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BEHIND CLOSED DOORS: NAVIGATING PRIVATELY PLACED HIGH-YIELD BONDS

– THOUGHT LEADERSHIP

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Companies are increasingly looking for faster and easier routes than traditional underwritten offerings to market their debt securities. With an annual deal flow of over US$100 billion, the debt private placement market is an attractive alternative to underwritten offerings, although nascent in the context of European high-yield issuances (with European market volume of less than €4 billion in 2022). In this briefing, we detail some of the current approaches to privately placed high-yield bonds and their practical and legal basis.

Overview

Capital flows into the European leverage credit market have grown significantly over the past decade, with high-yield funds deploying capital in excess of US$120 billion in H12023 and in excess of US$46 billion during Q32023 to high-yield bonds, leveraged loans and private credit products.[1] As capital has accumulated in high-yield funds, investors have sought new avenues to invest this capital and have helped develop a market for privately placed high-yield bonds. Such private placements of high-yield bonds can take many forms, but typically consist of:

(i) the issuance of an additional series of notes (Tap Notes) that are identical to an issuer's existing notes (Existing Notes), taking advantage of the "unlimited" nature of a typical bond indenture (a true tap);

(ii) the issuance of new notes under a new indenture that "mirror" the key covenants of an issuer's Existing Notes (a mirror tap); or

(iii) a new offering of notes under an indenture for an issuer that either does not have any Existing Notes or with covenants that are negotiated directly between an issuer and the investors (a new offering private placement and together true taps and mirror taps, European High Yield Private Placements).[2]

Each of these types of issuance benefits from a streamlined process, with reduced disclosure requirements and accelerated speed of issuance.

In common usage, the term "private placement" may also refer to a few different types of debt issuances in addition to the European High-Yield Private Placements described above, such as a "US-style" private placement based on the Model X form documents (*see "Legal Basis of Private Placements" below*). While the focus of this article is on European High-Yield Private Placements, US-style private placements represent a well-developed market that uses model form documentation developed by the American College of Investment Counsel in coordination with other market participants (primarily insurance companies). While there are similarities in the issuance process between this "US-style" private placement and European High-Yield Private Placements, the typical covenants of such "US-style" private placements are more similar to those found in bank debt rather than to the incurrence covenants that typically govern European high-yield notes.

Key advantages of privately placed high-yield bonds

There are a few key elements that distinguish a European High-Yield Private Placement from an underwritten offering of bonds; namely, the substantial flexibility in disclosure because an offering

1. Source: Dealogic
2. European High Yield Private Placements are not appropriate for all issuers and not all notes are suitable for high yield private placements which, depending on the transaction, have adverse effects on pricing.

memorandum is not required, direct interaction between the issuer and investors, and an accelerated timeline to market.

Disclosure flexibility

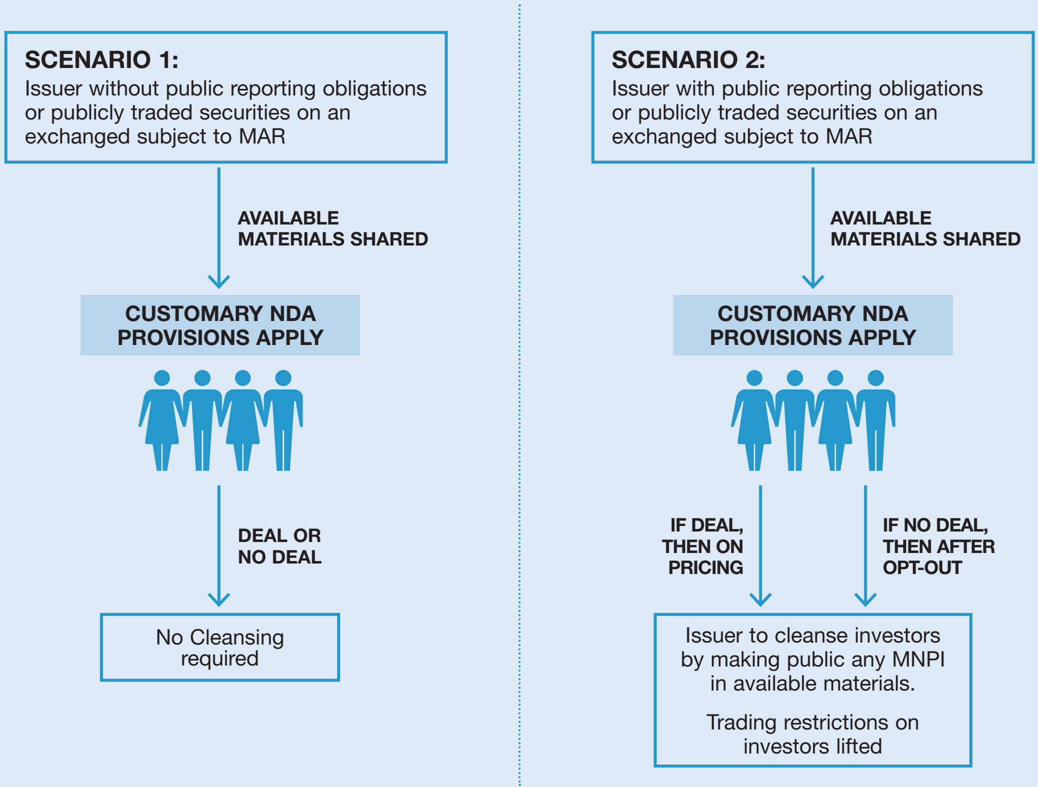
A European High-Yield Private Placement's most substantial benefit is the issuer's ability to bypass producing a formal disclosure document (an offering memorandum) and all of its associated costs and time implications. Private investors are responsible for conducting their own due diligence on the issuer's creditworthiness and the price of the privately placed bonds. Unlike initial purchasers in an underwritten offering, investors in a European High-Yield Private Placement generally do not receive 10b-5 negative assurance letters from counsel or comfort letters from auditors.

