MARF: Perspectives and risks for Spain´s new alternative fixed income market

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In Europe, and in Spain in particular, bank credit has been the predominant source of financing for companies. The trend towards financial disintermediation following the crisis has therefore seriously hindered Spanish companies´ access to finance. Spain´s new Alternative Fixed Income Market (MARF, in its Spanish initials) may help provide relief in the absence of traditional bank credit channels.

This article examines the Alternative Fixed-Income Market (MARF, in its Spanish acronym), which was launched in October 2013, in comparison to similar alternative funding markets set up in European countries in recent years. MARF is one of the main mechanisms driving the process of financial disintermediation in Spain, and may help alleviate the closure of traditional bank finance channels to Spanish companies. However, it is still too early to estimate its potential capacity, given limitations related to Spain´s high proportion of SMEs and the need for positive demonstration effects from leading new issuers.

MARF in the context of financial disintermediation in Spain

A comparative analysis of financing sources for non-financial companies in the US and in Europe is a good indicator of the differential effect of the financial crisis on these companies' ability to obtain credit in some regions compared to others. Whereas companies in the US obtain 47% of their financing from non-bank channels (mainly capital markets), companies in Europe receive only 15% from such sources, a fact that illustrates the severe impact the crisis has had on the capacity to start a business, invest and innovate.

Spain is no exception when it comes to companies´ access to finance. The situation of Spanish corporates has deteriorated due to the credit crunch since 2008, given a climate of significant regulatory changes and repair of bank balance sheets.

The persistent cutoff of bank finance to business, especially for unlisted companies, has led to a search for and development of a number of initiatives for raising funds through non-bank channels. The Alternative Fixed Income Market (henceforth, MARF) represents one of the cornerstones of this process, as it not only fulfills one of the commitments undertaken in the Memorandum of Understanding signed with the EU as part of Spain's financial sector assistance program of 2012, but also clears the way for companies to obtain funding through channels other than traditional bank routes.

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MARF is a multilateral trading facility (MTF) comprised of a trading platform of financial instruments from companies not listed on an official secondary market.

At a time in which the Spanish economy is stabilizing, following five years of economic and financial crisis, this new market – barely a month old– faces a number of challenges. We shall describe the main factors to take into account in studying MARF's potential to drive the process of financial disintermediation and economic growth in Spain.

Characteristics of MARF

MARF is a trading platform of financial instruments issued by companies not listed on secondary markets. As a multilateral trading facility, it offers fewer guarantees than a regulated market like the AIAF.[2] For this reason, MARF targets solely institutional investors. The minimum unit issue amount is 100,000 euros.

The formal issue requirements are also less strict than those of official markets, although they are stringent enough to ensure investor confidence. Such requirements include the following:

- Audited accounting information.
- Simplified, standard information document.
- Credit rating report.

Issues in this market may be short term (commercial paper) or long term (bonds).

We will now discuss the characteristics of potential MARF issuers in greater depth, as well as the capacity of this market to raise funds from the private sector.

Issuers and fundraising

Potential issuers

The following characteristics of issuers and issues will give us a clear idea of what type of companies can access this market:

- Issuer profile:
  - Internationalized companies.
  - A sufficient level of equity *vs*. short-term debt maturities, positive working capital and current in payment of debts.
  - EBITDA to debt ratio of less than 3.5 times.
  - EBITDA levels of at least 12 million euros.
  - Constant increases in turnover and in EBITDA in preceding years.
- Average issue size: 20 million euros.

As per the aforementioned characteristics, MARF's main recipients, in terms of fund demand, are large unlisted companies. This is a significant point for situating MARF within the process of financial disintermediation in Spain. Its aim is not to cover the funding deficit of all companies, but to provide access to funding to companies that have more limited access to capital markets because they are not listed on a secondary market. Smaller SMEs, therefore, have no place in this market, and they

Due to the target size of companies with access to MARF (i.e. EBITDA levels of at least 12 million euros) a massive entry of issuers on this new market is not expected.

[2] Spain's benchmark market for Corporate Debt and Private Fixed Income.

must seek out other alternatives to compensate for the lack of bank finance.

