of these risk-mitigation categories in turn.

Representation and Warranties

Overview of Representations and Warranties

Representations and warranties are statements of a factual or legal nature, made by an issuer, on the basis of which investors are willing to invest in the relevant security.

The purpose of representations and warranties is to ensure that the factual, legal and commercial basis on which the investors are prepared to make their investment is correct as of certain dates. If the representations and warranties are incorrect when first made or repeated, the investors will usually have the right to call an event of default.

1. Legal Representations

Most private placement instruments will typically contain representations dealing with the following legal matters:

- **Status**: a representation that the issuer (if a corporate entity) has been duly incorporated and is validly existing under the law of its jurisdiction of incorporation, and it and each of its subsidiaries has the power to own its assets and carry on its business.
- **Binding obligations**: a representation confirming that each of the issuer's obligations under the security are legal, valid, binding and enforceable.

684 Clause 23 (*Changes to the Holders*) of the LMA Subscription Agreement.
685 Clause 23 (*Changes to the Lenders*) of the LMA Facility Agreement.

- **Non-conflict with other obligations**: a representation confirming that the entry into and performance by the issuer of the agreements in respect of the security and any transactions contemplated by them would not conflict with any law or regulation to which the issuer is subject or its constitutional documents, or any other agreements to which it or any of its subsidiaries is party. The investors would not wish to find themselves in a situation where their transaction placed the issuer or another member of the group in breach of its other obligations, because of both the negative impact on the issuer and the possibility that the investors could be liable for procuring breach of contract.
- **Power and authority**: a representation that the issuer has power to enter into, perform and deliver the agreements in respect of the security to which it is party and the transactions contemplated thereby and has taken all necessary action (such as board and, if needed, shareholder resolutions) to authorise each of these things.
- **Validity and admissibility in evidence**: a representation that all authorisations required or desirable to enable the issuer to enter into and comply with its obligations in the agreements in respect of the security to which is it party and to make such agreements admissible in evidence, have been obtained and are in full force and effect. Such authorisations might include various governmental consents and approvals.
- **Governing law and enforcement**: a representation that the choice of governing law of the agreements in respect of the security will be recognised and enforced in the issuer's jurisdiction of incorporation, and any judgment obtained in the governing law country will be recognised and enforced in its jurisdiction of incorporation.
- **Taxes**: representations that the issuer is not required under the law of its jurisdiction of incorporation to make any tax deduction or payment, including stamp, filing and withholding tax, in relation to the finance documents or the transactions contemplated by the finance documents.
- **Pari passu ranking**: a representation that the issuer's payment obligations under the security rank at least *pari passu* with the claims of all its other unsecured and unsubordinated creditors.

2. Factual Representations

In addition to the legal representations, most private placement instruments will also typically contain representations dealing with the following financial and commercial matters:

- **No default**: a representation that no event of default (as set out in security) is continuing or might reasonably be expected to result from the issuance of the security, and no default under any other agreement which is binding on the issuer or any of its subsidiaries is outstanding which might have a material adverse effect.
- **No misleading information**: if an information memorandum has been prepared in connection with the issuance of the security, the issuer will be expected to confirm the accuracy of the information contained in that document, the reasonableness of any projections in it and that nothing has been omitted from it or withheld that would mean that the information memorandum is untrue or misleading in any material respect. If there is not an information memorandum, this representation may instead cover the information which the issuer has provided. On some transactions an information package, for example including any reports, may be provided and in this case the issuer should take care to identify its content clearly given that this package will be the subject of the information representation.

- **Financial statements and material adverse change**: a representation that the issuer's most recent audited financial statements have been prepared in accordance with generally accepted accounting principles consistently applied and fairly represent its financial condition and operations during the relevant financial year and that since the date of those financial statements there has been no material adverse change in its financial condition or operations.
- **No proceedings pending or threatened**: a representation that no litigation, arbitration or administrative proceedings which could have a material adverse effect on it have been started or threatened against any obligor or any of its subsidiaries.

3. Relationship with legal opinions

To a large extent, the legal representations overlap with the legal opinions (see "Legal Opinions" below for further details). Sometimes an issuer might resist giving these representations on the basis that lawyers cover the same matters in their opinions. The investors will be unwilling to accept this as they would want the ability not to fund or to trigger an event of default, rather than taking legal action against the lawyers. They would also want the ongoing protection provided by the representations, whereas the legal opinions only cover the position at the date of the opinion. Hence, the legal opinions typically provide comfort to the issuer in order for it to make the relevant legal representations.

4. Additional matters

In addition to those outlined below, certain transaction specific representations might be required. This will be shaped by the creditworthiness of the borrower, the purpose of the issuance (for example, to finance a public/private acquisition or to finance an investment in real estate), whether security is provided and the jurisdictions involved.

Additional matters to be addressed may include:

- sanctions;
- bribery/corruption;
- material contracts (if any) and their continued (unaltered) existence;
- title to and condition of other material assets;
- in the context of secured loans, the validity, priority and perfection of security;
- compliance with legislative or other regulatory requirements of special concern, such as environmental laws and licenses;
- correctness of any group structure chart; and/or
- ownership of intellectual property rights.

Schuldschein

There is no standard in the Schuldschein market on representations and warranties. However, the usual starting point is the representations and warranties listed above (legal representations and factual representations). The scope of the representations and warranties must be negotiated and modified for each transaction. The arranging banks are typically aligning the scope of the representations and warranties with the ones included in the other financing documentation of the borrower. Hence,

Schuldschein investors are receiving similar protections as other creditors of the borrower.[686]

Euro PP

Both the Euro PP in bond format[687] and in loan format[688] contain *pro forma* representations and warranties as a starting point for negotiations between the parties.

If the Euro PP is issued under a bond format, the issuer's representations and warranties can be included in two separate documents (the subscription agreement and the terms and conditions) whereas the representations and warranties are only contained in the loan agreement for Euro PPs in loan format.

These representations and warranties must be modified on each transaction to reflect the issuer's profile and activity. In particular, the parties must agree on the scope of the representations and warranties made by the issuer depending on whether they are made by the issuer in respect of itself only or regarding the issuer and all or some of its subsidiaries.

LMA

The representations contained in the LMA Subscription Agreement[689] and the LMA Facility Agreement[690] follow those in the LMA Primary Documents. The LMA notes that such pro forma representations will need to be tailored to a transaction on a case-by-case basis. In particular, are not intended to be exhaustive or absolute.

Legal Opinions

Legal opinions in private placement transactions vary in scope but typically address one or more of the following:

a. **Capacity and authority**: for example, that a company is validly existing, that it has the necessary corporate power under its constitutive documents to execute and perform the transaction document to which the opinion relates, and that the necessary corporate action has been taken to authorise the execution of the transaction document by or on behalf of the company.

b. **The legal effect of the transaction document**: for example, that it creates valid, binding and enforceable obligations (which will usually require reservations).

c. **Tax**: for example, that the transaction document will not be subject to stamp duty.

686 Interview with an international investment bank acting as arranger in the Schuldschein market conducted in April 2017.

687 The *pro forma* representations and warranties for Euro PP in bond format are available in the Article 5 (*Issuer's Representations and Warranties*) of the Euro PP Subscription Agreement.

688 The *pro forma* representations and warranties for Euro PP in loan format are available in the Article 14 (*Borrower's Representations*) of the Euro PP Loan Agreement.

689 Clause 18 (*Representations*) of the LMA Subscription Agreement.

690 Clause 18 (*Representations*) of the LMA Facility Agreement.

d. **Governing law and jurisdiction**: for example, that the law of the jurisdiction whose laws are selected to govern the transaction document has validly been chosen, that the submission by the relevant party to the courts of that jurisdiction is binding on it, and that a judgment obtained from such a court can be enforced or sued upon in the courts of the jurisdiction to which the opinion letter relates.

The primary purpose of a legal opinion is to state conclusions of law as to the ability of a party to enter into and perform its obligations under an agreement and/or the legal effect of the agreement. A legal opinion often serves to confirm that the assumptions about the legal position made by a party in deciding to enter into an agreement are well founded. It may also confirm what contractual relationship will be created by the documentation. Most opinion letters are subject to at least some qualifications. A qualification serves as an aid to risk management by assisting a party in the evaluation of the legal risk or legal uncertainties in the transaction. If a major problem is identified, it may lead to the transaction being restructured so that the problem is avoided or it may lead to a commercial decision to proceed or not to proceed with the transaction.

In the case of an issue of securities, the legal opinion has an additional purpose. If the managers or underwriters of the issue were sued by an investor alleging negligence in their handling of the issue because of a legal problem, the fact that they had received advice or a legal opinion addressing the point in question should assist them in demonstrating that they had not been negligent in that regard, provided that they had relied on the opinion and that it was reasonable for them to have done so.

Tax Gross-up

Overview of Tax Gross-up

Most private placement instruments contain a provision permitting the issuer to prepay the security if it is required to pay additional amounts to the investors to compensate them for certain withholding taxes.

The purpose of such a provision is to ensure that the investor always receives the full amount due to him. If the laws of the jurisdiction of the issuer provide that a Bondholder, even if not otherwise subject to tax in that jurisdiction, should suffer a withholding tax, the investor would receive a net payment plus, perhaps, a tax credit in the issuer's jurisdiction (which would be useless to him, because he cannot use it, not having any other taxable activity in that jurisdiction and assuming that he could not claim it back under a double taxation treaty).

Most finance instruments therefore contain a "grossing-up" provision, subject to certain customary carve-outs, effectively requiring the issuer to pay to the investor, if a withholding tax is imposed, a greater amount, so that, after the withholding, the investor receives net the same amount as he would have received in the absence of a withholding.

Schuldschein

The tax gross-up provision is usually highly negotiated between the parties and a Schuldschein may include a provision for gross-up or no gross-up. However, if a tax gross-up provision is included in the Schuldschein, an additional provision entitling the

borrower to early terminate the Schuldschein is usually included should the tax gross-up provision be applicable.

Euro PP

Most Euro PPs contain gross-up provisions and the possibility for the issuer/borrower to redeem the bonds or prepay its loan when certain additional tax amounts are required to be paid.

The Euro PP in bond format provides for a pro forma tax gross-up provision and tax redemption provision as a starting point for negotiation between the issuer and the subscribers (see Annex 1 – Paragraph 7 for details).

The Euro PP in loan format provides for a pro forma tax gross-up provision as a starting point for negotiation between the issuer and the subscribers (see Annex 1 – Paragraph 8 for details).

LMA

The LMA Subscription Agreement and LMA Facility Agreement contain provisions reflecting the exemption to withholding tax which came into force on 1 January 2016 (the "QPP Exemption"). In most cases the QPP Exemption will be available to lenders/holders who are resident in jurisdictions that are not tax havens.

The QPP Exemption has two advantages over the treaty passport scheme. First, it will be available to lenders/holders in jurisdictions where the treaty between the UK and their country of residence does not reduce withholding taxes on interest to zero (such as China and Korea). Second, it is also procedurally simpler to use the QPP Exemption than the treaty clearance route as the certificate is provided to the borrower on day one and there is no need for clearance from HMRC.

For these reasons, there will be few circumstances where the treaty passport scheme is more advantageous than the QPP Exemption, but the passport scheme is retained in the LMA Subscription Agreement and LMA Facility Agreement in the interests of continuity.

Any lender/holder wishing to rely on the QPP Exemption will need to provide a certificate to the borrower confirming that the lender/holder is:

i. beneficially entitled to all interest payable under the private placement;

ii. resident in a qualifying territory (as defined in the relevant regulations; most jurisdictions that are not tax havens will be "qualifying territories"); and

iii. beneficially entitled to the interest on the security for genuine commercial reasons and not as part of a tax advantage scheme.

The provision of such a certificate is one of the statutory requirements for the QPP Exemption.

In addition to the conditions referred to above relating to the status of the lenders/holders, there are other conditions for the QPP Exemption to apply which relate to the terms of the loan/security itself and the nature of the borrower/issuer. In

broad terms the security/loan must, at the time it is entered into, be for a minimum amount of £10 million, and the term of the security/loan must not exceed 50 years[691].

691 User Guide to the Form of Pan-European Private Placement Documents – April 2016.

Summary - Analysis of Most Common Risk-Mitigation Clauses in Private Placement Transactions

The Schuldschein market does not have a standard form of documentation and no standard form precedent is expected in the near future. Euro PP documentation, on the other hand, is typically based on the standard form Euro PP model private placement agreements. These models constitute non-binding agreements, intended to be adapted as part of the Euro PP negotiations. The LMA and ACIC have also published standardised forms of private placement documentation. Each of the Euro PP, LMA and US PP forms of template documentation contain broadly similar risk mitigation provisions, the more boilerplate of which (e.g. the basic representations and warranties) will often be accepted in the template form. However, in any private placement transaction, whether a Schuldschein or based on the Euro PP, LMA or US PP forms, there will be certain provisions (particularly any financial covenants) that will be the result of negotiations between the parties, based on the profile of the issuer, the characteristics of the transaction and market conditions.

The key risks associated with private placement transactions may be categorised as credit risk, market risk, liquidity risk and regulatory and legal risk. Both Schuldschein and Euro PP documentation provide for a range of risk mitigation provisions in order to address such risks, although such contractual risk mitigation provisions primarily address credit risk and legal risk. Market risk is typically priced into the purchase price of the private placement security and liquidity risk is primarily determined by the type of instrument, whether and where is it listed / traded and any restrictions on its transferability. The most common contractual provisions aimed at mitigating the credit risk of the issuer of the private placement instrument include financial covenants, information covenants, negative pledge, events of default and change of control. The most common contractual provisions aimed at mitigating legal and regulatory risk include representations and warranties, conditions precedent (particularly legal opinions) and tax gross-up / tax call provisions.

Certain provisions, such as financial covenants, are typically so bespoke that such template forms merely include a placeholder allowing the parties to include their negotiated form. Often, the form of such provisions will mirror those in the issuer's other outstanding debt documentation. The incorporation of financial covenants has become more common in recent years as private placement transactions have become partly more structured. However, although financial covenants are an effective form of risk mitigation, their relevance in the private placement markets is ultimately limited given the typically investment grade nature of issuers.

Conclusion of the legal part

This study has identified the German Schuldschein market and the French Euro-PP market as the dominant private placement markets in the EU. Neither Germany nor France has a specific legal and regulatory framework established for private placements. Instead, the applicable legal and regulatory framework is the same as that which applies to other forms of debt financing, such as corporate bonds and syndicated loans.

The development of the Schuldschein market and Euro PP market, in particular, has been characterised by the identification of potential and actual obstacles, legal, regulatory or otherwise, at an early stage, with subsequent legal or regulatory adjustments or the development of best practices in order to address or mitigate such obstacles and facilitate the development of such markets. In both the Schuldschein and Euro PP markets, a number of best practices have developed which have helped underpin their success. In particular, in each of the Schuldschein and Euro PP markets, the role of the arranger is of central importance, both in terms of guiding the transaction and ensuring that market standards are maintained.

Market participants have indicated that they do not currently see significant regulatory obstacles to the continued development of these established private placement markets requiring immediate attention. Rather, in each of the Schuldschein and Euro PP markets, this study has identified a number of lesser issues, some of which have arisen as a result of such private placement markets operating within the same regulatory framework other forms of debt financing. In particular, amendments to national legislation could be considered to facilitate the restructuring process in such markets. In the most part, the risks affecting issuers of, and investors in, Schuldschein and Euro PP are comparable to those affecting issuers and investors in the corporate bond market.

Overall, the key message from Schuldschein and Euro PP market participants in response to this study's analysis of the legal and regulatory framework applicable to such markets is that they are generally content with the current legal and regulatory environment and have indicated that, to the extent possible, they would like to limit further regulatory changes affecting these markets.

Aside from the Schuldschein market in Germany and the Euro PP market in France, no other EU Member State has developed a national private placement market to a comparable extent. Italy, the Netherlands and Spain are identified as jurisdictions with the potential to grow a national private placement market based on their issuer and investor base and, to a certain extent, do already have a form of domestic private placement initiative. However, their fledgling private placement instruments are not technically a separate class of instrument in the manner of Schuldschein and Euro PP. Austria, Belgium, Denmark, Ireland, Poland and Sweden, together with certain other Eastern European states, are further identified as jurisdictions with insufficient national investment capacity or other constraints preventing the development of a domestic private placement market but with a significant number of domestic issuers that issue into non-domestic private placement markets or a significant potential to do so in the future.

As is the case for the Schuldschein market in Germany and the Euro PP market in France, none of the above-mentioned jurisdictions has a specific legal or regulatory framework in place for private placement instruments. While some jurisdictions, such as Italy and Spain, have made certain adjustments to encourage the growth of their respective private placement markets, the applicable legal and regulatory framework

for private placement instruments in such jurisdictions is largely the framework for bond issues by companies in such jurisdictions generally.

Overall, market participants do not see any significant regulatory obstacles specific to the development of the private placement markets in the identified jurisdictions or to cross-border transactions with the Schuldschein or Euro PP markets. In terms of the development of national private placement markets in such jurisdictions, the obstacles that are typically identified are rather those which also affect the bond markets as a whole, although such obstacles can comprise a bigger challenge for the small and medium size enterprises looking to tap such markets. In terms of cross-border transactions with the Schuldschein or Euro PP markets, the concerns relate more to reconciling the different national legal and regulatory systems as they apply to such instruments, for example the tax treatment of payments under such instruments as result of differing local tax regimes.

In determining which actions could be taken to strengthen the growth potential identified in this study, regard should be to the desire of market participants to limit, to the extent possible, further regulatory changes affecting their respective markets. In this light, the following actions could be considered:

i. ***Best Practices:*** The best practices which have contributed significantly to the success of the Schuldschein and Euro PP markets should be advocated in the developing PP markets. In particular, the key role played by the arranger both in terms of bringing a proposed transaction to a potential issuer and in guiding the transaction and ensuring that market standards are maintained, cannot be underestimated.

ii. ***Clarification of PP's place in the EU regulatory framework:*** The application of certain EU regulations to PP transactions should be clarified where there is currently uncertainty (for example, the application of the MAR market soundings regime to Euro PP) or where such application creates an unfair playing field (for example, the calibrations for capital charges under Solvency II).

iii. ***Adjustment of restrictive local laws:*** In both the developed Schuldschein and Euro PP markets, and the new markets developing in Italy, Spain and the Netherlands, national laws have been adjusted to a certain extent to facilitate the issuance of, and investment in, private placement instruments. In order to continue and extend that development, certain restrictive provisions of local law applicable to the local debt markets in general should be analysed and potentially revised in light of the specifics of the relevant private placement market, particularly taking into account the nature of the potential issuers (i.e. size, credit quality, etc.), the target investor audience (i.e. number of investors, sophistication, etc.) and the often bilateral nature of private placement instruments (i.e. no public offer, negotiated transactions, etc.).

iv. ***Creation of pro-PP regulatory provisions:*** Local jurisdictions should also be encouraged to further augment their current legal environments by creating private placement specific provisions aimed at facilitating national and cross-border issuance of private placement instruments and encouraging investment in private placement instruments as an asset class (e.g. by clarifying the tax treatment of payments under private placement instruments in line the UK's QPP Exemption).

Conclusion

From an economic perspective, private placement of debt has considerable potential as it complements traditional funding instruments and offers specific advantages to the different stakeholders, namely issuers, investors and arrangers. Most notably, private placements allow medium-sized firms to access new funding opportunities and diversify their investor portfolio, and investors to diversify their investment portfolio to unrated, private firms while earning an attractive return. More generally, private placements are just one more important pillar of funding in the debt portfolio of an issuer.

In addition, the growth of alternative funding and investment instruments supports the European Commission's goal to reduce reliance on bank funding and thereby increase financial stability.

This study demonstrates that the two existing domestic markets in the EU, the German SSD and the French Euro-PP market, are generally well functioning and are expected to grow further. Moreover, no significant regulatory obstacles that prevent further growth of private placements in the EU have been identified. Market participants and industry experts do not see an immediate need for regulatory or legislative actions.

