In the United States, Treasury issues and IPOs differ in that there is a market for when-issued trading of Treasuries, but not for IPO shares. When-issued trading in IPO shares is effectively prohibited by a U.S. securities regulation that restricts the covering of short sales.\(^1\) This is despite the fact that a when-issued market might be useful as an indicator for how IPO shares should be priced. The stated reason for the short sale restriction is: “Such short sales could result in a lower offering price and reduce an issuer’s proceeds.”\(^2\) In contrast to this, there is a liquid market for when-issued trading of IPOs in Germany. To quote one of the larger market makers in the German when-issued market, this market is valuable for IPO pricing in that: “By observing when-issued trading, the underwriter can gauge the market’s interest in an IPO.”\(^3\)

The objective of these two papers is to examine the effect on IPO pricing of allowing when-issued trading of IPO shares. “IPO Pricing with Bookbuilding and a When-Issued Market” is an empirical study of IPO pricing in Germany. Underwriters in this market conduct bookbuilding and allocate IPO shares in a discretionary manner, very much as it is done in the United States. Bookbuilding in the U.S. has typically been viewed as a means for obtaining information on how to price IPO shares. We find that in the German market there is no partial adjustment phenomenon, and thus no evidence of the sort documented in the U.S. that bookbuilding provides information for IPO pricing. We do find that the when-issued market reveals information on how to price an IPO. Given that information about when-issued trading is freely and publicly available, one might expect this market to supplant bookbuilding as a source of IPO pricing information. However, we also find evidence suggesting that bookbuilding is used to gather information prior to the opening of

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\(^{1}\)Regulation M, Rule 105 prohibits the covering of short positions in IPO shares that were created within the last five days before pricing, with allocations received in the IPO. In addition to this rule, there are also restrictions on trading in unregistered shares.


\(^{3}\)This quote was taken from the website of Schnigge AG, http://www.schnigge.de/info/service/pre-ipo-trading.html. The original quote was in German: “Der Emittentenführer kann auf Grund der Handelstätigkeit im Handel per Erscheinen das Interesse des Marktes an der Neuemission messen.”
the when-issued market. It is only after when-issued trading commences that bookbuilding appears to no longer play an information gathering role. These results are in contrast to evidence found for U.S. IPOs that bookbuilding-type information gathering continues up to the time of pricing the IPO.

The empirical study answers a number of questions, but it also raises questions that cannot be answered with currently available data. Most importantly: is bookbuilding, together with when-issued trading, a more efficient means of gathering information for pricing unseasoned securities, than bookbuilding alone? We address this question in the paper “Primary Market Design: Direct Mechanisms and Markets”, in which we analyze a model of IPO pricing that allows for the coexistence of bookbuilding and when-issued trading. The main finding of our analysis is that in most cases, allowing for when-issued trading is a priori beneficial to issuers. This result is obtained because bookbuilding and when-issued trading do not merely coexist, but interact with each other. Without prior bookbuilding, the when-issued market may lack liquidity and even fail to open. Bookbuilding can resolve this problem by providing underwriters with information required to set a price range, and thus indicate how they plan to price an IPO. When-issued trading can then reveal further information that the underwriters have not obtained through bookbuilding. In the presence of when-issued trading, bookbuilding is also expected to be less costly, provided that: i) bookbuilding is a necessary part of the information gathering process (that is, it cannot be fully supplanted by when-issued trading), and ii) the when-issued market is sufficiently liquid and information is not too closely held.

The results of our theoretical analysis are consistent with the findings of our empirical paper, as well as with stylized facts concerning the structure of when-issued trading in Germany. For example, the German when-issued market never opens before the underwriter posts a price range. Price ranges in this market are binding at the upper end. As such, these ranges are not cheap talk: the underwriter must gather information before setting the range and the range at least partially reveals the information learned. Revelation of this information mitigates informational asymmetries that may prevent the when-issued market from opening. Once the market opens it provides further information as to how the IPO should be priced, within or below the posted range.