The size of companies with access to MARF is, in turn, a determinant of the potential funds that can be raised in this market. Given the composition of the Spanish corporate sector –96% of companies may be considered small, with fewer than 10 employees– it would be incongruous to envisage a massive entry of issuers in this new market, not only due to the economic requirements, but also because of the very size of such companies.

Legislative changes and institutional support for MARF

Before analyzing the potential for raising funds in the MARF, we shall briefly describe the legislative changes that have been enacted to support it. The most significant changes are as follows:

1. The limitation preventing public limited liability companies from exceeding equity plus reserves in the latest balance sheet and the regulation and restatement accounts has been lifted. This also applies to unlisted public limited liability companies that issue debt, provided the issue is targeting institutional investors, as is the case of MARF.

2. Enterprises that issue bonds in the alternative fixed income market will not be required to notarize the issue document as a public deed nor register it in the Mercantile Registry in order to record the securities in book entries.

3. Pension plans and funds can invest up to 3% of their assets under management in MARF instruments issued by a company.[3] Insurers can invest up to 10% of the technical provisions they must cover in MARF instruments.

The following are the most significant forms of public support that have been offered to this market:

1. ENISA (Empresa Nacional de Innovación, S.A.) [the "National Innovation Company"] will allocate part of its budget to funding companies' listings in MARF in order to mitigate issue costs and lend the market greater depth (ENISA Mercados Alternativos).[4]

2. The ICO has launched a new credit facility for the acquisition of commercial paper and bonds in this market by financial institutions, for an initial amount of 1 billion euros.[5]

Potential fund raising

As noted previously, MARF is not a platform for all SMEs, but rather for medium-sized enterprises with a large scale, a fact that may limit the total funds available through the mechanism.

Bearing in mind this requisite, we have undertaken an analysis of potential issue volume based on the investment capacity of financial institutions and institutional investors. Experience in other countries tells us that such actors would be more likely to invest in this type of asset.

Conservatively, the following scenarios are considered:

- Funds are raised only under support from the ICO facility: 1 billion.

- Funds raised amount to half of total allowed investment of pension funds and insurers:

  - Pension funds and plans: Legislative developments allow up to 3% of assets under

[3] For further information, see Law 14/2013, of 27 September, of support for entrepreneurs and their internationalization.

[4] For further information, see http://www.enisa.es/es/financiacion/info/consolidacion/enisa-mercados-alternativos

[5] For further information, see http://www.ico.es/webcomercial/portal/productos/adjuntos/ICO_PAGARES_y_bonos.pdf

Table 1
Potential fund raising through MARF

Category		Total amount (1)
ICO facility		
Approved amount		1,000
Institutional investment		
(A) Pension funds		
Assets managed (2)		87,067
% of maximum investment in MARF issues (3)	3%	
% investment considered in analysis	3%	
Amount of investment in MARF		1,306
(B) Insurance		
Balance of technical provisions to cover (2)		189,700
% of maximum investment in MARF issues (3)	10%	
% investment considered in analysis	5%	
Amount of investment in MARF		9,485

Notes: (1) Amounts in millions of EUR.
(2) Data at December 31st, 2012.
(3) Set in Law 14/2013, of September 27th, of support for entrepreneurs and their internationalization.
Sources: Dirección General de Seguros y Pensiones, AFI.

management to be invested in MARF. We shall assume a maximum investment of 1.5% of such assets, which represents 1.306 billion euros of the total funds managed by pension funds at year-end 2012.

- Insurers: Legislative changes allow investment in MARF of up to 10% of the total balance of technical provisions. We will assume a maximum investment of 5% in such assets, which amounts to 9.485 billion euros of total technical provisions at year-end 2012.

Our calculations estimate the maximum amount that could be captured through MARF (not cumulative figures). We believe that the market could generate a rather small volume of funding in the first phase. Hence, the range between 1 billion euros and 1.3 billion euros set by the ICO credit facility and the amount that may be invested by pension funds would appear to be most reasonable.

