

FeBAF-VOEB event on “New Financial Instruments: the Experience of Schuldscheindarlehen in Germany and the Comparison with Mini-Bonds in Italy”

Background Document on Schuldscheindarlehen

I. Introduction & Definition

With origins dating back to the 19th century, *Schuldscheindarlehen* have been used as a financing instrument by many small to medium-sized enterprises for a long time.

A *Schuldscheindarlehen* is a flexible, investment grade, private placement debt instrument, positioned between bank loans and corporate bonds. It is a bilateral contract between the borrower (issuer) and the lender (investor) and is not (other than corporate bonds) a security. It is an unsecured financing instrument often used as financing tool for company growth and investment projects – without being tied to a particular project – starting from nominal amounts of € 10 million. The principal underwritten by investors is disbursed to the issuer, with the full issue volume repaid at maturity. Usually there are several tranches, fixed and floating over 2 or 3 maturities and even two currencies. Compared to the documentation required for a corporate bond issue, the administrative requirements for a *Schuldscheindarlehen* are less demanding: publication and documentation costs are lower; neither a prospectus nor external rating is required. The German Civil Code (“BGB”) already includes regulation about loans and a *Schuldschein* certificate. The lean requirements are *pari passu* to existing syndicated/bilateral financings, warranting efficiency in the *Schuldschein* market along with a high degree of standardization. Given the streamlined concept, there are only few references to the civil law.

Due to its high flexibility in terms of volume, tenor, amortization, coupon and currency, the *Schuldscheindarlehen*, as an alternative mid- to long-term financing instrument, is suitable for medium-sized enterprises, as well as for larger domestic and international companies. A stable and reliable investor base (“hold to maturity”) builds broad fundament for future growth. The Investor base is becoming more international. This enables a flexible approach, for smaller Private Placements or for bigger transactions in the future.

In order to support the goals of Capital Markets Union, the successful practice of issuing *Schuldscheindarlehen* has been advocated as a 'best-practice' case for pan-European, capital markets-based corporate financing.

II. Issuers & Investors

The issuers are by majority from Germany, but the range of issuers is becoming wider, in particular in European countries. On an international basis, the volume is concentrated in Austria, France and Switzerland. The trend definitely shows an internationalisation which is expected to continue. SMEs are increasingly active as issuers of *Schuldscheindarlehen*: the instrument offers independence in the context of debt financing. This is due to the fact that issuers determine the scope of investor relations; in contrast to bond issues, investors are known to the issuers. In a current trend, increasingly complex issuers with hospital and nursing home groups or rated housing and real estate companies enter the market.

Further to the increasing orientation of larger municipalities and local authorities towards the capital markets, public-sector entities are progressively turning to *Schuldscheindarlehen*. A higher level of standardisation and a broadening of the investor base can be highly beneficial for financing municipal projects.

III. Issuing Companies & Volumes

The Schuldschein market is growing significantly, especially since the financial crisis. During the crisis it became much more interesting for issuers as these are not affected by the ceasing bond market. After the consolidation the growth has continued until to date. Due to the strong year 2016, today's volume is higher than the average annual volume of the past decade which amounted to around EUR 12 billion. In 2016, a new summit has been reached with a transaction volume of close to 30 billion. Due to the high demand from investors, there is no real summer break in July and August. Depending on the capacities of investors, currently around 20 transactions can be marketed at the same time. Nevertheless it is recommendable to check on competing transactions with an experienced arranging partner regarding sector, rating, etc., in order to achieve the best result.

Most issuances come from industrial companies; the relatively highest volume is placed by automotive companies with a little more than 3 billion. For instance, Sixt SE issued a quite large Schuldschein in Q3 2016 with a volume of 375 million EUR. Swedish polymere-specialist Trelleborg AB collected around 200 million among investors. Foreign issuers placed in Germany 7.3 billion in 2016, this is a record in volume as well as in number of transactions. E.g. Clariant (Switzerland) issued a Schuldschein over 277 million. France is a meaningful example, with more than 30 deals executed since 2014. High-volume placements are in the trend. 80 % of the market share is taken by Schuldscheins of more than 200 million €. Basically, maturities reach from 1 to 30 years, but are getting longer in average. Contracts with maturities of more than 10 years are becoming more significant.

Issuances in Q1 2017 sup up to 6 billion; given 31 new Schuldschein transactions in this year banks expect a solid further evolution. Forecasts for 2017 sway between 20 and 25 billion € in total.

IV. The Actors

There is always an arranger involved in a Schuldschein transaction. In most cases, the arranger is a long term core relationship bank of the borrower with sound knowledge of the borrower's credit and risk profile. This knowledge is helpful for the arranger when negotiating the contractual terms and conditions of the Schuldschein transaction; the majority of which is agreed in advance of the agreements document being presented to the investors. The Arranger also facilitates the overall documentation process, thereby eliminating the requirement for separate borrower's legal counsel.

Moreover, the arranger facilitates the execution process, providing settlement and paying agency roles [as well as advisory services] to the borrower throughout the life cycle of the Schuldscheindarlehen.

V. Future Perspectives

“Green Schuldscheindarlehen“ have recently come to life, with so far five issuances recorded. Moreover, an intensified demand by savings banks, the return of southern European issuers and a growing investor base are contributing to growth. Further development indicators are medium to higher Investment Grade (IG) issuers and those with good brand recognition, and a further simplified documentation (compared to 2010). The Zero Floor of the reference rate, longer maturities due to the low interest rate environment, and a higher number of Private Placements with custom-made investor approach and short marketing period will mostly determine the forthcoming evolution.