

Can a Minor Regulatory Intervention Lower Corporate Borrowing Costs?

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Motivation & Research Question

- The corporate bond market is the largest source of capital for U.S. firms.
- Significant information processing costs are in the primary corporate bond market due to extreme time constraints [1, 2].

CORPORATE BONDS

Bond Fund Managers Often Get Rushed Into Deals. The SEC’s Investor Advocate Is Worried.

By Alexandra Scaggs

Feb 24, 2021, 3:30 pm EST

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Reprints

Bond fund managers say they don’t have enough time to fully evaluate the contracts backing the bonds they’re buying, according to the latest Investor Advocate’s report [from the Securities and Exchange Commission](#). The report recommends that regulators take a closer look at the issue.

Figure 1. Barrons Anecdotal Evidence

- Research Question:** Do information processing costs play a role in shaping bond prices in the primary corporate bond market?

Institutional Background — IPC in the Primary Bond Market

Table 2 Issuance Timeline Example of a New Bond	
Time	Step
8:45 AM	<ul style="list-style-type: none">Underwriters announce a new issue, via Bloomberg system, phone and instant Bloomberg (IB). This is an eight-tranche deal, initially expected to total \$8 billion. Use of proceeds – provide a portion of the purchase price of Karft foods. Initial price “talk” (IPT) provided – not official guidance, simply the start of the process to determine pricing.Sales force begins discussions regarding investors’ interest and price expectations (price discovery).Investors attempt to evaluate the issuer’s credit quality and prospectus terms.Net roadshow available.
10:11 AM	Preliminary prospectus made available direct from underwriters. It is 140 pages, including 30 pages of “Description of Notes”, which includes the covenants.
11:30 AM	Deal goes subject (orders after this time are submitted on best-efforts basis).
12:45 PM	Revised price guidance issued: 20-25bp inside of IPT. Total amount raised to \$10 billion.
4:30 PM	Underwriters advise investors of their allocation.
4:59 PM	Deal is priced.
Source: The Credit Roundtable. (2015). Corporate bond underwriting and distribution practices, presented to the U.S. Securities and Exchange Commission on 07/01/2015.	

Figure 2. Issuance Timeline of a New Bond

Institutional Background — IPC for Exhibit Index

Exhibit Index in the bond prospectus:

- Attach secondary documents for validation.
- Exhibit files include **bond indentures**, financial ratios, loan agreements, etc.
- Exhibit files are often lengthy.
- Access to exhibit files is cumbersome.

“Why don’t investors have easy access to exhibit indenture and time to review it before the deal is priced and closed.”

“Investors have to search through the issuer’s EDGAR files and review the exhibits to multiple previous filings.”
—The Credit Roundtable

EXHIBIT INDEX	
Exhibit Number	Description of Exhibit
1.1*	Form of Underwriting Agreement.
3.1+	Restated Articles of Organization of the Company, as amended, filed as Exhibit 3.1 to the Company’s Quarterly Report on Form 10-Q for the fiscal quarter ended May 3, 2008 (File No. 001-07819), as filed with the SEC on May 20, 2008.
3.2+	Amendment to Restated Articles of Organization of the Company, filed as Exhibit 3.1 to the Company’s Current Report on Form 8-K (File No. 001-07819), as filed with the SEC on December 8, 2008.
3.3+	Amended and Restated By-laws of the Company, filed as Exhibit 3.1 to the Company’s Current Report on Form 8-K (File No. 001-07819), as filed with the SEC on January 28, 2010.
4.1+	Indenture dated June 3, 2013, by and between the Company and The Bank of New York Mellon Trust Company, N.A. (as Trustee), filed as Exhibit 4.1 to the Company’s Current Report on Form 8-K (File No. 001-07819), as filed with the SEC on June 3, 2013.
5.1	Opinion of Wilmer Cutler Pickering Hale and Dorr LLP.
12.1	Computation of Consolidated Ratios of Earnings to Fixed Charges.
23.1	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.
23.2	Consent of Wilmer Cutler Pickering Hale and Dorr LLP (included in Exhibit 5.1).
24.1	Powers of Attorney (included on signature pages).
25.1	Statement of Eligibility on Form T-1 of The Bank of New York Mellon Trust Company, N.A., Trustee.
+ Previously filed with the SEC and incorporated herein by reference. * To be filed by an amendment or as an exhibit to a report filed under the Exchange Act and incorporated herein by reference.	

Figure 3. Information Processing Costs for Exhibit Files

Setting

- Exhibit Hyperlink rule** in 2017 mandates all SEC’s registrants to add hyperlinks to each exhibit in the exhibit index of registration statements and periodic reports.