The issuer and the placement agent identify a select group of target investors and, particularly for publicly listed securities, it is best practice to ''wall-cross'' such investors by informing them that they may be given material non-public information (MNPI) about the issuer and enter into non-disclosure agreements to maintain confidentiality and prohibit any trading in the issuer's securities on the basis of MNPI (*see the below chart for some timing considerations regarding cleansing for the EU and UK Market Abuse Regulation (MAR) and non-MAR issuers with regards to providing MNPI to investors*).

Cleansing considerations

Issuers need to ensure that any MNPI provided to new investors on a private basis is also released to the wider market to "cleanse" the new investors so allowing them to start trading in the securities acquired based on any MNPI. Thus, issuers (and their advisors) should consider the marketing value of any information to be provided to investors in light of the sensitivities of eventually disclosing the same information to the world at large.

The below illustrations highlight the cleansing obligations and timing requirements under MAR. Note that to the extent an issuer has Existing Notes outstanding, investor expectations are in favor of receiving any MNPI used as part of a private marketing process to ensure informational symmetries even if the Existing Notes are not listed on an exchange subject to MAR.



Once the investors are wall-crossed, they are typically provided with the following information (Available Materials):

- the offering documents from the original issuance (not applicable for new offering private placements);
- a ''*Capitalization*'' table showing *pro-forma* capitalization of the issuer giving effect to the notes issuance and a ''*Sources and Uses*'' table annotating the use of proceeds of the notes;
- investor presentations or other documents highlighting any material updates to the issuer's business, finances, operations and prospects;
- the form of note purchase agreement for buying the notes;
- the form of indenture governing the notes;
- any annual or quarterly reports provided to existing investors (if available); and
- potentially other information tailored to the target investors' specific needs.

Investor interaction

Private placements create a direct contractual relationship between individual investors and the notes issuer without an investment bank acting as an underwriter. While this relationship is typically mediated through a placement agent, issuers ultimately have greater flexibility in choosing their investor base. Given the private nature of the issuance, long-term investors, such as private credit funds, can take a significant portion of the offered securities and build relationships with the issuer on a going-forward basis.

Timing

As no offering memorandum is required and the suite of Available Materials is generally fairly limited, a private placement can be undertaken and completed within a significantly shorter time frame than an underwritten offering. This allows issuers to capitalize on favorable market windows and secure advantageous pricing with relatively smaller transaction costs. Because investors are responsible for their own diligence and are already familiar with the issuer, the burden on management time is also reduced.

Further, for both true taps and mirror note offerings, the offering price will typically be based on the Existing Notes, such that price discovery can take place based on public information, such that the offering can proceed on a confidential basis with a limited number of investors.

For issuers with publicly listed securities outstanding, market timing is important (see the discussion on MAR above). Accordingly, even though the typical timing considerations of an underwritten offering (which often arise around availability of financials and staleness) do not apply to a private placement, the optimum time to launch a private placement offering is typically immediately following an underwritten offering or financial reporting when the issuer does not need to disclose any MNPI to investors.

Transaction tip

Issuers can also take advantage of favorable market windows by locking in commitments from private debt investors at a fixed price and defer the issuance of the notes until some point in the future.