This amount is equal to 0.10% of Spanish GDP, a figure that is similar to that found when analyzing the volume of funds raised in Germany (see below), which amounts to 0.13% of German GDP. Higher amounts would not be consistent with the characteristics of the composition of the Spanish corporate sector.

The experience in other countries

Launching an alternative fixed income market is not an unknown endeavor. The experiences of Germany, Norway and France allow us to formulate a more accurate diagnostic of the capacity to raise funds through such a market.

This section describes the characteristics of each of these markets, and their main differences from the model that has been implemented in Spain.

Germany. Mittelstand Bond Market (MBM)

The German Mittelstand Bond Market developed between 2010 and 2011, the year in which unlisted medium-sized enterprises began to make issues. At present, there are five markets with a fixed-income division for such enterprises: Stuttgart, Düsseldorf, Frankfurt, Munich and Hamburg-Hannover.

The main difference from the Spanish market is that it targets not only professional investors, but also retail investors, with a nominal issue minimum per unit of 1,000 euros.

The requirements for issuing companies are as follows:

- Sales of between 25 and 40 million euros.
- Interest cover ratio of 3x (EBIT/financial expenses).
- Rating assigned by one of the three credit rating agencies approved by BaFin: Creditreform, Euler Hermes and Scope.
- No minimum rating, although 80% of issues have had a credit rating at the time of issue of BB or BBB.
- Minimum issue volume of 10 million euros.

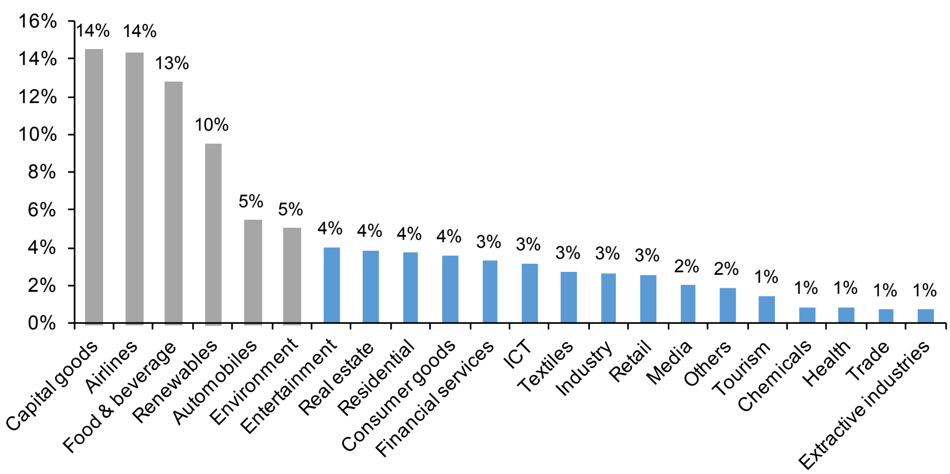
The information requirements are as follows: (i) prospectus with details of the issue; (ii) audited annual financial statements; (iii) quarterly earnings reports and, lastly (iv) credit rating report.

A total of 3.5 billion euros has been raised in the German MBM, which represents 0.13% of the economy's GDP.

Although the sector profile is quite mixed, it is concentrated in capital goods, airlines, food & beverage, renewable energies and automobiles.

Exhibit 1

Sector distribution of issues in Mittelstand Bond Market of Germany



Sources: MBM Germany, AFI.

Norway. Oslo ABM

The alternative fixed income market in Norway is the most long standing of all those analyzed herein. The market was established in 2005 as a self-regulated market that was to operate independently of EU directives.

The characteristics of the Oslo ABM are as follows:

- The inclusion process is simpler than being admitted for listing in the stock market, as is the case in Spain and Germany.
- There is greater flexibility for the issuer in selecting the accounting standards to apply (as opposed to the IFRS format they would have to adopt if the issues were made in an official market).

