

CAPITAL MARKETS

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► THE CAPITAL MARKETS TWO STEP

During its 2008 summer tour, the Dave Matthews Band reintroduced its single called 'Two Step'. When we think about the capital markets in the last few months of 2008 and our outlook for 2009, this song title seems particularly apt. The first of these steps will be the availability of government guarantees. For issuers that intend to sell public debt in 2009, nothing – absolutely nothing – will come in handier than a government guarantee. The second step involves the manner in which securities (both debt and equity) will be marketed. We think that private placements of securities and highly targeted pre-marketed public offerings will prove to be the most likely path to completed transactions.

By now, tomes have been written summarising the various government rescue plans implemented in the United States and Europe. A common element of these rescue plans is a state guarantee of senior debt issued by certain eligible or qualifying financial in-

stitutions. For example, in the US, the FDIC's Temporary Liquidity Guarantee Program provides for a guarantee backed by the full faith and credit of the government in respect of senior unsecured debt issued by financial institutions that have not 'opted out' of the program. Although each of the government guarantees differs, for example, the timeliness of payments and the claims process differs, the result has been universal. In recent weeks, issuances of government guaranteed senior debt by financial institutions has revived the debt markets. For buyers, these securities are a proxy for sovereign and agency securities. Investors, even institutional investors, remain wary that many of the largest financial institutions still have not made necessary valuation adjustments for securitised and other complex financial assets and still face additional year-end write downs. The government guarantee helps buyers overcome their fears relating to particular issuers and eliminates the need for well formulated assessments of any particular institution's future results of operations.

Issuers, no matter how large or sophisticated, requiring capital will be concerned about market volatility. Despite all of the efforts to regulate improper shorting activities, market participants remain concerned about market

reaction to a financing announcement. We anticipate that financial intermediaries will focus on private placements and on 'pre-marketing' public transactions instead of conducting widespread marketing efforts, like road shows. Financial intermediaries will identify potential offerees and approach these investors with confidentiality agreements prior to soliciting indications of interest. Once anchor orders or large percentages of deals are effectively pre-sold on a confidential basis, financial intermediaries may look to cast their net for retail investors and officially launch or announce the 'commencement' of transactions.

So, we expect that market participants will look back at 2009 as a year in which government guarantees, on the one hand, and private placements and private pre-sales of publicly offered securities, on the other hand, played a critical role in capital formation. ■

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This article first appeared in FinancierWorldwide's *January 2009's Dealmakers Forecast*.
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