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Swedish High Yield Corporate Bond Market

- A market outlook in the light of increasing financial regulations

Bachelor Thesis in Industrial and Financial Management

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Abstract

The high yield corporate bond market in Sweden has been all but inexistent until the last five years. The financial crisis that erupted in 2008 has led to a more regulated environment (Basel III) for the financial sector in general. This has given corporations incentives to search for alternative financing when bank loans become more expensive and the banks are getting more risk averse. At the same time, investors are also seeking investment alternatives other than the stock market due to its poor performance during the last decade.

This thesis was done with the intent to analyze the Swedish high yield corporate bond market in order to understand the market potential and likely development within a five-year time frame. Only bonds issued on the Swedish market was considered.

The study was performed through theory studies in combination with nine interviews covering four different perspectives of the high yield corporate bond market that finally were analyzed.

All data gathered showed strong signs of an increasing growth rate of the Swedish high yield corporate bond market. The Swedish high yield market size today is about 15 billion SEK compared to the Norwegian size of over 106 billion NOK. The real estate sector in combination with other capital intensive sectors such as industrials are believed to account for the main future growth. Larger single issues and longer maturities are also likely.

Although the Swedish market will likely experience a strong growth in the coming years, it is hard to quantify due to its vulnerability to volatile economic conditions and financial turmoil.

Keywords: High Yield, Junk Bonds, Swedish Corporate Bond Market, Basel III, Solvency II

Contents

1 Introduction

The high yield corporate bond market in Sweden has been all but inexistent until the last five years. In general it has for a long time been considered to be underdeveloped (Gunnarsdottir, Lindh 2011, 45), but in comparison with other countries in Europe like Norway and Denmark, Swedish corporations finance their operations with relatively more corporate bonds, although less than in the U.S.A. (Barr 2011, 6). The financial crisis in 2008 has led to a more regulated environment for the financial sector in general. For the bank sector, the coming regulations regarding extended capital buffers such as Basel III and increased risk aversion within the bank sector have already made it both more expensive and difficult for corporations to get traditional bank financing (Den Svenska Finansmarknaden 2011, 40). This creates incentives to find alternative ways of funding such as corporate bonds. The recent introduction of an additional component to the Swedish corporate bond market, a professional trustee function, can also be seen as an indicator for a more developed market. This function will address the problem of negotiating with a multitude of bond holders in the case of a corporate bankruptcy or any other credit event (Choudhry 2011, 355).

The bulk of the Swedish corporations lack an official credit rating by any of the three world dominating credit rating agencies (Standard & Poor's 2012).[1] This will by definition put them in the high yield segment if they choose to issue corporate bonds. At the same time, the largest corporations in Sweden already have access to the corporate bond market through the investment grade segment (Barr 2011, 4). It is therefore believed that the largest potential growth of the corporate bond market is to be found in the high yield segment. On the other hand is the definition of high yield segment somewhat unclear since there are different definitions among the market actors.

Hence, the focus of this thesis will be on the high yield market and the description of the current market situation but maybe more important, assess the trends and the near future development potential of the corporate high yield bond market in Sweden. This will be done in the light of these new market facilitators.

1.1 Background

When it comes to financing, corporations have two main ways to go – internally through retained earnings or externally through the capital market. The

[1]Standard & Poors, Moody's and Fitch.

capital market can in its turn also be divided into two parts – the stock market through issuing equity or the credit market through debt financing. Debt financing can mainly be in two different forms, by borrowing in banks or by issuing bonds (Barr 2011, 5). This thesis will deal with the latter form and the corporate bond market.

After the financial crisis in 2008, new regulations are being implemented with the purpose of avoiding a similar crisis in the future. Basel III is one of those regulations and will result in increased capital costs for banks due to increased requirements on capital buffers (Bank For International Settlements 2010). This fact has already had some effect and will most probably lead to even greater costs to finance the corporations through traditional debt (bank loans) and it will thereby increase the incentives for issuance of corporate bonds (Gunnarsdottir, Lindh 2011, 40-41).

Historically, Swedish corporations have mainly relied on long-term debt financing in form of bank loans. One reason for this is considered to be the close relationship that historically exists between the corporations and their banks in Sweden (Barr 2011, 5). Even though bonds were issued before, the bond market has developed quickly during the 1990s because of the late deregulation of the Swedish capital markets in the late 1980s (Boisen, Karlsson 2003, 25).

Today, bank loans are still the most important external financing method in Sweden. But when it comes to corporate bonds, the Swedish market has grown considerably in the last 15 years – from about 10% to about 25% of all debt financing today (SCB 2012). The outstanding amount of corporate bonds has also tripled in the same time period. This clearly shows that corporate bonds as a way of financing have increased significantly in importance on the expense of bank loans. There is however a widespread belief that the Swedish corporate bond market is underdeveloped and thus comparably smaller than in other European countries (Gunnarsdottir, Lindh 2011, 27). Statistics show that this is not true, see figure 1 (Eurostat 2012). Sweden is in fact one of the leading countries when it comes to financing through corporate bonds (Barr 2011, 6).

The Swedish corporate bond market does however differ from other markets in its composition (Gunnarsdottir, Lindh 2011, 35-36). The high yield part of the market is only a fraction of the total market and compared to the Norwegian high yield corporate bond market it is clearly underdeveloped in terms of outstanding amounts (Ackordscentralen Nyheter 2012, 8).

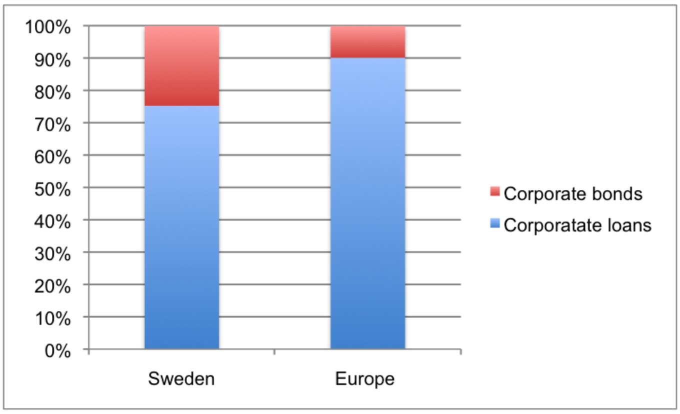

Figure 1: Non-financial corporations financing with loans vs corporate bonds in Europe (Eurostat 2012) and Sweden (SCB 2012).

1.2 Problem Discussion

According to Sveriges Riksbank (2012, 40) the Swedish market for corporate bonds is believed to grow and become an important funding alternative for Swedish corporations. In the previous sections, data were presented showing that the present Swedish corporate bond market on an aggregated level compared to the rest of Europe is well developed in terms of outstanding amounts. That is, the proportion of corporate bonds in relation to bank loans as a way of external debt finance is in fact on a higher level compared to the Eurozone (Euro 17) (Eurostat 2012).The Swedish market is almost entirely dominated by very large and mature, slow growth corporations (Den Svenska Finansmarknaden 2011, 40-41) and a very small fraction of the bonds are issued in the high yield market (Ackordscentralen Nyheter 2012, 8).

The need of external financing for corporations are in many cases crucial to be able to grow or even operate in a competitive market (Gunnarsdottir, Lindh 2011, 28). In the aftermath of the financial crisis and the coming implementation of new regulations (e.g Basel III) may according to Gunnarsdottir and Lindh (2011, 40-41) result in an increased interest in alternative sources of finance from corporations. For unrated or poorly rated corporations, an alternative way of external funding besides conventional bank loans is through the high yield corporate bond market. The issuing costs for these types of corporate bonds are though considered as high in relation to bonds issued by investment graded corporations but there are also costs related to the acquiring of a credit rating (Barr 2011, 6-7).

With respect to previous research, Gunnarsdottir and Lindh (2011) as well as Barr (2011) is the the only ones that are up-to-date and deals with almost the same research questions as us. The effects of the new regulations have been considered briefly in these reports already, but they have mainly concerned possible improvements of the market. There is however a lack of studies dealing with how the market participants experiences the current high yield corporate bond market situation and the future market development more in detail. In order to receive such information, interviews covering all perspectives given by four different groups of market participants, *issuers*, *intermediaries*, *investors* and *agents* must be performed. The last group is a relatively new market participant which has not been studied to a greater extent in earlier reports (e.g. Barr (2011) and Gunnarsdottir and Lindh (2011)). It is corporations who provide the so called trustee function and they acts as a third party in the bond issuance. They represent the bondholders and the impact of their presence on the market is therefore an area that requires to be highlighted in order to assess their importance as a market factor.

Intermediaries such as banks are of special interest since they have a key role as originators of bond issues in the corporate bond market. Larger banks have had their focus on the investment grade segment and smaller banks have taken care of the issues within the high yield segment. This have recently changed somewhat since the larger banks have showed an increasing interest of the high yield segment and added more resources to this business (Barr 2011, 4-5). This increased interest is another sign of that this market is starting to change. To be able to see how the market will change, we must identify what endogenous or exogenous factors that are acting as market factors and are driving the change.

The study will treat these concerns from a broader perspective at first, including the overall Swedish corporate bond market but then narrow the perspective to only include the high yield segment of the Swedish corporate bond market for non-financial institutions. This is based on the previously stated expectancy of a relatively larger growth in this segment.

1.3 Research questions

Based on the problem discussion where the intended scope and problems are stated, the following research questions have been created. The first question is necessary to answer before the second in order to create a foundation for analysis of the latter.

1: *What constitutes the current Swedish high yield corporate bond market with respect to market characteristics such as size, composition and behavior?*

2: *How is the Swedish high yield corporate bond market likely to develop within the next 5 years with respect to new or changed exogenous (e.g. Basel III and Solvency II) and endogenous (e.g. a trustee function) market factors?*

1.4 Purpose

This thesis is done with the intent to describe and analyze the Swedish high yield corporate bond market in order to demonstrate the market potential and its role as a financing tool for Swedish corporations as well as financial investment for investors.

2 Method

To be able to fulfill the purpose of this thesis, the problem was tackled from different ways in the pursuit to answer the research questions. A literature review was performed to create a foundation for general market understanding combined with qualitative interviews of market participants to create in depth knowledge of the specific environment. An analysis of the interviews in combination with the theory were then performed in order to finally come to a conclusion which could answer the research questions.

2.1 Type of Study

The study is based on a combination of quantitative and qualitative data collected from statistical databases and interviews. The main focus however, were on the *qualitative studies* through interviews due to lack of good statistical data of the Swedish market. In order to answer the research questions they had to be tackled from different angles and by the previously mention approach one secures both the preciseness and the validity of the result. This has in turn simplified the fulfilling of the purpose and made the study more accurate.

An *abductive research approach* was applied since the thesis is based on a theoretical foundation of what constitutes a corporate bond market as well as the theoretical impact of both exogenous (e.g. Basel III and Solvency II) and endogenous factors (e.g. a trustee function) already known to affect the market in general but also how the development of the market can be explained by these factors. The theory was then used as an analysis tool of the qualitative interviews with the aim of trying to assess the strength of these explaining factors on the Swedish conditions. Another function of the theory was to create a describing framework in order to have a stable foundation for our analysis of the future development of the Swedish high yield corporate bond market.