Notwithstanding, the study demonstrates that legislative action at a national level can facilitate the development of private placement markets, as has been the case in France and Italy for example. In addition and most importantly, there are strong incentives for the EU to support the development of private placements markets at an EU level. In addition to the promotion of best practices from existing markets, the following actions are proposed:

- First, **information campaigns** should be launched to increase the awareness of private placements among potential issuers (and also investors) and support further market participation across the EU. Furthermore, the EU should promote the understanding of rules and documentation to overcome possible reservations about entering the market. To address the lack of expertise on the investor side in potential growth markets, the EU should also foster education about the market and instruments.
- Second, the EU should **facilitate communication** between institutions of different member states to ensure the exchange of experience and best practices.
- Third, further promotion of **standardisation should be encouraged** by the EU and member states. In particular, the further use of standardised documentation should be promoted and the development of standardised processes should be supported.
- Fourth, the EU should consider the course of action in the US market and evaluate cost and benefits from providing **an independent, third-party opinion on the credit quality** of private placement issuers.
- Fifth, the EU should seek to **clarify the application of the EU regulatory framework** to European private placements and encourage efforts at a national level to **adjust the application of the regulatory framework to private placements** by further relaxing overly restrictive laws and creating private placement specific provisions aimed at facilitating the issuance of, and investment in, private placement instruments.

Appendix

Data sources economic part

General remarks on data sources

In general, data availability of private placement markets is not comparable to public markets. Being a private market, every data provider highly depends on the cooperation of market participants, particularly banks involved in private placement transactions. Moreover, data providers may use different definitions of private placements (see also pp.10f).

Given the high dependency on market participants on potentially differing definitions of private placement transactions, not every data provider is suitable to cover every market. As elaborated below, this study has therefore selected different databases for the three private placement markets in focus:

i. German SSD market: Thomson Reuter's LoanConnector

ii. French Euro-PP market: Dealogic

iii. US PP market: Thomson One

For the analysis of the issuer landscape in the different markets, the following data was extracted from Orbis and Capital IQ:

- Revenue (latest year available)
- Rating (S&P's current rating)
- Listing

The classification of companies into industry sectors is based on BCG's practice area logic:

- Consumer Products
- Energy
- Financial Institutions (excluded)
- Government (excluded)
- Health Care
- Industrial Goods
- Insurance
- Services
- Technology, Media & Telecommunication
- Other (Real Estate and Holding companies)

SSD market

Data provided by Thomson Reuter's LoanConnector

Thomson Reuter's LoanConnector covers Schuldscheindarlehen (i.e., loans) most extensively, as most other databases only cover bonds. The database comprises data from the 1980s on, but data availability has significantly improved since the 1990s, reaching a good coverage from 2000 on.

LoanConnector collects data directly from banks but also receives league table submissions that list all of these deals. It also sources annual reports and submissions from law firms to include any deals that may have not been submitted by the banks. Furthermore, LoanConnector has a secondary pricing team that seeks further insights and includes a team of journalists that reviews press releases, media articles and the like.

Data used in this study

In line with the definition of private placements used by this study (see pp.10f) and to focus on the corporate SSD market, further transactions were excluded:

- Issuances by German utility companies with a governmental entity as majority stakeholder;
- Issuances by financial services firms (mostly banks);[692]
- Issuances by public sector institutions;[693]
- Issuances by German transportation firms with a governmental entity as majority stakeholder;

Issuances by German real estate firms with a governmental entity as majority stakeholder.

Euro-PP market

Data provided by Dealogic

Dealogic has covered the Euro-PP market since 2014, after being approached by the Euro-PP working group.[694] The initial coverage included mostly data provided by several banks that were active in the market but in recent years, the coverage was extended to include more data. By December 2015, the response rate of banks active in the market was over 70%.[695]

The Dealogic definition of private placements follows ICMA's definition that is used by this study. [696] Dealogic's coverage of French Euro-PP market includes both Euro-PPs in the form of bonds and in the form of loans; however, it classifies transactions completed with loan documentation as bonds in their DCM database to distinguish it

[692] 52 deals recorded between 2000 and 2016
[693] 62 deals recorded between 2000 and 2016
[694] (Dealogic 2016)
[695] (Dealogic 2016). Due to internal compliance guidelines with regards to the sharing of data, some large banks are still not covered
[696] (Dealogic 2016)

from its loan database, which makes it unfeasible to distinguish between Euro-PP bonds or loans in the analysis.

The following transactions are excluded in the Dealogic PP database:

iv. Deals that are issued under a MTN programme;

v. Deals that include a book-building process as it may contradict the private negotiation aspect in the PP definition of ICMA;

vi. Project finance deals;

vii. Deals issued by government entities or banks.

Dealogic frequently reviews these exceptions by sending out questionnaires to its main participant banks to assess and re-evaluate basic guidelines concerning the coverage and definition of Euro-PPs. For more information on Dealogic's market coverage guidelines, please refer to the "European Private Placement Market – Guidelines Consultation" of January 2016.[697]

Data used in this study

In line with the definition of private placements used by this study (see pp.10f) and to focus on the corporate Euro-PP market, further transactions were excluded:

- Issuances by investment/asset management firms as well as financial services firms;
- Issuances by public sector institutions;[698]
- Issuances by schools and universities.

US PP market

Data provided by Thomson One

Thomson One is considered to be one of the most comprehensive databases for the US PP market. It comprises data from the 1990s on and has a good coverage of the market from 2000 onwards. Nevertheless, as Thomson and Reuters only merged in 2007, their respective databases included data from different sources. Since the full completion of the merger in 2014 there has been one unified database with improved data quality.

Thomson One's underlying data is based on direct submissions from banks that submit the key deal terms via e-mail, usually on a headed term sheet (submitted after the settlement date as opposed to the pricing date).

Data used in this study

In line with the definition of private placements used by this study (see pp.10f) and to focus on the corporate US PP market, further transactions were excluded:

- Issuances by educational service companies, such as colleges or universities;

[697] (Dealogic 2016)
[698] Only one deal in 2015

- Issuances by German utility companies with a governmental entity as majority stakeholder;
- Issuances by financial services firms *(*asset management and investment firms, banks, brokerage firms and others);[699]
- Issuances by public sector institutions.[700]

Additional information for the economic part

Additional information for Section I. Stock-taking

Survey with market participants[701]

In order to enrich the quantitative data with qualitative expert assessments, a survey was conducted among 52 interview partners. Out of these 52 interview partners, 16 interviewees completed the survey section.[702] Please note that the results represent the opinions of the experts interviewed.

[699] 820 deals between 2000 and 2016
[700] 32 deals between 2000 and 2016
[701] (BCG interviews 2017); (BCG analysis 2017)
[702] Results do not meet statistical significance

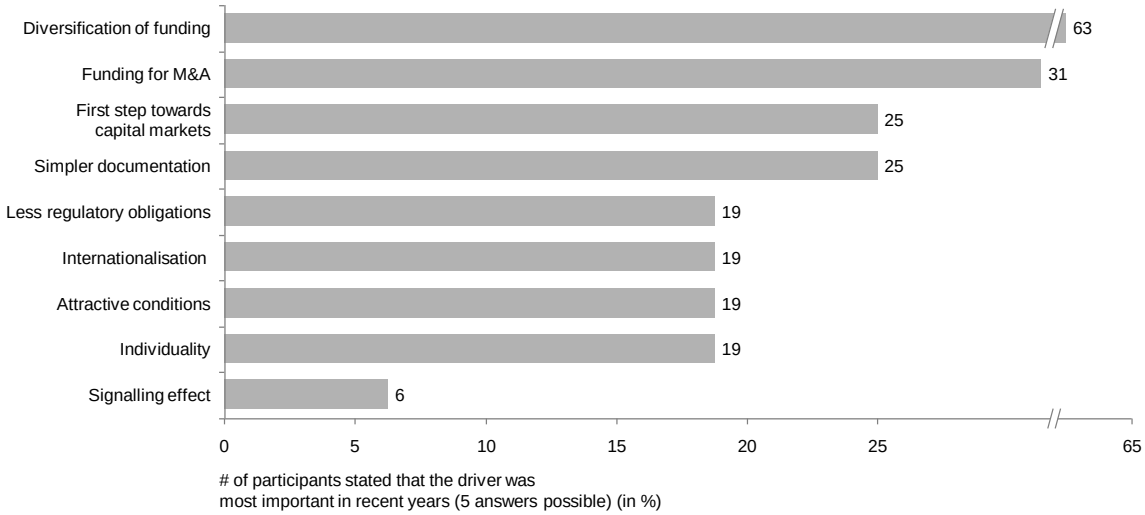

Figure 63: In your opinion, which factors were most important in driving growth of private placement markets in recent years (from an issuer's side)?

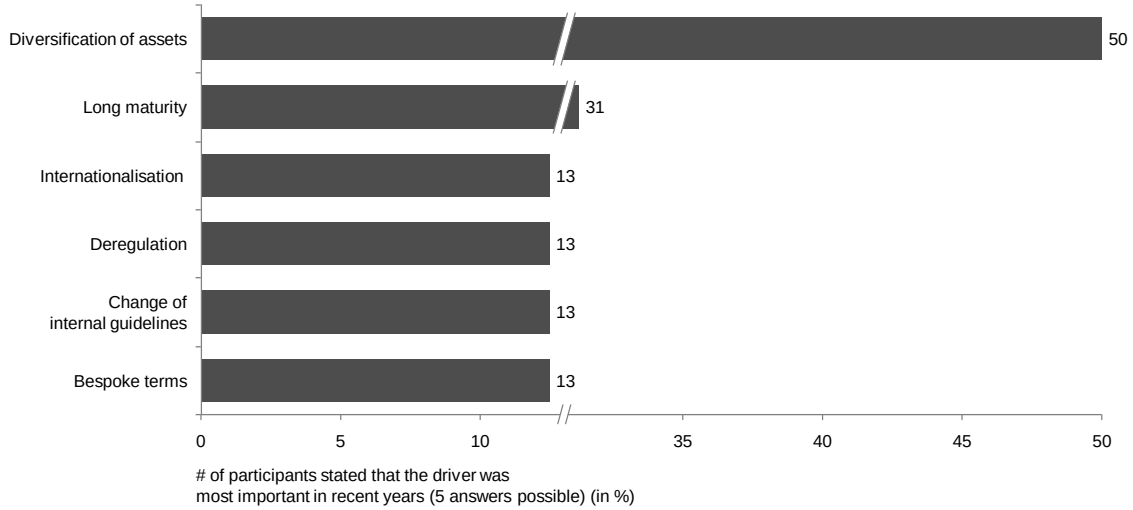

Figure 64: In your opinion, which factors were most important in driving growth of private placement markets in recent years (from an investor's side)?

From an issuer perspective, diversification of funding is considered to be as the driving factor for growth in recent years, followed by M&A activity (Figure 63). From an investor perspective, diversification of assets is considered to be the driving factor, followed by longer maturities (Figure 64).

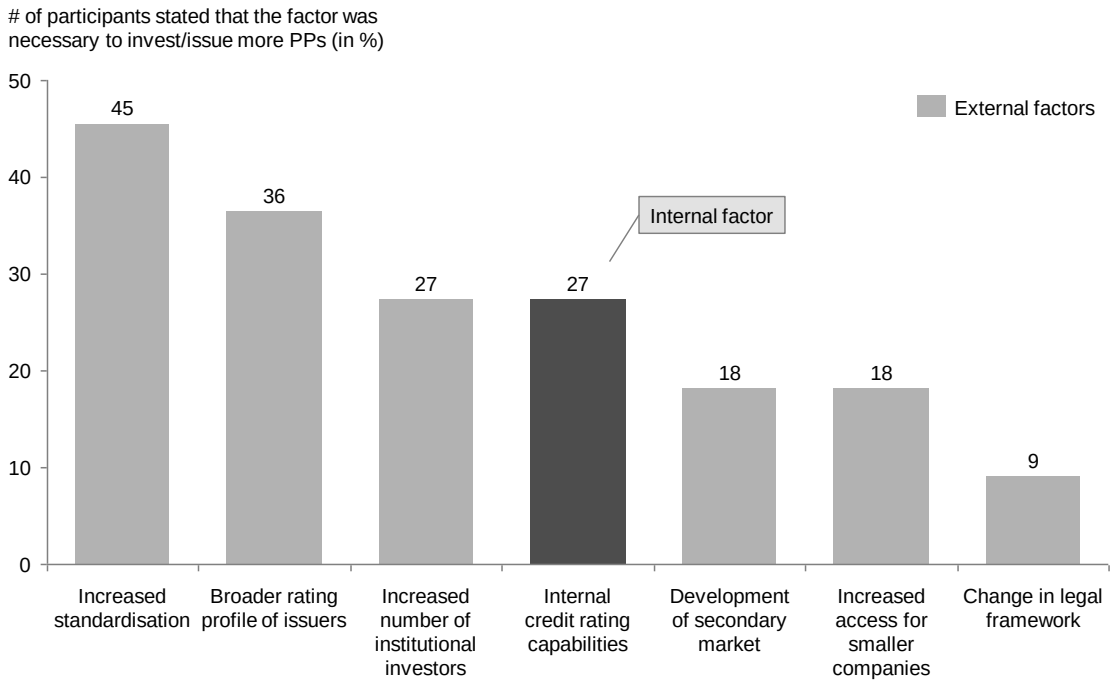

Figure 65: What would be necessary for you to push for more PPs?

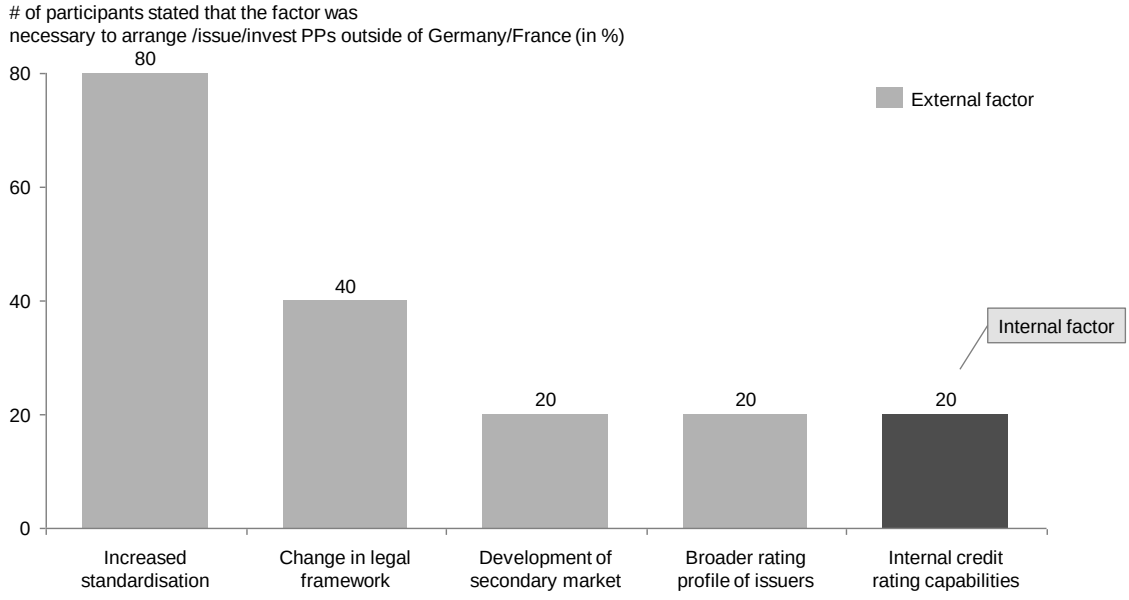

Figure 66: What would be necessary to promote PPs outside of Germany/France?

Increased standardisation is named most often as a necessary requirement to increase private placement activity for both existing PP markets in Germany and France (Figure 65) as well as for "newer" PP markets outside of Germany and France (Figure 66).

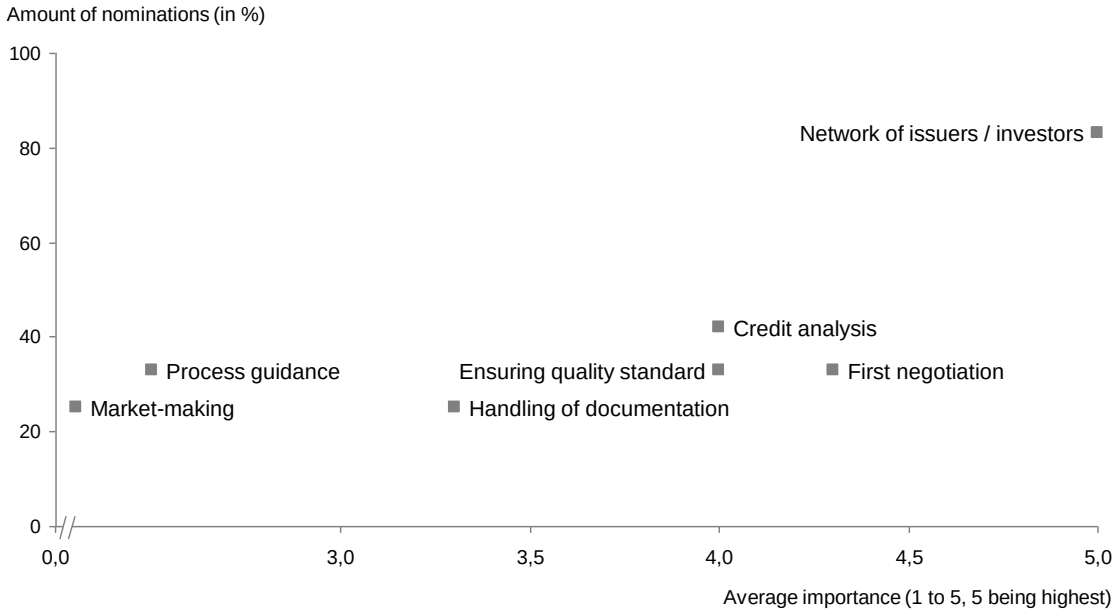

Figure 67: In your opinion, what makes a good arranger?

The most relevant characteristics of a successful arranger are considered to be an extensive network of issuers and investors, a good skill set for the credit analysis, assistance in negotiations and ensuring a certain quality standard in the market (Figure 67).

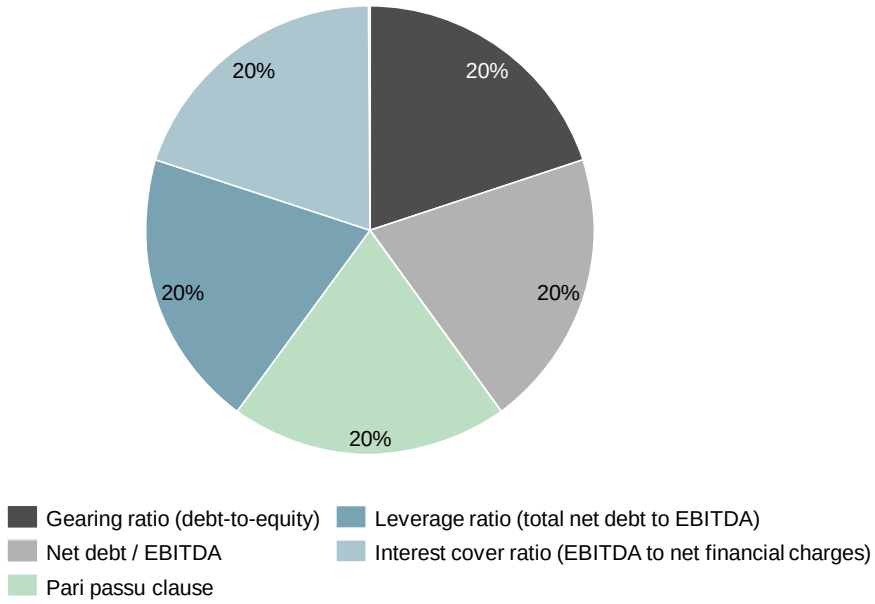

Figure 68: Which financial covenants are typically used in a PP transaction?

With regards to the use of financial covenants, the even split of 20% per covenant suggests that they are all considered to be a relevant part of a typical covenant package (Figure 68).

