



The Credit Roundtable

THE VOICE OF THE BUYSIDE

November 19, 2021

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RE: Make-Whole Calls

Dear Sir or Madam:

The Credit Roundtable¹ appreciates the opportunity to address varying practices regarding make-whole calls in the investment-grade bond market. Historically the market convention was to announce an irrevocable make-whole call thirty days in advance of the redemption and then the dealer would determine the price of the make-whole call by selecting the U.S. Treasury security whose maturity is closest to the maturity of the bond being called. The current market environment of a steep Treasury yield curve and tight corporate market credit spread, compared

¹ Formed in 2007, The Credit Roundtable ("CRT") is a group of large institutional fixed income managers including investment advisors, insurance companies, pension funds, and mutual fund firms, responsible for investing more than \$4 trillion of assets. The Credit Roundtable advocates for creditor rights through education and outreach and works to improve fixed income corporate actions, ineffective covenants, and the underwriting and distribution of corporate debt. Its mission is to improve risk assessment and management through education and seeks to benefit all bond market participants through increasing transparency, market efficiency and liquidity.



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to many outstanding bond's make-whole spread and make-whole call price, have created inconsistencies, ambiguities, and market inefficiencies.

We are concerned with non-standard indenture language that can result in inconsistencies or variations in the selection of the Treasury to calculate the make-whole call price (e.g. using a five year Treasury reference yield to call a corporate note with four years to maturity), shortening the call notice time frame from the thirty days to ten days, pricing to the shorter par call date instead of the actual maturity date, and conditional (i.e., not irrevocable) calls. Our concern has been highlighted with recent make-whole calls/tenders.

We support SIFMA's Model Provision for Investment Grade Optional Redemption (please see attached). We believe more prescriptive language will improve market efficiency for the benefit of issuers and investors. We also highlight the Credit Roundtable's IG New Issue Best Practices which discusses Optional Redemption terms and proposes that issuers Disclose all Optional and Mandatory Redemption terms (Highlight terms that are non-"Standard")².

We welcome the opportunity to discuss our concerns, opinions, and recommendations regarding make-whole calls in greater detail. Please direct any questions to Kelly Byrne Skarupa of The Credit Roundtable at kbyrne@taminc.com or (914) 332-0042.

Sincerely,

The Credit Roundtable

² https://cdn.ymaws.com/thecreditroundtable.org/resource/collection/980A2953-9DE6-49CA-A6E4-924E0582BA25/2008_CRT_Investment_Grade_Primary_Best_Practices_Framework.pdf

An aerial, high-angle photograph of a dense urban skyline at night. The image shows numerous skyscrapers and buildings, many of which are illuminated with lights. The scene is captured from a high vantage point, looking down on the city. A semi-transparent white rectangular box is overlaid on the upper left portion of the image, containing text. The overall color palette is dominated by the blues and greys of the city at night, with some warmer lights from the buildings.

SIFMA Model Provision Investment-Grade Bond Optional Redemption

Standardizing the make-whole redemption language and calculation

Project Background

INVESTORS AND OTHER MARKET PARTICIPANTS EXPRESSED THE DESIRE FOR STANDARDIZED LANGUAGE

Investment-grade bond optional redemption provisions, and the calculation of the make-whole redemption price, can vary by issuer and by the methodology used by the investment bank assisting with such calculation. This variation in language and calculation results in a lack of standardization in the manner of calculating the redemption price.

As a result, market participants expressed the desire for standardized language in investment-grade bond optional redemption provisions.



In many make-whole calculations, a reference United States treasury security is selected by the issuer with the assistance of an investment bank. In others, a United States treasury constant maturity as published by the Board of Governors of the Federal Reserve System (a “Treasury constant maturity”) is used. In both cases, a ‘make-whole’ spread that was established at the time of initial pricing of the issue is added to the yield of the selected treasury security or Treasury constant maturity, and the resulting yield is used to discount the sum of the present values of the applicable remaining scheduled payments of principal and interest to the redemption date.

The yield of the reference United States treasury security or Treasury constant maturity is most commonly referred to as the “Treasury Rate.”

Background (Cont'd)

In existing optional redemption provisions, there are variations in the method for selection of the United States treasury security or the Treasury constant maturity and the related yield. Many current provisions use a “**comparable treasury issue**” selected by an independent investment bank in accordance with “**customary financial practice in pricing new issues**” of corporate debt for determining the Treasury Rate. *Ambiguity over which treasury is “comparable” and what is “customary” may result in different investment banks selecting different references treasuries and yields.*

To promote consistency and clarity for the benefit of both issuers of corporate debt as well as the holders of such debt, the SIFMA working group focused on the Treasury Rate definition, and considered, among other things, the optimal source and method of selecting and calculating the Treasury Rate, including the role of the independent investment bank. The SIFMA working group also considered additional changes to existing provisions.