Exhibit 2

Nominal amount in circulation in Oslo ABM
(milllions of euros)

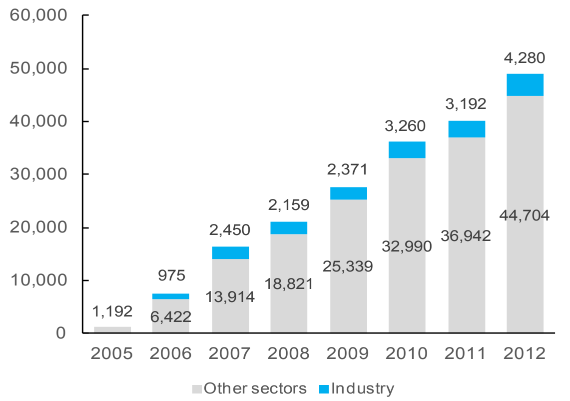


Exhibit 3

Number of issuers in Oslo ABM

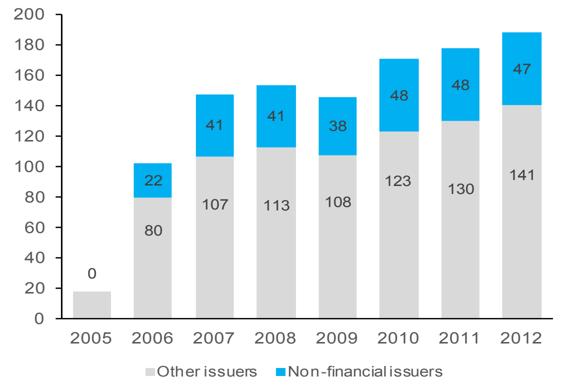


Exhibit 4

Investment by sector

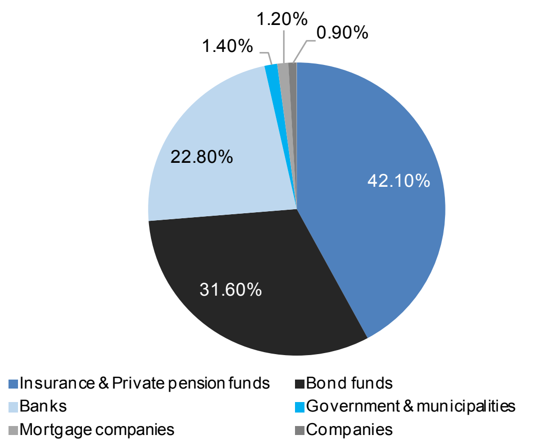
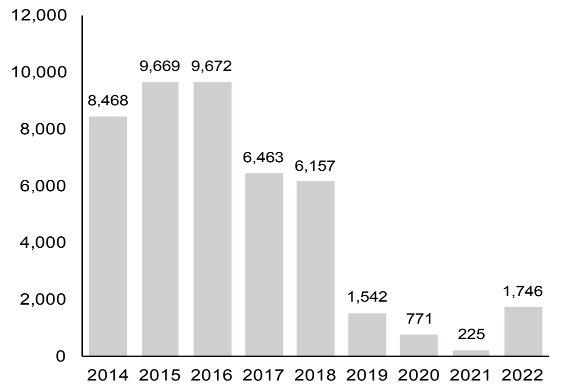


Exhibit 5

Total issues by maturity (all sectors)
(milllions of euros)



Sources: Oslo ABM, AFI.

- Nevertheless, rules on the disclosure of information and trading are largely the same as in the stock market, so as to facilitate comparison of information and to avert problems of investor confidence.

With regard to fund supply and demand:

- Industrial companies have raised some 4.28 billion euros, which is equivalent to 1% of Norwegian GDP. The greater volume of fund raising is of lesser importance when considering the number of years the Oslo ABM has been in operation, but it is a good example of the potential of such an infrastructure.

- The actors leading the way in investment in this market are insurers (42% of the total), fixed income funds (31% of the total) and financial institutions (22% of the total).

The main distinctive characteristic of the Oslo ABM as against the Spanish model is that it is segmented into two different markets:

- Oslo ABM Retail (nominal issue value of less than 68,000 euros), which is oriented to trading by the general public.

- Oslo ABM Professional (unit nominal issue value of greater than 68,000 euros), which is intended for trading by professional investors.

