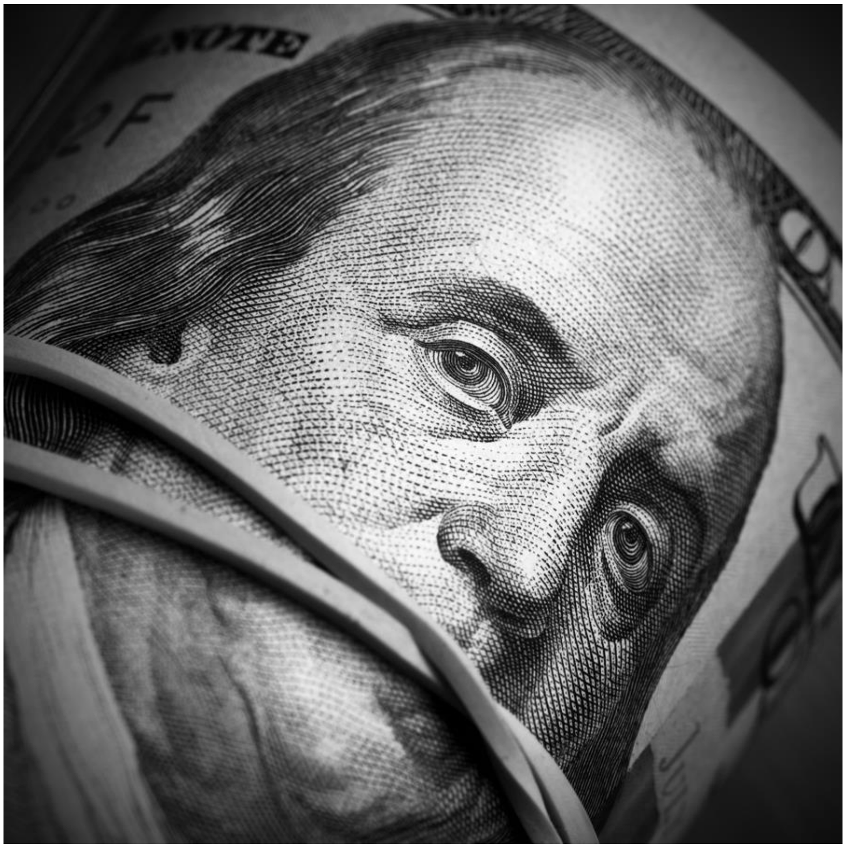

THE ALLOCATED'S DILEMMA:
THE DEVELOPMENT OF US CORPORATE BOND PRIMARY MARKETS IS GRADUALLY TAKING CENTER STAGE

Improving the mechanics of the US corporate bond market remains a popular topic amongst market participants, the media and regulators. The attention is warranted since the outstanding size of the US corporate bond market has increased rapidly over the last ten years. Almost every major corporation now relies heavily on debt to finance its on-going growth and development. Market modernization initiatives have almost exclusively focused on electronic trading. Currently, there are multiple platforms and protocols, but **all e-trading initiatives follow the guideline that technology should lead to greater efficiency, equality, and competition in the secondary market.** Recently, the conversation on innovation in the US corporate bond market has shifted to include primary markets. In the past few months there have been multiple articles discussing the future state of a technologically driven new issue process.

VIABLE MKTS

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Is primary market innovation taking center stage?

Who will be the voice guiding new issue evolution?

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New Issue is the New Black

In case you've been distracted, or not a consumer of this helpful weekly newsletter, you may have missed these articles on corporate bond new issue innovation:

Wall Street Accelerates Shake-Up in Market for New Bonds – Bloomberg (April 2019)
Wall Street Grafts New Technology on to Old-School Fundraisings (April 2019)
Bringing Corporate Bond Issuance Into the 21st Century – TABB (Sept 2018)

While there is palpable excitement for an improved process, one question has yet to be addressed: **What guiding principles should guide primary market development?**

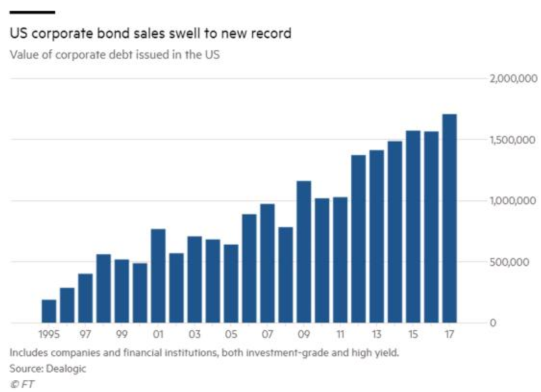
What are we fixing?