The resulting model provision seeks to provide issuers, investment banks, investors, and other market participants with certainty and specificity in the calculation of the redemption price of bonds being redeemed

Existing Language

VARIATION IN THE LANGUAGE FOUND IN THE MARKET TODAY

EXAMPLE

01

“Treasury Rate” means, with respect to any redemption date for the Fixed Rate Notes, the rate per annum equal to the *semiannual equivalent yield to maturity or interpolation* (on a day count basis) of the interpolated Comparable Treasury Issue, assuming a price for the Comparable Treasury Issue (expressed as a percentage of its principal amount) equal to the Comparable Treasury Price for such redemption date, *as determined by [the Issuer] or an Independent Investment Banker* appointed by [the Issuer].

“Comparable Treasury Issue” means the United States Treasury security or securities selected by an Independent Investment Banker *as having an actual or interpolated maturity comparable to the remaining term or Par Call Date*, as applicable, of the Fixed Rate Notes of that series to be redeemed that would be utilized, at the time of selection and in accordance with *customary financial practice, in pricing new issues* of corporate debt securities of a comparable maturity to the remaining term of such Fixed Rate Notes.

02

“Treasury Rate” means, with respect to any redemption date, the rate per annum equal to the *semiannual equivalent yield to maturity* of the applicable Comparable Treasury Issue, calculated using a price for the applicable Comparable Treasury Issue (expressed as a percentage of its principal amount) equal to the related Comparable Treasury Price for such redemption date. [...]

“Comparable Treasury Issue” means the United States Treasury security *selected by an Independent Investment Banker* (as defined below) as having a maturity comparable to the remaining term of the applicable series of notes, *calculated as if the maturity date of such notes were the Par Call Date* (the “Remaining Life”) of the notes to be redeemed that would be utilized, at the time of selection and in accordance with *customary financial practice, in pricing new issues* of corporate debt securities of comparable maturity to the remaining term of such notes, *calculated as if the maturity date of such notes were the Par Call Date for such notes*.

03

“Treasury Rate” means, with respect to any redemption date for the notes:

- The yield, under the heading which represents the average for the immediately preceding day, appearing in the most recently *published statistical release designated “H.15”* or any successor publication which is published daily by the Board of Governors of the Federal Reserve System and which establishes yields on actively traded United States Treasury securities adjusted to constant maturity under the caption “Treasury Constant Maturities,” for the maturity corresponding to the Comparable Treasury Issue, provided that, if *no maturity is within three months* before or after the maturity date for the notes, yields for the two published maturities most closely corresponding to the Comparable Treasury Issue will be determined and the Treasury Rate will be *interpolated or extrapolated* from those yields on a straight line basis rounding to the nearest month; or

“Comparable Treasury Issue” ... *in accordance with customary financial practice, in pricing new issues* of corporate debt.

04

The term “Reinvestment Rate” means (i) the arithmetic mean of the yields published in the most recent Statistical Release under the caption “U.S. Government Securities—Treasury Constant Maturities” *for the maturity (rounded to the nearest month) corresponding to the remaining life to the applicable Par Call Date...* If no maturity *exactly corresponds* to the applicable Par Call Date, yields for the two published maturities most closely corresponding to the applicable Par Call Date would be so calculated and the Reinvestment Rate would be *interpolated or extrapolated* on a straight-line basis, rounding to the nearest month. The most recent Statistical Release published prior to the date of determination of the Make-Whole Amount will be used for purposes of calculating the Reinvestment Rate.

The term “Statistical Release” means the statistical release *designated “H.15”* or any successor publication which is published daily by the Federal Reserve and which reports yields on actively traded U.S. government securities adjusted to constant maturities...

Summary of Model Provision

Investment-Grade Bond Optional Redemption

- The general principles of the make-whole calculation are unchanged. Payments of principal and interest are discounted to the redemption date using a Treasury Rate determined at the time of the redemption plus the make-whole spread that was determined at pricing of the issue.
- The calculation of the Treasury Rate and redemption price, are done by the issuer. It is no longer necessary for an independent investment bank to select a United States treasury security or perform the make-whole calculation.
- The primary method of calculating the Treasury Rate will be done using the most recent statistical release published by the Board of Governors of the Federal Reserve System designated as “Selected Interest Rates (Daily) - H.15” as of 4:15 p.m. New York time on the third business day preceding the redemption date and choosing the relevant Treasury constant maturity or Treasury constant maturities.