Other key considerations for european high-yield private placements

When considering whether to proceed with a European High-Yield Private Placement, issuers must consider the role of certain agents and advisors needed to fill some of the gaps left by the absence of underwriters, be familiar with the customary and required documentation and in the case of a true tap, ascertain whether the bonds can fungibly trade with applicable Existing Notes.

Transaction participants

In an underwritten offering, investment banks underwrite the offering and thus take the lead in identifying investors, mediating any interactions with investors and handling the settlement of the notes. Given a private placement's direct contractual nature of the relationship between issuers and investors, a placement agent may fill the void left by the underwriters by assisting issuers with identifying potential investors, and a settlement agent may assist with the settlement of the private placement through the clearing systems. In addition, legal counsel assist on a private placement – counsel for the issuer, counsel for the investors and often counsel for the placement agent.

Placement Agent.

The placement agent advises the issuer on the structure and marketability of the transaction, coordinates the transaction process and connects investors with the issuer.

The placement agent does not act as an underwriter and is not a party to the notes purchase agreement. The privity of contract with respect to the sale of the notes (and consequently any right of recourse) is only between the investors and the issuer. The placement agent may require investors to provide so-called ''big boy'' letters attesting that the investor is a ''sophisticated'' investor capable of its own diligence and assessment of the prospective investment and that it will not rely (or place blame) on the placement agent for any representations or investigations made or omitted by the placement agent with respect to the notes.

The issuer and the placement agent will typically sign a placement agency agreement to memorialize their respective roles and any rights against each other in respect to the transaction.

Transaction tip

As private placements are placed with the investors directly by the issuer (typically through a settlement agent) rather than through an underwriting bank, the closing mechanics can vary from what your settlement teams are accustomed to. It is vital to have clarity on the settlement mechanics, including the timing and precise amount of the purchase money as this can be operationally challenging if you are subscribing on behalf of multiple funds.

Settlement Agent

As the contractual relationship is directly between the issuer and the investors, a settlement agent assists the issuer with the settlement of the privately placed notes, coordinating the flow of the purchase money from the investors (and their underlying funds) to the issuer and the transfer of the notes from the issuer to the DTC and/or Euroclear/Clearstream accounts of the investors.

The issuer and the settlement agent will typically sign a settlement agency agreement to outline the settlement agent's services, rights and remedies.

Legal Counsel

Issuer's counsel typically holds the pen on most of the transaction documentation and is also expected to deliver legal opinions to the investors.

A single counsel is generally appointed to jointly represent the purchasers on the transaction. Although the issuer often covers the fees of the investors' counsel, there is an independent attorney-client relationship between such counsel and the investors.

Placement agents may also engage counsel to negotiate the placement agency agreement with the issuer and any ''big boy'' letters with the investors, and otherwise advise the placement agent or mitigating liability from the marketing and book-building process.

Similar to an underwritten offering, there is also counsel for the trustee and security agent (if applicable) who will assist with finalizing key legal documentation.

Transaction tip

Investors can always opt out of the designated counsel engagement and engage separate counsel for themselves either in lieu of or in addition to the designated counsel. This is not uncommon in cases where an investor requires a wider scope of representation than what is agreed, such as tax or bespoke regulatory advice.

Documentation

One of the key features of any underwritten securities offering is the production of an offering memorandum, which sets out key information related to the issuer as well as the securities. In a private placement, investors are individually responsible for conducting their own diligence and typically no such offering memorandum is produced (though often a short investor presentation is created summarizing the key features of the offering). As a result, the documentation requirements are reduced and can be produced more rapidly than in an underwritten offering, consisting primarily of a note purchase agreement, an indenture (or supplemental indenture if these are Tap Notes under an existing indenture) and global notes, and a placement agency agreement (if a placement agent is assisting).

Transaction tip

While the investors do not have recourse to placement agents, legal counsel or auditors for any material misstatements or omissions in the Available Materials, anti-fraud provisions still apply to private placements and investors potentially have legal recourse in the case of securities fraud. Both investors and issuers should ensure that the issuer's representations and warranties covering the Available Materials are appropriate for the transaction and suitable to ensure compliance with investor risk mitigation practices.

Note Purchase Agreement

This is the keystone agreement whereby the issuer agrees to sell, and the investors agree to purchase, the privately placed notes at a set price subject to the satisfaction of certain customary conditions precedent.

The issuer (and any guarantors, if applicable) makes standard representations and warranties, including with regards to its business, operations and financial condition, the completeness and accuracy of the Available Materials and the use of proceeds of the notes. The issuer also typically enters into a standard set of transactional covenants.