The area of study and delimitations have been updated during the study process to focus more on a limited range of factors that were found to have the greatest impact on the market development.

2.2 Data Collection

The collection of qualitative data have been accomplished through several interviews in order to get a good picture of how the different market participants perceives the market and what the current market trends are. The interviews have been performed in a semistructured manner which meant that no fixed question set was used. Instead we adjusted the interviews and the questions as our cumulative knowledge of the market was built up.

The motive for this approach was that we wanted the respondents to free in their interpretation of the issues and to give them an opportunity to develop and describe their own and opinions in depth. By using a few main discussion points in conjunction with some key questions if needed, we let the respondents lead the interviews and thus enabled us to get farther and beyond our own initial knowledge of the subject than if we would have used a structured interview approach with fixed questions. Because the purpose was to paint a picture of the market and not of the individual organizations that the respondents represented, differing answers were not considered a problem but merely something that widened the picture. The interviews resulted in a collected up-to-date data set and opinions from the market participants that can not be found in any report or other documentation.

The interviews where performed over telephone due to practicalities. The Swedish bond market participants are concentrated to Stockholm and the research was performed entirely from Gothenburg. The use of telephone interviews have also made the data collection more efficient and enabled us to accomplish more interviews because of the relatively smaller sacrifice of time and preparation from the interviewees perspective in comparison with a personal meeting. Telephone interviews also enables a substantially higher response rate than surveys conducted via correspondence. (Bourque, Fielder 2003, 14-21). The type of information that was asked for could also easily be transmitted via speech so the potential data loss was considered to be very low compared to a personal meeting.

To get a holistic picture of the high yield corporate bond market, we selected respondents in the different perspectives of the four types of actors presented in the problem discussion. The different perspectives were crystallized from the initial screening of the previous research as well as the theory. The interviews were subsequently performed in the following way:

1: *Issuers of high yield bonds*
Interviews with two different Swedish corporations issuing high yield corporate bonds were performed. The purpose was to get their perceived pros and cons with bond finance compared to other options but also how they think the market will develop.

2: *Intermediaries*
This perspective was considered the most important due to their central position and great contact with the other market participants. Because the big banks conventional lending business to some extent compete with the bond market, this could have created a risk that our answers got distorted by the banks. Our belief is that this however wasn't the case because we choose to interview representatives from only one large bank together with three smaller investment banks that completely lack this activity. Since the smaller investment banks traditionally have the largest market share of the high yield segment whereas the big banks focus on the larger, often investment graded corporations, this was a natural course of action.

3: *Agents*
An agent are acting as a cohesive factor for the bondholders versus the borrower for example if the need for any renegotiation of the terms are necessary. This function is called acting as a trustee. Due to their business as a representative for the bondholders they are well informed about the current market situation. They are also more involved in the high yield segment as opposed to the investment grade segment due to the natural state of more credit events in that segment. One interview was performed with an agent acting in the trustee role.

4: *Investors in high yield corporate bonds*
The investors' opinion are of course also very important for the development of the market. We wanted to know how important this market was for them and what potential they saw in it. Two investors were interviewed, one insurance company and one dedicated high yield investment company.

Quantitative data were collected form various statistical databases such as Eurostat and SCB. Chosen data were condensed into diagrams with the purpose of giving a good picture of the overall current market situation. Thomson

Reuters Datastream was used to find data over the current outstanding corporate bonds in Sweden sorted after current coupon rate. Here a bond with coupon rate of 6% or above has been considered as a high yield bond due to comparison reasons.

2.3 Data Processing

The quantitative data were analyzed in order to see if there were any structural (size and composition) similarities or differences between the Swedish and other selected high yield corporate bond markets. The U.S. market was used as an example of a well developed and mature market. The data was also compared with the European market. Although of special importance was as earlier mentioned, a comparison between the Swedish and the Norwegian high yield corporate bond market composition. This because of the geographical vicinity, well established trustee function and access to extensive statistical data from Norway which could not be found in other countries in the near geographical region. The results from the quantitative analysis are an important part of the later qualitative analysis in order to put the information into the right perspective.

The qualitative data was first transcribed and summarized in order to ease the subsequent analysis. The respondents also had the opportunity to review and comment on the summaries. Thereafter, the summaries were consolidated into an overall picture to be able to make an assessment of the current situation of the Swedish high yield corporate bond market. This was done in order to see what constitutes the market as well as to see what difficulties and possibilities that are present in order to assess there respective strength. The likely development of the Swedish high yield corporate bond market was finally assessed through the performed current market assessment and by comparing it both qualitatively and quantitatively with the more mature markets of Norway and the U.S.

2.4 Delimitations

In order to keep focus and due to possible difficulties with data gathering, the following delimitations are valid:

- *Only non-financial corporations have been considered* when the corporate bond market in terms of issuers has been described. This is derived from the definition of a corporate bond where other large non-government issuers such as banks, municipalities and financial institutions not are considered as corporations when it comes to the definitions in the financial system.

- *Only corporate bonds issued in Sweden are considered (i.e. the Swedish market)* when the amounts of outstanding debt is to be described. It's very common for larger Swedish corporations with an extensive activity abroad to issue bonds in the international bond market.
- *Commercial papers are not included in the thesis* although one can say that they have the same characteristics as bonds but with a maturity of less than one year. (Although they are not bonds per se, some authors include commercial papers in the bond market.)

3 Theory

This section aims to cover the basics within the area of corporate bonds and the corporate bond markets. It will also address special characteristics of the high yield segment. Everything described is with the purpose to give the reader a framework to put the interviews and subsequent analysis in the right perspective.

3.1 Valuation of Bonds

For corporations, the issuance of bonds is not only a source of external funding but also a determining factor for the firms cost of capital. The main core of how to value different types of bonds is stated by the Law of One Price. It states that in a competitive market, the price of different kind of securities is set to be the present value of receivables from the bond to the investor. Even though the theory of valuing bonds in reality is complex and hard to quantify exactly due to for example potential financial distress costs, it is with appropriate assumptions a straight forward process. In the perspective of pricing, there are two distinctive types of bonds, coupon bonds and zero-coupon bonds. The latter are in general issued by governments (Berk, DeMarzo 2011, 217-238).

3.1.1 Changing Bond Prices

The price of a bond changes mainly due to two reasons after it has been issued. The price increases as time gets closer to the bond's maturity date since the effective discount of the face value decreases. The other reason for a change in the bond price are changes in market interest rates that affect the bonds Yield To Maturity (YTM) and thereby the price of the bond. As a consequence, bond prices will fall as interest rates and bond yields rise. The sensitivity of these types of price changes due interest rate fluctuations can be measured by the bond's duration (Berk, DeMarzo 2011, 217-238).

The credit risk (default risk) may also change during the term to maturity for the bond and thereby also alter the price of it. This is only valid for corporate bonds since government bonds usually are considered to be risk free. It is important to note that the yield to maturity of a defaultable bond is not equal to the expected return of investing in the bond. This is because the YTM corresponds to the promised cash flows rather than the expected return (Berk, DeMarzo 2011, 217-238). The default of a business does not generally result in a total loss of all funds invested in the bond. The holders of defaulted bonds usually recover a part of the face value which results in that the default loss rate can be smaller than the default rate. The default loss rate has the following relationship with the default rate (Antczak et al. 2009, 25-30):

$$\text{Default loss rate} = \text{Default rate} \times (100\% - \text{ Recovery rate}) \tag{1}$$

In reality it is very complex to assess the implications of a firms default risk on the YTM and thereby the bond price. This is because the risk of default depends on the current capital structure and will not follow the Modigliani-Miller theorem due to imperfect markets (Berk, DeMarzo 2011, 217-238).

3.2 Factors affecting Bond Yields

There are many factors contributing to the level of yield that is required by the investors. The YTM is not only determined by the term to maturity but also of the structure of the bond and the duration of the debt. If the interest rate is fixed or floating also affects the YTM and can thereby vary during the time to maturity. The yield also depends heavily on the type of issuer and the overall state of the economy (Fabozzi 2010, 93-122).

The benchmark (BM) interest rate is the rate which is the minimum interest rate (yield) demanded from the investors on non-treasury related securities. The difference between two bond yields are referred to as the yield spread and can be interpreted as the risk difference between the bonds. The spread can be expressed as the relation in equation (2) and can be seen as a risk premium demanded by the investor to be willing to hold the bond.

$$\text{BM spread} = \text{yield non-BM bond} - \text{yield BM bond} \tag{2}$$

The factors affecting this benchmark spread (bond yield) are described in the following subsections and can be concluded to the following points (Fabozzi 2010, 93-122):

- Default/Credit Risk
- Bond Options
- Interest Rates
- Securities
- Liquidity
- Term to Maturity

3.2.1 Default Risk

The market for bonds is divided into different sectors according to which type of issuer that issues the bond. These sectors are considered to have different levels of risk and returns. The earlier mentioned default risk of bond issuers is one of the main factors determining the yield demanded by the market. These types of risks are normally assessed by credit rating agencies and subdivides the specific sectors of the bond market into a finer structure (Fabozzi 2010, 95-96).

3.2.2 Bond Options

Issued bonds often include additional options for the bondholder or the issuer. A very common option included is the right for the issuer to retire the debt before the maturity date. This call option results in a benefit for the issuer due to the opportunity to replace the bond with less expensive debt. The result of including this option is an increase of the spread demanded by the investors since it favors the issuer. Correspondingly, if the bondholder receives a favorable option, the benchmark spread decreases and can even be negative in some cases (Fabozzi 2010, 96-97).

3.2.3 Interest Rates

The interest rate paid to the investors may change over time or be fixed. The so called floating rate bond usually has an interest rate that follows a reference rate (e.g. STIBOR) with an additional spread add-on margin. The spread is usually kept constant until the maturity date. These types of bonds are commonly referred to as Floating Rate Notes (FRN) (Fabozzi 2010, 212-213). FRN-notes are considered to carry less risk than fixed rate bonds due to the avoidance of a decline in price when the overall market rates increases. FRNs thereby only carries the credit risk of the bond and no interest risk.

Taxes on interest incomes may also affect the yield spreads on bonds. Since the tax differs between different geographical areas, the required spread may be lower in areas with lower taxes than in areas with higher (Fabozzi 2010, 97-98).

3.2.4 Securities

How easily a corporation can issue unsecured debt on the market is more or less determined by its credit risk (often depicted through a credit rating). In the pursuit of reducing the cost of debt, one may not only try to increase the credit rating but also try to secure the bond. The securities can be fixed assets belonging to the corporation (Choudhry, Feasey 2011, 205-206).

