

144A-for-Life in Real Time

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Over the summer, FINRA proposed a rule that, if adopted by the SEC, would allow TRACE to disseminate real-time secondary transaction information on 144As to the broader market. Under the proposal, the real-time data on 144As would be similar to what is currently disseminated for SEC-registered corporate bonds, and under a further proposal, a historical data set of 144A transactions would also be released. On September 6, the SEC responded that “the proposal is reasonable and consistent with the [Securities Exchange] Act” and approved of a rule change. FINRA now has until November 6 to file a regulatory notice on the change, which will become effective within 270 days of the notice.

The amount of 144A debt has grown quickly over the past 15 years. In fact, the growth in the 144A-for-life market has outpaced the rest of the high yield market, with the former accounting for nearly 25% of the overall market today (Figure 2); recently, new issue volumes have also skewed significantly toward the 144A-for-life market. And 144As account for an increasingly large fraction of volumes in the high yield market (see *Voluminous*, August 2, for more details).

The popularity of 144As has increased for several reasons. From the issuers’ perspective, the ability to avoid costs associated with filing public financials is a significant positive, especially since the passage of the Sarbanes-Oxley Act in 2002. For investors, the decrease in transparency – in terms of both public filings and secondary market transaction data – has come with some incremental spread compensation.

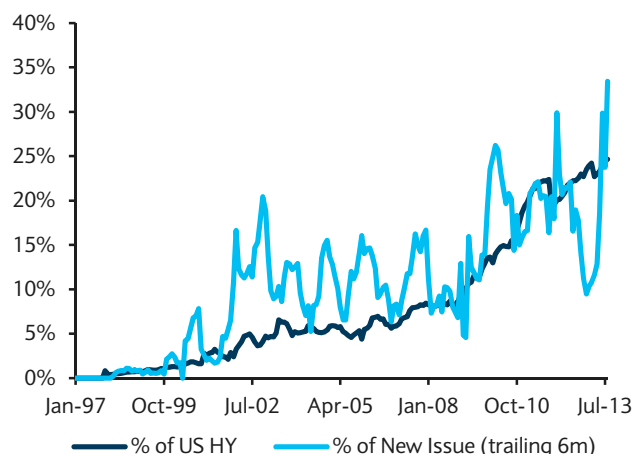
Indeed, taking into account other factors such as credit rating, duration, and issue size, the average excess spread compensation for private placements is currently 54bp¹. This additional amount paid by 144A-for-life issuers has declined in the past few quarters, from as high as 140bp in 3Q12, amounting to about \$0.75 of high yield market price performance over that period. Notably, the amount that issuers pay on average for a one-notch decrease in ratings has been relatively constant in the past decade, hovering at 50-70bp, while the compensation on offer for 144A-for-life bonds has fluctuated significantly (Figure 3).

FIGURE 1
Cash and CDS Movers

High Yield Cash					
Best	Px	Chg	Worst	Px	Chg
BZ 8 '20	113.50	+6.5	TXU 6.55 '34	32.00	-8.0
VRS 11.75 '19	67.50	+4.5	SRNCOM 10.5 '15	69.00	-3.0
CZR 6.5 '16	79.00	+4.0	AFFINI 11.625 '15	58.75	-2.0
High Yield CDS					
Best	5y	Chg	Worst	5y	Chg
SRAC	12.2 pts	-4.8 pts	TXU_E	94.5 pts	+0.5 pts
RSH	21.5 pts	-2.7 pts	NMG	363 bp	+92 bp
AKS	19.0 pts	-2.7 pts	MBIA	10.0 pts	+2.0 pts

Source: Barclays Research

FIGURE 2
144A-for-Life Component of U.S. High Yield Index and of High Yield Supply

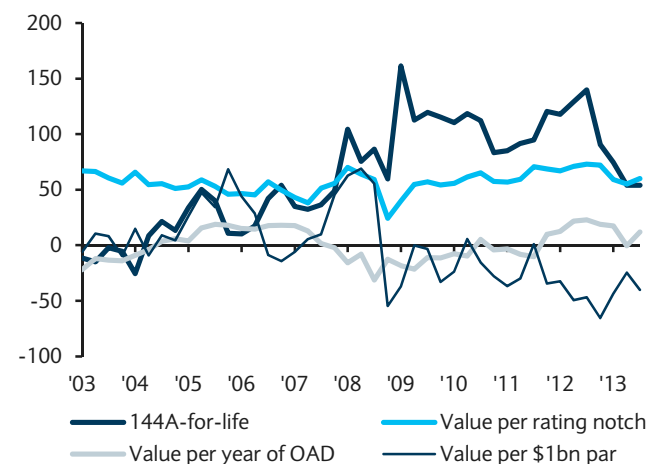


Source: Barclays Research

¹Based on a four-factor regression of OAS on credit rating, par amount, duration, and a 144A-for-life dummy variable.