This is published by the Federal Reserve on a daily basis, currently at

<https://www.federalreserve.gov/releases/h15/>

Board of Governors of the Federal Reserve System

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Selected Interest Rates (Daily) - H.15

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The release is posted daily Monday through Friday at 4:15pm. The release is not posted on holidays.

Release date: November 12, 2021

Selected Interest Rates

Yields in percent per annum

Instruments	2021 Nov 5	2021 Nov 8
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Instruments	2021 Nov 5	2021 Nov 8	2021 Nov 9	2021 Nov 10	2021 Nov 11*
Treasury constant maturities					
Nominal 9					
1-month	0.05	0.04	0.04	0.06	
3-month	0.05	0.06	0.04	0.05	
6-month	0.07	0.07	0.06	0.07	
1-year	0.14	0.16	0.14	0.17	
2-year	0.39	0.45	0.41	0.51	
3-year	0.66	0.75	0.71	0.83	
5-year	1.04	1.13	1.08	1.23	
7-year	1.30	1.38	1.32	1.45	
10-year	1.45	1.51	1.46	1.56	
20-year	1.88	1.91	1.86	1.96	
30-year	1.87	1.89	1.83	1.92	
Inflation indexed 10					
5-year	-1.83	-1.81	-1.88	-1.85	
7-year	-1.43	-1.43	-1.50	-1.47	
10-year	-1.09	-1.11	-1.17	-1.14	
20-year	-0.66	-0.70	-0.76	-0.72	
30-year	-0.45	-0.50	-0.57	-0.52	

Summary of Model Provision (Cont'd)

Investment-Grade Bond Optional Redemption

- Applicable calculations use the period from the redemption date to the maturity date (or, if the notes have a 'par call' date, the par call date), with such period being referred to as the "Remaining Life."
- In the majority of redemptions, two yields are selected—one yield corresponding to the Treasury constant maturity on H.15 immediately shorter than the Remaining Life, and one yield corresponding to the Treasury constant maturity on H.15 immediately longer than the Remaining Life.
- The two yields are interpolated to the maturity date, or par call date, as applicable, on a straight-line basis using the actual number of days. To calculate the actual number of days, the applicable Treasury constant maturity on H.15 is deemed to have a maturity date equal to the relevant number of months or years, as applicable, of such Treasury constant maturity from the redemption date. Other than for maturities of less than one year, this means that a Treasury constant maturity will be deemed to have a maturity date with a month and day the same as the redemption date, and the applicable year matching the selected Treasury constant maturity.

Summary of Model Provision (Cont'd)

Example

If the redemption date is November 15, 2021, and the par call date is April 15, 2027, and the period from the redemption date to the par call date is 5 years and 5 months, the issuer will select the yield corresponding to the 5-year Treasury constant maturity and the yield corresponding to the 7-year Treasury constant maturity on H.15 (there is no 6-year Treasury constant maturity). The yields will be interpolated on a straight-line basis using the actual number of days. For this interpolation calculation the 5-year Treasury constant maturity will be deemed to have a maturity date of November 15, 2026 and the 7-year Treasury constant maturity will be deemed to have a maturity date of November 15, 2028.



Instruments	2021 Nov 5	2021 Nov 8	2021 Nov 9	2021 Nov 10
3-year	0.66	0.75	0.71	0.83
5-year	1.04	1.13	1.08	1.23
7-year	1.30	1.38	1.32	1.45
10-year	1.45	1.51	1.46	1.56

Summary of Model Provision (Cont'd)

Investment-Grade Bond Optional Redemption

- In more limited circumstances, only one treasury and yield will be used. This happens when (i) the Remaining Life matches exactly a Treasury constant maturity (for example, if the period from the redemption date to the par call date is exactly 5 years, the yield for the 5-year Treasury constant maturity on H.15 will be the Treasury Rate) or (ii) if there is no Treasury constant maturity on H.15 immediately shorter or immediately longer than the Remaining Life, as applicable (for example, if the period from the redemption date to the maturity date, or par call date, as applicable, is less than one month or greater than 30 years).
- If H.15 (or any successor designation or publication) is no longer published, the model provision provides a backup which calculates the Treasury Rate using the yield of the United States Treasury security maturing on, or with a maturity that is closest to, the maturity date, or par call date, as applicable.
- Subjective determinations such as the “comparable treasury,” or what is consistent with “customary financial practice in pricing new issues” have been eliminated.

Summary of Model Provision (Cont'd)

Investment-Grade Bond Optional Redemption

- Notice of redemption must be mailed or electronically delivered at least 10 days but not more than 60 days before the redemption date. While this period is shorter than the historical 30-day notice period, 10 days has become customary in current debt issues and should provide investors with sufficient notice of the redemption.
- After all calculations are completed, the Treasury Rate is rounded to three decimal places.