Debt with a lower priority than secured debt is referred to as subordinated. The credit rating of the debt depends on the rate of seniority and is thereby specific for each bond. That is, one corporation may issue bonds classified as investment grade bonds with higher seniority than bonds issued as high yield debt (Fabozzi et al. 2006, 108-109). The bonds with the lowest seniority have the highest credit risk due to lack of security and in case of bankruptcy the credit holders have no or limited rights to securities as so called senior debt holders. Subordinated bonds therefore pay a higher YTM than other more senior debt. By making these bonds convertible (the bonds include an option to convert the bond to shares) the attractiveness to investors increases. Some subordinated bonds also possesses a so called step-up feature. This means that the coupon rate is increased after some period (Choudhry, Feasey 2011, 216-217).

3.2.5 Liquidity and Term to Maturity

The risk premium is to a significant extent determined by the degree of liquidity. Higher liquidity typically results in lower yields and vice versa.

As earlier mentioned in previous sections, the term to maturity directly affects the bond prices. Bonds are generally classified into three different categories (Fabozzi 2010, 98-99):

- *Short-term bonds*: Maturity between 1-5 years.
- *Intermediate-term bonds*: Maturity between 5-12 years.
- *long-term bonds*: Maturity greater than 12 years.

3.3 The High Yield Corporate Bond Market

A high yield bond or junk bond is a bond which is rated below investment grade. Issued bonds with a rating of BBB- (S&P definition) or above are classified as investment grade bonds.[2] The non-rated and rated bonds typically attract different types of investors. High yield bonds offer a nominal higher return on invested capital for the cost of a higher default risk and attract investors seeking more speculative and riskier investments than investment grade bonds (Yago, Trimbath 2003, 5-8).

The high yield corporate bond market is a relatively young market and is said to be originating from the U.S. in the mid 1970*s*. The market situation was then characterized by poor performance of long term fixed rate mortgages, government- and corporate bonds but also the stock market's performance was insufficient. These factors resulted in a search for new investment opportunities (Yago, Trimbath 2003, 2-6). The high yield market later developed during the 1980*s* but the later crash of the market in 1990 crippled the market. But the market later recovered and the high yield market is now considered to be a relatively stable market. It is a very important source of capital for corporations which lacks investment grade or are non-rated (Choudhry, Feasey 2011, 419-421).

The high yield corporate bond market in Europe developed during the second half of the 1990*s*. The stable economic situation in the U.S. combined with a low inflation and the introduction of the euro lowered the bond yields to all time low levels leading to increasing demand for high yield bonds, both as a financing- and investment strategy (Choudhry, Feasey 2011, 419-421).

The high yield corporate bond market give corporations the opportunity to acquire capital in an alternative way other than retained earnings, issuance of equity or bank loans. An overall stronger bond market is also expected to lower the overall cost of capital for corporations and increase the earlier mentioned

[2] See Appendix A Credit Ratings for a detailed listing.

diversity of funding. Although, bond financing can be seen as a competitor to traditional bank loans, financing through bonds could also function as a way of decreasing the credit risk and reduce the credit losses for banks and at the same time offer a high yield investment opportunity for the bank's investor clientèle (Gunnarsdottir, Lindh 2011, 45-46).

3.3.1 Issuers

Issuers of high yield bonds could typically be placed into one of the following three major categories:

1: **New Corporations**
Many so called new corporations lack a strong balance sheet and even though they have good growth prospects they have a poor current financial situation and thus a poor credit rating. These corporations are sometimes called *original issuers* (Antczak et al. 2009, 11-13).

2: **Fallen Angels**
These are corporations that have got their credit rating lowered due to a deteriorating financial condition (Antczak et al. 2009, 11-13).

3: **Corporations involved in shareholder-friendly activities**
These corporations increase the debt holding with the purpose to increase the stock value. Large dividends are typically shifted out to the shareholders (Antczak et al. 2009, 11-13).

Additionally, investment grade-rated companies can access the high yield market through subordinated bonds.

3.3.2 Bond Structures

There are different kinds of structures of the bonds issued on the high yield market. The traditional term bonds where a coupon rate is paid with equal intervals but also structures where special types of coupon payments occurs that are more cash hoarding. Deferred-interest bonds use the later coupon structure and do not pay interest payments in the first periods. They are sold to a deep discount in the primary markets.

Another bond type is the Step-up bond which pay a progressive coupon interest. That is, the coupon rate increases stepwise closer to maturity. Coupon payment may also increase if the credit rating is negatively changed.

So called Payment-In-Kind bonds (PIK) includes an option for the issuer to choose between paying the coupon payment with cash or give the bond holder an equivalent bond which corresponds to the payment. The issuer can only perform these options under a certain period.

The two latter described structures are beneficial for bond issuers due to the ability to delay initial payments and increase the liquidity (Antczak et al. 2009, 21-22).

3.4 Market Influencing Factors

3.4.1 Credit Ratings

A credit rating is an opinion about the credit risk that investors will be exposed for when investing in particular securities. These opinions are provided by credit rating agencies and are given to any public issue of debt securities (Choudhry 2004, 284-288). They are labeled as official credit ratings as opposed to unofficial credit ratings (synthetic credit ratings) that sometimes are performed by banks and other financial entities. The issued bonds are given a specific rating that may or may not coincide with the issuing corporation and they are categorized as either investment grade bonds or non-investment grade bonds (i.e. High Yield- or Junk bonds).

Usually the ratings are lower for securities with a long term to maturity due to the increased probability of default. Many investors use the following two main methods when deciding which credit risk a debt security has:

- **Name recognition**
  This method builds upon name reputation of the issuer. This method is more used when the debt securities concerns corporate or less developed government debt.
- **Credit ratings**
  This method is based on the rating performed by the credit rating agencies. The issuer must carry the rating cost but it will at the same time raise the profile of the company and its bonds. The ratings are connected to the specific debt issue even though a credit analysis of the issuer is performed (Choudhry 2004, 284-288).

3.4.2 The Basel III Rules

The Basel III regulations results in a substantial strengthening of the current capital requirements for a large part of the banks in the world. The regulations are a part of the global financial reform agenda together with a global liquidity standard. They affect banks and will lead to an increase in the requirement for common equity from a current minimum of 2% to 4.5%. Banks will also be forced to hold an extra 2.5% in a so called conservation buffer which results in a total buffer of 7% of common equity. Additionally, a countercyclical buffer within the range of 0-2.5% will also be implemented at a national discretion. Here common equity is interpreted as the highest form of loss absorbing capital.

The purpose of the increased requirement of capital buffers is to assure that banks will be better prepared when facing economical and financial stress. Basel III also impose supplementary requirements on systemically important banks. The transition to the Basel III regulation will occur in steps between 2013 and 2019. In 2013 banks will be obligated to fulfill the first step with the following minimum requirements in relation to risk weighted assets (RWAs):

- 3.5% common equity/RWAs
- 4.5% Tier 1 capital/RWAs
- 8.0% total capital/RWAs

The Tier 1 capital requirements and the minimum common equity ratio will increase in phases to 6% and 4.5% respectively in 2019. Tier 1 requirement includes the common equity and additional financial instruments based on stricter criteria (Bank For International Settlements 2010).

There are several potential direct implications of the Basel III regulations on the financial markets. As a consequence of the required increase of capital ratios, the banks will have to reduce their lending. The implications for the corporations will be decreased credit access and increased cost of borrowing. Since non-financial institutions are not covered by the rules, the willingness for corporations to issue debt on their own may increase. It is also believed that credit conditions will be even more harsh for small and medium sized companies due to the fact that the new regulations mostly will affect smaller financial institutions (D&B 2010).

3.4.3 The Trustee Function

The trustee function plays an important role on the market. A trustee represents the interests of investors and is appointed by an issuer. This is different from other agents who solely acts on the behalf of issuers. If the issuing part faces the event of default, the trustee will negotiate on the behalf of the investors or at least order for a smooth negotiation. The involvement of a trustee is not mandatory on all markets (such as the Swedish market) but in for example the U.S. it is required by law (since 1939) that a trustee must be present in all corporate bond issues. The trustee may in other markets be appointed to create an increased interest for the bond. In the case of secured issues, the trustee may possess a collateral for the benefit of investors. These assets are then protected from other creditors in the event of bankruptcy (Choudhry 2011, 355).

3.4.4 The Solvency II Directive

The solvency II directive aims to increase the requirement of solvency in insurance companies and also connect it to the risks in the company. That is, the requirements of having a sufficient level of equity relative to the liabilities will increase. The directive have been postponed a number of times but is considered to be implemented January 1, 2014. It is based on the three pillars regarding quantitative requirements (1), governance, risk management and supervision (2) as well as disclosure and transparency requirements (3) (Finansinspektionen 2012).

It is believed that the Solvency II directive will make it more expensive to invest in equity as opposed to bonds which could lead to a reallocation to corporate bonds as an alternative to the stock market (Finansinspektionen 2012).

3.5 The International Corporate Bond Market

3.5.1 U.S.A

The total amount of outstanding corporate bonds was 4936.3 billion USD at the end of 2011 (63% of total credit debt for non-financial corporations). The total U.S. bond market had a value of 38314.6 billion USD in the same time period (Federal Reserve Bank of New York 2012).

The high yield segment in the U.S. is substantial. Although it is hard to find any source on the total size of the segment, statistics shows that the high yield issues accounted for 22.1% of all corporate bonds issued in 2011 (SIFMA 2012).

3.5.2 Europe

According to the ECB, the European bond market in the continental Europe has historically been made up of government bonds and bank debt securities to a large extent. But since the introduction of the euro, corporate bonds have rapidly increased their share of the bond market from 9% in 2001 to 14% in 2003 due to the larger potential investor pool that became available (ECB 2004, 5). The growth has stagnated during the recent years to an annual growth of 5.7% in 2011. The growth of the total European security market was 4.3% in 2011 for securities traded in euro. The total market value of euro denoted bonds was 14.698 billion euro in 2011 (ECB 2012).

The high yield corporate bond market in Europe 2011 set a new all time high with 49.7 billion euro in issuance value, which was a growth of 11.6% compared to 2010, thus significantly higher growth rate than the euro bond market. The high yield issues of almost 50 billion euro can also be compared with the low in 2008 of only 5 billion euro to understand the exploding growth rate in the high yield segment.

The total value of the high yield issues in the fourth quarter 2011 was 39.7% of the total corporate bond issues. By the end of 2011, the European high yield corporate bond segment[3] comprised of about 28% of the total outstanding amount in the corporate bond market (AFME 2012).

3.5.3 Norway

The Norwegian corporate bond market is considered to be will developed with a size of 543.5 billion NOK in outstanding amounts issued (2012-04-10). The size of the total bond market was at the same time 1370.5 billion NOK which shows that the corporate bond market makes up a fairly large piece of the total bond market (40%). The Norwegian corporate bond market is famous for its large amount of high yield issues, mainly due to a large oil, gas and shipping sector with very high returns. It is not rare to find bonds with a coupon rate of 12% or even 15% (Norsk Tillitsmann Stamdata 2012). These high yielding sectors in terms of total returns can of course sustain a higher cost of debt and are therefore a perfect case for high yield bond issues.