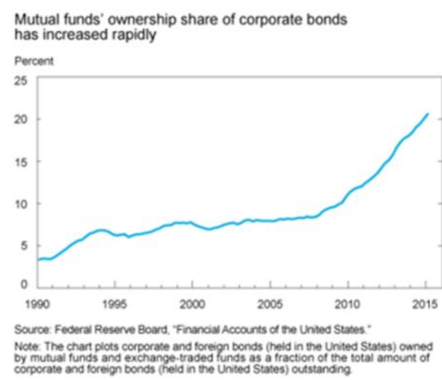
The inefficiencies of secondary trading are easy to visualize because they are relatable to all markets. Lack of organization between buyers and sellers is sub-optimal for trading, so electronic solutions address this problem by coordinating market participants. The process of issuing new corporate bonds is highly specialized, so only those with direct experience are familiar with the manual structural impediments. Without going into excessive detail, the corporate bond primary market problem is best described as a workflow and communication issue. **On a single deal, multiple syndicate desks, sales and trading desks, and buy-side clients must consistently and appropriately exchange information in a timely fashion WITHOUT committing any mistakes regarding accuracy**. Now imagine if several deals were happening at relatively the same time. This has occurred often over the past few years as the new issue market has consistently broken year over year records in terms of volume. Electronic solutions in the primary market can fix this workflow issue by introducing functionality that streamlines and coordinates this complicated workflow and communication process.

New Isn’t Always Improved

There is a tendency to assume that all new initiatives are additive to a given market’s evolutionary process. After all, what sense would it make to introduce a new idea if it wasn’t an improvement? Fundamentally, the purpose of a new solution is driven by the motivations of the platform operators. Based on their long-term goals, the idea may serve to improve the entire market or act as a barrier to preserve a closed system for a select few. If it is the latter, the pace of market evolution will stagnate. **Evolutionary delays to the primary US corporate bond market would be extremely dangerous because it is the heart of corporate finance** and vital to buy-side clients who need access to new bonds.

Therefore, it is imperative that all new primary market initiatives be evaluated based on guiding principles that promote a system that will be beneficial to all market participants and issuers.





BACE Standards for Primary Market Innovation

Guiding principles create objective reference points that can be leveraged to examine the workflow and protocols of any platform. While these standards were established organically in the secondary corporate bond market, the primary market requires an initial framework to accelerate the process:

Balance
New issuance innovation and related technologies must consider and balance the needs of investors, issuers and all syndicate banks.

Access
Technologies introduced should not create new barriers for ANY market participants to take part in the new issue process. Outsized or incumbent participants should not be able to exclude qualified smaller or newer participants.

Collaboration
Technologies should be interoperable, allowing competing solutions to exist, but without burdening investors with the inefficiency of needing to make multiple investments to access the full set of available deals.

Economics
Shifts in the economic or commercial terms brought on by innovation should not exclude or disadvantage qualified investors from participating in the issuance process.

This framework is not fixed and will undoubtedly be shaped and improved by an ongoing debate on the future of the primary US corporate bond market. However, even in this current form, the BACE Standards can be used to evaluate existing and impending primary market initiatives to help the market avoid disruption and ensure that all issuers, syndicate desks, trading desks and buy-side clients benefit from modernization.

The Allocated's Dilemma

The romantic version of how markets improve is that a swashbuckling entrepreneur with a vision eventually establishes a better solution and Voila! another step is taken towards modernization. No new idea gets off the ground without consistent support for the concept by a group of market participants. In fixed income markets, this responsibility falls to the buy-side and more specifically to asset mangers because they must make best efforts to improve execution for their clients. This is the reason why fixed income conferences, online articles and TV appearances are dominated by buy-side voices. However, in the debate to improve primary corporate bond market structure, the buy-side is conspicuously absent. This is especially noticeable relative to how vocal buy-side leaders are when it comes to electronic trading and secondary market liquidity. This is due to a dilemma that is specific to the primary market. **Receiving new issue allocations is so important to investment returns in corporate bond funds, that buy-side institutions do not want to risk being viewed as critical of the banks who determine these allocations**. Further complicating this problem, the buy-side institutions that benefit most from the existing manual, discretionary allocation process, may view innovation of the primary market as a material threat to their performance.

Unless key corporate bond market participants put their fears and self-interests aside, there will be no real debate on the evolution of the primary market. The ongoing protection of investors and issuers could be compromised because silence will result in new issue market structure being dictated by the few instead of collaboratively developed by the many.