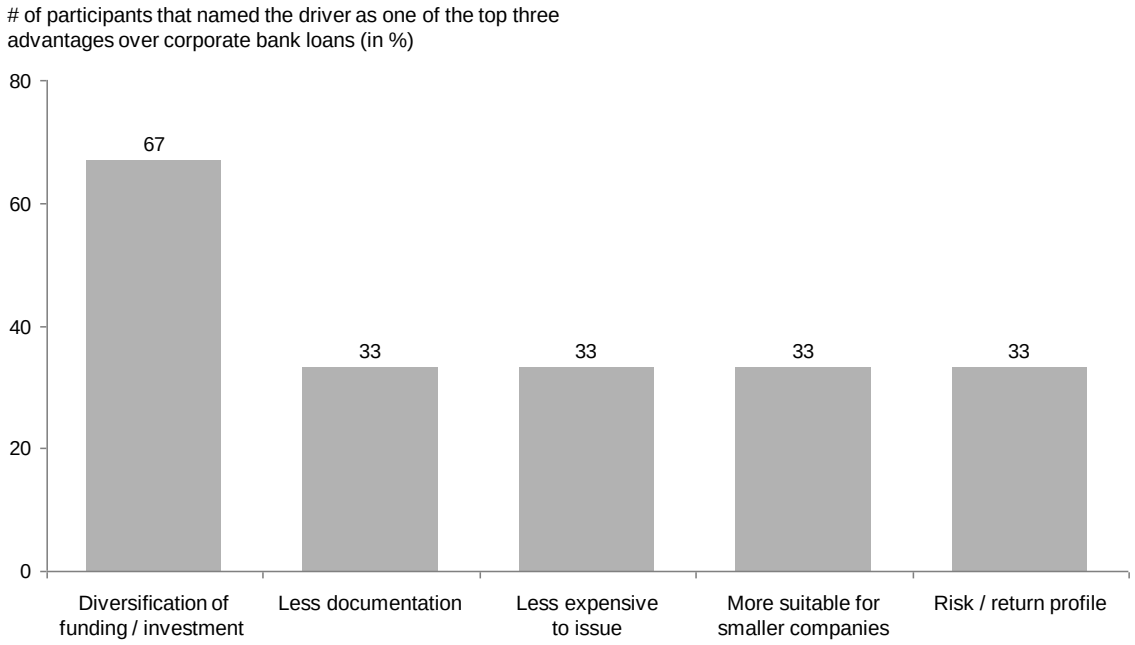

Figure 69: What are the three main advantages of private placement products over corporate bank loans?

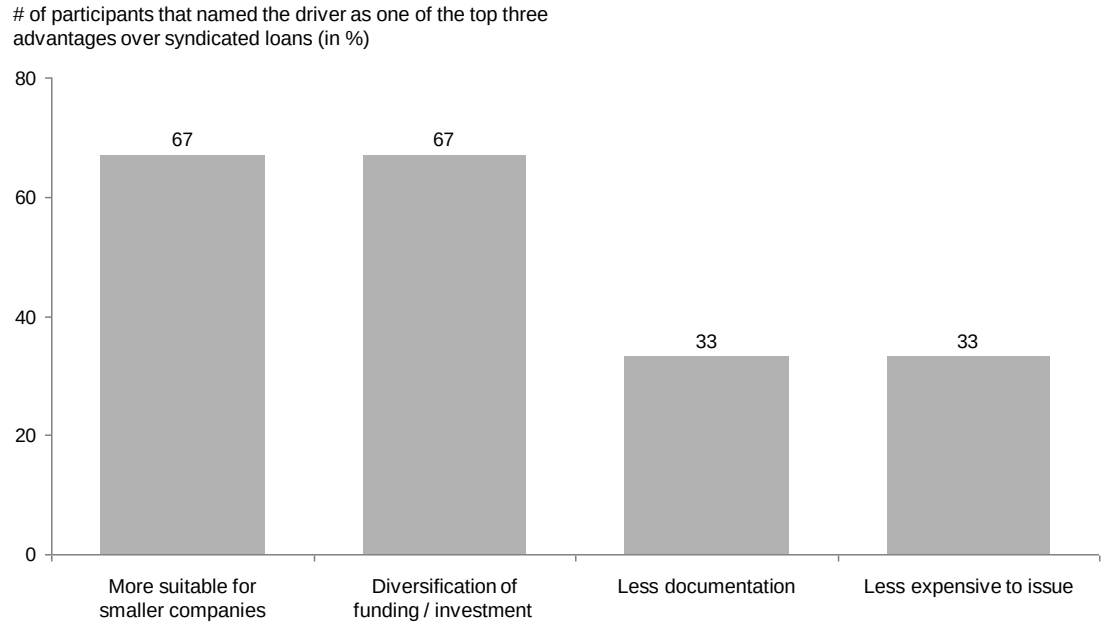

Figure 70: What are the three main advantages of private placement products over syndicated loans?

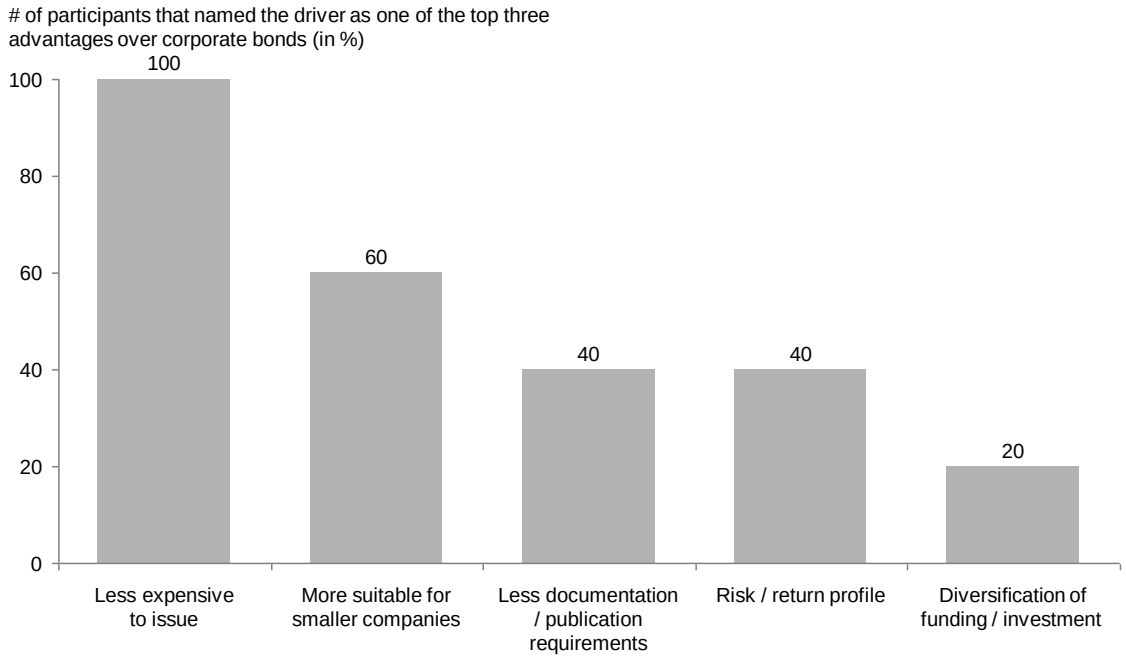

Figure 71: What are the three main advantages of private placement products over corporate bonds?

Comparing private placement products with other debt financings instruments (Figure 69, Figure 70, Figure 71), survey participants named the lower issuance price of private placements to be a key advantage. Furthermore, lean documentation is another key advantage mentioned by many interviewees.

Outstanding debt in European private placement markets

As part of the analysis on the development of European private placement markets, the study also estimates the development of outstanding debt for corporate private placements in the respective markets. The model assumes bullet repayment at maturity date and uses the same data as in the main part of the study (see pp.217ff).

The calculations yield a total amount of €72B[703] outstanding debt for the corporate SSD and €22B[704] for the Euro-PP by the end of 2016. The value for the corporate SSD is close to similar calculations by UniCredit, which estimates the amount of outstanding debt to €74.5B.[705] Other sources estimate different volumes.[706]

[703] (BCG analysis based on LoanConnector 2017)
[704] (BCG analysis based on Dealogic 2017)
[705] (UniCredit 2016)
[706] (CAPMARCON 2017) estimates the volume of outstanding debt to €85M uses a different data set, for instance also including issuances by public utility. See *Data sources* (pp.211ff) for more details.

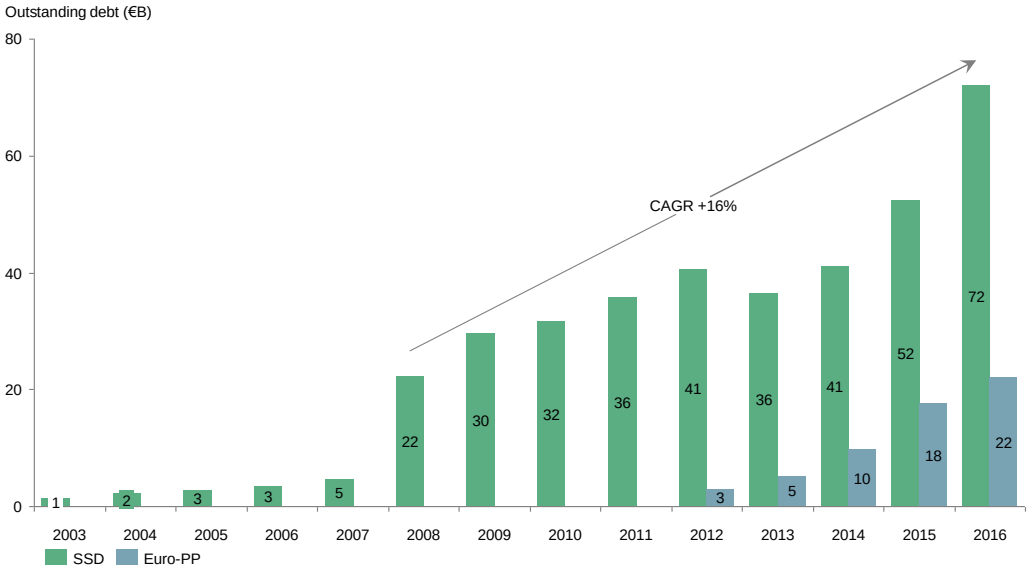

Figure 72: Development of outstanding debt for SSD and Euro-PP markets[707]

Additional figures

SSD-market

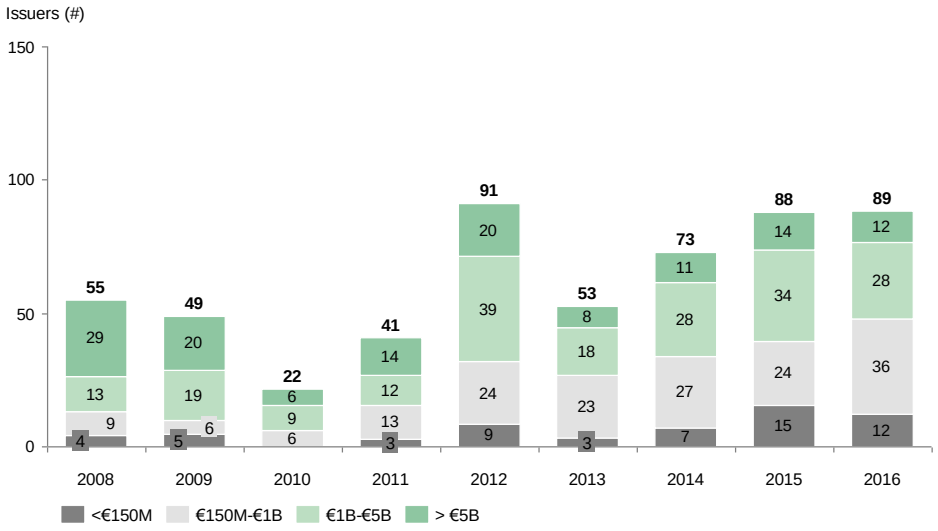

Figure 73: Revenue split of issuers in the SSD market[708]

[707] (BCG analysis based on LoanConnector 2017); (BCG analysis based on Dealogic 2017)
[708] (BCG analysis based on LoanConnector 2017); (BCG analysis based on Orbis 2017); (BCG analysis based on Capital IQ 2017)

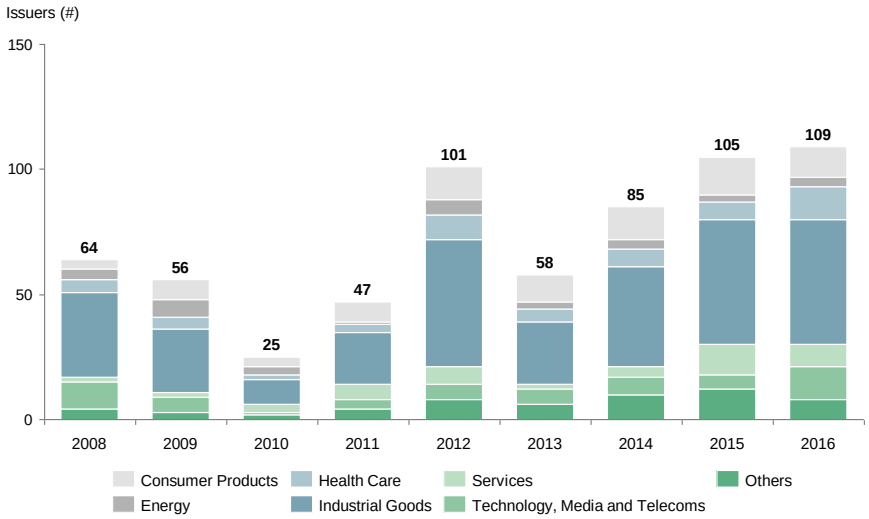

Figure 74: Sector split of issuers in the SSD market[709]

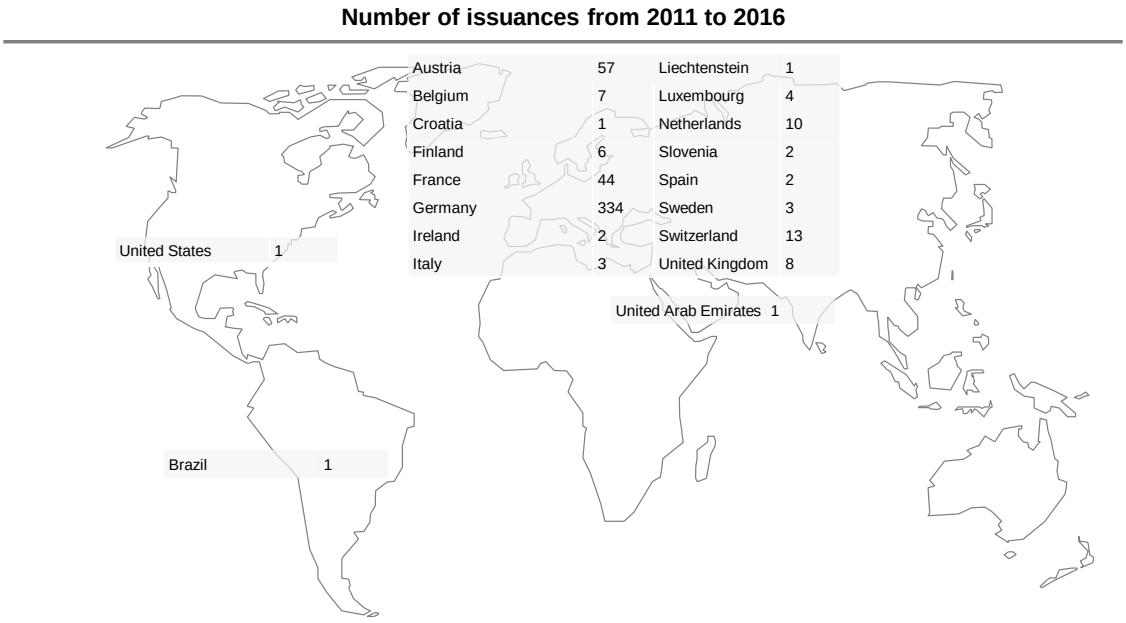

Figure 75: Regional split of issuers in the SSD market[710]

[709] (BCG analysis based on LoanConnector 2017); (BCG analysis based on Orbis 2017); (BCG analysis based on Capital IQ 2017)
[710] (BCG analysis based on LoanConnector 2017)

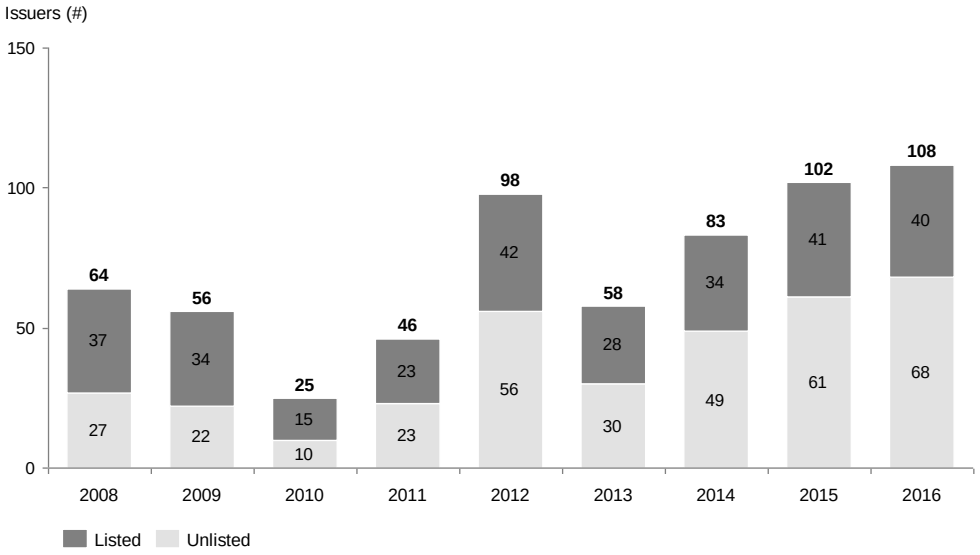

Figure 76: Share of listed and unlisted issuers in the SSD market[711]

Euro-PP market

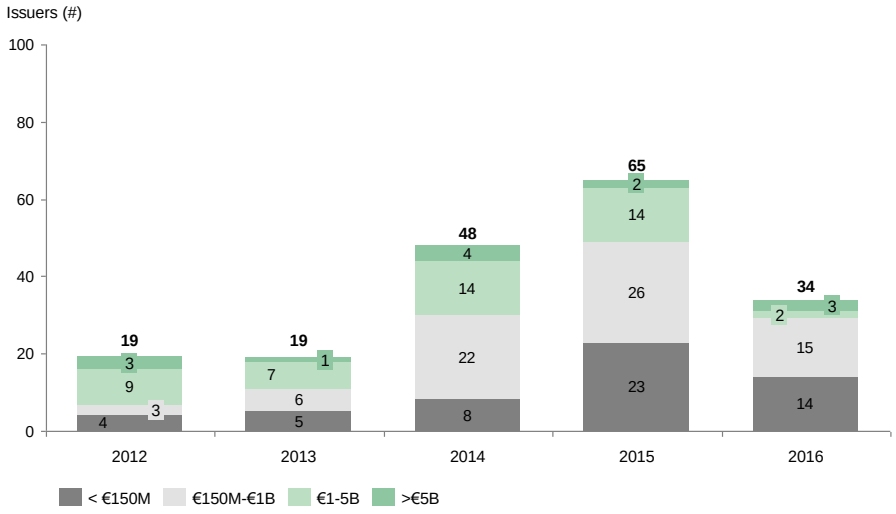

Figure 77: Revenue split of issuers in the Euro-PP market[712]

[711] (BCG analysis based on LoanConnector 2017); (BCG analysis based on Orbis 2017); (BCG analysis based on Capital IQ 2017)
[712] (BCG analysis based on Dealogic 2017); (BCG analysis based on Orbis 2017); (BCG analysis based on Capital IQ 2017)

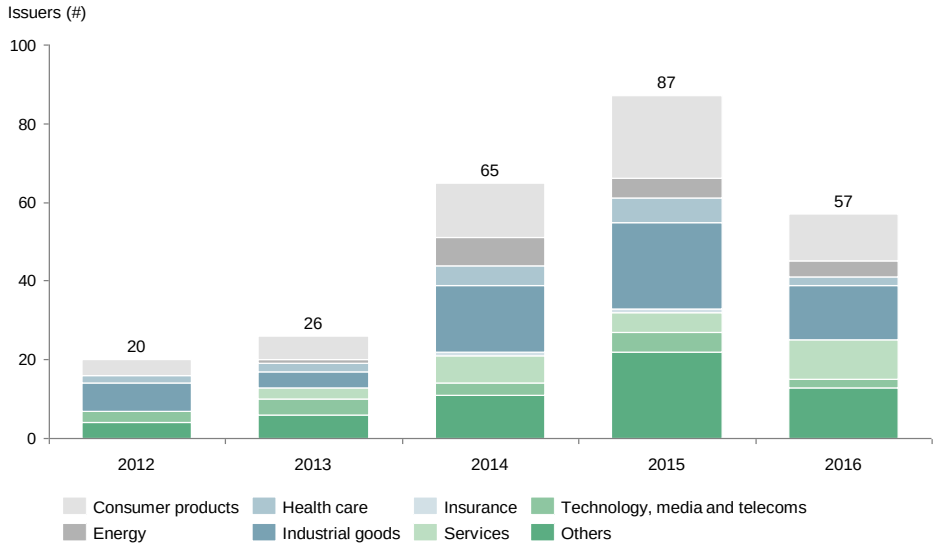

Figure 78: Sector split of issuers in the Euro-PP market[713]

