Flexibility in Designing the Nature and Term of a Bond Issue

Focus Points

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The Bond Market

- The three dominant sectors across the corporate bond market are hospitality, real estate and financial services accounting for close to 70% of the total bond issuance across the corporate bond market.

- New entrants to the market from other sector include shipping, gaming, retail, marketing, and manufacturing.

What is a Bond?

- In terms of the Companies Act, a company may raise finance via the issuance of equity or debentures – a term which includes bonds.

- A bond is a tool for corporates to raise money to finance their projects.

- This is done by means of a special type of borrowing agreement represented by the bond instrument via which the lender (Investor) lends money to the borrower (Issuer) and regulated by the terms and conditions laid down in the offering document (typically in the form of a prospectus).

Article 2 of the Companies Act (Chapter 386 of the Laws of Malta):

"security" includes a share, debenture or any other similar instrument issued by a company or other commercial partnership

"debenture" includes debenture stock, bonds and any other debt securities of a company.

Main Players in a Bond Issue

- **Issuer** – *the entity raising finance;*
- **Guarantor** – *the entity acting surety to the issuer for the repayment of interest and principal;*
- **Sponsor** – *the financial intermediary taking the issuer to market;*
- **Financial Advisor** – *the advisory firm responsible for preparing the Financial Due Diligence Report and advising on other financial matters;*
- **Legal Advisor** – *the advisory firm responsible for the drafting of the offering document (typically the prospectus) and advising on other legal matters;*
- **Security Trustee** – *required in secured offers;*
- **MFSA** – *authorises the publication of the Prospectus and admission to listing;*
- **Trading venue operator** – *admits the securities to trading.*

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Bond Features

- **Payment of Principal and Interest** - The bond instrument is composed of principal and interest payable by the issuer to the investor. The interest is typically (but not necessarily) paid on an annual basis whilst principal is typically paid on maturity.

- **Security** - Whilst bank finance – particularly in the case of end-project financing – banks would require some form collateral from the borrower including but not limited to hypothecs and privileges on the asset being financed as well as general hypothecs personally by the shareholders and/or ultimate beneficial owners, a bond may be secured or unsecured. Typically, a secured bond would be considered as less risky and therefore, would attract a lower interest rate. Security can take many forms but should be tangible such as a security interest over immovable or movable property.

Bond Features (ctd 1)

- **Guarantee** - Bonds can also be guaranteed whereby a corporate guarantee can be given by a third party (usually a related party) in order to strengthen investor confidence. This would mean that the entity giving the corporate guarantee would be considered as a surety in relation to the bondholders in case of default. On the other hand, the guarantor would still retain the flexibility of acquiring and/or disposing of certain assets as the guarantee is not as restrictive as a hypothec or privilege which disallows the disposal of certain assets without creditor pre-approval.

Bond Features (ctd 2)

- **Programme and Tranches** - Whilst typically a bond is issued to the full amount required to be financed, there may be circumstances where although the project value is known from the beginning, funding would be required in stages. Therefore, rather than borrowing the full amount of the project from day 1 and paying interest on funds not initialized immediately, a Programme would be a better solution. In this case, authorization would be obtained for the full amount being requested on the basis of what is known as a Base Prospectus. Then once funding is required, a separate Tranche is issued to the extent necessary. A bond programme is valid for 12 months.

- **Series** - Alternatively a bond may be composed of two or more series within the same issue having varying characteristics such as term and coupon.

Bond Features (ctd 3)

- **Tradability** – being a security in nature, the bond is tradeable. Being listed on a trading venue provides the comfort of liquidity to investors.

- **Use of Proceeds** – financing would typically be utilized for the financing of identified projects, refinancing of debts, and working capital.

- **Passporting** – Securities issued in terms of a prospectus can be passported across all EU/EEA jurisdictions in terms of the Prospectus Regulation.

Embedded Options

- **Callability** - A bond may be issued with an early repayment mechanism exercisable at the option of the issuer.

- **Convertibility** – A bond may be convertible into another security, typically equity, upon the occurrence of certain events or at the option of either the issuer or the investor.

- **Floating Rate Bonds** – A bond may have a variable interest rate that fluctuates according to a chosen market interest rate benchmark.

- **Profit Participation Notes** – A bond may be structured so as to give investors a percentage of the profits generated by the issuer.

To note that should the bond include any of these features, it would be classified as complex thereby restricting access by the retail market which is the lion’s share of the investing public in Malta.

Additional Covenants

The issuer may undertake a number of self-imposed obligations restricting its activities so as to provide further protection to the bondholders. Such covenants could take the form of:

- Restrictions on further indebtedness;
- Dividend policy or a restriction on dividend distributions;
- Gearing limitations;
- Provisions on use of assets used as collateral; and
- The creation of sinking funds.

Types of Bond Issues

- **Offer to the Public** - Should the bond form part of an offer to the public in terms of the Companies Act and the Prospectus Regulation, the issuer would be required to publish a prospectus;

- **Private Placement** - In offers which are not to the public, such as private placements, the terms and conditions of the bond would be regulated by means of an offering document. In the case of an admission to the Prospects MTF, this would be structured as a Company Admission Document and requires the approval of the MSE.

- **Listed Bonds** - In the case of a listed bond, the prospectus would need to be approved by the MFSA.

- **Unlisted Bonds** - On the other hand, in the case of unlisted bond, the prospectus would need to be registered with the MBR.

Article 2(3)(b) of the Companies Act

The following shall not constitute offers of securities made to the public:

(i) an offer of securities made only to ***qualified investors****; or*

(ii) an offer made to ***less than 150 persons*** *per Member State or EEA State, not including qualified investors; or*

(iii) an offer where the ***minimum consideration*** *which may be paid by any person for securities acquired pursuant to the offer is at least* ***Eur100,000.00****, for each separate offer; or*

(iv) an offer of securities where the ***nominal value of each security amounts to at least Eur100,000.00,*** *or the total consideration of the offer in the European Union and the EEA shall not exceed Eur100,000.00, which limit shall be calculated over a period of twelve months; or*

(v) an offer where the total consideration of the securities for the offer in the European Union and the EEA ***does not exceed Eur5,000,000****, which limit shall be calculated over a period of twelve months; or*

(vi) an offer in respect of non-equity securities issued in a continuous or repeated manner by credit institutions where the total consideration of the offer in the European Union and the EEA, over a period of 12 months ***is less than Eur75,000,000****, provided that these securities:*

(i) are not subordinated, convertible ore exchangeable; and

(ii) do not give a right to subscribe to or acquire other types of securities and they are not linked to a derivative instrument:

Trading Venues

Main Market	Prospects MTF	IFSM
Eur5 mil +	›Eur 5 mil	Eur5 mil +
Requires the publication of a Prospectus	Requires the publication of a Company Admission Document	Requires the publication of a Prospectus
Requires operating history	Geared towards SMEs	Geared towards institutional investors
Requires a team of professionals until listing	Requires a Corporate Advisor to be engaged throughout the term	Requires a Listing Agent amongst others
More liquid	Less liquid	Attracts technical listings