It is hard to make a good estimate of the volume in outstanding amounts of the Norwegian high yield corporate bond market. DnB Markets estimated it to about 20 billion US dollar in 2011 (DnB NOR Markets 2011). The trustee

[3] Including non-rated bonds.

function in Norway, Norsk Tillitsmann, have available statistics of the corporate bond market through the database Stamdata.no. Although it is not categorized in investment grade versus high yield, it is possible to get a good estimate of the high yield corporate bond market by dividing it by the current coupon paid by the issuing corporation.[4]

Coupons of 6% and above is generally belonging to the high yield segment although some investment grade bonds could be included as well as some high yield bonds could be excluded. By that definition, the Norwegian high yield corporate bond market has a size of about 106 billion NOK (17.7 billion USD)[5]. Thus, the Norwegian high yield corporate bond market is about 19.5% of the total corporate bond market (including NOK and FX) (Norsk Tillitsmann 2012). A detailed breakdown of the high yield segment is shown below in figure 2 where the amounts have been converted to SEK for comparability with figure 4 showing the Swedish high yield segment by the same definition.

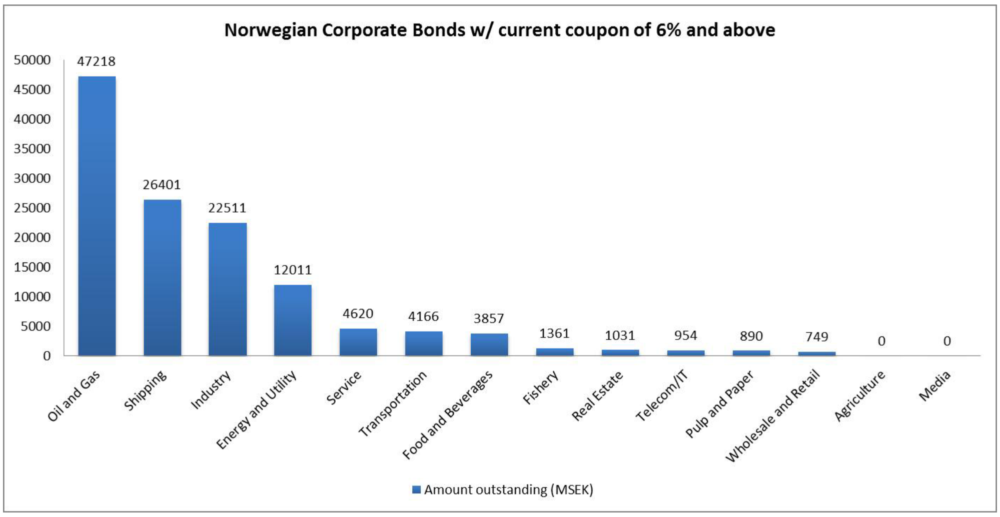

Figure 2: Norwegian "high yield" corporate bond market capitalization 2012-05-15 (Norsk Tillitsmann 2012)

3.6 The Swedish Corporate Bond Market

The corporate bond market in Sweden has an outstanding volume almost entirely made up of investment grade bonds issued by large and mature Swedish companies who often already have good access to the financial markets. According to the Central Bank of Sweden, the ten biggest issuers account for 70%

[4]Current coupon is the nominal yield that the company pays to its debt holders.
[5]Every currency conversion is made with the actual exchange rates at 2012-05-15.

of the corporate bond market value (Den Svenska Finansmarknaden 2011). The corporate bond market issued in SEK had a size of approximately 192 billion SEK in the end of 2011. The majority of the issues are however issued in foreign currencies - FX (mainly EUR and USD). The total market value of the outstanding issues in both SEK and FX were approximately equivalent to 499 billion SEK by the end of 2011. The Swedish total bond market capitalization can be seen in figure 3, which had a total outstanding volume of approximately 2333 billion SEK at 2011-12-31 (SCB 2012). Note that the Swedish corporate bond market had a share of 7% in relation to 40% for Norway.

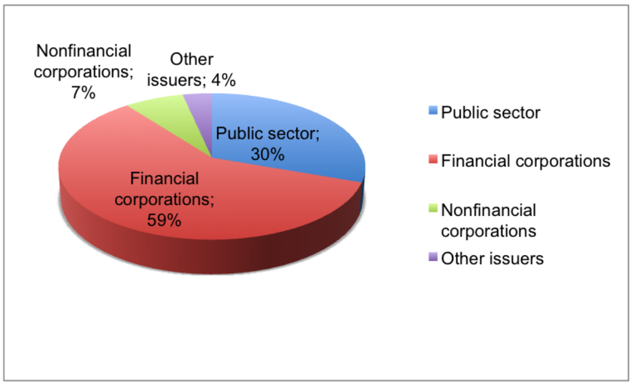

Figure 3: Swedish bond market capitalization 2011-12-31 (SCB 2012)

The outstanding amount of corporate bonds in comparison to loans taken by non-financial corporations in Sweden can be seen in figure 1.

There are no published data over the exact size of the high yield segment of the market with the generally accepted definition, but it is substantially smaller in comparison with Norway. By using data from Thomson Reuters Datastream and sorting out only corporate bonds with a current coupon of 6% and above, the Swedish high yield corporate bond market had an outstanding amount of 15.1 billion SEK (2.1 billion USD) with 95.5% issued in SEK.[6] With this definition, the high yield segment is only 7.8% of the total outstanding amount of corporate bonds in SEK and only 3% of the total Swedish corporate bond market (including SEK and FX). The detailed breakdown of the high yield segment is showed in figure 4 (Thomson Reuters Datastream 2012). A recently conducted survey also shows that the largest need for external funding is within the real estate sector which also today is one of the dominating sectors in the Swedish high yield corporate bond market (Danske Bank 2012, 6-12).

[6]See Appendix B Active Swedish High Yield Issues for detailed information of the currently active bonds.

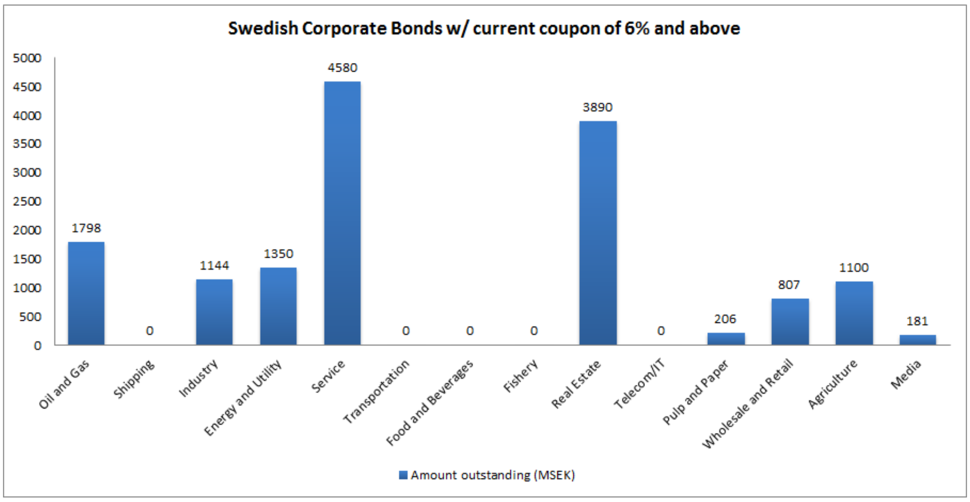

Figure 4: Swedish ”high yield” corporate bond market capitalization 2012-05-12 (Thomson Reuters Datastream 2012)

3.7 Theory Summary

There are several factors affecting the prices of bonds and their structure to fit issuers and investors in the most beneficial way, making the precise market behavior very complex. The high yield corporate bond market in Sweden is very small with respect to the overall corporate bond market. If one benchmarks it against the U.S. market which is considered to be one of the most developed market, it may not be a fair comparison due to different legislations and market characteristics. In the near geographical region, one can compare it with the Norwegian market which has a fairly developed high yield corporate bond market. But the theory shows that the two countries have a very different business structure.

Norway also has an established trustee function, an endogenous factor which just have been established on the Swedish market and may fulfill an important purpose as representative for investors. The acquired theory point toward an overall market growth of the corporate bond market but how it exactly will affect the high yield segment still needs to be explored further with help from qualitative interviews. Although essential market driving factors such as Basel III can be sorted out it is still unclear how the market actors will be affected by them. It is though clear that market drivers such as Basel III will result in an increase of capital requirements for banks and thereby a possible increase of cost of capital for corporations. This opens up questions if the Swedish high yield corporate bond market will grow, and if it does, how much?

The acquired theoretical results have served as a analyzing tool in the following qualitative interviews and improves the accuracy of the study as well as the understanding and interpretation of the acquired results.

4 Empirical Data and Key Findings

The performed interviews have been summarized in the following sections and categorized into the four perspectives. We conclude each perspective with our key findings that will form the backbone of the subsequent analysis.

4.1 Issuer Interviews

Two issuers of high yield corporate bonds were interviewed. The first interview was made with Bactiguard AB which is a small R&D intensive medtech corporation. The second interview was made with SAS which is one of northern Europe's largest airline corporations. In the following subsections the respective respondent's opinions are summarized.

4.1.1 Interview with Bactiguard

Bactiguard issued its first and so far only corporate bond in 2011. By the issuance, the company raised 450 million SEK with a fixed interest rate of 11 % per annum. The respondent thinks that the relatively high interest yield of the bond is, among other things the result of turbulent financial markets compared to the situation before 2008. Before the corporation entered the bond market it had debt in the form of bank loans. Even though they could have got a new bank loan, they wouldn't have been able to get it with the terms they needed so bond finance was the type of financing that best suited the company. The bond investors also demanded that the current bank loans should be repaid so they got closer to the security. The capital raised by the bond issue was finally used for the following three purposes.

1: *Expansion financing*

2: *Owner buyout*

3: *Repayment of bank loans as demanded by the investors*

The most important reason and favorable characteristic of bond finance for the company was the flexibility it created. The corporation is experiencing an expansion phase and has changed its business model since 2005 when the company went from being a license manufacturer to a company with its own product portfolio. With the bond, Bactiguard only pays a yearly coupon of the bond and the amortization does not occur until the maturity date. *"The banks would not have given us an amortization free loan for five years"*. Additionally, the bank loans were part of the old capital structure that was optimized for the business model before 2005.

The choice of issuing a bond was considered as a fairly easy decision. The respondent pointed out that issuance of equity was not an option since the owners have a long term engagement in the company with the intention to expand the business. Further advantages of a bond issue compared to a bank loan were also the lower pressure on the cash flow and fewer covenants which also improved the operating flexibility of the company. The general knowledge about bond finance was high in the company board and management with previous individual professional experiences in the capital markets.

Before the bond issue, a financial advisor was contacted with whom the terms of the bond were discussed. The advisor then scanned the market in order to get opinions about the terms. Thereafter, decisions were taken regarding the terms and conditions of the bond which included issues like if it should be listed or not and if it should involve any securities and so forth. After that, they were ready to go to the market with their offering.

