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A managed buy/sell private placement programme: creating non-repayable profits from debt

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BY

Michael J. Weiner

PreConstruction Catalysts

In a managed buy/sell trading programme, the spread between the buying and selling of bank debentures creates profits by buying low and selling high to a predetermined exit buyer. Because traders cannot use their own money to operate a programme, they look for financially qualified investors to provide collateral support for the initial purchase of a new issue asset.

In trading, as we are discussing it here, a trader has locked in the first issuance of some instrument – such as a standby letter of credit, a bank guarantee or a medium term note – while, at the same time, the next, or secondary buyer has been lined up and ready to take the asset at a higher price. However, the trader cannot execute the start trade without having shown new money, such as a line of credit; there is nothing to buy or sell. That is where the investor comes in.

Typically, a credit line makes the trades work, and in order to get the credit line, the trader must show that an investor is proffering his cash or instrument assets to be monetised. In many cases, the investor becomes a joint venture partner in the process of this monetisation. The investor money is never really touched – it simply acts as supporting collateral for the trade credit line. As the credit line is generally non-repayable, non-recourse or non-depletion, this

means little to no risk to the investor of losing his money. This limits the risk of the underlying collateral being tapped in the event of a default. For additional safety, the bank blocks cash funds in an administrative hold, which prevents credit line depletion during the trade contract, or utilises an acceptable instrument as the support. In the case of a bank instrument, the trader can rightfully use the instrument to support the credit line.

Because the trader already has the 'exit' buyer – the second buyer taking the asset at the predetermined higher price – the profit spread has also been predetermined.

When profits are generated, they are generally split so that the investor shares in the bounty, sometimes up to the full amount of the trade credit line, resulting in an 80 to 100 percent profit to the investor, sometimes more. Each programme has different types of profit sharing with the trader, which are negotiated when the programme is established with the client.

For illustration purposes, a new issue bank debenture may be purchased at about 40 percent of the face value. So, a €500m face value instrument may cost the trader €200m to buy. The trader uses the trade credit line to make that new issue purchase. Then an exit buyer who was pre-established at the beginning of the programme may purchase it at 70 percent (or €350m). The difference is the profit made in the trade, of €150m. That is then used to pay profit to the investor (a shared percentage of the total profit), as well as the trader. When bank debentures trade multiple times during a month, this profit adds up handsomely. This is why an investor can see a profit on his money ranging from 80 to 100 percent of the amount of the trade credit line, and sometimes more (depending on the programme).

The challenge for many investors is understanding the minimal risk for loss of principal, particularly if the money owned by the investor stays in his own bank account or is used to issue a cash-backed standby letter of credit. Small cap programmes typically require movement of funds to a trader account in order to obtain the trade credit line. Few small cap programmes, although there are some, can take under €100m and some offer an insurance policy against loss of principal. Several that we have seen do not offer this. One that we know of, does.

Having understood the principles behind a managed buy/sell, the next question most potential investors ask is, 'what are the steps needed to engage with such a programme?'.

Most investors need a minimum of $100m or €100m – either in cash in a commercial corporate bank account or the face value of a bankable instrument. That number is a little bit deceiving, because you have to factor in the trade credit line being anywhere from 70 to 80 percent of the value of the account. That 70 to 80 percent net must equal at least $100m. So, the real need is for the investor to

have about $150m, to account for the deduction with the loan-to-value factored in.

A financially qualified investor, in order to avoid potential solicitation rules, is the one who moves first to establish the relationship. This is done with the submission of a Know Your Customer (KYC) and proof of funds set of documents which indicate the investor's desire and capacity to enter a programme. While the preparation of these documents takes just a little time to complete, it fulfils the solicitation rules allowing the trading organisation to open the conversation and subsequently prepare the trade contract shortly after receipt by the appropriate authorised intake person.

In general, it takes a couple of weeks to arrange the trade commitments and the banks, along with approval from the authorities governing these programmes, at which time the trading may proceed at the next opportunity to start.

With the noise of internet brokers misinforming people about these programmes, building trust must first be mutual between parties. Without trust, there can be no transaction. Trust is the first thing any investor needs to feel is in place before too much discussion of a programme is presented.

The fact is that managed buy/sell programmes using bank debentures do exist, however actual providers are few and far between. The supply of these programmes is small, and demand far exceeds it. Getting in the way of being connected to something real are usually the internet brokers, who smell money but do not have the relationships or knowledge of how these work, so, the likelihood of success is almost nil. When you have a trusted party to work with, with authentic relationships and compatibility, it is possible to be included in a programme. For most investors, this is the mechanism used to fund projects without debt or repayment.

Michael J. Weiner is chief executive of PreConstruction Catalysts. He can be contacted on at +1 (202) 657 6960 or by email: info@preconstructioncatalysts.com.