Illustrative Example

\$100,000,000 of 2.00% Senior Notes due July 1, 2027

Redemption Date:
October 1, 2021

Calculation Date:
September 28, 2021

Par Call Date:
April 1, 2027

Maturity Date:
July 1, 2027

- 01** Go to H.15 - *Selected Interest Rates (Daily) - H.15 -- Treasury constant maturities -- Nominal*
- 02** On the Calculation Date, find the most recent data available after 4:15 p.m., New York City time, which is data for September 27, 2021
- 03** Select the yield corresponding to the Treasury constant maturity on H.15 immediately shorter than the Remaining Life = 5-Year Treasury constant maturity = **0.98%**
 - The 5-Year Treasury constant maturity has a deemed maturity date of October 1, 2026, which is the date equal to five years from the redemption date of October 1, 2021
- 04** Select the yield corresponding to the Treasury constant maturity on H.15 immediately longer than the Remaining Life = 7-Year Treasury constant maturity = **1.30%**
 - The 7-Year Treasury constant maturity has a deemed maturity date of October 1, 2028, which is the date equal to seven years from the redemption date of October 1, 2021

We refer to the deemed maturity dates of the two Treasury constant maturities as the “H.15 maturity dates.”

- 05** Day Count Calculations
Using the Microsoft Excel function = DAYS is an accurate way to find actual number of days for use in these calculations.

(X) Actual days from October 1, 2021 (Redemption Date) to, but excluding, April 1, 2027 (Par Call Date) = **2,008**

(Y) Actual days from October 1, 2021 (Redemption Date) to, but excluding, October 1, 2026 (5-Year Treasury constant maturity date) = **1,826**

(Z) Actual days from October 1, 2021 (Redemption Date) to, but excluding, October 1, 2028 (7-Year Treasury constant maturity date) = **2,557**

Then:

- 01** Compute the difference in days between **(X)** and **(Y)** = $2,008 - 1,826 = 182$
- 02** Compute the difference in days between **(Z)** and **(Y)** = $2,557 - 1,826 = 731$

Illustrative Example (Cont'd)



- 06 Calculate when the Par Call Date occurs in the period between the two H.15 maturity dates, as a percentage of the difference between = $182/731 = 24.8974\%$
- 07 The Par Call Date occurs 24.8974% of the way between the two H.15 maturity dates
- 08 Calculate the difference in yields between the two H.15 maturity dates ($1.30\% - 0.98\% = 0.32\%$) and multiply the result by the distance fraction ($0.32\% * 0.248974 = 0.07967\%$)
- 09 Add the result (0.07967%) to the yield for the Treasury constant maturity shorter than the Remaining Life (0.98%) = $0.98\% + 0.07967\% = 1.05967\%$ and round to three decimal places = **1.060%**

The Treasury Rate is 1.060%

Frequently Asked Questions

Introducing the new language

01 What is the new language?

Standardized language for investment-grade bond optional redemption provisions.

Shearman & Sterling and SIFMA assembled a working group of investment banks operating in the U.S. and global capital markets to agree on general principles and proposed language. The new language is expected to be introduced throughout the industry starting in the fourth quarter of 2021 and into 2022.

04 Will this (adversely) impact the new bonds or previously-issued bonds?

Including the new language will not adversely impact new or previously-issued bonds. The new language has the support of SIFMA, The Credit Roundtable, Investment Banks, and Asset Managers (Investors).

While the calculation of the Treasury Rate will likely use a different method, there are no issues in using different methodologies to redeem different bonds.

02 Why should we change?

The new language provides issuers, investment banks, investors, and other market participants with certainty and specificity in the calculation of the redemption price of bonds.

The new language promotes consistency and clarity while removing the ambiguity found in historical provisions.

Strong investor support. We expect this language to become the market standard.

05 OK, what do we have to do to make this change?

The new language should be added to the preliminary prospectus supplement / offering document in the description of notes and summary. The change should then be reflected in the supplemental indenture / global notes.

The issuer and counsel should be advised of the change early in the deal process. For frequent issuers who typically do deals quickly, raising this issue in advance of the next deal is recommended.

03 How is this different from what we have now?

The general principles of the make-whole calculation are unchanged. Payments of principal and interest are discounted to the redemption date using a Treasury Rate determined at the time of the redemption plus the make-whole spread that was determined at pricing of the issue.

The new language clarifies the determination of the Treasury Rate.

06 Still have questions?

Shearman & Sterling is happy to discuss the new language with any issuer or bank team.

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