Bactiguard used an agent to act as a trustee for the investors in the bond. The respondent claimed that they wouldn't have been able to issue the bond if they did not have a trustee, especially since they are not a large public corporation. In order to inform the investors, road shows were initiated where the advisor invited investors in order for them to assess if Bactiguard had enough cash flow to fulfill its obligations.

The term to maturity of the bond is 5 years which was the maturity that the company looked for. The respondent added that with this maturity, the corporation has time to develop so they probably can refinance the loan under more beneficial conditions.

The respondent also believed that more information and a larger understanding of the how the corporate bond market really works would make more companies use corporate bonds as a financing alternative. The secondary market was considered important with respect to initial facilitation of sufficient liquidity for the investors but after that it was of less importance for the company other than keeping a good relation with the investors in general.

4.1.2 Interview with SAS

SAS has several outstanding corporate bonds with different yield to maturity. The most recently issued bonds are from the spring of 2011 with a coupon rate of 10.5% (issued in SEK) and 9.65% (issued in EUR). The respondent pointed out that the possibility of financing with bank loans will become smaller and smaller for the company because of the banks' greater risk aversion, especially against airline corporations. One source of finance today is through the EKN (Exportkreditnämnden) which could give export credit finance when it comes to acquisition of new airplanes. By using the airplanes as a security the terms are significantly better and the yield decreases to 5-6% when this type of secured finance is used.

During the autumn of 2008 almost all types of financing were frozen, but *"the bond market is opportunistic and recovers very quickly"* and the key to a successful bond issue is a good timing. The respondent is sure that the company can not fully finance its operations with corporate bonds, they are only considered to be one source of financing among many. For the outstanding bonds issued by the company the term to maturity is as long as possible with respect to a fair price. The reason for the issuance of bonds with relatively high yield is the lack of securities. The yields are perceived as volatile and swings up and down and the respondent stressed that the bond market is very sensitive for events that are out of the firms control. The market is simply not considered to be deep enough to facilitate an issue at any given time.

The secondary market is perceived to be quite large for the bonds issued by SAS and there is also a credit default swap available in conjunction with the bonds. But the secondary market is not as important as the transaction of funds and the company has not developed any deep investor relations compared to those with the shareholders.*"The bond holders are a little bit more 'hands off'."*

4.1.3 Key Findings from the Issuer Perspective

From our interviews with issuers, the following points are considered substantial and important for the continued analysis and conclusion.

- The more restrictive lending from the banks makes it more attractive and sometimes necessary to seek finance through the bond market.
- The higher flexibility with respect to maturity as well as the opportunity to get a better cash flow compared with a bank loan was considered as highly beneficial. This flexibility was also important when it comes to refinancing at beneficial conditions.
- The secondary market in terms of liquidity of the bond was not considered important other than before the issue. Good relations to the investors was considered important to have a good reputation for future transactions.
- The use of an agent was considered important only if the corporation was small or not listed on a stock exchange.

- The corporate bond market was perceived to be volatile in terms of depth and the timing of the issue was important.

4.2 Intermediary Interviews

The intermediaries are the organzations that orginiates the bond on the order of the issuer. That is, they are responsible for creating an acceptable offering for the investors. The intermediares in Sweden are naturally the largest banks but also the smaller independent investment banks. The large banks (i.e. SEB, Nordea, Handelsbanken, Swedbank and Danske Bank) have in reality an oligopoly on the big issues which also includes the investment grade issues. This leaves the high yield corporate bond market to the smaller investment banks. That is why focus have been on the latter group when the interviews were performed.

We have interviewed the following intermediaries:

- **SEB** is one of the biggest bond originators in Sweden. As a large bank, they are strong in the investment grade segment but have recently built up a dedicated high yield team.
- **Nordic Fixed Income** is a small investment bank with Nordic focus that started in the fall of 2011. They are part of the Catella group. In the Debt Capital Markets, their focus is on high yield issues.
- **Pareto Öhman** is an investment bank with Nordic focus. They were very early on the Swedish market establishing themselves as a high yield originator.
- **ABG Sundal Collier** is an investment bank with focus on the Nordic markets that mainly deals with high yield bond issues in their debt capital market activities.

4.2.1 Interview with SEB

SEB have noticed a significant growth in the high yield segment but also in the investment grade segment as well as from corporations that lacks an official rating (i.e. non-rated corporations). The respondent mentions the fact that traditional bank loans are not going to be as easy to receive in the future with tougher regulations where the banks can not have as high risk level as today in their balance sheet.*"If you are a risky corporation with a shorter history and therefore have a lower rating, then it is maybe the bank door that closes first. If they [the banks] have to decrease something, then it is maybe not the oldest relationships. Therefore will maybe this sector [the high yield sector] grow the* *most."* He says that all of their market connections have the same opinion, more corporations are going to seek bond finance in the future.

SEB have a slightly different definition of what constitutes a high yield corporate bond. Every corporation that lacks a rating is given a synthetic rating that follow the S&P evaluation matrix. That means that if the synthetic rating is BBB- or above, it is defined as an investment grade bond and everything rated below is a high yield bond. The respondent says that *"The important thing for us isn't if it's high yield or not, but if it's a corporation that has not used bonds before, since then it's a growth on the market and that is good for every actor on the market."*

According to the respondent, the only factor that holds back the market somewhat today is that it is considered as an expensive source of funding. This implies that there is a matching problem today between issuers and the investors on the market. Investors have good access to the global bond market and a sufficient knowledge of what yield they can get in other parts of the world. The average corporation has bank financing and of course wants to keep its low interest rate level which many times could be unsustainable for the banks. This means that a new bank loan would be on a significantly higher interest rate level today. All companies haven't fully accepted that they need to pay higher interest rates. On the other hand, investors sometimes demand a higher yield for a bond than what is reasonable to pay which creates this matching problem. So there is a matter of an adjustment process before an equilibrium is reached. How long this process will take is in the respondents opinion unclear but non the less, in a five year period the market is predicted to be significantly larger than today.

SEB argues that official credit ratings have had a declining importance for the investors in recent years even though the majority still pays much attention to them and the bulk of money is still found in the investment grade segment. The big change came though with the financial crisis of 2008. Before that, the investors trusted the rating given by the credit rating agencies to a much lager extent. Now, the investors think it is more important to perform an additional analysis of their own. According to the respondent, a non-rated corporation is generally on average treated as having a higher credit quality than corporations rated as high yield. This is because the investors have understood that something is unrated because for example the corporation did not receive a fair rating according to their opinion or simply because the corporation does not want to pay for a rating due to its significant cost. The investors that perform their own analysis generally wants to meet the company and see the financial statements. Often the investors gain more information by acting this way than what they would get from the big corporations public information.

This causes that investors in some cases feel safer to invest in smaller and more unknown corporations than in the largest public corporations.

The growth of the high yield segment is mainly driven by what the respondent calls the *"regulatory tsunami"*. By this it is meant that the Swedish governmental agencies have imposed stricter regulations than Basel III and also implements them earlier than other countries which enhances that effect. This will create a greater volume in the bond market which will make it easier and more attractive for investors to invest in high yield bonds than before. The need for high yield investments as well as high yield financing existed before the financial crisis but it has accelerated since 2008. The investors are already starting to adapt to this situation in terms of starting new high yield mutual funds as well as incorporating more high yield bonds in the present funds. Furthermore, they start to recruit more fund managers and credit analysts for this segment.

According to the respondent, growth will take place on the expense of more traditional government- and mortgage bonds as well as decreased investments in the stock market. This is explained by the record low yield in both of the previously mentioned sectors over the last years and according to the respondent, investors are to some extent forced to seek alternative investments such as the high yield segment to be able to get a decent yield. They have also learned that you will get a more *"senior treatment"* if you are a bond owner and if the corporation get problems as opposed to a shareholder. This is of course also dependent on which "hierarchy level" you are on when you buy bonds.

The recent establishment of a dedicated trustee function on the market is regarded as very important by SEB. The respondent calls that function as a *"hygiene factor"*, which means that it does not drive the market growth by it self but merely works as an enabler for a sound market. It is a function that is most important for the high yield corporations which of course is explained by the higher risk for a credit event in these risker and more hard analyzed corporations.

The secondary market for corporate bonds in Sweden has historically been illiquid and poorly working since investors usually have bought and held the bonds until the maturity date. They have not wanted to let go of the bond almost regardless of price. But if bad corporate news suddenly arrived, everyone wanted to sell and no one wanted to buy, consequently the market worked poorly. But this has become better along with that the market has become more mature and deep. Many investors have started to realize that they have to sell sometimes to be able to buy other times. This can mean that the investor does not get the volume it wants sometime but it is essential to have a functioning market. If the market is OTC through telephone or electronic is not an issue in this case according to the respondent.

As a result of the previously very illiquid secondary market which also created difficulties for issuers on the primary market, many corporations now demand that several banks participates in the origination process since it facilitates trading on the secondary market and by extension attracting more investors in the first place to let the issuer sell its bonds more easily. If, for instance one investor later wants to sell quickly, the bank can buy the bond and temporarily keep it on its books and then sell it later. By having more banks, this allows for a larger "safety cushion" if the investors wants to exit quickly. A secondary effect is that the issuer also gets access to a larger investor pool. A secondary market is thus important for the issuing corporation due to the risk of receiving a bad reputation in the future among investors if this liquidity function provided by the banks is not big enough.

4.2.2 Interview with Nordic Fixed Income

Nordic Fixed Income started as a result of more favorable market conditions for corporate bonds in Sweden. They see the new credit restrictions coming with Basel III and Solvency II as well as a general low-interest rate climate as strong facilitators for a growing corporate bond market.

The respondent thinks that the market is not growing as fast as it could do. Currently, there are more investors than there are issuers and it is hard to find issuing corporations. The reason for the lack of issuers could be due to several reasons. One could be that they for the moment simply do not have any need for new capital or that they still in many cases have the possibility to use traditional bank financing. The corporations that seek bond finance have often traditionally had some flaws that make the bank reject a loan and at the same time owners who also rejects further equity finance. Then it has often been a good option to get debt finance through the issuance of a high yield bond.

This situation has changed somewhat in the last years in terms of that more and more corporations that could get bank finance now seek bond finance as a way of decreasing the dependency of banks. This effect is reinforced as the price of bond finance has been decreasing and now better can compete with bank loans. The respondent thinks that the current factor driving the growth of the market is the effects of Basel III, hence the banks will be forced to shrink or stop the growth of their assets and the insurance companies will slowly increase their presence in the credit market and decrease the presence in the stock market due to the effects of the upcoming Solvency II directive. He also adds that the knowledge about bond finance among the corporations is quite low *"When I call a CFO on a Mid Cap company, I basically have to educate him of what a bond is."* The general knowledge of stocks in Sweden today is good but fewer knows what a bond is even though the interest for it is increasing.