Figure 79: Regional split of issuers in the Euro-PP market[714]

[713] (BCG analysis based on Dealogic 2017); (BCG analysis based on Orbis 2017); (BCG analysis based on Capital IQ 2017)
[714] (BCG analysis based on Dealogic 2017)

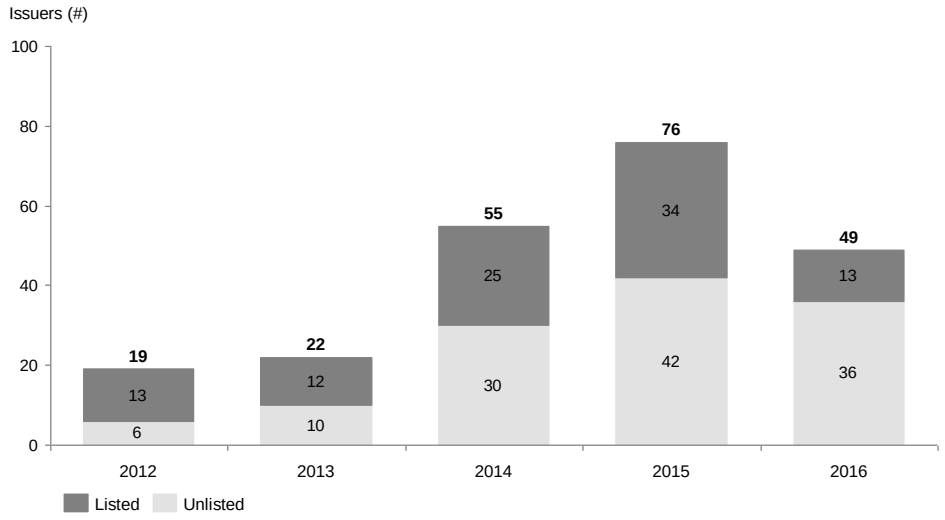

Figure 80: Share of listed and unlisted issuers in the Euro-PP market[715]

US PP market

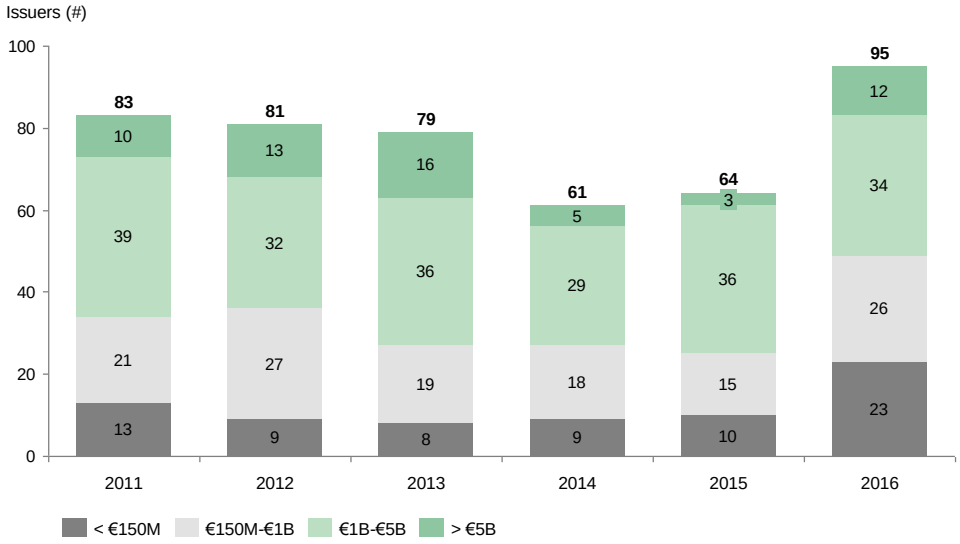

Figure 81: Revenue split of issuers in the US PP market[716]

[715] (BCG analysis based on Dealogic 2017); (BCG analysis based on Orbis 2017); (BCG analysis based on Capital IQ 2017)
[716] (BCG analysis based on Thomson One 2017); (BCG analysis based on Orbis 2017); (BCG analysis based on Capital IQ 2017)

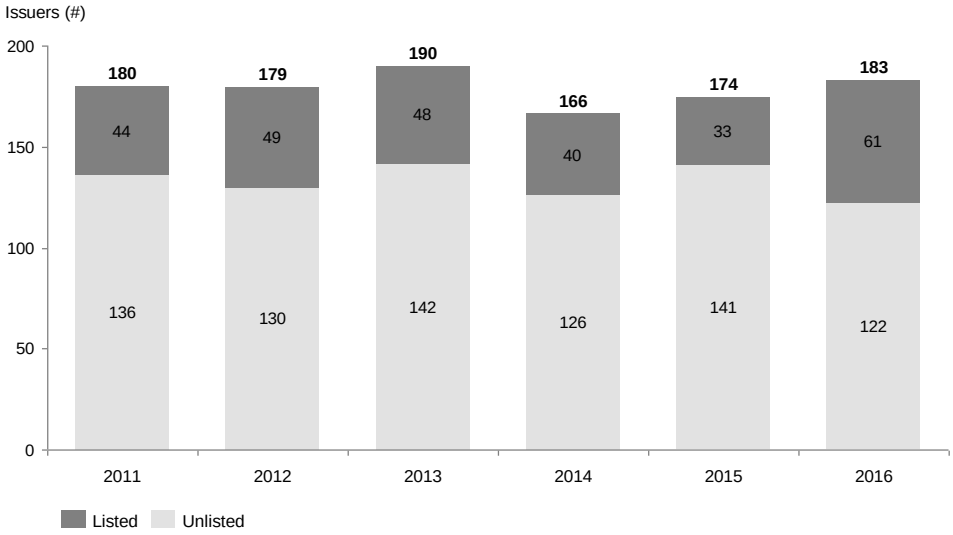

Figure 82: Share of listed and unlisted issuers in the US PP market[717]

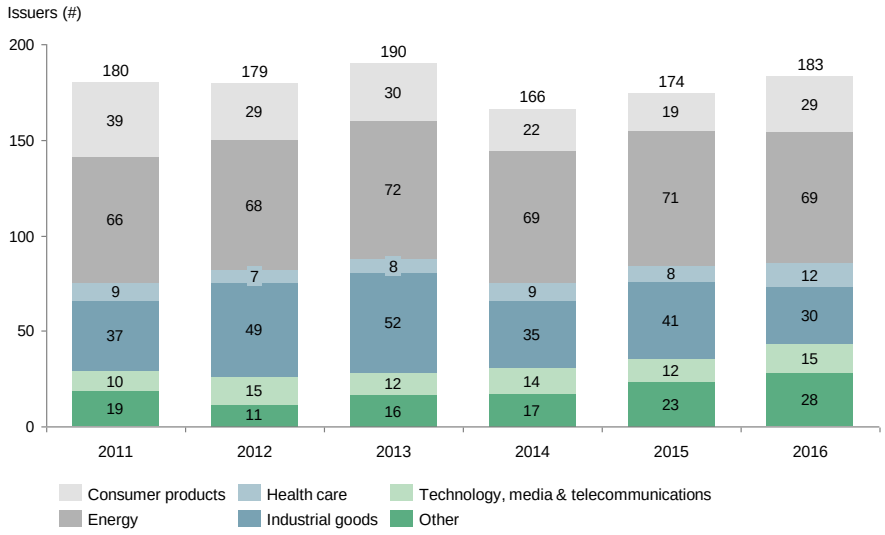

Figure 83: Sector split of issuers in the US PP market[718]

[717] (BCG analysis based on Thomson One 2017); (BCG analysis based on Orbis 2017); (BCG analysis based on Capital IQ 2017)
[718] (BCG analysis based on Thomson One 2017); (BCG analysis based on Orbis 2017); (BCG analysis based on Capital IQ 2017)

Issuer landscape – deep-dives SSD and Euro-PP market[719]

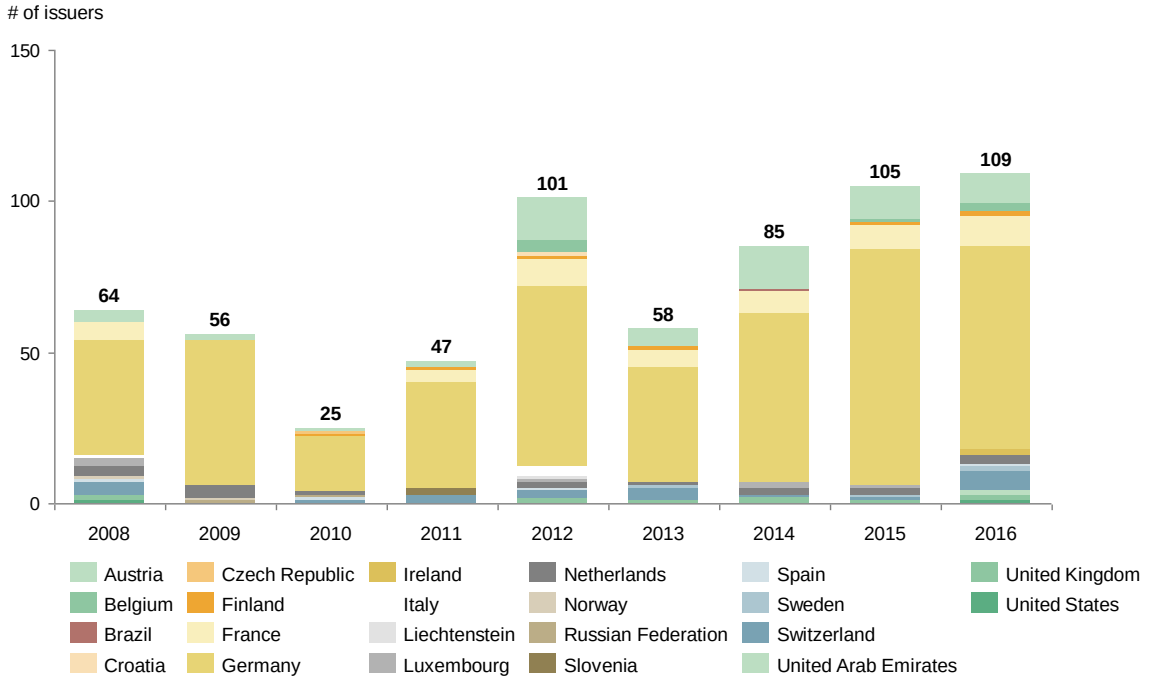

Figure 84: Issuers per year in the SSD market - nationality split on a country basis

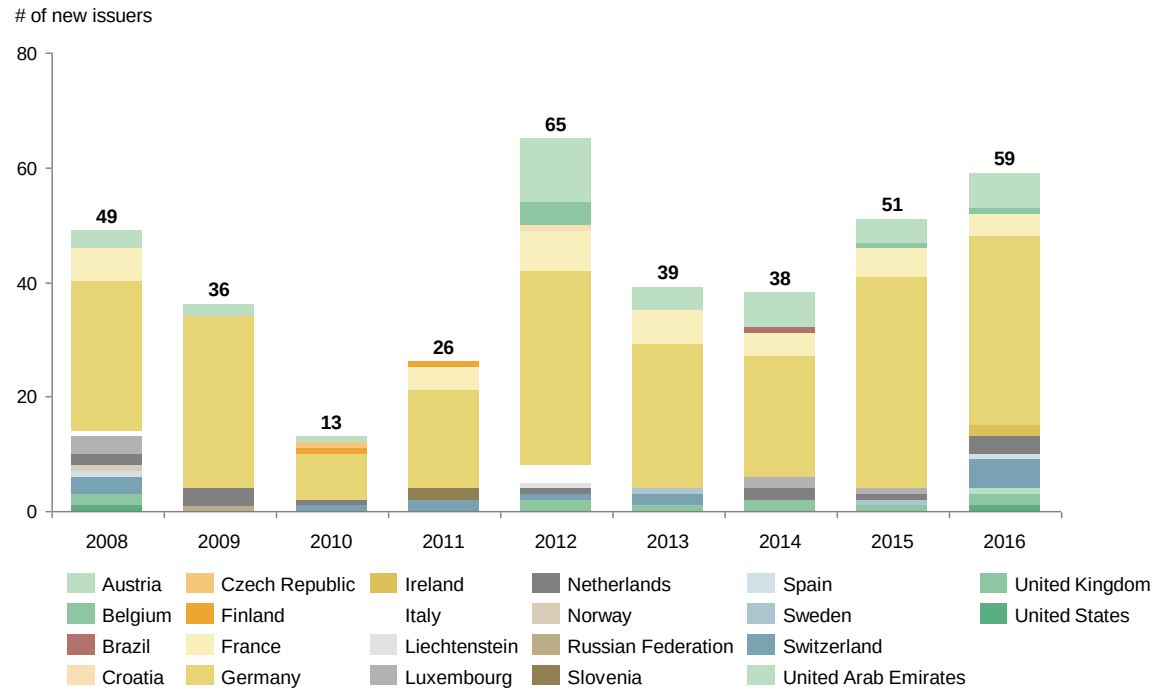

Figure 85: New issuers per year in the SSD market - nationality split on a country basis

[719] (BCG analysis based on LoanConnector 2017); (BCG analysis based on Dealogic 2017); (BCG analysis based on Thomson One 2017)

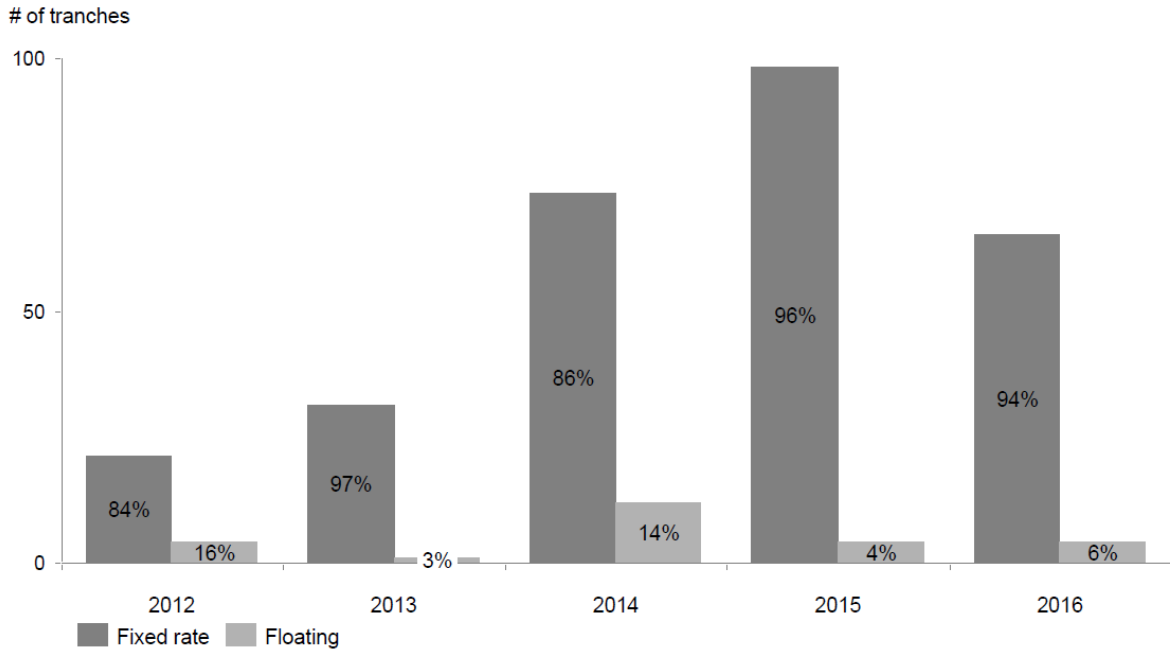

Figure 86: Details on base rate for Euro-PP deal tranches

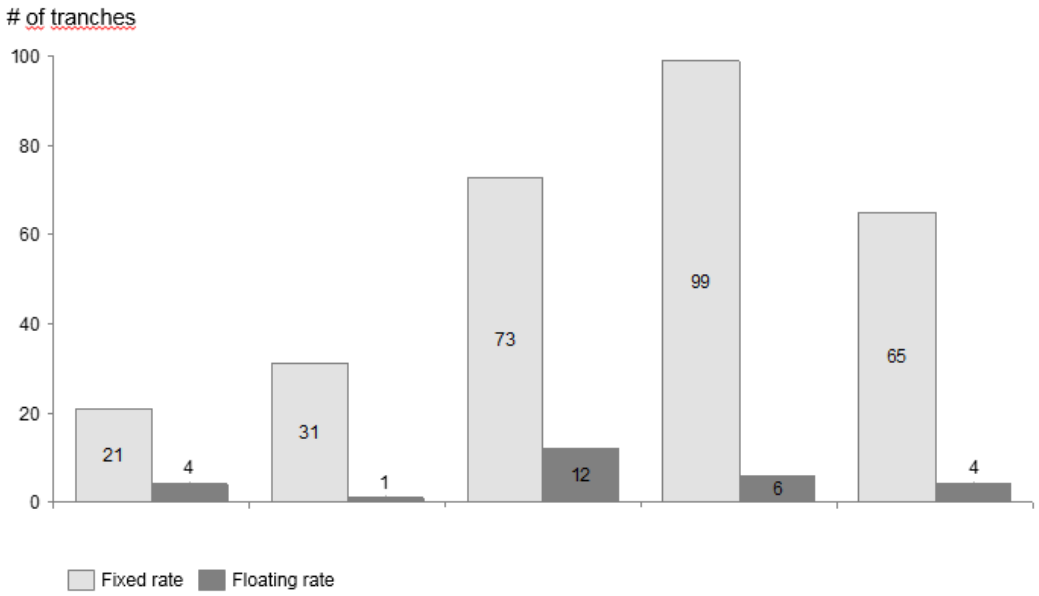

Figure 87: Details on base rate for Euro-PP deal tranches

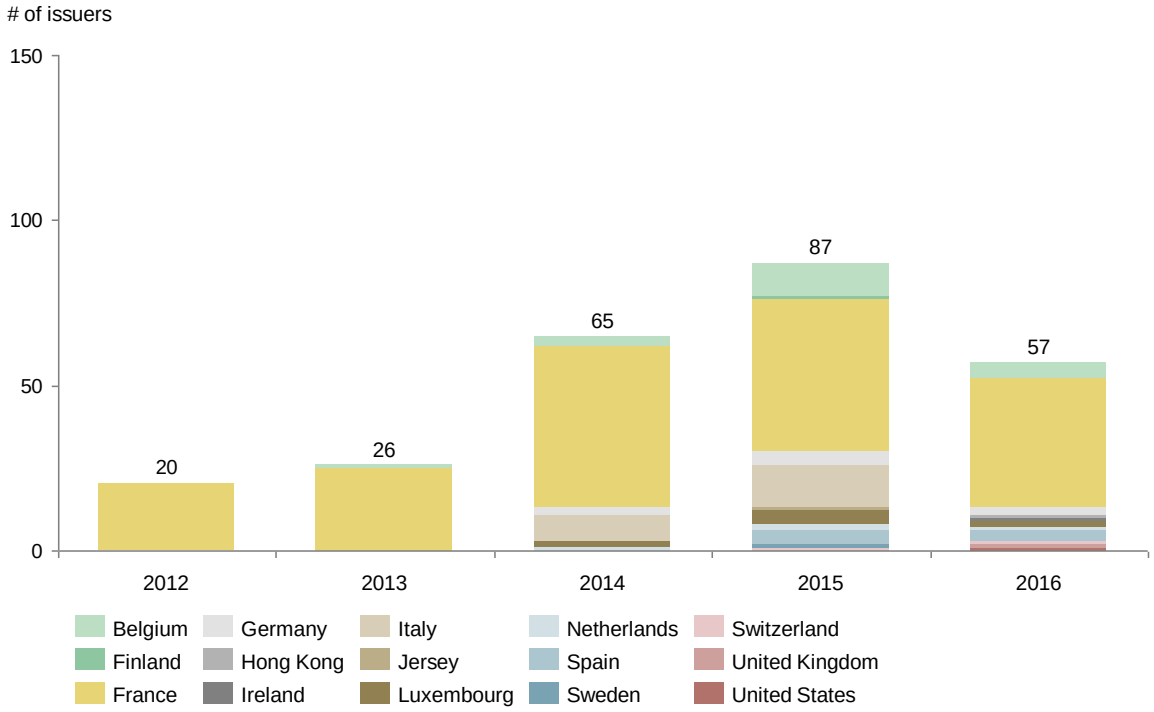

Figure 88: Issuers per year in the Euro-PP market - nationality split on a country basis

