# Introduction

Existing literature on bond market trading has predominantly focused on liquidity-based trading and the negative effects of such trades on the market. Studies have found that corporate downgrading, fund flows, and illiquid fund holdings can lead to fire sales and fragility in the bond markets (Ellul et al., 2011; Goldstein et al., 2017; Falato et al., 2021; Jiang et al., 2021). Some research has examined the ability of bond funds to benefit from liquidity provision trades (Wang et al., 2020; Anand et al., 2021). However, the examination of information-based trading in the bond market remains limited. This study aims to fill this gap by investigating the transmission of information from private debt to public debt markets and the role of relationships between bond mutual funds and affiliated banks in these activities.

Modern large financial conglomerate may have business branches including commercial loan and mutual fund. We investigate the possible interaction between the commercial lending business and the bond mutual funds within the same conglomerate. A leading bank can obtain in-depth information of the borrower as of the guideline by OECD [[1]](#footnote-1) , *“Due diligence is appropriate to an enterprise’s circumstances – The nature and extent of due diligence can be affected by factors such as the size of the enterprise, the context of its operations, its business model, its position in supply chains, and the nature of its products or services. Large enterprises with expansive operations and many products or services may need more formalised and extensive systems than smaller enterprises with a limited range of products or services to effectively identify and manage risks.”*

For the benefit of the business, the possible motivations for a lead bank to share borrower information with its bond mutual fund could include:

* Investment Opportunities: Sharing information with the mutual fund can provide the fund with investment opportunities in the form of bonds issued by the borrower. This can lead to potential returns for the mutual fund's investors.
  + *Example: CEQUEL COM Holding, a private cable satellite service provider in St. Louis, took a revolver loan of $160 million on Feb. 10th, 2012 with Wells Fargo as one of the arrangers. Wells Fargo Advantage High Income A fund purchased the bond CUSIP 15672WAA2,rated B3 by Moody’s, $10 million, for a price about 100% of face value and the bond appreciated to 103% of the face value a quarter later. The bond also carries a coupon of 8.625%. The unrealized return of the bond for the quarter is 5.15625% approximately*.
* Enhanced Credit Assessment: The mutual fund could use the borrower's information to conduct a thorough credit assessment and better understand the borrower's financial health and creditworthiness. This can help the fund make more informed investment decisions.
* Synergy and Information Sharing: By sharing borrower information, the lead bank and the mutual fund can benefit from each other's expertise and insights, leading to better decision-making and risk management practices across both entities.
* Cross-Selling Opportunities: The lead bank may want to introduce the mutual fund as an investor in the borrower's bonds, loans, or other securities, potentially generating fee income for the bank and creating a stronger relationship with the borrower.

Lending activities and loan negotiations should discover the exact information that is pertinent to bond investors.

The graph in *Figure 1* demonstrate the parties: Bank/Financial Institutions, Bond Mutual Funds and loan Borrower who is also the Bond Issuer; the financial instruments: Laon Facility and the Corporate Bond; and the actions of each parties: Bank/Financial Institution serves as the lead lender who arranges the loan and also own the mutual fund, Borrower/Bond Issuer borrow the loan and also issued bond, whereas the Mutual Fund buy or sell the bond during the loan arrangement.

Our investigation shows that lead bank affiliated mutual funds outperformed on the corporate bonds issued by the syndicated loan borrowers. The performance is driven by the purchasing activities and the performance reflects the borrower’s fundamentals such as rating and therefore there is no reversal of such observations.

This project also adds to emerging literature on how relationships affect trading in the bond market. Hendershott et al. (2021) focus on the relationships between insurers and dealers and examine how insurers trade off the benefits of repeat business and efficient trade execution. Gil-Bazo et al. (2021) show that bank-affiliated funds in Span provide funding support to their parent company during crisis times at the expense of fund investors (via purchases of bank bonds in the primary market). We add to the literature by examining how bond funds exploit the connection to their affiliated banks to gain information advantage via loan originations.

1. <https://mneguidelines.oecd.org/final-master-due-diligence-for-responsible-corporate-lending-and-securities-underwriting.pdf> [↑](#footnote-ref-1)