FIGURE 3

Average Spread Compensation for Size, Duration, Credit Quality, and 144A-for-Life Risk Factors

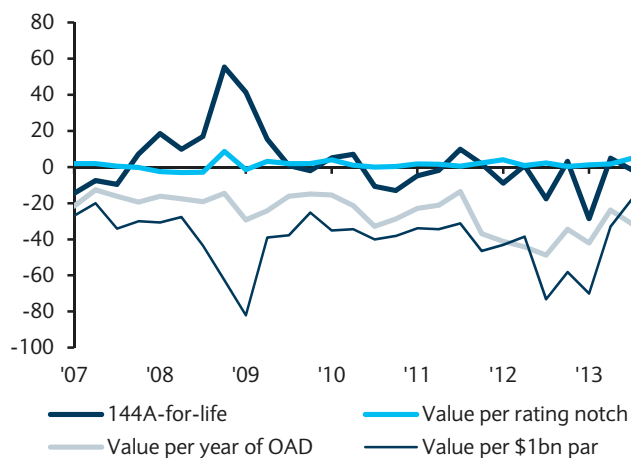


Note: Excludes bonds with OAS greater than 1,500bp.

Source: Barclays Research

FIGURE 4

Average Bid-Ask Explained by Size, Duration, Credit Quality, and 144A-for-Life Risk Factors



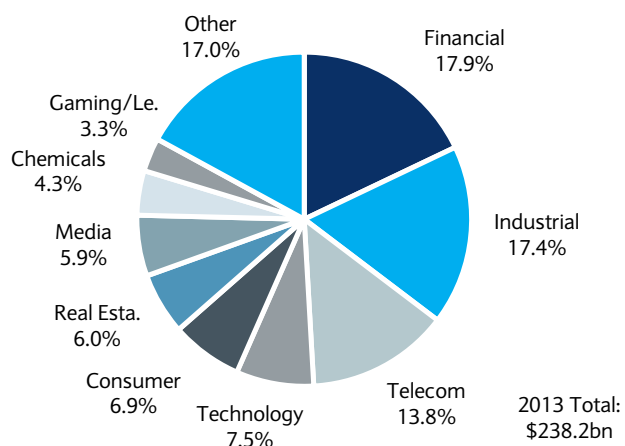
Note: Excludes bonds with OAS greater than 1,500bp.

Source: Barclays Research

Interestingly, the average incremental bid-ask spread paid for 144A-for-life bonds in excess of the bid-ask for non-144A-for-life bonds is negligible once other factors (especially size and duration) are taken into account (Figure 4).

While some managers are altogether restricted from holding 144A-for-life securities and many others have 144A concentration caps, the trend of increasing issuance in that part of the market suggests that those limits have not been a constraining factor yet. With increased secondary market transparency coming soon, we expect managers to push for those limits to be relaxed over time. At the same time, to the extent that a portion of the incremental spread compensation came from a lack of secondary market transparency, the 144A-for-life discount should compress once real-time data become available; it should not disappear entirely, though, given that investors will continue to demand compensation for the lack of public financials.