Investors also make representations that they are sophisticated investors who are aware of the risks in their investment and have conducted their own due diligence on the creditworthiness of the issuer.

Conditions precedent to the issuance of the privately placed notes typically include the confirmation of credit ratings and delivery of pre-agreed certificates and legal opinions to the investors. Once the conditions precedent are fulfilled, the investors transfer the funds to the issuer in exchange for the notes through the common depositary, typically with the assistance of a settlement agent.

Indenture and Global Notes

While the note purchase agreement governs the terms of the sale of the bonds and any representations made by either party speak to matters as of the day of signing and as of the day of settlement, the contractual relationship between the issuer and the noteholders is governed by the indenture.

The indenture serves as the operative contract between the issuer and the noteholder (represented by the bond trustee) and outlines matters such as any maintenance and/or incurrence covenants the issuer is subject to, the payment of interest and principal, default provisions, bondholder rights and remedies and the roles of the trustee and other agents.

In a true tap, the Tap Notes are represented by one or more global notes carrying the same CUSIP/ISIN as the Existing Notes and issued under the existing indenture. The global notes will be deposited with a custodian for the clearing system through which the Tap Notes will be settled and will be exchangeable with the Existing Notes. In this case, a new indenture will not be signed, but the issuer will execute a supplemental indenture or an officer's certificate, depending on the existing indenture, that increases the quantum of the original issuance.

If the new notes are not fungible, mirror notes are created under a new indenture. These notes will be functionally the same as the Existing Notes in terms of the key covenants and redemption schedules, but will trade separately under different CUSIP/ISINs and will not vote together with the Existing Notes.

For a new offering private placement, new covenants will be separately negotiated as part of the process between the issuer and investors.

Transaction tip

Investors need to consider their preference for immediate fungibility when discussing pricing with the issuer and the placement agent. If the deal is priced as a ''clean tap'', the initial interest period on the Tap Notes is calculated from the tap issue date to the first interest payment date of the Existing Notes. The Tap Notes and the Existing Notes are practically fungible thereafter, although they have different securities identifiers.

If the parties agree to a ''dirty tap'', the purchase price includes interest which would have accrued on the notes from the start of the most recent interest calculation period on the Existing Notes until the tap issue date. Tap notes in a ''dirty tap'' are typically issued under the same securities identifiers as the Existing Notes and are immediately fungible as the interest calculations are identical.

Legal basis of high-yield style private placements

A "private placement" is any placement of securities, including notes, that is not undertaken by way of a public offering. Such a placement may be structured to be exempt from the registration requirements of Section 5 of the Securities Act of 1933, as amended (the Securities Act) (which would require US registration) through Section 4(a)(2) of the Securities Act (Section 4(a)(2)), which provides an exemption for "transactions by an issuer not involving any public offering." Section 4(a)(2), however, offers no other significant definitions or means to interpret what falls within its scope. Based on case law, further safe-harbors set up under the scope of Section 4(a)(2) and common market practice, the following deal elements are generally accepted as qualifying a transaction to fall under the Section 4(a)(2) exemption: (i) limiting the number of offerees; (ii) generally smaller size; (iii) no general solicitation or advertisement; (iv) experience of the proposed investors; (v) nature of information and negotiation; and (vi) resale restrictions. For placements outside of the United States, the safe harbor afforded by Regulation S under the Securities Act (Reg S) may also be available for use, although market practice is generally the same as for a 4(a)(2) private placement.

Transaction tip

To properly avail themselves of the exemption under Reg S, issuers should take care to not take any actions which could reasonably be expected to ''condition'' the market in the United States for the debt securities. If in doubt, consult your legal counsel before releasing any non-routine information in the public domain or to any targeted persons in the United States during the transaction process.

Fungibility

A key consideration for true taps, both for issuers and investors, is whether or not Tap Notes will trade alongside the issuer's Existing Notes under the same ISIN/CUSIP.

Fungibility for US tax purposes

In the context of a true tap, differentiating tax treatments on Tap Notes as compared with the Existing Notes can affect their fungibility. Tap Notes typically require an identical coupon interest payment but do not require the same issue price. Thus, if the trading price of the Existing Notes has declined since the original issuance, the Tap Notes would likely be sold at or around the current trading price of the Existing Notes and will thus contain an ''original issue discount'' (OID), calculated as the difference between the purchase price of the tap notes and their face value (technically, their stated redemption price at maturity, or SRPM).