One historical problem on the Swedish high yield bond market has been the mispricing where the relatively limited investor base in combination with low experience created situations where two completely different corporations in the same sector get the same pricing. Another explanation for the mispricing could be the fact that the big insurance companies that are now beginning to establish a presence in the high yield market not are familiar with the valuation of unrated high yield bonds. They have historically, to a great extent relied on credit ratings and hence lack the necessary staff for credit analysis. The respondent points out though, that an increased presence of the insurance companies is a necessity for an increased growth level. This is of special importance when issues are larger than 200-400 million SEK.

Today, the investors in the Swedish high yield market are almost entirely made up of domestic investors which differs from the Norwegian market where the foreign presence is heavy, especially hedge funds from the U.K. and the U.S. The respondent argues that the previous lack of a trustee function in Sweden may have affected the situation and the establishment of such a function may facilitate an attraction of foreign capital although it is unclear at the moment. Nordic Fixed Income now sees the presence of a trustee in a high yield issue as mandatory and a demand from the investors.

The respondent thinks that there is a need for foreign investment capital on the Swedish high yield market, although domestic investors are allocating more and more capital to the market. He also sees a need for more professional capital in the form of dedicated credit funds as well as high yield funds with more flexible investing mandates contrary to most of today's credit funds that mostly invests in credit rated bonds.

The corporations that seek high yield bond finance are according to Nordic Fixed Income typically real estate-, agriculture-, forest- and infrastructure corporations, that are capital intensive companies. Also companies with growth strategies through mergers use bond financing to a high extent due to their high debt ratio. Compared to the situation in Norway the market composition is different where they have a large oil and gas sector that needs project financing. The respondent claims that Sweden will never get such a vivid market like Norway because of this composition difference, but adds that the Swedish wind power industry could have a good potential for a large share of bond financing. Currently the real estate sector have the largest presence on the Swedish high yield corporate bond market. The respondent argue that corporations within this sector have a slightly harder situation finding finance though bank loans since the banks don't earn any money on other services like cash management systems et cetera. In times when the banks have to pay more for capital, the real estate corporations will be more active on the corporate bond market.

4.2.3 Interview with Pareto Öhman

Pareto Öhman have experienced a strong increase in the interest of issuing bonds from its customers. They see different reasons for this. The banks are increasing their margins on bank loans as well as becoming more restrictive in terms of approval of new loans to new customers. A third reason could also be that there is a general lack of bank credit since the foreign banks that also had a strong presence on the Swedish market before the crisis, now have decreased there activity on the market due to their generally smaller capital base. The Swedish domestic banks are relatively more solvent and thus are able to fulfill the Basel rules as well as the additional rules from the Swedish Financial Supervisory Authority (Finansinspektionen) more easily. This situation is believed to be existent for some years which enables an expansion of the Swedish corporate bond market.

The companies that have been present on the Swedish high yield market are the ones that couldn't get traditional bank financing due to flaws that prohibit them from getting bank loans. The reason for this has many times been due to an immature business. The respondent thinks that the banks now encourage corporations to seek bond financing because they want to stay clear of the more risky business. It is also seen as a way for the companies to differentiate themselves and use the bond market as a complement to bank finance, which for example real estate corporations do.

The respondent mention agriculture, mining and smaller oil and exploration corporations along with the real estate sector as typical high yield issuers.

In the past, there has been some problems with the legal documentation. In the recent years though, an informal standard has been established by it self with more and more issues which makes it much easier for the investors. This development leads the respondent to believe that a corporate bond in the future more will be treated as a "COTS" - Commercial Of The Shelf.

Pareto Öhman says that there is not any problem with the demand for bonds from the investors. But the relatively small issuing amount makes high yield investments attractive only to domestic investors so far. Larger issues have attracted some foreign investors. The composition of the investors is mutual funds, insurance companies, private equity companies and retail investors that often manage family fortunes. For the insurance companies, the high yield investments are only a spice to their portfolio.

That the issuing corporation uses an agent to act as a trustee is now mandatory when Pareto Öhman originates high yield bonds. This is because Pareto Öhman wants to prevent problems if a credit event occurs because they don't have any possibility to represent any party.

4.2.4 Interview with ABG Sundal Collier

ABG Sundal Collier have seen a growing interest for high yield bonds from both the issuing side when the banks restrict their credit lending and the increased bank processing times as well as from the investing side where there is more money available for these types of investments, possibly due to the low yield in the stock market during the last decade. Currently, there is a much higher demand from investors than from the issuing corporations.

The respondent thinks that the growing interest and market size of the corporate bond market in general and the high yield segment in particular is a structural change and not only an effect of the current favorable market conditions with low interest rates. But at the same time, he says that the market is vulnerable to sudden negative market news that could scare off the investors (mainly professional credit funds) very easily.

The Swedish average company is also not in any significant need of capital and is very strongly capitalized. This differs from the Norwegian market for instance, where some companies are in a constant need of capital. The corporations that have a general need of capital in Sweden have historically been the real estate companies. Also Swedish companies with a large presence outside of Sweden have been attracted to the high yield market due to difficulties of getting bank finance. The Swedish corporations have probably also become more aware of the financing risk to only rely on the bank and the stock market for funds which implies that diversification is also a reason for an increased interest in issuing bonds.

Historically, the perception among the issuing corporations has been that bond finance takes a long time to complete. The respondent mean that bond finance now is a relatively fast way of raising capital with a time frame of as fast as 4-6 weeks in a standardized process. At the same time, the bank process of getting a loan has slowed down considerably during the last five years. The respondent also stresses that standardization in terms of documentation is necessary today with a larger number of participating investors (typically between 30-50) in every issue than before.

ABG Sundal Collier also points out the importance of a trustee function in every high yield issue, *"They have, so to say, appeared mainly because we financial advisors have requested it"*. The fact that there now are two agents present on the Swedish market is considered as a sign that the market have reached a critical size to sustain their business. But it is not their presence that is driving the growth, they are merely providing a good service if the market starts to get more credit events which hasn't been the case so far.

The respondent says that the reason for the low number of credit events in the Swedish market is due to the relatively low debt level as mentioned before but also the strong and almost unique Swedish tradition of a rights issue in secondary offerings, where the owners can inject more money in the company if needed to prevent default. That option also has a positive impact on the yield that the issuer pays. Furthermore, the intermediaries also acts as an implicit gatekeeper for unsuitable corporations that wants to issue debt in terms that they promise a sound and fully functioning company for their investors.

Today, the typical high yield issuer is a publicly traded mid cap corporation with a market capitalization between 5-30 billion SEK. It is therefore natural that the size of a bond issue is between 300-800 million SEK where the refinance risk and credit premium don't become to high. Although, the respondent believe that there will be more common with larger issues in the future when the market is more mature. The implicit demand to be a listed corporation as well as to list the bond on an exchange is because of the transparency demand from the investors but also because of the added safety cushion in terms of the possibility for a rights issue.

The investors in high yield bonds are according to ABG Sundal Collier mainly domestic professional credit funds. This is due to that the Swedish issues are of small amounts and non-rated which do not attract the larger international funds. Also, the fact that the issues almost entirely are in SEK adds a currency risk as well. Now, the Swedish credit funds have had an inflow of capital that previously was allocated to the stock market which means that there is currently sufficient Swedish capital to support the relatively few issues. The respondent even express that it is an implicit pressure on larger bond issues to enable even more capital allocation from the credit funds.

Even though it does not look like that now, he thinks that if the Swedish capital would be insufficient in the future, the corporations would adapt to that by getting official credit ratings which in turn would enable a reach to international investors. But the fact that the majority of the Swedish corporations are unrated is not of any significant importance for the Swedish investors today according to the respondent.

ABG Sundal Collier sees a secondary market that works better and better even though many investors are of the type "buy and hold".

The trend of the Swedish high yield segment is quite bright and the respondent thinks that even though the Swedish market will not reach the Norwegian level in the near future, it is realistic to believe that it would reach yearly high yield corporate transaction volumes of 10-20 billion SEK.

4.2.5 Key Findings from the Intermediary Perspective

Because of their central role as bond originators on the market, the intermediaries get insights from all the perspectives. The most significant findings are summarized below.

- Every interviewed intermediary express a unison opinion that the Swedish corporate bond market in general but also the high yield market are experiencing a significant growth due to structural changes. This became obvious after the financial crisis of 2008 when the banks started to be more restrictive with their lending. It has been further strengthened with the upcoming implementation of Basel III.
- The typical Swedish high yield issuer is a capital intensive corporation, very often a public company in the mid cap segment. Most commonly from the real estate-, forest-, agriculture-, oil-, infrastructure-, exploration- and medtech sector. The typical issue is between 300-800 million SEK.
- Official credit ratings in the high yield market are not considered necessary. The intermediaries are offering synthetic ratings when needed. The larger investment-grade companies that need access to the international bond market are often officially rated though.
- The underlaying reason for the big difference between the size of the

Norwegian and the Swedish high yield corporate bond market is the lack of a natural capital intensive, high yielding sector in Sweden like the oil and gas sector in Norway.

- The general experience is that the demand to invest in high yield bonds is bigger than the supply from issuing corporations. This is believed to be due to several reasons; Swedish corporations are well capitalized and are not in any general need of capital. The knowledge about the corporate bond market is low among the corporations compared to the knowledge about the stock market. There is also a matching problem on the market because of the unfamiliarity of what constitutes an accurate price, both from the corporation and the investor's perspective.
- The high demand of investing in high yield is likely to increase further because of reallocation of capital from the stock market but also from the bond market with higher credit quality (government- and mortgage bonds). The reallocation is considered to be due to both the effects of Solvency II and a higher general risk awareness from the volatility of the stock market.
- The typical investor is a professional credit fund. Other investors are insurance companies and retail investors. They are all but entirely domestic investors, that is most likely because almost all issues are in SEK and too small to attract the large international investors. There are also some concerns over mispricing of bonds due to a immature and inexperienced investor collective.
- The secondary market is not optimal but is starting to get better in terms of liquidity. This is also facilitated by the fact that it is more common even for high yield issues to involve several intermediaries. It has historically been a ”buy and hold” market but this is starting to change to some extent which also could open up for longer maturities.
- The trustee function is considered a hygiene factor when issuing high yield bonds but nothing that could drive a market growth on its own. It is also a good sign that the high yield market has reached a critical size to support the agent's operations.

4.3 Agent Interviews

There are only two agents available that offer trustee services to the Swedish market, CorpNordic and Swedish Trustee. The latter is in the state of starting up its business and does not have a fully functioning organization of its own at the moment. We only interviewed CorpNordic.

4.3.1 Interview with CorpNordic

CorpNordic is a company that, among other legal services, offers a trustee role on the Swedish corporate bond market. The trustee role is a very common function abroad, regardless of if it's investment graded bonds or high yield bonds.

The Swedish market is considered by the respondent to be very active at the moment, *"We see that the banks, issuers and investors think it is very important with the trustee role."* The increased importance is because of two main reasons. A more developed high yield market also brings more risk into it. It is then considered important to have an objective and independent party if a default or covenant breach should occur. In that case, the presence of a trustee function makes communication between the issuer and the investors easier. The second reason is that as the market grows, the trustee function will make sure that the process and agreements will be similar which will make it easier for the investors to buy bonds.