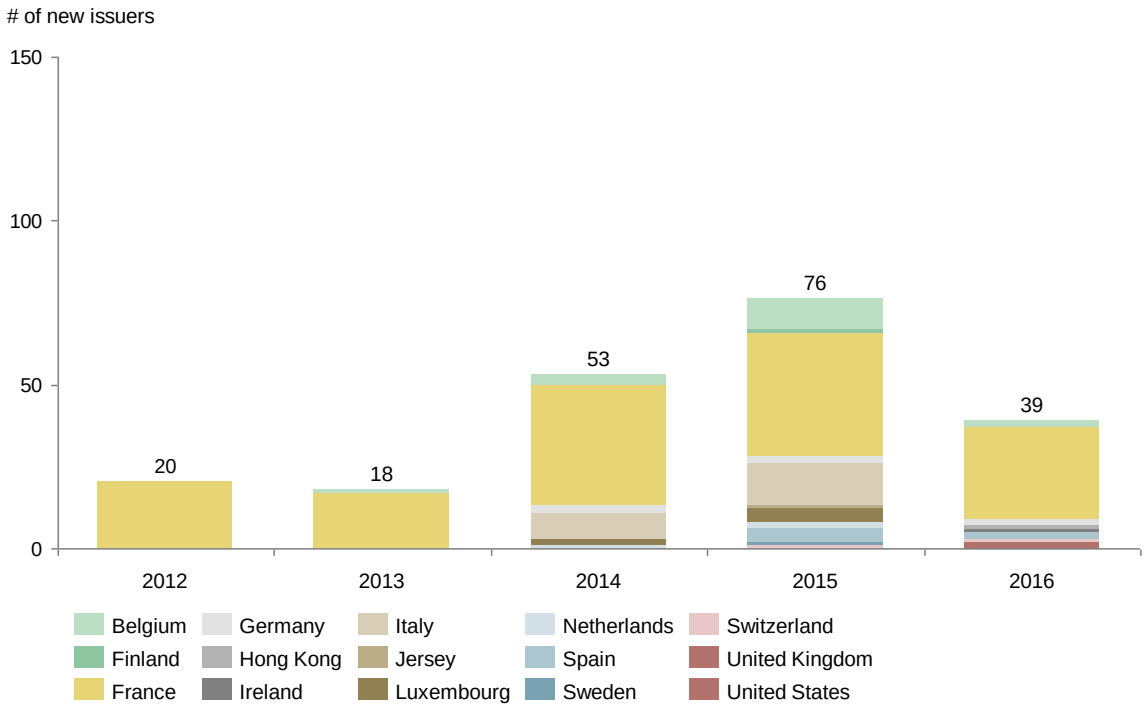

Figure 89: New issuers per year in the Euro-PP market - nationality split on a country basis

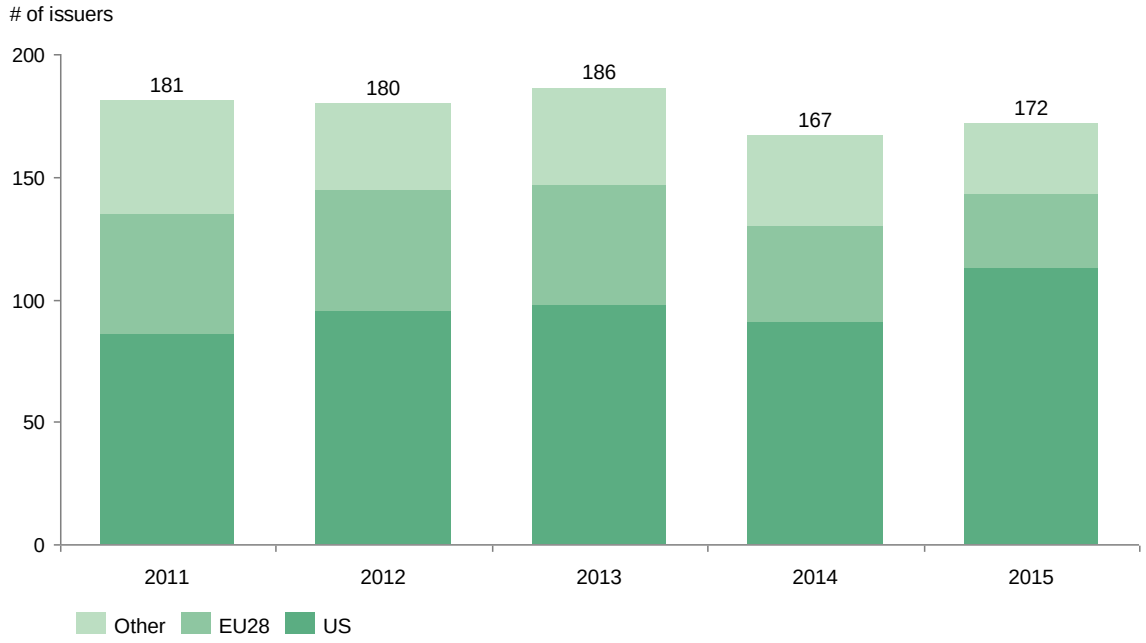

Figure 90: Issuers per year in the US PP market - nationality split on a country basis

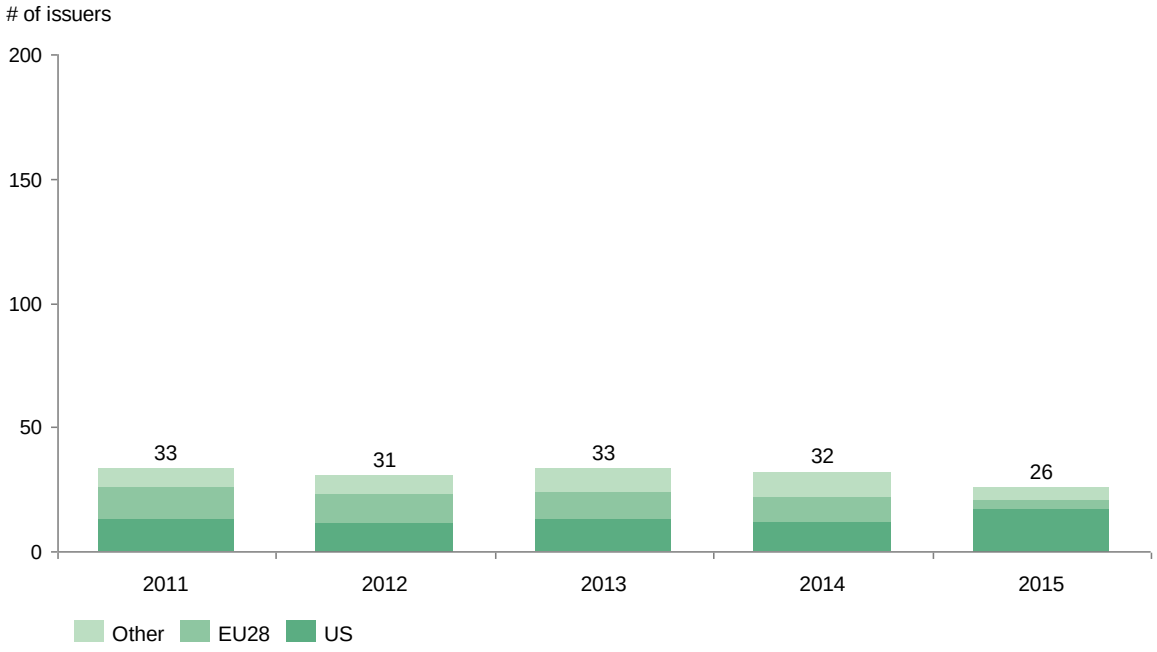

Figure 91: New issuers per year in the US PP market - nationality split on a country basis

Company profiles – examples from the SSD market

This subsection lists several examples for SSD issuances. Details of the deal are given and key financial ratios of the issuer are provided. Due to data availability and consistency, key financial ratios are shown for 2015.

Logo of company

axel springer

Key features of company

- **Company name:** Axel Springer SE
- **Sector:** Media / TMT
- **Headquarter:** Berlin, Germany
- **Rating:** n.a.
- **Listing:** DAX

Short description: Axel Springer is one of the largest publishing houses in Europe with media brands such as *Bild* or *Die Welt*. It is mostly focused on the German market.

Key financial ratios 2015

Revenue: €3.3B	**Debt-to-equity ratio**: 1.6x
EBITDA: €560M	**Total assets/EBITDA**: 11.6x
Operating profit: €450M	**Net debt/EBITDA**: 3.1x
EBITDA/Interest: 14.8x	**Total assets**: €6.5B

SSD details

Axel Springer issued a €500M SSD in 2012
Schuldscheindarlehen

- Volume: €500M
- Maturity: 4-6-year tenor
- Coupon: floating Euribor +100bps
  fixed 238-306bps
- Listing: unlisted
- Arranger: Commerzbank as lead, Helaba and UniCredit as support

The Schuldscheindarlehen was used for corporate refinancing purposes. After initially aiming for €300M, the overwhelming demand of investors increased the principal amount to €500M. The spread of both the floating and fixed rate tranches were at the low end of the spectrum. Axel Springer used the Schuldscheindarlehen as a mean to diversify funding.

Source: Axel Springer Annual Report (2015), Loan Connector (2017), FDP Financial Dataportal (2017), Aktienjournal (2017)

Figure 92: Large SSD issuance in 2012

Logo of company

FRESENIUS

Key features of company

- **Company name:** Fresenius AG
- **Sector:** Pharmaceutical
- **Headquarter:** Bad Homburg, Germany
- **Rating:** BBB-
- **Listing:** DAX

Short description: Fresenius is a global healthcare group offering high-quality products and services for dialysis, hospitals, and outpatient treatment.

Key financial ratios 2015

Revenue: €27.6B	**Debt-to-equity ratio**: 1.3x
EBITDA: €5.0B	**Total assets/EBITDA**: 8.6x
Operating profit: €3.9B	**Net debt/EBITDA**: 4.5x
EBITDA/Interest: 5.8x	**Total assets**: €43.2B

SSD details

Fresenius issued a €500M SSD in 2014
Schuldscheindarlehen

- Volume: €500M
- Maturity: 4-6-year tenor
- Coupon: fixed rate 209-267bps
- Listing: unlisted
- Arranger: BayernLB, Helaba, DZ Bank, Raiffeisen Bank International

The Schuldscheindarlehen was used to finance the acquisition of Rhön-Klinikum. After originally issuing €375M, the overwhelming investor demand allowed Fresenius to issue another €125M tranche. The Schuldscheindarlehen was structured as a convertible. Fresenius secured call options on its own shares to prevent any share dilution at maturity.

Source: Fresenius Annual Report (2015), Loan Connector (2017), FDP Financial Dataportal (2017), Börsen-Zeitung (2017)

Figure 93: Large SSD issuance in 2014

Logo of company

Key features of company

- **Company name:** Lufthansa AG
- **Sector:** Aviation
- **Headquarter:** Cologne, Germany
- **Rating:** BBB-
- **Listing:** DAX

Short description: Lufthansa is the largest German airline and, including its subsidiaries, it is also the largest airline in Europe in terms of fleet size.

Key financial ratios 2015

Revenue: €32.0B	**Debt-to-equity ratio**: 4.6x
EBITDA: €3.0B	**Total assets/EBITDA**: 10.8x
Operating profit: €1.5B	**Net debt/EBITDA**: 3.3x
EBITDA/Interest: 17.2x	**Total assets**: €32.5B

SSD details

Lufthansa issued a €1B SSD in 2016
Schuldscheindarlehen

- Volume: €1B
- Maturity: 4-10-year tenor
- Coupon: n.a.
- Listing: unlisted
- Arranger: DZ Bank, LBBW, Helaba

The Schuldscheindarlehen was used for general corporate refinancing. More than 180 investors participated, many of them from Asia. The SSD was split into two parts, one issued in April and the other in December. The April issuance experienced higher than expected demand and was increased from €300M to €475M.

Source: Lufthansa Annual Report (2015), Loan Connector (2017), FDP Financial Dataportal (2017), Lufthansa Group (2017)

Figure 94: Large SSD issuance in 2016

Logo of company

Key features of company

- **Company name:** Palfinger AG
- **Sector:** Engineering
- **Headquarter:** Bergheim, Austria
- **Rating:** n.a.
- **Listing:** DAX

Short description: Palfinger is an Austrian manufacturer specialized in lifting solutions for use on commercial vehicles and in the maritime field.

Key financial ratios 2015

Revenue: €1.2B	**Debt-to-equity ratio**: 1.4x
EBITDA: €132M	**Total assets/EBITDA**: 9.1x
Operating profit: €96M	**Net debt/EBITDA**: 3.3x
EBITDA/Interest: 11.0x	**Total assets**: €1.2B

SSD details

Palfinger issued a €78M SSD in 2012
Schuldscheindarlehen

- Volume: €78M
- Maturity: 3-7-year tenor
- Coupon: n.a.
- Listing: unlisted
- Arranger: Raiffeisen Bank International, UniCredit (HVB)

The Schuldscheindarlehen was used as general corporate refinancing. A significant proportion of investors was international. After issuing a smaller SSD in 2009, Palfinger has thus returned to the SSD market to get another refinancing done. According to the CEO, Palfinger values the high tenure of the loan which allows the company to use the funds for long-term projects.

Source: Palfinger Annual Report (2015), Loan Connector (2017), FDP Financial Dataportal (2017), Palfinger Investor Relations (2012)

Figure 95: Medium-sized SSD issuance in 2012

Logo of company

ALLGEIER

Key features of company

- **Company name:** Allgeier SE
- **Sector:** Information Technology (IT)
- **Headquarter:** Munich, Germany
- **Rating:** n.a.
- **Listing:** DAX

Short description: Allgeier is one of the leading IT companies for business performance, with a growth strategy oriented to innovations and future trends.

Key financial ratios 2015

Revenue: €454M	**Debt-to-equity ratio**: 1.8x
EBITDA: €24M	**Total assets/EBITDA**: 13.7x
Operating profit: €11M	**Net debt/EBITDA**: 1.5x
EBITDA/Interest: 6.0x	**Total assets**: €328M

SSD details

Allgeier issued a €80M SSD in 2014
Schuldscheindarlehen

- Volume: €78M
- Maturity: 5-7-year tenor
- Coupon: fixed rate n.a.
  floating rate: Euribor + 140-170
- Listing: unlisted
- Arranger: BayernLB, LBBW, NordLB

The Schuldscheindarlehen was used as general corporate refinancing. Due to higher than expected demand, the SSD was increased to €80M. With a face value of €66.5M, the 5-year tranche was significantly more attractive for investors as opposed to the 7-year with higher coupon alternative. Allgeier decided to issue the SSD in order to improve conditions of their mid- to long-term liabilities and to have more flexibility regarding future growth or acquisition strategies.

Source: Allgeier Annual Report (2015), Loan Connector (2017), FDP Financial Dataportal (2017), Allgeier Investor Relations (2014)

Figure 96: Medium-sized SSD issuance in 2014

Logo of company

GfK

Key features of company

- **Company name:** GfK SE
- **Sector:** Market research services
- **Headquarter:** Nuremberg, Germany
- **Rating:** n.a.
- **Listing:** DAX

Short description: GfK is the largest market research institute in Germany and the fourth largest market research organization globally.

Key financial ratios 2015

Revenue: €1.5B	**Debt-to-equity ratio**: 1.6x
EBITDA: €209M	**Total assets/EBITDA**: 8.6x
Operating profit: €166M	**Net debt/EBITDA**: 2.0x
EBITDA/Interest: 11.0x	**Total assets**: €1.8B

SSD details

GfK issued a €80M SSD in 2014
Schuldscheindarlehen

- Volume: €78M
- Maturity: 5-12-year tenor
- Coupon: n.a.
- Listing: unlisted
- Arranger: BayernLB, LBBW

The Schuldscheindarlehen was used as general corporate refinancing. Due to higher than expected investor demand, the SSD was increased from €40M to €78M. Because of significant interest rate improvement of 1.1%, GfK used part of the financing to buy back outstanding bonds. As of April 2016, SSDs made up more than half of GfK's total debt outstanding.

Source: GfK Annual Report (2015), Loan Connector (2017), FDP Financial Dataportal (2017), GfK Bilanzpressenkonferenz (2016)

Figure 97: Medium-sized SSD issuance in 2014

Logo of company

GETEC heat & power Aktiengesellschaft

Key features of company

- **Company name:** GETEC heat & power AG
- **Sector:** Energy
- **Headquarter:** Magdeburg, Germany
- **Rating:** n.a.
- **Listing:** DAX

Short description: GETEC operates in the energy solution industry. It supplies industrial corporates with heat, steam and electricity.

Key financial ratios 2015

Revenue: €163M	**Debt-to-equity ratio**: 0.8x
EBITDA: €27.2M	**Total assets/EBITDA**: 6.5x
Operating profit: €19.6M	**Net debt/EBITDA**: 1.9x
EBITDA/Interest: 18.6x	**Total assets**: €178M

SSD details

GETEC issued a €20M SSD in 2013
Schuldscheindarlehen

- Volume: €20M
- Maturity: n.a.
- Coupon: n.a.
- Listing: unlisted
- Arranger: NordLB

The Schuldscheindarlehen was used as general corporate refinancing. GETEC is keen on high flexibility regarding the loan and general corporate strategy. In the past, banks tried to implement operational covenants which restricted their corporate development. Through the SSD, they are now fully flexible and can still keep the publishing requirements to a minimum.

Source: GETEC Annual Report (2015), Loan Connector (2017), FDP Financial Dataportal (2017), Handelsblatt (2015)

Figure 98: Small SSD issuance in 2013

Logo of company

HELMA Eigenheimbau AG

Key features of company

- **Company name:** Helma Eigenheimbau AG
- **Sector:** Real Estate
- **Headquarter:** Lehrte bei Hannover, Germany
- **Rating:** BBB+
- **Listing:** DAX

Short description: Helma is a construction provider in Germany. They offer the development, planning, sale as well as construction management of detached houses.

Key financial ratios 2015

Revenue: €211M	**Debt-to-equity ratio**: 2.5x
EBITDA: €18.0M	**Total assets/EBITDA**: 13.6x
Operating profit: €17.0M	**Net debt/EBITDA**: 5,5x
EBITDA/Interest: 18.0x	**Total assets**: €245M

SSD details

Helma issued a €5M SSD in 2015
Schuldscheindarlehen

- Volume: €5M
- Maturity: 5-7-year tenor
- Coupon: fixed rate: 291 – 358bps
- Listing: unlisted
- Arranger: n.a.

The Schuldscheindarlehen was used as general corporate refinancing. The majority of the loan was used to prematurely buy back corporate bonds with an interest rate of 5.9%, thus approximately twice as expensive as the Schuldscheindarlehen. Additionally, Helma prefers the low administrative and publishing efforts that come with the SSD. In addition to the Schuldscheindarlehen, Helma also wants to use bank loans since these are even cheaper and easier to issue.

Source: HELMA Annual Report (2015), Loan Connector (2017), FDP Financial Dataportal (2017), HELMA Investor Relations(2016)

Figure 99: Small SSD issuance in 2015

Company profiles – examples from the Euro-PP market

This subsection lists several examples for Euro-PP issuances. Details of the deal are given and key financial ratios of the issuer are provided. Due to data availability and consistency, key financial ratios are shown for 2015.

Logo of company

Key features of company

- **Company name:** Vallourec SA
- **Sector:** IG
- **Headquarter:** Bolougne Billancourt, France
- **Rating:** B
- **Listing:** listed

Short description: Manufacturer of steel and alloy tubing products and components used by the automobile, oil and gas refining, construction, and aerospace industries.

Key financial ratios 2015

Revenue: €3.8B	**Debt-to-equity ratio**: 1.3x
EBITDA: €-146M	**Total assets/EBITDA**: -47.9x
Operating profit: €-692M	**Net debt/EBITDA**: -22.8x
EBITDA/Interest: -1.2x	**Total assets**: €7.0B

Euro PP details

Vallourec issued a €455M Euro-PP in two tranches in 2012

Euro-PP tranche 1:

- Volume: €400M
- Maturity: 7-year tenor
- Coupon: 325bps
- Listing: unlisted

Euro-PP tranche 2:

- Volume: €55M
- Maturity: 15-year tenor
- Coupon: 412.5bps
- Listing: unlisted

- Arranger: Credit Agricole, HSBC, Natixis

Both issues were used to increase the group's financial flexibility, extend the average duration of its indebtness and to diversify its financial resources. They were also used to support Vallourec's development projects.