US tax law requires US noteholders to accrue OID that is in excess of a "de minimis" amount over the term of the notes under a constant yield method as taxable income. OID on Tap Notes is de minimis if it is an amount less than or equal to 0.25% x SRPM x number of complete years from tap issue to maturity date. If OID is de minimis then US tax laws allow this additional interest income to be ignored and Tap Notes can be traded fungibly with the Existing Notes.

If there is non-de minimis OID, then there could be tax consequences for both holders of the Tap Notes as well as those of the Existing Notes. In this situation, issuers must consider whether to issue the Tap Notes with separate ISINs to the Existing Notes or to issue "mirror notes," which could impact trading liquidity for investors in the Tap Notes (and so could dampen investor interest).

Transaction tip

In assessing whether to proceed with an issuance of Tap Notes, it is essential to discuss fungibility with counsel at the outset of a transaction and what steps, if any, can be done to ensure fungibility from a US tax perspective.

In examining the key questions of whether Tap Notes will be fungible, there are considerations based on US Securities laws as well as US tax laws.

From a US Securities law perspective, an issuer of unregistered securities must first determine the key exemption it intends to rely on from the Securities Act. In an underwritten transaction, issuers typically rely on Reg S when selling notes to investors outside of the United States and Rule 144A of the Securities Act (Rule 144A) when selling notes to US investors. For a private placement, such exemptions are analogous as most non-US corporate issuers rely upon (i) Reg S when placing Tap Notes outside the United States through offshore transactions and (ii) Section 4(a)(2) when placing Tap Notes to US investors (*see Annex I (Transfer Restrictions) for further information*).

Thus, the timing of when Tap Notes become fungible with the Existing Notes depends on the key exemption relied on to place the Tap Notes as well as the distribution compliance requirements and resale restrictions applicable to such notes as explained in the table below. Once fungible, the Tap Notes and Existing Notes bear the same security identifiers and are identical to the holders for all practical purposes.

Conclusions

Issuing notes through a European High Yield Private Placement can be a streamlined method for issuers to raise a significant amount of capital in a cost effective and expedited manner. This placement structure offers issuers flexibility and advisors with experience in private placements can add a considered view on whether such an offering can be effectively utilized by an issuer and optimize the process for both issuers and investors.

ANNEX I

Exemption Category	Fungibility with Existing Notes	Resale Restrictions
Reg S Category 1 No SUSMI*	Immediately fungible with the Existing Reg S Notes and have same ISIN/CUSIP.	No resale restrictions
Reg S Category 2 There is SUSMI*	Contain temporary ISIN/CUSIP for 40 days following the issue date. After the 40-day period, the ISIN/CUSIP is replaced by those applicable to the Existing Reg S Notes and they become fungible.	Prohibited from freely reselling the notes in the United States or to, or for the account or benefit of U.S. persons for 40 days following the issue date unless availing of a resale exemption such as Rule 144A.
Section 4(a)(2)	Fungible with Rule 144A Notes immediately upon issue.	Deemed ''Restricted Securities'' and prohibited from freely reselling** the notes in the United States for at least one year following the issue date unless availing of a resale exemption such as Rule 144A.***

* SUSMI means ''Substantial U.S. Market Interest'' which is considered to exist if the issuer has more than US$1 billion and 20% of its debt securities held by 300 or more U.S. holders. Most non-U.S. corporate debt issuers assume the existence of SUSMI out of caution if they have previously issued debt securities inside the United States.

** Note that holders of the Rule 144A Notes can resell the Notes outside the United States at any time. In this case, the clearing systems and the transfer agent will convert your Rule 144A Notes to Reg S Notes before resale.

*** Note that Rule 144A Notes in Europe are typically issued as "Rule 144A for life" and as long as such notes are outstanding, the procedures of Rule 144A are required to be followed for any resales inside the United States.

CONTACTS

Michael Dakin
Partner
T: +44 20 7006 2856
E: michael.dakin@cliffordchance.com

Jill Concannon
Partner
T: +44 20 7006 1142
E: jill.concannon@cliffordchance.com

Drew Rundus
Partner
T: +44 20 7006 2875
E: drew.rundus@cliffordchance.com

Phil Houten
Senior Associate
T: +44 20 7006 3088
E: phil.houten@cliffordchance.com

Yash Ranade
Senior Associate
T: +44 20 7006 1458
E: yash.ranade@cliffordchance.com

Garo Yaghsezian
Associate
T: +44 20 7006 5448
E: garo.yaghsezian@cliffordchance.com

C L I F F O R D

C H A N C E

www.cliffordchance.com

Clifford Chance, 10 Upper Bank Street, London, E14 5JJ

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