High Yield Supply by Sector – 2013 Breakdown



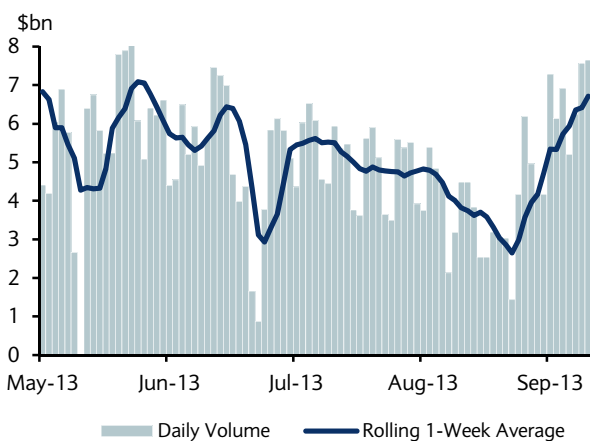
Source: Barclays Research

Top On-the-Run CDX Index Names by Weekly CDS Volume

	Notional Outstanding (\$bn)		Volume – Week Ending 9/13/13 (\$mn)
	Gross	Net	Gross
J. C. Penney	26.8	1.8	876.1
Tex Comp Elec Hds	15.3	0.8	685.6
Caesars Ent.	26.7	1.4	618.8
MBIA Insurance	61.2	1.7	600.6
RadioShack	20.3	0.9	539.3
Radian Group	34.7	1.1	486.9
Ally Financial	21.4	1.2	415.4
Lennar	27.4	1.1	394.6
Clear Channel	24.1	1.0	384.0
Chesapeake Energy	11.0	1.1	374.4

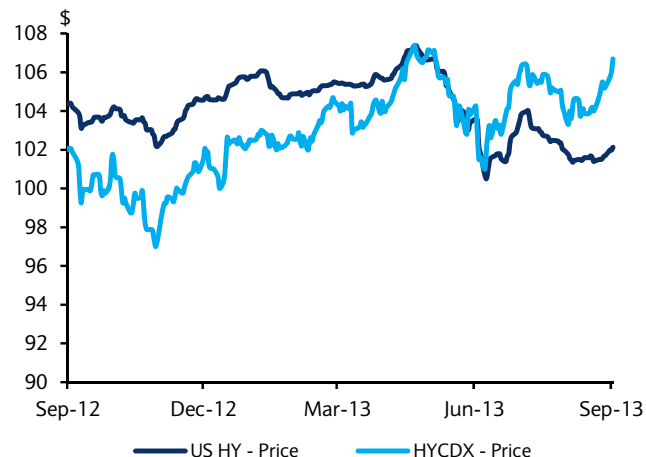
Source: Barclays Research

High Yield Average Institutional Trade Volume



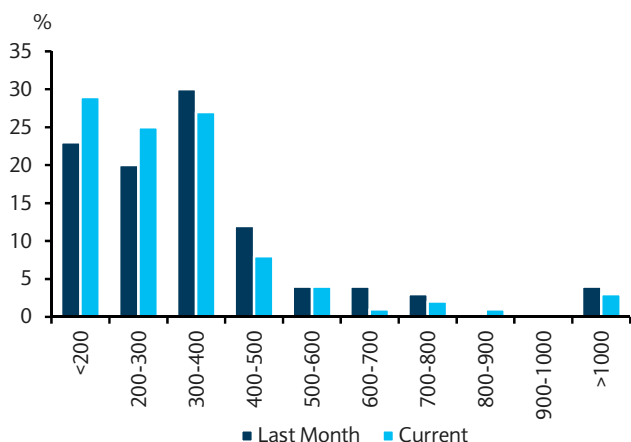
Source: Barclays Research

On-the-Run HYCDX versus U.S. High Yield Index



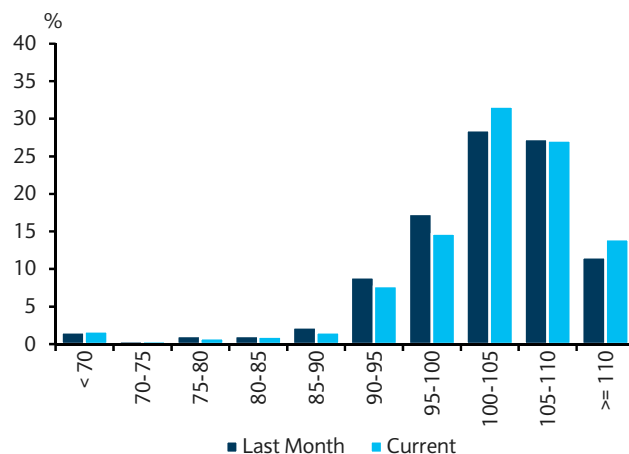
Source: Barclays Research

On-the-Run HYCDX Spread Distribution



Source: Barclays Research

High Yield Index Price Distribution by Par



Source: Barclays Research

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