Source: BFM Trading Sat (2012); Dealogic (2017); Orbis (2017)

Figure 100: Large Euro-PP issuance in 2012

Logo of company

Key features of company

- **Company name:** Hipercor SA
- **Sector:** CP
- **Headquarter:** Madrid, Spain
- **Rating:** NA
- **Listing:** unlisted

Short description: Hipercor is a hypermarket offering grocery products as well as accessories, fashion, household and leisure items. It's a subsidiary of El Corte Inglés.

Key financial ratios 2015

Revenue: €1.7B	**Debt-to-equity ratio**: 2.5x
EBITDA: €76.5M	**Total assets/EBITDA**: 25.8x
Operating profit: €4.1M	**Net debt/EBITDA**: 18.4x
EBITDA/Interest: 24.0x	**Total assets**: €2.0B

Euro-PP details

Hipercor issued a €600M Euro-PP in 2015

Euro-PP bond

- Volume: €600M
- Maturity: 7-year tenor
- Coupon: 387.5bps
- Listing: listed
- Arranger: Morgan Stanley

Hipercor first launched a PP of €500m, which it extended by €100m one week later because of the good acceptance by investors. The objective of the Euro-PP issuance was to use the funds to reduce Hipercor's bank debt and diversify its funding. It also serves to increase its average life of debt. The Euro-PPs are listed on the Irish Stock exchange and are guaranteed by El Corte Inglés, Hipercor's parent company.

Source: Dealogic (2017); El Pais (2015); Orbis (2017)

Figure 101: Large Euro-PP issuance in 2015

Logo of company

Key features of company

- **Company name:** Atos SE
- **Sector:** TMT
- **Headquarter:** Bezons, France
- **Rating:** NA
- **Listing:** listed

Short description: Atos is an international information technology services company. It provides integrated design and operates solutions to large multi-national clients.

Key financial ratios 2015

Revenue: €10.7B	**Debt-to-equity ratio**: 1.6x
EBITDA: €1.1B	**Total assets/EBITDA**: 9.5x
Operating profit: €731M	**Net debt/EBITDA**: 4.1x
EBITDA/Interest: 21.8x	**Total assets**: €10.7B

Euro-PP details

Atos issued a €300M Euro-PP in 2016
Euro-PP bond

- Volume: €300M
- Maturity: 7-year tenor
- Coupon: 144.4
- Listing: unlisted
- Arranger: Credit Agricole CIC and CM-CIC

According to press news, the private placement deal seems to have no financial covenants. Atos decided to seize the current favorable European private placement market conditions to reduce the average cost of its debt. The company will use the proceeds from the issue for general corporate purposes.

Source: Atos (2016); Dealogic (2017); Orbis (2017)

Figure 102: Large Euro-PP issuance in 2016

Logo of company

Key features of company

- **Company name:** Sonepar SE
- **Sector:** TMT
- **Headquarter:** Malakoff, France
- **Rating:** NA
- **Listing:** unlisted

Short description: Sonepar distributes electrical products. It offers wiring devices, alarms and safety products, cables and wires, heating, ventilation and air conditioning solutions.

Key financial ratios 2015[1]

Revenue: €302M	**Debt-to-equity ratio**: 3.7x
EBITDA: €13.2M	**Total assets/EBITDA**: 14.6x
Operating profit: €11.4M	**Net debt/EBITDA**: 7.9x
EBITDA/Interest: 11.0x	**Total assets**: €192M

Euro-PP details

Sonepar issued a €100M Euro-PP in 2012
Euro-PP loan

- Volume: €100M
- Maturity: 5-year tenor
- Coupon: NA
- Listing: unlisted
- Arranger: SG Corporate & Investment Banking

The Euro PP was signed by Axa, the French insurance company. It was signed after the partnership of Société Générale and Axa. It was one of the first Euro-PP deals. In the same year Sonepar signed a Schuldschein for €400M and more Euro-PP's in the following years (€75M in 2013, €150M in 2014).

1) Sonepar has many subsidiaries in France. These numbers are for Sonepar Ils-de-France
Source: Dealogic (2017); Euromoney (2012); Orbis (2017)

Figure 103: Medium-sized Euro-PP issuance in 2012

Logo of company

direct energie

Key features of company

- **Company name:** Direct Energie SA
- **Sector:** Energy
- **Headquarter:** Paris, France
- **Rating:** NA
- **Listing:** listed

Short description: Direct Energie is a private French electricity and gas supplier and producer and the 3rd largest player in the French electricity and gas market.

Key financial ratios 2015

Revenue: €1.0B	**Debt-to-equity ratio**: -21.9x
EBITDA: €68M	**Total assets/EBITDA**: 9.0x
Operating profit: €45M	**Net debt/EBITDA**: 8.8x
EBITDA/Interest: 18.2x	**Total assets**: €614m

Euro-PP details

Direct Énergie issued a €40M Euro-PP in 2014 in two tranches

Euro-PP tranche 1:

- Volume: €28.5M
- Maturity: 5-year tenor
- Coupon: 470bps
- Listing: unlisted

Euro-PP tranche 2:

- Volume: €11.5M
- Maturity: 7-year tenor
- Coupon: 500bps
- Listing: unlisted
- Arranger: Oddo & Cie

The Euro-PPs are used to pursue the company's growth strategy. It will be used to accelerate its commercial development to reach its target of two million customers by 2018. The company has issued more private placements later in the same (€15M) and in the following years (€15M in 2015 and €68M in 2016).

Source: Dealogic (2017); Orbis (2017); Romandie (2014)

Figure 104: Medium-sized Euro-PP issuance in 2014

Logo of company

RÉSIDE ÉTUDES
Invest'
UNE MARQUE DU GROUPE RÉSIDE ÉTUDES

Key features of company

- **Company name:** Réside Études Invest
- **Sector:** Other
- **Headquarter:** Paris, France
- **Rating:** NA
- **Listing:** NA

Short description: Réside Études Invest is a real estate porperty managment group specialising in student housing and residences for seniors.

Key financial ratios 2015

Revenue: €342M	**Debt-to-equity ratio**: 3.7x
EBITDA: €186M	**Total assets/EBITDA**: 20.7x
Operating profit: €9.6M	**Net debt/EBITDA**: 14.8x
EBITDA/Interest: 2.8x	**Total assets**: €384M

Euro-PP details

Réside Études issued a €50M Euro-PP in 2016

Euro-PP bond

- Volume: €50M
- Maturity: 7-year tenor
- Coupon: 450bps
- Listing: unlisted
- Arranger: Natixis, Compagnie Financière Jacques Coeur

The Euro PP was used to extend another PP investment, which had been made in 2013 (€44M, 6 years, 520bps). It was also used to make additional investments.

Source: Dealogic (2017); Option Finance (2016); Orbis (2017)

Figure 105: Medium-sized Euro-PP issuance in 2016

Logo of company

Key features of company

- **Company name:** Group Gorgé
- **Sector:** Industrial Goods
- **Headquarter:** Paris, France
- **Rating:** NA
- **Listing:** listed

Short description: Groupe Gorgé specializes in high-tech industries and is recognized for its expertise in robotics, specialized automation systems and simulation.

Key financial ratios 2015

Revenue: €271 .1M	**Debt-to-equity ratio**: 2.7x
EBITDA: €20.5M	**Total assets/EBITDA**: 17.7x
Operating profit: €10.2M	**Net debt/EBITDA**: 11.3x
EBITDA/Interest: 8.6x	**Total assets**: €362.9M

Euro-PP details

Groupe Gorgé issued a €10M Euro-PP plus a €10M SSD in 2012

Euro-PP

- Volume: €10M
- Maturity: 6-year tenor
- Coupon: 540bps
- Listing: NA
- Arranger: Kepler Capital markets

Schuldscheindarlehen

- Volume: €10M
- Maturity: 5- year tenor
- Coupon: NA
- Listing: listed
- Arranger: Deutsche Bank AG

Both the Euro-PP and the SSD were used to extend and diversify the group's debt. Additionally they are going to finance futures investments. The Euro-PP was underwritten by the fonds Fédéris Core Euro Credit 2018.

Source: Dealogic (2017); Groupe Gorgé (2012); Orbis (2017)

Figure 106: Small Euro-PP issuance in 2012

Logo of company

Key features of company

- **Company name:** Settentrionale Trasporti SPA
- **Sector:** Industrial Goods
- **Headquarter:** Possagno, Italy
- **Rating:** NA
- **Listing:** unlisted

Short description: Settentrionale trasporti is specialized in transportation of dangerous goods and waste products nationally and internationally.

Key financial ratios 2015

Revenue: € 45.5M	**Debt-to-equity ratio**: 2.2x
EBITDA: € 4.6M	**Total assets/EBITDA**: 10.6x
Operating profit: € 2.1M	**Net debt/EBITDA**: 6.5x
EBITDA/Interest: 6.4x	**Total assets**: €49M

Euro-PP details

Settentrionale trasporti issued a €5M Euro-PP in 2015

Euro-PP

- Volume: €5M
- Maturity: 5-year tenor
- Coupon: 515bps
- Listing: unlisted
- Arranger: Finanziaria internationale Group

The Euro-PP was used to reach the strategic goals of the company for the next 5 years, aimed at a consolidation of the market of dangerous waste transportation. It is not going to be used to refinance debt.

Source: BeBeez (2015); Dealogic (2017); Orbis (2017)

Figure 107: Small Euro-PP issuance in 2015

Euro-PP market – additional information

Exchange	RM (# of deals)	MTF (# of deals)
AIAF	1	
Brussels	7	
Dublin		13
Euro MTF		4
Frankfurt General	12	
Frankfurt Prime	2	
Helsinki	1	
Luxembourg	19	
Madrid	4	
Paris	52	
Paris Marché Libre		2
Sum	**98**	**19**
Percentage of total	***84%***	***16%***

Figure 108: Place of listing of Euro-PPs[720]

[720] (BCG analysis based on Dealogic 2017)

Additional information for Section III. Growth potential

Number of potential issuers in different revenue brackets

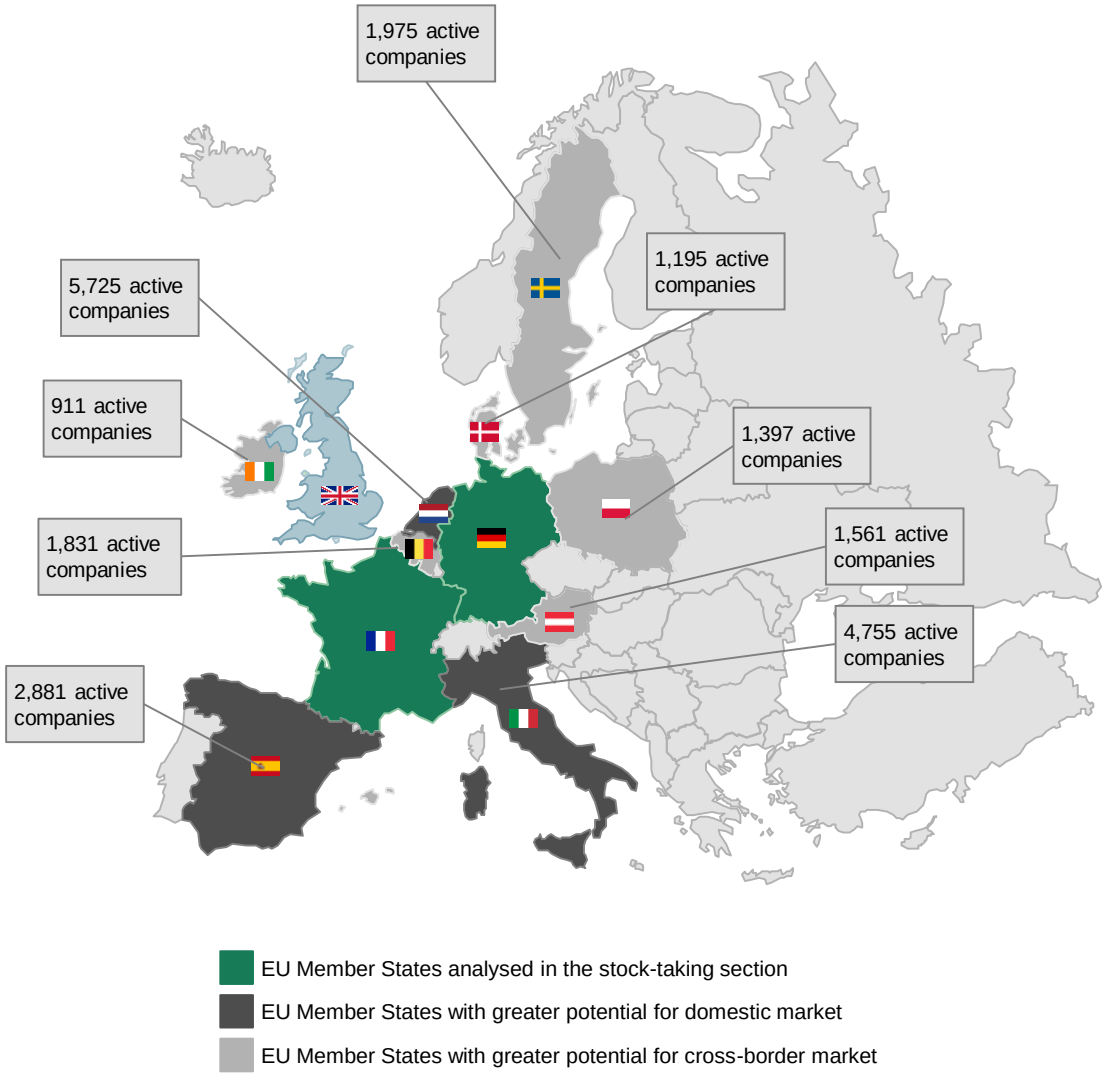

Figure 109: Number of potential issuers with revenues between €75M-€5B[721]

[721] (BCG analysis based on Orbis 2017)

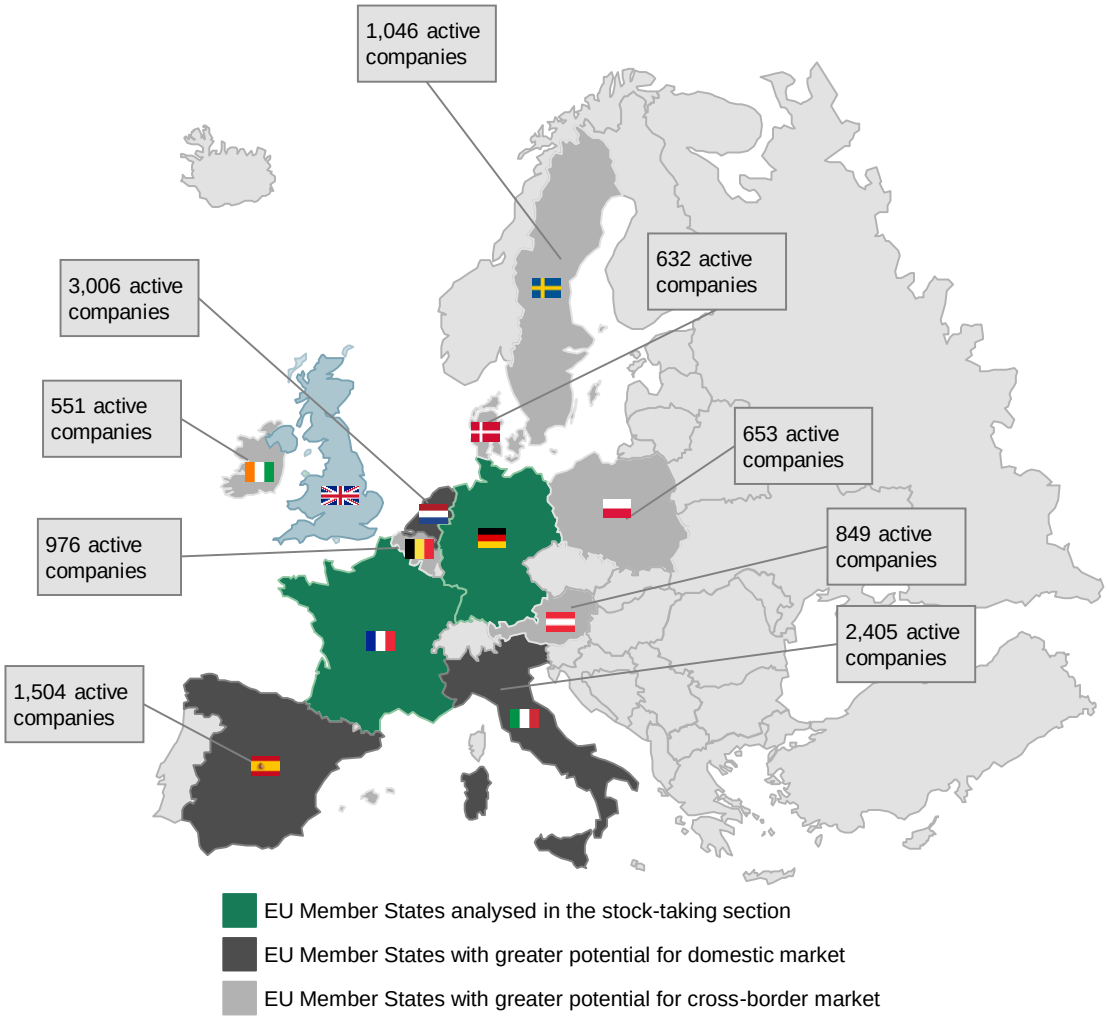

Figure 110: Number of potential issuers with revenues between €150M-€5B[722]

[722] (BCG analysis based on Orbis 2017)

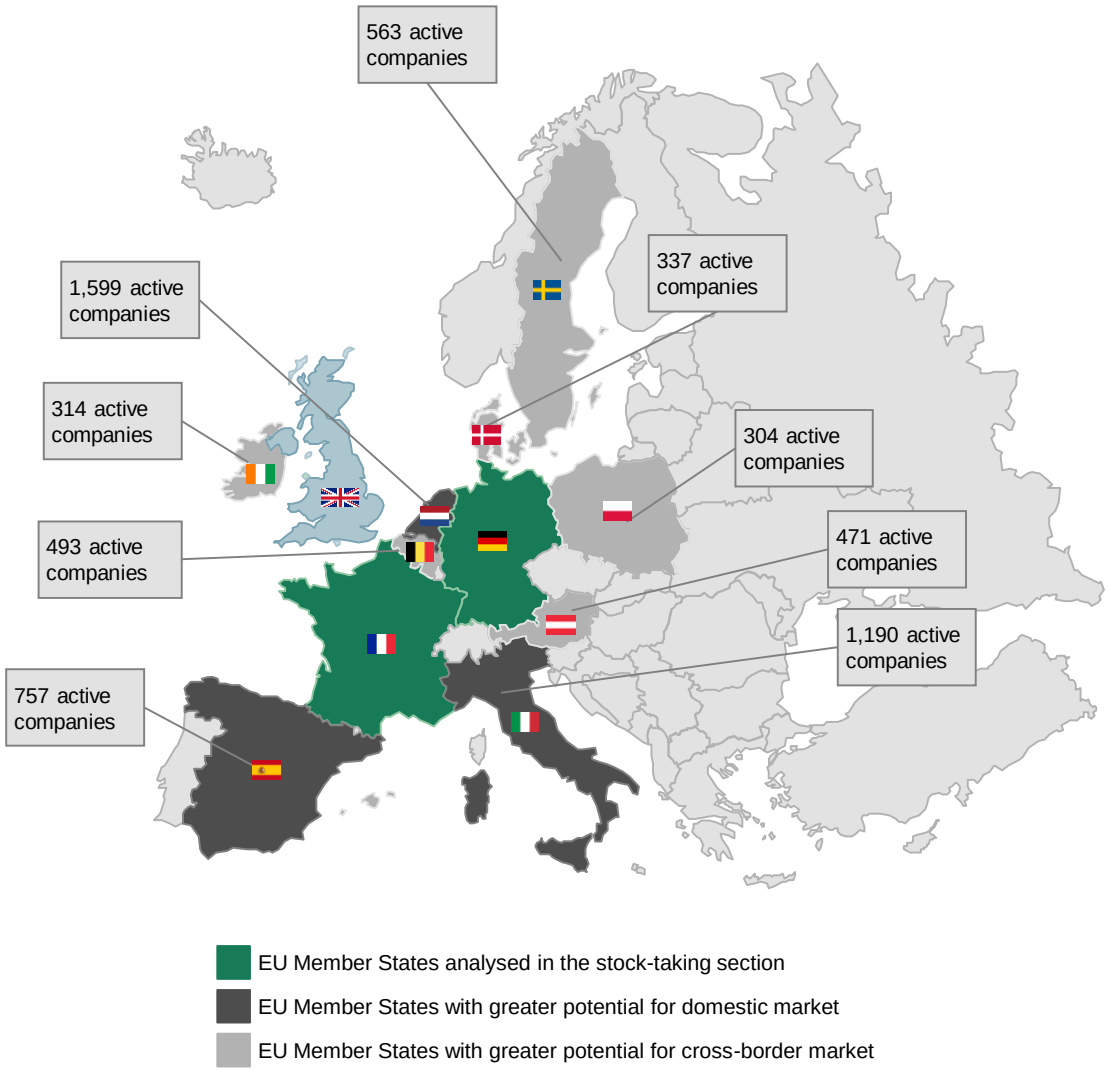

Figure 111: Number of potential issuers with revenues between €300M-€5B[723]

[723] (BCG analysis based on Orbis 2017)

Additional information for Section IV. Risk analytics

Selected examples of issuers active in both the bond and the PP market[724]

The following analysis includes selected examples of companies that issued both a corporate bond and a private placement at approximately the same time. The example selection includes five examples from the SSD market and five from the Euro-PP market.

