CGIF-wrapped bond to spark Asean local currency market

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KEY TAKEAWAYS

· Noble Group's baht-denominated bond issue is the first fully guaranteed by a wrap from the Credit Guarantee & Investment Facility, an ADB trust supported by Asean+3;

· CGIF was established to deepen the local currency bond market in the Asean+3 jurisdictions;

· Under the guarantee, the acceleration of the bonds is only triggered by non-payment. Other events, such as a technical default, would not trigger the acceleration event;

· Structurally the CGIF resembles a guarantee by a monoline insurance company, but has more flexible criteria.

Noble Group's baht-denominated bond issue is the first fully guaranteed by a wrap from the Credit Guarantee & Investment Facility (CGIF).

The CGIF, established by the Association of Southeast Asian Nationals (Asean) along with China, Japan, Korea and Asian Development Bank (ADB), is a trust fund of ADB. Its initial authorized capital is $700 million, and it was created to encourage the development of the local currency bond market.

The trust allows local investment-grade corporates in the Asean+3 region to raise cheaper funds by borrowing its AA+ rating from Standard & Poor's, providing an alternative to bank lending and deepening the debt capital markets in Asean +3.

Allen & Overy's Yvonne So explained that CGIF's involvement enhances the credit ratings for these companies that otherwise have difficulties tapping local bond markets to secure longer-term financing and reduce their dependency on short-term foreign currency borrowing to mitigate currency and maturity mismatches.

Viroj Piyawattanametha of Baker & McKenzie added that typically there are parent guarantees or downstream guarantees from subsidiaries. But that won't have any meaningful impact on the credit rating, particularly if it is a corporate gurantee as credit risk still within the group.

"But this transaction, in which CGIF is providing the guarantee, will provide a new avenue for lower-rated corporates' fundraising activities," he said.

The product

The THB 2.85 billion ($96.34 million) offering issued by SGX-listed Noble Group have a tenor of 3 years and pay a coupon of 3.55%.

They are guaranteed by the CGIF and obtained a AAA(tha) rating from Fitch. In its press release, Fitch said that its view is that CGIF's credit profile is stronger than Thailand's Long-Term Local Currency IDR of A-, so its rating is similar to that of the Thai government.

A new guarantee structure

While standby letters of credit (SBLCs) have become a popular credit enhancement tool, the CGIF guarantee as a wrap introduced a slightly new structure into the Asian bond market.

Doungporn Prasertsomsuk, counsel at Clifford Chance, noted that the CGIF guarantee structure is similar to ADB's guarantees for loans and project finance deals.

Piyawattanametha added that the deal's complexity is from the structure itself. He stressed that this is the first time that CGIF has provided credit enhancement to an issuer in the market, so there was no precedent for its guarantee.

"We had to start from scratch, especially related to how the guarantee would look and how it would be called," he said.

Further, CGIF had made it clear that the only acceleration event whereby bondholders could request payment would be a payment default, such as failure to pay interest or principal. Other defaults, such as technical defaults in terms of the bond, will not trigger the acceleration event.

Why?

Marketing the bonds was complex, said Piyawattanametha. Investors expect certain features, such as a laundry list of defaults including payment and non-payment that will trigger acceleration under the terms of the bonds.

He added that for the CGIF guarantee, CGIF will only pay when there is a payment default. Other non-payment events would not result in CGIF obligations.

"We needed to explain and fully disclose the risk of this guarantee to investors to market the bonds, as this was a new feature for the market," he said.

Deal counsel also had to coordinate CGIF and the issuer's interests. So said that there is a parent guarantor, the parent and issuer will have one voice.

But a third-party guarantor has to look out: the guarantor and issuer may look at certain issues slightly differently. CGIF also takes into account local bond market practices in structuring the guarantee, she added.

Monoline guarantee comparisons

Deal counsel noted that the CGIF-guaranteed wrap resemble monoline guarantees provided by bond insurance companies in the US pre-financial crisis.

Allen & Overy's Yvonne So noted that the CGIF guarantee structure is similar to that found in monoline guarantees, but this is the first that ADB has completed via this trust fund in local bond markets.

"While other supranational entities like Japan Bank of International Cooperation (JBIC) guarantee bonds, they don't' usually do so in local currency issues," she said.

But CGIF may be more flexible than traditional monoline guarantees. So said that although the structures are similar, if one were to look at monoline deals, they'd see that CGIF looks at different and wider criteria because CGIF's guarantee is targeted at certain corporations and certain currencies.

"CGIF looks at what's required in the market and then considers whether they will accept a slightly different credit risk profile than what was originally intended," she commented.

What's next

Although Asia has so far seen more high-yield debt issuance so far in 2013 than it did in both 2011 and 2012 combined, corporates are looking to credit enhancement structures to achieve a lower funding cost.

Therefore credit enhancement structures have been a key source of innovation in Asia's debt capital markets since last year. SBLCs have been popular: in March, a subsidiary of Suzlon Energy completed an offering backed by a SBLC from the State Bank of India. Chinese securities broker Citic Securities also recently issued an SBLC- backed bond.

International institutional investors restricted from buying bonds below a certain rating are looking closely at these structures. To attract foreign investors, this deal is one of the few baht-denominated deals that is Euroclear-legible, so that they can buy, sell and trade their securities using their Euroclear accounts.

But this may be the beginning of CGIF-backed issuances to spark local currency bond markets. Regardless, deal counsel do not expect the credit enhancement trend to fade anytime soon.

So added that in this environment, some companies are finding it difficult to raise funds in a cost-effective way, predicting that supranational and government-sponsored entities would probably play a larger role.

Tear sheet

Allen & Overy represented CGIF, while **Clifford Chance** acted for the issuer.

Baker & McKenzie advised HSBC and TMB Bank Public Company as the joint lead arrangers and HSBC and Societe Generale as the joint financial advisors.

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