Using Corporate Bond-Market Data to Benchmark Intercompany Loans

When benchmarking an intercompany loan, the most natural comparable is an uncontrolled loan entered into on similar terms.

The difficulty is practical. Pricing information for private third-party loans is limited: coverage is concentrated in large syndicated transactions; interest rates reflect market conditions at origination rather than at the date under review; and fees, covenants, and security often sit outside the reported rate.

But if loans are privately negotiated contracts, how can bonds traded in liquid markets be used to benchmark an intercompany loan agreement? It is a fair question, and one worth answering carefully.

Realistic alternatives and transparency

The starting point is the concept of realistic alternatives. Funds placed in an intercompany loan could have been invested elsewhere. Corporate bond yields indicate the return that independent investors require for assuming comparable credit and term risk at a given date, providing a relevant market reference for determining an arm's-length interest rate.

The second reason is transparency. Bond-market data differ in one decisive respect: they are observable.

Instrument terms are disclosed in a structured manner, including currency, maturity, coupon type, seniority, and security. Bond prices and yields can be observed at the relevant pricing date, allowing the analysis to reflect prevailing market conditions and the bond's remaining term to maturity. The breadth of the bond market can also support a statistical range rather than reliance on only a handful of observations.

An important distinction: the coupon is not necessarily the relevant market return. The coupon is established when the bond is issued, while the yield reflects its market price and remaining cash flows as of the date of observation.

None of this makes a bond identical to an intercompany loan. Differences may arise in liquidity, maturity, repayment structure, currency, seniority, collateral, covenants, fees, and other contractual features. A reliable analysis should not simply assume that these differences are immaterial.

In practice, the process involves:

1. Accurately delineating the intercompany loan.
2. Identifying bonds with sufficiently comparable economic characteristics.

3. Observing their yields and remaining maturities at the relevant pricing date.
4. Refining the comparable set, testing alternative assumptions, and, where appropriate and supported by available data, making reliable adjustments.

The transparency of bond-market data is what makes this assessment possible. Observable terms allow differences to be identified, evaluated and documented.

Bond data do not remove judgment from the analysis. They provide transparent market evidence to which informed judgment can be applied.