Before the establishment of a dedicated trustee function in the Swedish market, the banks handled that role although it mostly concerned investment-grade bonds. With a growing primary and secondary market, it will be impossible and unsuitable for the banks to cover that role.

According to CorpNordic, everything points towards that agents acting as a trustee are going to be a mandatory and natural part of a bond issue. Today, it is a demand from some of the smaller investment banks that are dealing with the high yield issues but it is also believed that there is a cultural change going on within the larger banks regarding this issue. The view of the trustee function has changed in Sweden during the last two years, *"two years ago we were in the process to convince the banks that they needed a trustee, we don't need to do that today"*. It is considered as only a matter of time before the investment-grade issues also involves a trustee role. The respondent is also convinced that the market will grow extensively within the coming 3 to 5 years due to the effects of the implementation of Basel III. The corporations will begin to seek alternative financing as a reaction and corporate bonds are then one possible solution.

The companies that are willing to issue high yield bonds in Sweden come from very different industries and it is often not the issuers them selves who contact CorpNordic, but law firms or the issuers bank, which are seen as the most important contacts. In order to vitalize the market for trustee services the work with a standardization of the terms is in process.

4.3.2 Key Findings from the Agent Perspective

Although we only interviewed one of the two agents on the market, we can draw the following conclusions.

- The trustee role is a natural part of the high yield segment today and is about to establish itself in the investment grade segment as well.
- With an increased market activity, a trustee function is required by the investors to facilitate further investing as well as trading on the secondary market.
- The presence of two actors on the Swedish market indicates that a critical level in terms of the volume on the high yield market has been reached.

4.4 Investor Interviews

Two companies with a large presence on the corporate bond market were interviewed. Proventus, an investment company focusing on investments in publicly traded high yield corporate bonds and private corporate loans and Skandia Liv, a life insurance company investing in both the stock market and the bond market.

4.4.1 Interview with Proventus

Proventus have a slightly different definition of what constitutes a high yield corporate bond than the common definition. It is considered to be a bond with a significantly large spread to the risk free rate which in their case is a spread of at least 6-7%. This definition is used instead of ratings. The respondent is slightly skeptical about the accuracy of official ratings sometimes and have the opinion that the only correct definition of a high yield are the actual yields of the bond and argues that with this definition the problem with how to treat a rated or non-rated bond or corporation is also avoided.

The historical large weakness of the Swedish high yield corporate bond market is the very cyclical behavior. During economic downturns there were a number of high yield bonds available. When the economy was getting stronger there were no high yield bonds available. *"The market has existed for a couple of years and then disappeared again."* This behavior has in turn resulted in that people investing in this market were investors with very flexible mandates who relied on the stock market when the high yield market was non existent. But this has changed since the last 2-3 years. Before that, it almost only existed so called "fallen angels" that were downgraded to high yield level or "junk bonds" as opposed to now when we have bonds originally issued as high yield. The respondent added that somewhere after 2009 one can actually talk about a market which can support professional investors over a complete business cycle. But the interest from the investors for this market has always been there but even though the market has been considered as too unbalanced with large imbalances in terms of supply and demand. Under some time periods it has existed a lot of investors willing to invest but few companies willing to issue and the other way around.

The most obvious reasons for this significant change of the Swedish high yield corporate bond market are, according to the respondent, the more expensive bank finance and generally more restrictive credit lending after the financial crisis of 2008. This has increased the attractiveness of issuing bonds. Another important factor in the long run is the introduction of the Basel III rules which will make this trend permanent. That will of course likely make the market for high yield corporate bonds even more attractive. The Solvency II rules for the insurance companies are also seen as a factor that may increase the attractiveness of corporate bonds on the expense of stocks which will demand a higher capital buffer than bonds. In the light of the poor stock market return the last decade, this could cause an increased inflow of capital from the insurance companies into the corporate bond market. The same effect could also arise from a reallocation on the bond market where the insurance companies could buy more high yielding corporate bonds because of the low yields on the government- and mortgage bonds.

The respondent also wants to point out another likely reason for the increased interest in financing through bonds. The corporations have since the financial crisis started to realize that it is a risky strategy to rely solely on lending from banks. The banks don't want to give longer maturities on the loans and also have tough covenants that makes it possible to call the loan if a some of the covenants are breached. With a bond, a borrower could feel much more secure. *"You know that the money is there until the maturity date."*

The respondent finds the introduction of agents on the high yield corporate bond market as an important part of the maturity process of the market. He claims that the function earlier was fulfilled by the banks, but it could create a conflict of interest when the bank has two roles in a process. The introduction of agents are making the market more sound but are not any large facilitator of increased interest from neither the investors nor the issuers but merely a hygiene factor. *"Sure, on the margin this is good but one can hardly see this as a game changer."*

The main investors today on the Swedish high yield market are dedicated high yield mutual funds but also some insurance companies. The respondent thinks that the small market today hinders many of the big insurance companies and pension funds to invest directly because it is not justified to have its own staff of corporate credit analysts, but this is something that likely will change when the market deepens.

One reason for the relatively small market compared to the Norwegian and U.S. markets is the different industry structure in Sweden, with fewer corporations with a high return that could support the payment of 10-15% in annual interest payments. A real estate company with an annual return on assets between 5-10% could hardly finance itself with a large share of high yield bonds. Another factor that has kept back the market before has according to the respondent been the banks lack of ambition to give support to the high yield corporate bond market because they have seen it as a competitor in some way.

The secondary market is seen as poorly working by the respondent and it must be dealt with if the market should become deeper and attract more investors. The importance of transparency of how the bonds are priced and of the buyers and sellers on the market are important and a possible next step may be an electronic market or the introduction of mandatory reports of all transactions for banks. The current system with low liquidity and a "buy and hold" behavior prevents some investors from entering the market as well as preventing some corporations to get longer term to maturity on the bonds. The implicit limit on the high yield market is 5 years. This works better in Norway where there is a kind of post trade transparency and the brokers reports the deals on a weakly basis, even if the market mainly is a telephone market as in Sweden. *"Today if I want to know how the bonds are traded I need to call 3-4 brokerage firms and this transparency must be improved."*

4.4.2 Interview with Skandia Liv

Skandia Liv is a life insurance company. In Sweden, the insurance companies have focused on investing in three different assets: stocks, bonds (government- and mortgage bonds) and real estate. The respondent believes that there is a larger perception now that the risks need to be even more diversified which also include the credit risks, *"then high yield investments is a risk you should have"*. Sweden is perceived to be lagging in this process in comparison to other countries such as Denmark. The insurance companies there have large investments in the high yield segment and other types of credit investments. The respondent added that he believes that the high yield corporate bond market *"has come to stay"*.

The coming Solvency II directive is believed to be postponed in its implementation although the current official date is January 1, 2014. But today it is already existing a similar form of regulation on the Swedish market which is known as the ”Tjänstepensionsdirektivet” (which is a directive concerning allocation of funds from employment-based pensions) and the associated monitoring system which popularly is called ”the traffic light system” that have been in effective use since 2006. The Solvency II directive is just considered as another stress test for the company even though it is believed to be more detailed than the current rules.

The respondent believed that the changes on the bank side will have more effects on the high yield corporate market than the Solvency II directive. *”I believe that for the high yield market, it is more important what is happening in the bank area and Basel III than what is happening for the insurance companies.”* The Solvency II directive was not considered as a reason on its own to invest more in credit risk and high yield bonds in particular, not for Skandia Liv anyway. Bonds with a weaker credit rating are seen as expensive during their stress test. It is believed that the high yield market is more attractive for retail investors rather than for institutions and he claims that the expected actual return on high yield corporate bonds could be low in the event of increasing interest rates. The respondent thinks that other insurance companies that are not as solvent as Skandia Liv could be forced to reallocate in some extent to corporate bonds due to a weaker balance sheet.

The corporate bond market is, according to the respondent, definitely more interesting to invest in now due to risk diversification reasons. *”We see credits as a natural part of our portfolio onwards and in that spectrum there is high yield too.”* But to buy high yield bonds you need to do a thorough credit analysis on every bond and Skandia does not have the staff to do this today, they are probably going to get that capability in the near future though. The company will then invest in more credit risk but it is unsure if it will be in high yield corporate bonds.

4.4.3 Key Findings from the Investor Perspective

- Both of the respondents have noticed a clear change in the market for high yield corporate bonds and that it now have reached a critical size. It is now able to support both professional investing entities over a complete business cycle as well as getting more mature with the entrance of professional agents on the market.
- The Basel III rules are believed to have a greater impact on the growth of the corporate high yield market than the Solvency II rules.

- Besides the increasing difficulties of getting bank loans to the right conditions, the corporations have likely also started to realize that it is risky to rely solely on banks for their finance needs. Bond issues could then be a good alternative for risk diversification.
- Even though Solvency II maybe not forces the insurance companies to invest more in corporate bonds, they still have an increased interest in the market for risk diversification purposes. This will also require that the insurance companies adds more credit analysis capacity.
- The poorly functioning secondary market has to get more transparent and liquid in order to attract more investors. It will then be easier for issuing corporations to get longer term to maturities than today's implicit limit on 5 years.

5 Analysis of Findings

5.1 The Present Conditions

This section is based on the key findings from each perspective. The data will be aggregated to cover the market as a whole and get a holistic view. The goal is to answer the first research question and build a reliable picture of the current Swedish high yield corporate bond market in order to be able to answer the final research question about the likely market development within a five year time frame.

Every respondent, regardless of role in the market, has the opinion that there is a change in the perception of bonds as a corporate financing tool. This shift has occurred due to structural changes which to a large extent were initiated as a result of the financial crisis of 2008. This finding is also expressed in earlier research by Gunnarsdottir and Lindh (2011, 45) as well as by Barr (2011, 11). The crisis changed the general perception of banks as both a cheap and reliable source of funding. This correlates well with our initial theoretical studies which indicated that banks are more risk averse and forced to be more restrictive with their credit expansion. The effect of the upcoming formal implementation of Basel III have also made the funding much more expensive even though Swedish banks are well capitalized. This can be explained by the tougher Swedish capital buffer rules imposed by the government and the Swedish Financial Supervisory Authority.

Based on the interviews, two main effects originating from the changing bank sector have been observed which have a direct positive impact on the growth of the corporate bond market. The companies have realized that they need to spread their risks and adopt a certain amount of diversification to their funding - from mainly relying on two sources, the banks and the stock market, corporate bonds are becoming a third source. The second effect is that some companies simply cannot get bank loans to the same low cost as before, which make bond finance a relatively less expensive source. With cost, we are referring to both a generally higher interest rate but also a shorter time to maturity and a higher amortization rate which have negative cash flow effects for the companies.