**4.13	Indenture, dated as of December 1, 2001, from Ameren to The Bank of New York Mellon Trust Company, N.A., as successor trustee (relating to the senior debt securities) (“Ameren Senior Indenture”) (Exhibit 4.5, File No. 333-81774).
**4.14	First Supplemental Indenture to Ameren Senior Indenture dated as of May 19, 2008 (June 30, 2008 Form 10-Q, Exhibit 4.1, File No. 1-14756).
**4.15	Ameren Senior Indenture Company Order, dated November 24, 2015, establishing the 3.65% Senior Notes due 2026 (including the global note) (November 24, 2015 Form 8-K, Exhibits 4.3 , 4.4 and 4.5 , File No. 1-14756).

Figure 4. Example of Hyperlinked Exhibit Index

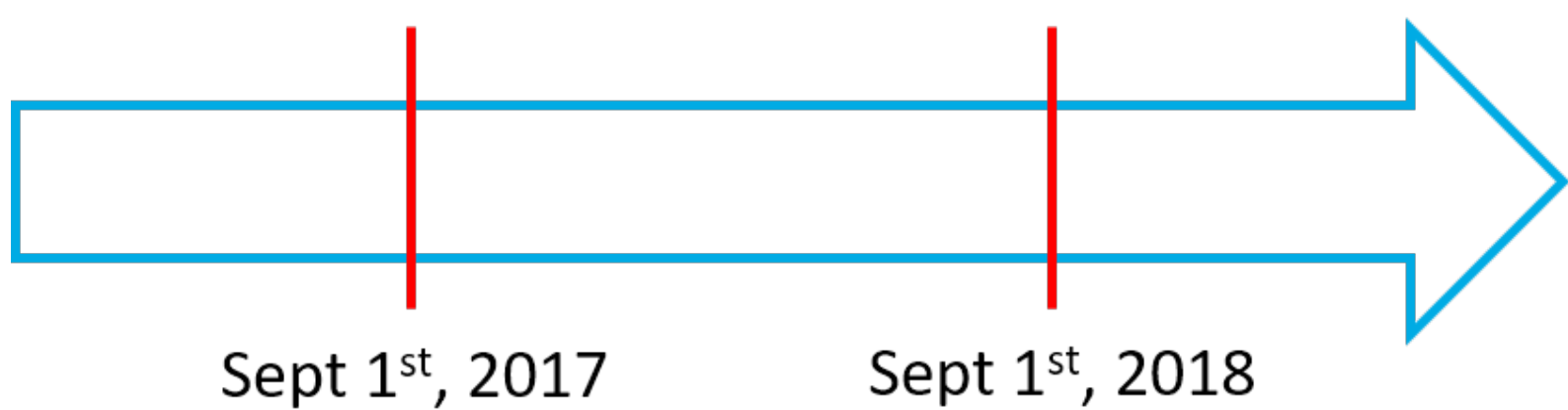


Figure 5. Effective Timeline

- Bond prospectus remains valid up to three years after announcement.

Research Design & Results

$$Offering\ Yield\ Spread_{i,j,t} = \alpha + \beta_1 Hyperlink_{i,j,t} + \beta_2 X_{i,j,t} + \eta_j + \mu_t + \phi_i + \varepsilon_{i,j,t} \quad (1)$$

Table 1. The Effect of Hyperlink Inclusion on Corporate Bond Yield Spread

	Offering Yield Spread			
	(1)	(2)	(3)	(4)
Hyperlink	-0.1328** (-2.12)	-0.1282** (-2.41)	-0.1355*** (-2.67)	-0.1217*** (-2.59)
Observations	3,985	3,985	3,985	3,985
Adjusted R^2	0.721	0.766	0.801	0.812

Table 2. Cross-Sectional Analyses

	Offering Yield Spread			
	(1)	(2)	(3)	(4)
Hyperlink	0.0890 (0.98)	-0.0820 (-1.51)	-0.2303*** (-3.38)	-0.1361*** (-2.93)
LargeEx*HL	-0.2408** (2.57)			
LargeCov*HL		-0.1376** (-2.09)		
BetterRating*HL			0.1238* (1.75)	
HighLiquid*HL				0.1783*** (2.80)
Observations	3,985	3,985	3,985	3,985
Adjusted R^2	0.814	0.817	0.813	0.814

Conclusion

- The inclusion of hyperlinks to exhibits facilitates easier access to relevant information and reduces bond borrowing costs.
- The documented effect is more pronounced for bond issues with higher information processing costs.

Contribution

- Extends the scope of the literature on information processing costs.
- Uncovers issues inherent in the bond issuance process.
- Informs investors, issuers, and regulators.

References

- [1] Jillian Grennan and David K Musto. Who benefits from bond market modernization? *SSRN Electronic Journal*, 2018.
- [2] Liying Wang. Lifting the veil: The price formation of corporate bond offerings. *Journal of Financial Economics*, 142(3):1340–1358, 2021.