The analysis has certain limitations:

- Limited data: the data is limited by default given that there are less reporting requirements for debt instruments, particularly for private placements. Being a private market, data on private placement transactions is further limited (see General remarks on data sources, p.217)
- Consequently, not every transaction in the database comprises all economic attributes (issue data, tenor, face value, etc.) and it is therefore not possible to include all relevant economic attributes in the analysis (e.g., in deal context this could be discounts/premiums, degree of covenants and in market data terms this could be traded volume, long time-series pricing).
- Different data sources[725]: data is sourced from different providers, Eikon, Bloomberg and Capital IQ. Despite efforts to enhance comparability, the underlying data (e.g., classifications, taxonomy, inferred/modelled attributes) may be handled fundamentally differently across providers. In particular not all vendors are capable of modelling the difference between corporate bonds and Euro PPs without error.

SSD examples

FRESENIUS

Instrument	Issue Date	Maturity (yrs)	Coupon Rate (bps)	Issue Price	Face Value (€M)	Issuer Rating
Corporate bond	23-Jan-2014	7	300	98.751	450	BBB-
Schuldschein	23-Jan-2014	6	FR+267	99.496	500	BBB-

Figure 112: Debt financing instruments used by Fresenius

Fresenius is a healthcare group that specializes in dialysis, hospitals, and outpatient medical care worldwide.

[724] (BCG analysis based on Eikon 2017); (BCG analysis based on Bloomberg 2017); (BCG analysis based on Capital IQ 2017); press research
[725] (BCG analysis based on Eikon 2017); (BCG analysis based on Bloomberg 2017); (BCG analysis based on Capital IQ 2017); press research

In 2014, Fresenius issued both a vanilla fixed coupon corporate bond with a face value of €450M and a variable rate SSD with a face value of €500M. The fixed margin applied to the floating rate was 2.67%, implying an all-in rate that is higher than the 3.00% issued on the corporate bond.

With roughly on-par tenors, the corporate bond could also exhibits more advantageous pricing in its coupon due to the additional discount at which the bond is issued relative to the SSD.

Instrument	Issue Date	Maturity (yrs)	Coupon Rate (bps)	Issue Price	Face Value (€M)	Issuer Rating
Corporate bond	16-May-2012	6	375	99.847	318	na
Schuldschein	23-Feb-2012	7	EUR+ 140	100	125	na

Figure 113: Debt financing instruments used by Sixt

Sixt operates mobility services for private and business clients around the world, separated in to main business segments: rental and leasing.

In 2012, Sixt issued a corporate bond with 6 years to maturity and face value of €319M at a coupon rate of 3.75%. This would seem to be an expensive issuance relative to the SSD issued in the same year; variable rate with a fixed margin of 1.4%. This implies a break-even float of approximately 2.35% to make the coupon rates equivalent across the two instruments.

The deviation in pricing on the coupon is likely due to other company and external factors given the financial terms of the two instruments are similar.

Instrument	Issue Date	Maturity (yrs)	Coupon Rate (bps)	Issue Price	Face Value (€M)	Issuer Rating
Corporate bond	30-Mar-2016	7	225	99.616	1,133	BBB-
Schuldschein	10-Feb-2016	6	EUR+ 150	100	20	BBB-

Figure 114: Debt financing instruments used by HeidelbergCement

HeidelbergCement produces and distributes cement, asphalt, and other aggregates heavily used in the construction process around the world.

In 2016, HeidelbergCement issued a 7-year 2.25% fixed coupon corporate bond with a face value of €1,133M. In the same year, the company also issued a 6-year variable rate SSD with a face value of €20M; the applicable fixed margin was 1.50%. Despite the large difference in face value and issued amount, the pricing across the two instruments would appear to be fairly inline. A float fixing on the Euribor of 75bps would create a situation whereby the two instruments break-even.

DAIMLER

Instrument	Issue Date	Maturity (yrs)	Coupon Rate (bps)	Issue Price	Face Value (€M)	Issuer Rating
Corporate bond	12-Jan-2016	5	87.5	99.796	540	A
Schuldschein	04-Dec-2015	5	EUR+80	99.665	1,100	A

Figure 115: Debt financing instruments used by Daimler

Daimler is key market player in the production and sales of passenger and commercial vehicles across Europe and the globe, particularly in the high-end market with its Mercedes-Benz brand.

In late 2015 / early 2016, Daimler issued two debt financing instruments with very similar economic features. Both the fixed rate corporate bond and the floating SSD were issued with a tenor of 5 years, above €500M in proceeds, and at ~300bps discount. There appears to be a fairly consistent credit profile across the structure of the instruments: the corporate bond exhibits a low coupon rate of 0.88% while the applicable fixed margin on the SSD is also in the range of 80bps. Given trending interest rates at the time, the all-in rate would be close to the coupon rate on the bond.

BERTELSMANN

Instrument	Issue Date	Maturity (yrs)	Coupon Rate (bps)	Issue Price	Face Value (€M)	Issuer Rating
Corporate bond	27-Apr-2016	10	113	99.223	565	BBB+
Schuldschein	01-Dec-2015	10	EUR+95	100	250	BBB+

Figure 116: Debt financing instruments used by Bertelsmann

Bertelsmann activities primarily include media services and education, with global leading brands such as RTL Group, Penguin Random House, and Gruner + Jahr.

Between December 2015 and first quarter of 2016, Bertelsmann issued a 10-year 1.13% fixed rate corporate bond at 99.22 with a face value of €565M. Over the same period, Bertelsmann also issued a variable +95bps margin SSD with a face value of €250M at par. and identical tenor of 10 years.

The pricing across these two instruments also appears to be consistent. Given the margin and spread on the SSD, it is expected to be more expensive in coupon terms than the corporate bond but this could be explained by fewer covenants attached to the SSD.

Euro-PP examples

Instrument	Issue Date	Maturity (yrs)	Coupon Rate (bps)	Issue Price	Face Value (€M)	Issuer Rating
Corporate bond	11-Oct-2012	6	575	100	4	na
Euro-PP bond	22-Nov-2012	6	540	100	10	na

Figure 117: Debt financing instruments used by Groupe Gorge SA

Groupe Gorge SA is a publicly listed French company that is a specialist in manufacturing technology-based solutions geared towards safety in severe weather conditions.

The company issued two highly comparable debt instruments in 2012, a €4M corporate bond with six years to maturity and a fixed coupon of 5.75%.

In the same year, Groupe Gorge also issued a €10M Euro PP bond with a tenor of six years but with a slightly lower coupon rate of 5.40%, highlighting the common economic characteristics of these two instruments. Although the difference is small, it could be due to different face values and a premium for the smaller issuance factored in for the corporate bond.

Instrument	Issue Date	Maturity (yrs)	Coupon Rate (bps)	Issue Price	Face Value (€M)	Issuer Rating
Corporate bond	29-May-2013	7	287	99.221	500	na
Euro-PP bond	04-Oct-2012	6	387	99.314	250	na

Figure 118: Debt financing instruments used by Compagnie Plastic Omnium

Compagnie Plastic Omnium is a French company listed on the French Euronext exchange which specializes in the manufacturing and distribution of plastics and plastic products, particularly for the use in the automobile industry.

Plastic Omnium issued two debt instruments in the second quarter of 2013 and last quarter of 2012. The corporate bond issued in 2013 was a 7-year €500M face value corporate bond with a fixed coupon rate of 2.87%. This compares to a more expensive Euro-PP bond issued for 3.87% at face value of €250m. This could reflect comparatively more expensive financing via Euro PPs for Plastic Omnium, but could also be swayed by other economic factors.

Instrument	Issue Date	Maturity (yrs)	Coupon Rate (bps)	Issue Price	Face Value (€M)	Issuer Rating
Corporate bond	22-Dec-2015	10	314	100	19	na
Euro-PP bond	17-Dec-2015	7	256	100	26	na

Figure 119: Debt financing instruments used by Orpea

Orpea is a publicly-listed French company operating in healthcare; specifically in nursing homes, home care, and rehabilitation.

Orprea issued two debt instruments virtually back-to-back in December of 2015. The corporate bond was issued at 3.14% on a face value of €19M and time-to-maturity of 10 years, while the Euro-PP bond was issued at 2.56% on a face value of €26M and time-to-maturity of 7 years. Given the tenor of the corporate bond, it is not a surprise to see a premium on the fixed coupon rate however the premium spread appears relatively small compared to the difference in tenors across the two instruments.

RALLYE

Instrument	Issue Date	Maturity (yrs)	Coupon Rate (bps)	Issue Price	Face Value (€M)	Issuer Rating
Corporate bond	02-Oct-2013	7	100	100	375	na
Euro-PP bond	25-Jun-2014	8	340	100	110	na

Figure 120: Debt financing instruments used by Rallye

Rallye is a French publicly-listed company that operates in the retail sector. Rallye sells both food and sporting goods through hypermarkets, supermarkets, and discount stores.

Rallye issued a corporate bond in late 2013 with a face value of €375M and a tenor of 7 years (2020) at a fixed coupon rate of 1%. This would appear to be a fairly cheap bond compared to the Euro-PP of 3.4% for a face value of €110M for 8 years. While the Euro-PP was issued almost an entire year later and time-to-maturity is two years longer, this would presumably not be enough to explain the coupon differential. The differential is most likely explained by the fact that the corporate bond is a convertible, which has allowed the issuer to price it lower than straight debt due to the embedded option investors' have to participate in the upside equity of Rallye.

vallourec

Instrument	Issue Date	Maturity (yrs)	Coupon Rate (bps)	Issue Price	Face Value (€M)	Issuer Rating
Corporate bond	02-Aug-2012	15	412	100	55	B
Euro-PP bond	30-Jul-2012	7	325	99.496	360	B

Figure 121: Debt financing instruments used by Vallourec

Vallourec is a French Euronext-listed company whose main activities are in the energy sector. Vallourec develops and manufactures tubular solutions used in specialty products in the oil & gas, power, chemical, and automotive industries.

Vallourec issued two debt instruments, a corporate bond and a Euro-PP, in the second half of 2012 but with very different maturities, whereby the corporate bond was more than twice the tenor of the Euro-PP. Similar to other observed instances, the fixed coupon on the corporate bond is indeed higher but not by the amount one would expect given the difference in tenors. While both are non-convertible, there does seem to be some evidence that the shorter-term Euro-PP bond was riskier at issuance (possibly due to covenants) than the corporate bond, which would have driven the fixed coupon higher. This is evidenced by a recent downgrade on the Euro-PP rating in 2017 with no outlook change on the corporate bond. The difference in face values is also notable.

Additional information for the legal part

Annex 1 – Euro PP Pro Forma Risk Mitigation Provisions

1. Euro PP bond format information covenant

The Euro PP in bond format provides for the following pro forma information covenant as a starting point for negotiation between the issuer and the subscribers:

"Financial statements

a. The issuer undertakes to deliver to [the Representative of the Masse and to] the Fiscal Agent, for transmission to the Noteholders, promptly after the same are available and in any event within [__] ([__]) calendar days after the end of the relevant fiscal year, a copy, certified by an authorised representative of the issuer, of its consolidated annual financial statements certified by its statutory auditors regarding the relevant fiscal year, together with the related report of the statutory auditors.

b. The issuer undertakes to deliver to [the Representative of the Masse and to] the Fiscal Agent, for transmission to the Noteholders, promptly after the same are available and in any event within [__] ([__]) calendar days after the end of the relevant fiscal year, a copy, certified by an authorised representative of the relevant entity, of the annual non-consolidated financial statements of the issuer and [of its Subsidiaries/of the Material Subsidiaries], certified by the statutory auditors, together with the related report(s) of the statutory auditors.

c. The issuer undertakes to deliver to [the Representative of the Masse and to] the Fiscal Agent, for transmission to the Noteholders, promptly after the same are available and in any event within [__] ([__]) calendar days after the end of the first sixth month-period of the relevant fiscal year, a copy, certified by an

authorised representative of the issuer, of its consolidated semi-annual financial statements of the relevant six-month period."[726]

2. Euro PP bond format negative pledge

The Euro PP in bond format provides for the following pro forma negative pledge as a starting point for negotiation between the issuer and the subscribers:

"Negative Pledge

a. So long as any of the Notes remains outstanding, the issuer will not (and will ensure that none [of its Subsidiaries/of the Material Subsidiaries] will) grant or permit to subsist any Security Interest upon the whole or any part of its assets or its revenues unless, at the same time or prior thereto, the issuer's obligations under the Notes are equally and rateably secured therewith.

b. So long as any of the Notes remains outstanding, the issuer will not (and will ensure that none [of its Subsidiaries/of the Material Subsidiaries] will):

   i. assign or dispose in any manner whatsoever, of assets intended, or that could potentially be intended, to be leased or acquired by the issuer or any other member of the Group;

   ii. carry out any assignment of receivables with recourse;

   iii. consent to an amount of money, a bank account or any other account from being used for a special purpose, a merger or for setting off with other amounts; and

   iv. enter into a preferential agreement having an effect that is similar to the above;

   if the agreement is entered into or the transaction is executed primarily in order to contract a Financial Debt or to finance the acquisition of an asset.

c. Paragraphs (a) and (b) above do not apply:

   i. to Security Interests granted after the Issue Date with the prior consent of the Masse (as defined in Article 11 (Representation of the Noteholders);

   ii. to any Security Interest and/or Quasi-Security Interest existing on the Issue Date, contained in the list set out in Schedule 2 to these Conditions, that are maintained or rolled over after the Issue Date, unless the principal amount they guarantee exceeds the amount indicated in such list or if such Security Interests or Quasi-Security Interests are not rolled over to guarantee the same obligations as those they guarantee on the Issue Date;

   iii. to the reservation of title clauses, rights of retention or merger or set off clauses resulting from the continuation of the activities or from the normal course of business of the relevant entity or in accordance with the standard terms and conditions of its suppliers; and

   iv. to the statutory preferential rights regarding the management of the day-to-day business of the relevant entity.

[726] Article 4.2.1 (*Financial Statements*) of Schedule 1 (*Terms and Conditions of the Notes*) to the Euro PP Subscription Agreement.

In this Article 3.2 (Negative Pledge), "Quasi-Security Interest" means any agreement or transaction described in paragraph (b) above."[727]

3. Euro PP bond format change of control

The Euro PP in bond format provides for the following pro forma change of control put provision as a starting point for negotiation between the issuer and the subscribers:

"Early redemption at the option of the Noteholders following a Change of Control

If a Change of Control occurs, each Noteholder will have the option during the Put Period to require the issuer to redeem all or parts of its Notes (the '"Put Option following a Change of Control"), at their nominal amount, together with interest accrued from (and including) the last Interest Payment Date (or, if applicable, from (and including) the Issue Date) to (but excluding) the date for redemption specified in the Change of Control Notice (the "Early Redemption Date following a Change of Control")."[728]

The Euro PP in bond format provides for a placeholder for the definition of "Change of Control", to be determined by the issuer and the subscribers based on the issuer's shareholder structure.[729]

4. Euro PP loan format change of control

The Euro PP in loan format provides for the following pro forma mandatory early repayment provision following a change of control as a starting point for negotiation between the borrower and the lenders:

"Change of Control

In case of a Change of Control:

a. the Borrower shall inform the Agent of such situation promptly upon becoming aware of it, and the Agent shall in turn inform the Lenders; and

b. unless otherwise agreed by the relevant Lender(s), the Commitment of the relevant Lender(s) shall be cancelled and the Borrower shall be required to repay the Participation of the relevant Lender(s) and to pay the associated interest and all other amounts due pursuant to the Finance Documents that will become immediately due, at the latest within a period of [__] ([__]) calendar days following the date of the occurrence of the Change of Control."[730]

The Euro PP in loan format provides for a placeholder for the definition of "Change of Control", to be determined by the borrower and the lenders based on the borrower's shareholder structure.[731]

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727 Article 3.2 (*Negative Pledge*) of Schedule 1 (*Terms and Conditions of the Notes*) to the Euro PP Subscription Agreement.

728 Article 6.3 (*Early redemption at the option of the Noteholders following a Change of Control*) of Schedule 1 (*Terms and Conditions of the Notes*) to the Euro PP Subscription Agreement.

729 Article 1 (*Definitions*) of Schedule 1 (*Terms and Conditions of the Notes*) to the Euro PP Subscription Agreement.

730 Article 4.2.3 (*Change of Control*) of the Euro PP Loan Agreement.

731 Article 1.1 (*Definitions*) of the Euro PP Loan Agreement.

5. Euro PP bond format tax gross-up / early redemption

The Euro PP in bond format provides for the following pro forma tax gross-up provision as a starting point for negotiation between the issuer and the subscribers:

"If [French] law should require that any payment of interest or principal in respect of the Notes be subject to deduction or withholding with respect to any present or future taxes, duties or charges, the issuer will, to the fullest extent then permitted by law, pay such additional amounts as may be necessary in order that the Noteholders, after such withholding or deduction, receive the full amount provided in such Notes to be then due and payable; provided, however, that if by reason of a change in any law or regulation of France or any change in the official application or interpretation of such law or regulation, becoming effective after the Issue Date, and if the issuer would, on the occasion of the next payment of principal or interest due in respect of the Notes, not be able to make such payment without having to pay additional amounts (and such payments cannot be avoided by reasonable measures taken by the issuer), the issuer may at any time, but no earlier than [__] ([__]) calendar days prior to the effective date of the such change, redeem all of the Notes then outstanding, at their nominal amount, together with the interest accrued to the date fixed for redemption.

The provisions of the above paragraph do not apply:

a. where the holder of such Notes is subject to such taxes, duties or charges by reason of its having some connection with [France] other than the mere holding of such Notes; or

b. where such withholding or deduction is imposed pursuant to the Directive of the Council of the European Union 2003/48/EC dated 3 June 2003, as amended by Directive 2014/48/EU dated 24 March 2014, or with any other European Union Directive implementing the conclusion of the ECOFIN Council meeting of 26 and 27 November 2000 on the taxation of savings income or in accordance with any law implementing or complying with, or introduced in order to conform to, such Directive[732].

If the issuer is required to make additional payments in accordance with the provisions of Article 8.2 above and if the issuer would be prevented by law from making payment to the Noteholders of the full amount then due and payable (and the obligation to make such additional payments cannot be avoided by reasonable measures taken by the issuer), the issuer shall redeem all of the then outstanding Notes, at their nominal amount, together with interest accrued to the date fixed for redemption, at the earliest [__] ([__]) calendar days prior to the effective date of the change referred to in Article 8.2 above and at the latest on the date on which the additional payments should have been made."[733]

The Euro PP in bond format further provides for the following related pro forma tax redemption provision:

"Early redemption for taxation reasons

[732] Note that the Savings Directive has been repealed and this carve out is not standard in new bond issues.

[733] Article 8.2 – 8.3 (*Taxation*) of Schedule 1 (*Terms and Conditions of the Notes*) to the Euro PP Subscription Agreement.