Real estate was the sector that clearly stood out in the interviews as in need to use bond financing due to the credit restrictions from the banks. This can be validated from a recent survey from Danske Bank that showed that the real estate sector have the largest need for external funding and at the same time are experiencing this funding problem (Danske Bank 2012, 6-11). (The general funding problem for all but the largest corporations was also something that Gunnarsdottir and Lindh (2011, 42) concluded.) That is why the real estate sector has been and likely will be one of the bigger issuers on the Swedish high yield corporate bond market.

From the investor perspective, the corporate bond market is gaining from more attention and subsequently allocation of capital. According to our interviews, the main reason for the increased attention is the relatively poor stock market performance during the last decade. The upcoming Solvency II rules are also believed to have some effect of the increased interest in the corporate bond market as well as low interest rates on more safe assets such as government- and mortgage bonds. This coincides with our theory, although it is not so obvious that Solvency II will affect the allocations to any greater extent in Sweden. This is also a conclusion that Gunnarsdottir and Lindh (2011, 39) points out in their research study.

Although some respondents preferred to talk about growth in the corporate bond market in general rather than to specifically point out growth in the high yield segment, it is not far fetched to believe that the major growth will take place in the latter segment. The largest Swedish corporations, typically with an investment grade rating, already have good access to the bond market and many times this means the international bond market which don't benefit the Swedish market. The new issuers then logically have to come from the relatively smaller companies which not previously have been engaged in the market. Because of the Swedish tradition of having non-rated companies[7] the

[7] Only 46 Swedish companies had a rating with S&P which is the largest credit rating agency (S&P 2012).

growth will likely to a large extent take place in the high yield segment simply because the bulk of the Swedish companies belong to that group today. Because of demands of transparency, the issuing companies many times have to be publicly traded which will restrict and more easily define the potential growth to companies typically listed in the Mid Cap segment on the Swedish stock exchange (NASDAQ OMX).

The perception of what constitutes high yield are somewhat differing among the respondents. This fact complicates the estimation of the actual outstanding amounts of high yield bonds and the structure of the overall market. The fact that there are now two agents operating on the Swedish market is seen as a sign of maturity and an enabler for the market to grow even further. It is also seen as evidence that the high yield market has reached a critical size, hence it can support professional organizations over a complete business cycle.

5.2 A Market Outlook

Based on the previous section,the theory and also compared to the Norwegian market, we will here try to make a prediction of the likely high yield corporate bond market development. We will focus on the likely characteristics of the market as opposed to simply try to quantify it.

An important question is what type of corporations that will drive the growth of the market. Capital intense sectors in general are, as said before, the typical issuers on the market. Based on the previous findings and analysis, the real estate sector will likely continue to be the backbone of the market.

Additionally, the fact that most of the issuing corporations also are publicly traded companies indicates that the bulk of the growth likely will be found among corporations listed there. A look on the 254 listed corporations on the NASDAQ OMX reveals that Industrials, Technology and Financials (including the real estate sector) are the three dominating sectors as well as very capital intense (NASDAQ OMX 2012). This correlates somewhat to the present situation on the high yield market where Services is the largest sector (note that SAS accounts for 100% of that sector) followed by Real Estate, Oil & Gas and Industrials. Another capital intense sector is the energy and utilities sector, but that is a very small sector on the stock exchange so its contribution to the overall high yield growth are not considered to be very high.

We expect the main growth of the high yield segment to come from new corporations, rising stars as opposed to fallen angels. This is a natural development because the relatively smaller corporations will be more affected by the credit restrictions as well as because the large corporations already have good access to the market.

Because of the structure of the Swedish economy, we will likely not see as high yield as in Norway with many companies yielding over 12%. If the real estate sector will form the bulk, the typical sustainable coupon rate will likely be between 6-10%.

Additionally, the issued high yields have to be as a complement to other funding sources, typically bank loans because of the relatively low return on assets. Another reason to have it as a complement will likely also be in order to diversify the refinancing risk.

It will also likely be longer term to maturities in the near future, as some respondents pointed out. This will become possible as more investors enter the market and thus also improves the liquidity on the secondary market. That will make the investors ready to accept longer maturities because they could feel confident of being able to sell the investment if needed. The increased possibility of longer term to maturity could also attract more corporations that have a more long-term financing strategy.

When the investors are getting larger, the pressure for larger issues will also increase. The typical range of today will likely expand somewhat with more issues over 1 billion SEK.

6 Conclusion

6.1 The Current High Yield Corporate Bond Market

The current market situation of the Swedish high yield corporate bond market is characterized by fundamental changes which creates growth. The main factor driving the current market development is the implementation of Basel III and the increased risk aversion among banks. This also means that an unexpectedly smooth implementation of the new market regulations could have a slowing effect on the growth of the high yield corporate bond market and contrary, even tighter regulations of the same kind will likely speed up the growth of the high yield market.

The fact that there now are two corporations offering trustee services in the market indicates that the market has already reached a critical size and can support professional organizations. The market is today dominated by the corporations originating from the real estate and service sector, which differs from the Norwegian market where it is dominated by corporations within the oil & gas and shipping industry. This difference in composition explains the great difference in size between the Swedish and the Norwegian high yield segment.

A difference between the current market situation and the one that existed before the financial crises is that so call original issuers or rising stars hold a larger market share with respect to corporations that are considered as fallen angels. This contributes to a more stable market and indicates that a shift also has occurred in that perspective.

6.2 The Likely Market Developments within 5 Years

According to our study, the main growth in the coming years will come from the exogenous factors that affect the corporate bond market from the outside, namely the effects of Basel III and associated local "add-on" regulations by the Swedish Financial Supervisory Authority (Finansinspektionen). The other exogenous factor discussed, Solvency II will likely not act as a market driver to the same extent as Basel III but will non the less affect it in a positive way (i.e. create growth). The endogenous factors inside the market such as the trustee function will according to our study, not create any growth on its own but will merely allow the market to grow because of the before mentioned reasons.

From the analysis, we can conclude that the likely market development will be a continued dominance of real estate issues in the future due to their extensive capital requirements in combination with their increasing difficulties of receiving traditional bank finance. Other likely sectors that will use the high yield bond market to a larger extent are estimated to be the industrial and technology sectors due to the same reasons.

A more mature market will form and with that comes likely longer term to maturities as well as larger issues due to a larger investor collective in combination with the requirement of individual issuers.

Because of the relatively limited return on assets that the companies on the Swedish market experience in general, it is rather safe to say that we will not see the same high yields (coupon rate) that are common on the Norwegian market.

One has to remember that with the small size of the current market, a doubling of the market will still make it only a fraction of the total corporate bond market and about a quarter of the Norwegian high yield segment. Like Gunnarsdottir and Lind (2011, 46) also points out, we would like to conclude that the market is furthermore highly vulnerable to changing business climate so the growth of the market is in the end solely dependent of favorable conditions on the financial markets and the economy in general. The bank dominance as the leading provider of external capital for the Swedish corporations in the future will not be challenged yet.

6.3 Suggestion for Further Studies

The following topics would be interesting for further studies starting from the results of this study:

- A more direct study of what impact Basel III will have on the Swedish high yield corporate bond market. Preferably with a quantitative approach where implications of the new regulations are more exactly evaluated.
- How a reporting system like the American TRACE-system could develop the Swedish market and if it is possible to implement such a system. Does a common record increase the liquidity and the transparency of the market?
- A more detailed study of which corporations that have the possibility to issue high yield bonds on the Swedish market. What characteristics do they have and from which industry do they come from?
- How can foreign investors be attracted to invest in bonds issued on the Swedish high yield bond market? Are there any legal obstacles and what are the benefits of investing in the market.

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A Credit Ratings

Credit ratings			
Moody's	**S&P**	**Fitch**	
Aaa	AAA	AAA	Prime
Aa1	AA+	AA+	High grade
Aa2	AA	AA	High grade
Aa3	AA-	AA-	High grade
A1	A+	A+	Upper medium grade
A2	A	A	Upper medium grade
A3	A-	A-	Upper medium grade
Baa1	BBB+	BBB+	Lower medium grade
Baa2	BBB	BBB	Lower medium grade
Baa3	BBB-	BBB-	Lower medium grade
Ba1	BB+	g	Non-investment grade
Ba2	BB	BB	Non-investment grade
Ba3	BB-	BB-	Non-investment grade
B1	B+	B+	Highly speculative
B2	B	B	Highly speculative
B3	B-	B-	Highly speculative
Caa1	CCC+	CCC	Substantial risks
Caa2	CCC	CCC	Extremely speculative
Caa3	CCC-	CCC	In default with little prospect for recovery
Ca	CC	CCC	In default with little prospect for recovery
Ca	C	CCC	In default with little prospect for recovery
C	D	DDD	In default
/	D	DD	In default
/	D	D	In default

Source: Yago, Trimbath 2003, 6-7

B Active Swedish High Yield Issues

Outstanding High Yield Corporate Bonds In MSEK[8]			
Name	**CPN**	**O.A.**[9]	**Sector**
ORESUNDSBRO KONST.	$6\frac{3}{4}\%$	10000	Real-Estate
RUSS.RL.EST.INV.CO.	$8\frac{1}{2}\%$	410	Real-Estate
ZODIAC TELEVISION CV	6%	177.3	Media
RUSS.RL.EST.INV.CO.	16%	400	Real-Estate
BILIA AB	7%	107.3	W&R[10]
PA RESOURCES CV	11%	984.2	Oil&Gas
BIOPHAUSIA AB	7%	64.1	Industry
ALLENEX AB	6%	7.7	Industry
SAS AB	$7\frac{1}{2}\%$	1600	Service
LAPPLAND GOLDMINERS	FRN	122.2	Industry
SCANDIN.AIRL.SY.	$13\frac{1}{2}\%$	1000	Service
SAGAX AB	7%	250	Real-Estate
RUSS.RL.EST.INV.CO.	10%	510.7	Real-Estate
BLACK EARTH FARMING	10%	750	Agriculture
PROCAST MEDIA AB CV	10%	3.7	Media
COREM PROPERTY GP.	$6\frac{3}{4}\%$	200	Real-Estate
FAST PARTNER AB	$6\frac{3}{4}\%$	300	Real-Estate
PA RESOURCES	$10\frac{1}{2}\%$	850	Oil&Gas
SCANDIN.AIRL.SY.	$10\frac{1}{2}\%$	1300	Service
SCANDIN.AIRL.SY.	9.65%	680.2	Service
RUSFOREST AB	11%	500	Industry
MEDSTOP AB	9%	700	W&R
TRIGON AGRI A/S	11%	350	Agriculture
RORVIK TIMBER AB	6%	206.1	Pulp&Paper
BACTIGUARD HLDG.AB	11%	450	Industry
SEFYR VARME AB	7%	1000	Energy&Utility
KLOVERN AB	FRN	500	Real-Etsate
KLOVERN AB	FRN	320	Real-Etsate
ARISE WINDPOWER AB	FRN	350	Energy&Utility

Source: Thomson Reuters Datastream 2012 (Active bonds 2012-05-12)

[8] One bond denominated in EUR has been converted to SEK for comparability reasons.
[9] Outstanding Amount.
[10] Wholesale & Retail.