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Banking & Finance Update

Retail Bond Offers: raising liquidity in a difficult financial market

Introduction

With the global credit crunch leading to banks tightening their lending criteria, bank funding has become less readily available and more expensive. In this difficult financial market, retail bond issues have become a popular alternative to banks and corporate borrowers seeking to raise capital, with a number of fixed rate, fixed term security offers being made to the public in recent months.

This newsletter considers in more detail the mechanics of raising funds through bond issues and some key considerations for issuers who are considering making a public offer of bonds.

Liquidity constraints and the retail bond market

The global financial crisis has signalled an end to a long period of readily available and cheaply priced bank debt, with banks having been forced to tighten their lending criteria. Overseas credit lines have practically closed to banks and corporate borrowers seeking to raise funds from New Zealand.

As the financial crisis has worsened, the retail bond market has seen a noticeable increase in activity, with public bond offers becoming an appealing alternative to entities looking to improve their liquidity.

Historically, bond issues in the New Zealand retail bond market have been made predominantly by corporate issuers and have been in an aggregate annual amount of NZ\$1 to 2 billion. However, recent market trends have seen the number of retail bond issues in New Zealand rise markedly, with a predicted NZ\$5 billion of retail bonds to be issued in 2008.

Despite the financial downturn, there has been a surprisingly good uptake of public offers of securities by investors, with recent bond issues quickly becoming fully subscribed. The past few months have seen public offers of securities by Auckland Airport, TrustPower, Fletcher Building and Genesis Energy as well as ANZ, BNZ and ASB, with further proposed bond offers in the pipeline.

Legal framework

Debt security issues in New Zealand are subject to a comprehensive statutory framework designed to ensure investors are fully informed and that the terms of an issue are comprehensively and accurately disseminated. The legal framework establishes detailed requirements in respect of the content of offer documents and advertisements, disclosure, registration and, in the case of listed issuers, compliance with the NZX listing rules.

From a documentary point of view, potential issuers of debt securities will need to put in place a trust deed appointing a trustee to act on behalf of holders of securities. A prospectus, an investment statement and various ancillary documents in respect of the proposed offer will also need to be prepared.

Throughout, it will be necessary to liaise with the trustee, the Companies Office and (if applicable) NZX to ensure compliance with the relevant legislation. Documenting a bond offer and obtaining relevant consents and approvals require conscientious management and are processes with which Minter Ellison is very familiar.

Due diligence and verification

Ultimately, responsibility for the contents of the offer documents rests with the board of the issuer and a range of civil and criminal liabilities may be imposed on issuers, directors of issuers and promoters where the statutory requirements in respect of securities offers are found to have been breached.

The best way to ensure compliance with the relevant legislation and to avoid criminal liability is to undertake a due diligence procedure, which involves formulating, implementing and documenting a system of enquiries and reviews to avoid incorrect or misleading statements or omissions in the offer documents and to identify gaps in the information contained in those documents.

Part of the due diligence process is a verification procedure, whereby all material statements of fact or opinion in the offer documents are checked and verified by a group of people with the relevant expertise and/or knowledge of the issuer and the proposed bond issue. This is important because, in order to establish a due diligence defence, directors must be able to show that they had reasonable grounds to believe and did believe that a statement of fact was true.

Given the highly prescriptive nature of the regulatory framework, the due diligence process needs to be comprehensive and rigorous. The Minter Ellison team has extensive experience in this area and is well placed to assist issuers in undertaking the process thoroughly and efficiently.

Key considerations for issuers

Reputation

With some exceptions, corporate borrowers may not wish to incur the time and expense of obtaining a credit rating. Accordingly, in making a security offer to the public, their reputation will be key, particularly if they do not enjoy the benefit of the government's recent deposit guarantee scheme. Banks looking to make bond offers, on the other hand, will most likely be entitled to the benefit of the government guarantee scheme in respect of any bond issue they make.

Underwriting

Issuers may wish to consider having their bonds underwritten, providing prospective investors with an additional level of comfort in respect of their proposed investment.

Pricing

Pricing of bonds will be an important consideration for potential investors. With the official cash rate having fallen by 3.25% over the last five months, and with further rate reductions predicted, the rates offered on new public bond offers are likely to track the interest rate reductions in due course. Investors will be keen to invest in securities offering higher fixed rate returns while they are available. Accordingly, potential issuers would be prudent to kick-start the process sooner rather than later to ensure that they remain competitive in this market.

Key bond terms

Factors such as the maturity date for the bonds and whether or not bonds are secured or subordinated will also be important in determining how attractive the bonds will be to potential investors.

Listing

Where an issuer wishes to trade its bonds on the NZDX, compliance with the NZX listing rules will be necessary. This will involve liaising with both the NZX and, in the later stages of the transaction, the organising broker, to ensure that the various requirements in connection with listing the bonds are complied with within the required timescales.

Timetable

A detailed timetable will assist with the smooth running of the offering process. The time involved in ensuring compliance with the statutory requirements for a bond offer should be borne in mind, including time required to obtain any consents and to seek the necessary approvals from the Companies Office and, where relevant, NZX prior to opening the offer.

How we can help

The Minter Ellison team has extensive experience acting for issuers as well as underwriters and trustees in connection with securities offerings to the public. Our expertise in this area means that we are well placed to guide issuers through the detailed rules that govern retail bond offers and to provide specific advice in relation to a proposed bond offer.

We can help with ensuring that an appropriate timetable for an offer is established at the outset and adhered to throughout the process, as well as with the preparation of documents, the due diligence and verification process and liaising with all relevant parties to finalise the documents in advance of the offer.

Summary

The New Zealand market is ripe for raising funds through retail bond offers, but the window of opportunity may be limited, as interest rates continue to fall and competition in the bond market increases. Investor appetite for good quality bonds remains strong, providing an ideal alternative for banks and corporate borrowers seeking to raise capital.

Should you have any questions or wish to discuss a potential retail bond offer, we would be delighted to assist. The details of the relevant contacts at Minter Ellison are set out below.

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