Clarification & Basic Understanding of Private Placement Programs - PPP

I did not pen this article and I do not take credit for it. A close associate; compliance officer and Interpol Agent that is an Intake Officer for a Primary Platform wrote this for me to help explain to my clients how the Primary Market work and the reason for their existence.

CONCEPT:

Private Placement Trading is the continuous recycling of the world's debt, for which estimations vary from US$ 250 to 600 Trillion. A nuclear scenario would occur if this debt were to be called as it reaches maturity, without being replaced by further capital or debt. This would collapse the world banking system and companies would fold. Therefore, a way had to be found of ensuring that, when a debt reaches maturity, it can be recycled and sold to an investor in the form of an investment grade security which is, generally, an unsubordinated bank debt obligation in the form of MTNs (Medium Term Notes), mainly in very large USD denominations.

These MTNs are sold to institutional buyers via a conduit, usually a private investor or an entity, for onward selling in bulk to other institutions such as pension funds. This is commonly called “Private Placement”. The reason for the conduit is to overcome the rule that no bank should hold another bank's paper, and the trader, via the conduit, ensures that this does not happen.

Often a bank will decide to sell of a portion of its debt book and will specify how much to sell, the level of discount of each instrument and instruct a trader to initiate a market. Anybody who has taken out a loan over the last 20 years will see, in fine print, words to the effect that “the bank reserves the right to transfer this loan to another lender without notice”. This also applies to corporate lending. Major organizations such as Caterpillar, Boeing, Rolls Royce etc. will raise finance in the capital markets by issuing Corporate MTN's and these are treated in the same manner as bank issued MTNs.

TRADING PRACTICE:

A trader may initiate a trade with a mix of both types of MTNs and other types of investment grade bonds and securities. The trader will typically

purchase an instrument at a discount and sell onward, thus generating, depending on the quality of the instrument, a net book profit averaging not less than 1.5% to as high a 9% per trade. This is book profit, not earned interest.

The explanation for the high yields of PPP trading is as follows: The trader can repeat this trade multiple times daily; trading is generally conducted for four days each week with consolidation and bookkeeping on Mondays. Thus, an example of a relatively low-grade trade, generating, say, 2% per trade, but traded 5 times per day for 4 days, generates 40% per week. Higher-grade paper earns a significantly higher multiple.

The frequency of trades is determined by different factors. For example, if a bank is selling € 50 Billion of debt over, say, 6 months, the trader will calculate how many trades and at what value for each trading day, under consideration of all interruptions, bank holidays and so on. This entails that agreement is reached and contracted with the end buyer or buying entity which will generate a “buy ticket” confirming the buyer’s funds and intent. The trader then screens the instrument for the buyer who, on acceptance will pay automatically, in multiple tranches. With major banks and institutions these will usually be collateral first transactions. The paper is then transferred, initially electronically, then in hard copy by bonded courier at the agreed frequency. Importantly, in all such transactions, the trader uses the PPP Investor’s cash or asset as trading collateral and acts contractually for and on behalf of the PPP Investor with his platform’s funds.