France. Alternext

Alternext is one of the most recent markets set up as an alternative fixed-income segment for SMEs. As in Spain, Alternext was launched as a market aimed at enabling companies to raise capital (similar to MAB). In January 2012, Alternext created the fixed-income segment for SMEs.

The main characteristics of this market are as follows:

- Bonds are not allowed in an EU-regulated stock market; this eases the transparency requirements for protection of investors, as is the case in Germany, Norway and Spain.

- In contrast to Germany, the issuer does not need a rating to be listed, but it must have a registered sponsor that has been approved by NYSE Euronext to support the issuer during the admission process and throughout the period of listing.

- Historic financial information must be periodically disclosed by the issuer.

Table 2

Summary of main characteristics of European alternative fixed-income markets

Market	Start date	Target investor	Rating	Issue volume (millions of EUR)	Issue volume (as % of GDP)
Germany	2010	Institutional and retail	Mandatory	3,500	0.131%
Norway	2005	Institutional and retail	Non-mandatory	4,280	1.079%
France	2012	Institutional	Non-mandatory	360	0.018%

Sources: AFI, alternative fixed-income markets of Germany, Norway and France.

- The minimum amount of the first issue admitted to trading is 200,000 euros.

The fixed income segment of Alternext has enabled the raising of 360 million euros since its rollout in early 2012, which is 0.018% of French GDP, ranking this as the market with the lowest level of activity of the three infrastructures analyzed herein, in both absolute and relative terms.

Main challenges faced by MARF

The value of MARF as part of financial disintermediation in Spain cannot be analyzed without discussing the challenges entailed by its establishment, and which are associated with its development. Such risks are related to three variables: solvency risk, yields and liquidity risk.

As in any market in the development phase, investor confidence plays a key role in defining the market's potential. This is why leading new issuers in this market must be companies whose repayment capacity is unquestionable, to the extent that they will not only determine spreads in fund raising, but will also open the way for other issuers to enter without suffering excessive penalties.

Issuers leading offerings in this market must be solid companies because they open the way for other issuers to enter without suffering excessive penalties.

The credit profile of a MARF issuer will be that of a high-yield company. Hence, investors will be offered higher returns to compensate for the greater risk they are assuming. We should not be misled by this credit classification - high-yield companies have a greater likelihood of default than investment grade companies, but this does not mean they are less solvent. As market leaders respond to players' expectations, it will be easier to reduce the additional risk premium imposed on new participants in the fixed-income market, thus gradually easing the cost for companies to gain funding through this channel.

Lastly, issue liquidity will play an important role in the development of the market. One must not expect a deep and liquid market like the continuous market or like major international markets, especially in the initial phases. Hence, actors who make investment bets on the market's initial issues must be aware that keeping their positions in the issues until maturity may be better than deciding to sell at some point midway. As the market gains depth and new funds joint, the illiquidity premium will begin to slacken, but it cannot be ruled out that this factor will penalize the first issues in the market.

Conclusion

MARF is one of the main mechanisms driving the process of financial disintermediation in Spain. Having opened quite recently, it is too soon to gain clear visibility of the infrastructure's potential given the high percentage of SME´s in Spain, but our analysis of comparable experiences shows that such markets have resulted in significant advances in improving companies´ access to finance.

The examples of Norway and Germany, with markets raising volumes of funds that represent 1% and 0.13% of GDP (that is, 4.3 and 3.5 billion euros, respectively), are significant precedents for MARF's potential capacity. Nevertheless, any comparison with other countries must take into account that the composition of the corporate sector in Spain (96% of companies have less than 10 employees) may place a ceiling on the total funds that can be raised through MARF compared to other European economies, especially Germany.

It must be emphasized that, for MARF to realize its full potential, the companies leading the first issues must win investor confidence. It is advisable, therefore, for institutions responsible for supervising the market's functioning and transparency to place a premium on issue quality over quantity. Such a dynamic will deepen the market and strengthen its capacity to rationally determine the cost of a company´s financing through channels other than the traditional bank route.