The Notes may, and in certain circumstances shall, be redeemed prior to the Maturity Date in the event that certain French taxes are imposed, in accordance with Article 8 (Taxation)."[734]

6. Euro PP loan format tax gross-up / early repayment

The Euro PP in loan format provides for the following pro forma tax gross-up provision as a starting point for negotiation between the issuer and the subscribers:

"Replacement and voluntary early repayment and cancellation vis-à-vis only one Lender

a. If:

   i. a sum due to a Lender by the Borrower must be increased by applying the stipulations of paragraph (c) of Article 9.2 (Payment *increases*) or of any equivalent stipulation of the Finance Documents; or

   ii. a Lender asks the Borrower to indemnify it by application of the stipulations of Article 9.3 (*Tax indemnity*) or of Article 10.1 (*Additional costs*); or

   an amount due to any one of the Lenders by the Borrower pursuant to a Finance Document is not, or will not be (at the time of the calculation of corporate tax) treated as a deductible charge or expenses of the Borrower from a [French] tax standpoint [1], solely on the ground that such amount is (1) paid or due to a Lender that is incorporated, domiciled, established or acting through a Facility Office located in a Non-Cooperative Jurisdiction, or (2) paid to an account open in the name of or on behalf of such Lender in a financial institution located in a Non-Cooperative Jurisdiction,

   the Borrower shall be entitled, for as long as the situation resulting in such additional cost persists, indemnification or non-deductibility from a [French] [2] tax standpoint persists, by a notice sent to the Agent, either announce its intention to cancel the Commitment of such Lender and to repay in advance the Participation of such Lender in the conditions provided for in paragraph (c) of Article 4.3.1 (*Illegality for a Lender*), or announce its intention to replace such Lender in the conditions stipulated in paragraph (d) of Article 4.3.1 (*Illegality for a Lender*).

b. Upon receipt of the termination notice mentioned in paragraph (a) above, the Commitment of the relevant Lender shall be immediately and permanently cancelled and reduced to zero.

Mandatory early repayment and cancellation vis-à-vis only one Lender

If the Borrower's performance of its obligations to a Lender pursuant to paragraph (c) of Article 9.2 (Payment increases) or an equivalent stipulation of a Finance Document becomes illegal:

a. the Borrower shall notify the Agent promptly becoming aware of such fact;

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734 Article 6.2 (*Early redemption for taxation reasons*) of Schedule 1 (*Terms and Conditions of the Notes*) to the Euro PP Subscription Agreement.

[1] To be adjusted if the Borrower is not registered in France.

[2] To be adjusted if the Borrower is not registered in France.

b. as soon as the Agent notifies the relevant Lender, the latter's Commitment shall be cancelled or, if the maintenance of such Lender's Commitment is legally possible during a certain period of time, the Borrower shall be entitled, by a notice sent to the Agent, either to announce its intention to cancel the Commitment of such Lender and to repay in advance such Lender's Participation in the conditions contained in paragraph (c) of Article 4.3.1 (*Illegality for a Lender*), or to announce its intention to replace such Lender in the conditions defined in Article 4.3.1 (*Illegality for a Lender*).

   In the absence of immediate termination if the maintenance of such Lender's Commitment is illegal on such date, the Commitment of the relevant Lender shall be immediately and permanently cancelled and reduced to zero upon receipt of the termination notice mentioned in Article 4.5.1.

Payment increases

a. The Borrower must make all payments pursuant to the Finance Documents net of any Tax Deduction, unless a Tax Deduction is required by law.

b. Promptly becoming aware of the obligation to carry out a Tax Deduction or to modify the rate or base of a Tax Deduction, the Borrower shall inform the Agent. Similarly, a Lender shall inform the Agent, promptly upon becoming aware of such fact, of any Tax Deduction applicable to a payment to which it is entitled. Once a Lender has received such information, the Agent shall inform the Borrower.

c. If a Tax Deduction must be carried out by the Borrower, the amount of its payment must be increased to reach an amount equal, after deduction of the Tax Deduction, to the amount it would have been liable for if the payment had not undergone a Tax Deduction.

d. A payment shall not be increased pursuant to paragraph (c) above due to Tax Deduction for a Tax levied by [France] [3], if, on the date on which such payment becomes due:

   i. the payment could have been made to the relevant Lender without Tax Deduction if it were a Qualifying Lender, but on such date such Lender is not or is no longer a Qualifying Lender for a reason other than a modification, made after it became a Lender pursuant to the Agreement, the law or a tax agreement (or their interpretation or application) or a practice or a tolerance published by a competent tax authority; or

   ii. the relevant Lender is a Lender Benefitting from a Tax Treaty and the Borrower is able to demonstrate that the payment could have been made without Tax Deduction for a Tax levied by [France] [4] if the Lender had performed its obligations pursuant to paragraph (g) below,

   it being specified that the exclusion mentioned in paragraph (i) above in the event of a modification occurring after the date on which a Lender has become a Lender pursuant to the Agreement, shall not apply in the case of Tax Deduction for a Tax levied by [France] [5] on a payment made to a Lender, if such Tax Deduction is due only because such payment is made to

[3] To be adjusted if the Borrower is not registered in France.
[4] To be adjusted if the Borrower is not registered in France.
[5] To be adjusted if the Borrower is not registered in France.

an account open in the name and on behalf of such Lender in a financial institution located in a Non-Cooperative Jurisdiction.

e. The Borrower must carry out any Tax Deduction to which its payments are subject and pay the competent tax authority the corresponding amount, within the time limits defined by law and within the limits of the minimum legal requirements.

f. At the latest thirty (30) days after having carried out a Tax Deduction or paid the competent tax authority the corresponding amount, the Borrower shall send the Agent, on behalf of the relevant Finance Party, the evidence enabling the latter to reasonably conclude that the Tax Deduction was carried out or, if applicable, that the corresponding payment was duly made to the competent tax authority.

g. A Lender Benefitting from a Tax Treaty and the Borrower that owes it a payment must co-operate in the performance of the formalities enabling the latter to make such payment without Tax Deduction."

Annex 2 – LMA Pro Forma Risk Mitigation Provisions

1. LMA Subscription Agreement Information Undertaking

The LMA Subscription Agreement provides for the following pro forma information undertakings as a starting point for negotiation between the company and the holder:

"19. INFORMATION UNDERTAKINGS

The undertakings in this Clause 19 are for the benefit of the Holders and shall remain in force from the date of this Agreement for so long as any amount is outstanding under the Finance Documents.

19.1 Financial statements

The Company shall supply to each Holder:

a. as soon as the same become available, but in any event within [ ] days after the end of each of its financial years:

   i. its audited consolidated financial statements for that financial year; and

   ii. the audited financial statements of each Obligor for that financial year; and

b. as soon as the same become available, but in any event within [ ] days after the end of each half of each of its financial years:

   i. its consolidated financial statements for that financial half year[; and

   ii. the financial statements of each Obligor for that financial half year].

…

19.4 Information: miscellaneous

The Company shall supply to each Holder:

a. all documents dispatched by the Company to its shareholders (or any class of them) or its creditors generally at the same time as they are dispatched;

b. promptly upon becoming aware of them, the details of any litigation, arbitration or administrative proceedings which are current, threatened or pending against any member of the Group, and which might, if adversely determined, have a Material Adverse Effect;

c. promptly upon becoming aware of them, the details of any judgment or order of a court, arbitral body or agency which is made against any member of the Group, and which might have a Material Adverse Effect; and

d. promptly, such further information regarding the financial condition, business and operations of any member of the Group as any Holder may reasonably request"[735].

[735] Clause 19 (*Information Undertakings*) of the LMA Subscription Agreement.

2. LMA Facility Agreement Information Undertaking

The LMA Facility Agreement provides for the following pro forma information undertakings as a starting point for negotiation between the company and the lender.

"19. INFORMATION UNDERTAKINGS

19.1 Financial statements

The Company shall supply to each Lender:

a. as soon as the same become available, but in any event within [_____] days after the end of each of its financial years:

   i. its audited consolidated financial statements for that financial year; and

   ii. the audited financial statements of each Obligor for that financial year; and

b. as soon as the same become available, but in any event within [_____] days after the end of each half of each of its financial years:

   i. its consolidated financial statements for that financial half year[; and

   ii. the financial statements of each Obligor for that financial half year].

   ….

19.4 Information: miscellaneous

The Company shall supply to each Lender:

a. all documents dispatched by the Company to its shareholders (or any class of them) or its creditors generally at the same time as they are dispatched;

b. promptly upon becoming aware of them, the details of any litigation, arbitration or administrative proceedings which are current, threatened or pending against any member of the Group, and which might, if adversely determined, have a Material Adverse Effect;

c. promptly upon becoming aware of them, the details of any judgment or order of a court, arbitral body or agency which is made against any member of the Group, and which might have a Material Adverse Effect; and

d. promptly, such further information regarding the financial condition, business and operations of any member of the Group as any Lender may reasonably request"[736].

3. LMA Subscription Agreement Negative Pledge

The LMA Subscription Agreement provides for the following pro forma negative pledge as a starting point for negotiation between the company and the holder.

"21. GENERAL UNDERTAKINGS

[736] Clause 19 (*Information Undertakings*) of the LMA Facility Agreement.

The undertakings in this Clause 21 are for the benefit of the Holders and shall remain in force from the date of this Agreement for so long as any amount is outstanding under the Finance Documents.

21.3 Negative pledge

In this Clause 21.3, "**Quasi-Security**" means an arrangement or transaction described in paragraph (b) below.

a. No Obligor shall (and the Company shall ensure that no other member of the Group will) create or permit to subsist any Security over any of its assets.

b. No Obligor shall (and the Company shall ensure that no other member of the Group will):

   i. sell, transfer or otherwise dispose of any of its assets on terms whereby they are or may be leased to or re-acquired by an Obligor [or any other member of the Group];

   ii. sell, transfer or otherwise dispose of any of its receivables on recourse terms;

   iii. enter into any arrangement under which money or the benefit of a bank or other account may be applied, set-off or made subject to a combination of accounts; or

   iv. enter into any other preferential arrangement having a similar effect,

   v. in circumstances where the arrangement or transaction is entered into primarily as a method of raising Financial Indebtedness or of financing the acquisition of an asset.

c. Paragraphs (a) and (b) above do not apply to any Security or (as the case may be) Quasi-Security, listed below:

   i. any Security or Quasi-Security listed in Schedule 8 (Existing Security) except to the extent the principal amount secured by that Security or Quasi-Security exceeds the amount stated in that Schedule;

   ii. any netting or set-off arrangement entered into by any member of the Group in the ordinary course of its banking arrangements for the purpose of netting debit and credit balances;

   iii. any payment or close out netting or set-off arrangement pursuant to any hedging transaction entered into by a member of the Group for the purpose of:

      i. hedging any risk to which any member of the Group is exposed in its ordinary course of trading; or

      ii. its interest rate or currency management operations which are carried out in the ordinary course of business and for non-speculative purposes only,

      iii. excluding, in each case, any Security or Quasi-Security under a credit support arrangement in relation to a hedging transaction;

   iv. any lien arising by operation of law and in the ordinary course of trading;

   v. any Security or Quasi-Security over or affecting any asset acquired by a member of the Group after the date of this Agreement if:

i. the Security or Quasi-Security was not created in contemplation of the acquisition of that asset by a member of the Group;

ii. the principal amount secured has not been increased in contemplation of or since the acquisition of that asset by a member of the Group; and

iii. the Security or Quasi-Security is removed or discharged within [ ] months of the date of acquisition of such asset;

vi. any Security or Quasi-Security over or affecting any asset of any company which becomes a member of the Group after the date of this Agreement, where the Security or Quasi-Security is created prior to the date on which that company becomes a member of the Group, if:

i. the Security or Quasi-Security was not created in contemplation of the acquisition of that company;

ii. the principal amount secured has not increased in contemplation of or since the acquisition of that company; and

iii. the Security or Quasi-Security is removed or discharged within [ ] months of that company becoming a member of the Group;

vii. any Security or Quasi-Security entered into pursuant to any Finance Document;

viii. any Security or Quasi-Security arising under any retention of title, hire purchase or conditional sale arrangement or arrangements having similar effect in respect of goods supplied to a member of the Group in the ordinary course of trading and on the supplier's standard or usual terms and not arising as a result of any default or omission by any member of the Group;

ix. [ ]; or

x. any Security or Quasi-Security securing indebtedness the principal amount of which (when aggregated with the principal amount of any other indebtedness which has the benefit of Security or Quasi-Security given by any member of the Group other than any permitted under paragraphs (i) to (ix) above) does not exceed [ ] (or its equivalent in another currency or currencies)"[737].

4. LMA Facility Agreement Negative Pledge

The LMA Facility Agreement provides for the following pro forma negative pledge as a starting point for negotiation between the company and the lender.

"21. GENERAL UNDERTAKINGS

The undertakings in this Clause 21 remain in force from the date of this Agreement for so long as any amount is outstanding under the Finance Documents or any Commitment is in force.

21.3 Negative pledge

In this Clause 21.3, "**Quasi-Security**" means an arrangement or transaction described in paragraph (b) below.

[737] Clause 21.3 (*Negative Pledge*) of the LMA Subscription Agreement.

d. No Obligor shall (and the Company shall ensure that no other member of the Group will) create or permit to subsist any Security over any of its assets.

e. No Obligor shall (and the Company shall ensure that no other member of the Group will):

   i. sell, transfer or otherwise dispose of any of its assets on terms whereby they are or may be leased to or re-acquired by an Obligor [or any other member of the Group];

   ii. sell, transfer or otherwise dispose of any of its receivables on recourse terms;

   iii. enter into any arrangement under which money or the benefit of a bank or other account may be applied, set-off or made subject to a combination of accounts; or

   iv. enter into any other preferential arrangement having a similar effect,

   v. in circumstances where the arrangement or transaction is entered into primarily as a method of raising Financial Indebtedness or of financing the acquisition of an asset.

f. Paragraphs (a) and (b) above do not apply to any Security or (as the case may be) Quasi-Security, listed below:

   i. any Security or Quasi-Security listed in [ ] (Existing Security) except to the extent the principal amount secured by that Security or Quasi-Security exceeds the amount stated in that Schedule;

   ii. any netting or set-off arrangement entered into by any member of the Group in the ordinary course of its banking arrangements for the purpose of netting debit and credit balances;

   iii. any payment or close out netting or set-off arrangement pursuant to any hedging transaction entered into by a member of the Group for the purpose of:

      i. hedging any risk to which any member of the Group is exposed in its ordinary course of trading; or

      ii. its interest rate or currency management operations which are carried out in the ordinary course of business and for non-speculative purposes only,

      iii. excluding, in each case, any Security or Quasi-Security under a credit support arrangement in relation to a hedging transaction;

   iv. any lien arising by operation of law and in the ordinary course of trading;

   v. any Security or Quasi-Security over or affecting any asset acquired by a member of the Group after the date of this Agreement if:

      i. the Security or Quasi-Security was not created in contemplation of the acquisition of that asset by a member of the Group;

      ii. the principal amount secured has not been increased in contemplation of or since the acquisition of that asset by a member of the Group; and

iii. the Security or Quasi-Security is removed or discharged within [ ] months of the date of acquisition of such asset;

vi. any Security or Quasi-Security over or affecting any asset of any company which becomes a member of the Group after the date of this Agreement, where the Security or Quasi-Security is created prior to the date on which that company becomes a member of the Group, if:

i. the Security or Quasi-Security was not created in contemplation of the acquisition of that company;

ii. the principal amount secured has not increased in contemplation of or since the acquisition of that company; and

iii. the Security or Quasi-Security is removed or discharged within [ ] months of that company becoming a member of the Group;

vii. any Security or Quasi-Security entered into pursuant to any Finance Document;

viii. any Security or Quasi-Security arising under any retention of title, hire purchase or conditional sale arrangement or arrangements having similar effect in respect of goods supplied to a member of the Group in the ordinary course of trading and on the supplier's standard or usual terms and not arising as a result of any default or omission by any member of the Group;

ix. [ ]; or

x. any Security or Quasi-Security securing indebtedness the principal amount of which (when aggregated with the principal amount of any other indebtedness which has the benefit of Security or Quasi-Security given by any member of the Group other than any permitted under paragraphs (i) to (ix) above) does not exceed [ ] (or its equivalent in another currency or currencies)"[738].

5. LMA Subscription Agreement Change of Control

The LMA Subscription Agreement provides for the following pro forma change of control put as a starting point for negotiation between the company and the holder.

"6. REDEMPTION

6.3 Redemption at the option of Holders following a Change of Control

a. If a Change of Control Event occurs, the Company shall promptly notify the Holders (a "**Change of Control Event Notice**").

b. The Company shall, at the option of the Holder of any Note, redeem such Note on the Change of Control Put Date at a price equal to [100] per cent. of its principal amount together with interest accrued to such date.

c. In order to exercise the option contained in this Clause 6.3, the Holder of a Note must, during the Put Option Period, deposit with the Company the Note Certificate relating to such Note and a duly completed Put Option Notice.

738 Clause 21.3 (*Negative Pledge*) of the LMA Facility Agreement

d. Upon such deposit, the Company shall deliver a duly completed receipt for such Note Certificate (a "**Put Option Receipt**") to the depositing Holder.

e. Subject to paragraph (f) below, once a Note is deposited with a duly completed Put Option Notice in accordance with this Clause 6.3, it may not be withdrawn.

f. If, prior to the Change of Control Put Date, any such Note becomes immediately due and payable or, upon due deposit of any such Note Certificate and Put Option Notice, payment of the redemption moneys is improperly withheld or refused on the Change of Control Put Date, such Note Certificate shall, without prejudice to the exercise of the Put Option Notice, be returned to the Holder at the address specified by such Holder in the relevant Put Option Notice.

g. For so long as any outstanding Note Certificate is held by the Company in accordance with this Clause 6.3, the depositor of such Note Certificate and not the Company shall be deemed to be the holder of such Note Certificate for all purposes.

h. A "**Change of Control Event**" occurs if [[_____] ceases to control the Company]/[any person or group of persons acting in concert gains control of the Company].

i. For the purpose of paragraph (h) above, "**control**" means [_____].

j. For the purpose of paragraph (h) above, "**acting in concert**" means [_____]"[739].

6. LMA Facility Agreement Change of Control

The LMA Facility Agreement provides for the following pro forma change of control early repayment as a starting point for negotiation between the company and the lender.

"7. CHANGE OF CONTROL

7.2 Change of control

a. If [[ ] ceases to control the Company]/[any person or group of persons acting in concert gains control of the Company]:

i. the Company shall promptly notify the Lenders upon becoming aware of that event;

ii. [a Lender shall not be obliged to fund the Utilisation;] and

iii. if a Lender so requires and notifies the Company within [ ] days of the Company notifying the Lenders of the event (the "Change of Control Notice Period"), that Lender may cancel its Commitments and declare its participation in the outstanding Loan, together with accrued interest, and all other amounts accrued under the Finance Documents due and payable on the date which is the [ ] day after the last day of the Change of Control Notice Period, whereupon its Commitments will be cancelled and such outstanding Loan and amounts will become so due and payable.

[739] Clause 6.3 (*Redemption at the option of Holders following a Change of Control*) of the LMA Subscription Agreement

b. For the purpose of paragraph (a) above "control" means [ ].

c. [For the purpose of paragraph (a) above "acting in concert" means [ ].]"[740].

[740] Clause 7.2 (*Change of Control*) of the LMA Facility Agreement.

List of abbreviations

AMAFI	Association Française des Marchés Financièrs
AuM	Assets under Management
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht
BCG	Boston Consulting Group
CMU	Capital Markets Union
CRR	Capital Requirements Regulation
ECAI	External Credit Assessment Institution
ECB	European Central Bank
ESG	Environmental, social and governance
EURIBOR	Euro Interbank Offered Rate
FIBEN	Fichier bancaire des entreprises
GDP	Gross Domestic Product
IAS	International Accounting Standards
ICMA	International Capital Markets Association
IDF	Île-de-France
IFRS	International Financing Reporting Standards
IFSC	International Financial Services Centre
LBBW	Landesbank Baden-Württemberg
LDR	Loan-to-deposit ratio
LMA	Loan Market Association
M&A	Mergers and acquisitions
MAR	Market Abuse Regulation
MARF	Mercado Alternativo de Renta Fija
MiFID	Markets in Financial Instruments Directive
MTF	Multilateral Trading Facility
NAIC	National Association of Insurance Commissioners
NPA	Note Purchase Agreement
NSV	Namensschuldverschreibung
OTC	Over-the-counter
PP	Private placement
SCR	Solvency Capital Requirement
SEC	U.S. Securities and Exchange Commission

SME	Small and medium-sized enterprise
SSD	Schuldschein(darlehen)
SVO	Securities Valuation Office
YTD	Year-to-date
ZBP	Związek Banków Polskich

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