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Revised Bond Index Eligibility Puts Renewed Focus on Reopeners

In January 2017, Bloomberg announced that the Barclays Benchmark Fixed Income Index would, effective April 1, 2017, raise its minimum tranche size from \$250 million to \$300 million.¹ Prompted by this increased eligibility standard, several issuers have tapped or are considering tapping existing sub-\$300 million tranches in order to remain eligible for the index. The volatile bond market for the past few weeks has not helped these efforts. We have previously analyzed various aspects of reopeners in past issues of Baseload.² Given the potential for

an increase in these types of issuances, we thought it would be helpful to supplement those articles with some recent observations.

First Thing To Do: Check the Record Dates

A record date is the date on which the holder of a bond must be the “record holder” in order to receive interest payments. The record date in most instances is roughly two weeks before the interest payment date and is memorialized in the indenture (as well as disclosed in the offering document).

¹ Press Release, Bloomberg, Bloomberg Announces Changes to Bloomberg Barclays Fixed Income Indices (Jan. 24, 2017), available at <https://www.bloomberg.com/company/announcements/bloomberg-announces-changes-bloomberg-barclyays-fixed-income-indices>.

² We previously covered reopenings in our June 2012 Baseload article entitled “Reopening Previous Issues of Debt Securities”, available at <https://www.hunton.com/files/Publication/f29741f2-82ed-4d28-91bd-bb8dd0762eba/>

[Presentation/PublicationAttachment/73eea09b-c297-4eee-8320-bd9350ed9a50/Baseload_June_2012.pdf](https://www.hunton.com/files/Publication/73eea09b-c297-4eee-8320-bd9350ed9a50/Baseload_June_2012.pdf) and in our June 2013 Baseload article entitled “Too Late to the Party: The 144A Reopening Post A/B Exchange”, available at https://www.hunton.com/files/Publication/9c511452-8a0a-4729-ac6c-66af7299861d/Presentation/PublicationAttachment/e2ef1fe2-71ca-43d9-918c-69c0f3f2c464/Baseload_Newsletter_June_2013.pdf.

A potential record date issue may arise with respect to the payment of accrued interest on reopeners if the reopened bonds are issued after a record date, but prior to the next interest payment date. In such instance, purchasers of the reopened bonds (despite being issued and outstanding) will not be entitled to receive payment on the first interest payment because they were not holders of record on the record date.

The problem presented by this scenario is this: how does the trustee know who is entitled to interest payments on that first interest payment date. The holders of the reopened bonds are not entitled to interest on that first interest payment date because they were not holders of record on the record date (the reopened bonds had not been issued yet). But the holders of the original bonds who owned the original bonds on the record date are entitled to interest on that interest payment date. Given that the reopened bonds and the original bonds have identical terms (including CUSIPs), there is no practical way that the trustee or DTC can discern as to which holders are entitled to interest and which holders are not on that interest payment date.

The easiest way to plan around this issue is to avoid reopeners that close between a record date and an interest payment date. So, whenever considering reopeners, check the record date of the original bonds immediately.

If the issuer cannot wait and needs to access the market at a time that is after the record date and before the next interest payment date, the problem can be avoided by scheduling the closing after the interest payment date. By doing so, the reopened bonds will not be outstanding as of the interest payment date and, thus, will not be entitled to be paid interest on that day. If this route is chosen, the closing may need to extend beyond the normal T+3 to ensure that the issue closes after the interest payment date.

Other more complicated methods may be employed to avoid the record date issue (e.g. setting a special record date or establishing a separate temporary CUSIP for the reopened bonds). Our experience has been, however, that a more complicated fix requires more complicated disclosure. This may become a marketing issue as it potentially leads to more questions and concerns from investors.

Make Sure You Get the Day Count Right

In order for the reopened bonds to be fungible with the original bonds, investors purchasing the reopened bonds are required to pay, as part of the purchase price, any accrued interest on the reopened bonds. This accrued interest is the amount of interest that has accrued from the last interest payment date to, but excluding, the issuance date of the reopened bonds. (This payment is necessary (assuming the reopened bonds are holders of record for the next interest payment) because such days of accrued interest will nonetheless be paid as part of the full interest payment on the next interest payment date, but will not be owing to the holders of the reopened bonds).

The indenture governing the bonds typically contains terms outlining the manner in which interest accrues over time and how it is calculated. For fixed rate bonds, accrued interest is computed on the basis of a 360-day year consisting of twelve 30-day months. So, when counting the number of days for a full month period in which interest was accruing, the number of days will always be 30, whether it is February (28/29 days) or March (31 days). That's easy.

It gets a little more interesting for partial months. For a partial month that starts on the first day of the month, the accrued interest day count is calculated based on the actual number of days that has elapsed during that month to, but excluding, the issuance date of the reopened bonds.

For a partial month that includes the last day of the month, the accrued interest day count is calculated by subtracting (i) the actual number of days that have passed during that month to, but excluding, the last interest payment date from (ii) 30 days. If there are more days in the calendar month period than 30 days, the extra days do not earn interest.



If there are less days in the calendar month period than 30 days, then the last day counts as many times as necessary in order to get to 30 days of interest.

Using the accrued interest day count formulation above, let's assume that an offering of the reopened bonds closed on March 27, 2017 and the last interest payment date was December 15, 2016. The total number of days that elapsed since the last interest payment date are, for interest calculation purposes, 102 days. This means that investors who purchase the reopened bonds will need to pay 102 days of accrued interest on the reopened bonds. For the partial month of December, 14 days (the actual number of days that has passed since the last interest payment date) will be subtracted from 30 days, resulting in 16 days of accrued interest. For each month of January and February, 30 days of interest will have accrued. For the partial month of March, interest will have accrued for 26 days, the actual number of days that have elapsed to (but not including) the issuance date. See the calendar below for an illustration of the hypothetical day count calculations.

OID: In Volatile Times, Each Basis Point Counts

For tax purposes, if the reopening does not take place within

six months of the original issuance, the initial offering price of the reopened bonds can have no more than a *de minimis* amount of original issue discount (OID). In general, OID is treated as *de minimis* if it is less than (**not equal to**) $\frac{1}{4}$ of 1 percent (25 basis points, or 0.25%) of the stated redemption price at maturity (which presumably is par), multiplied by the number of complete years to maturity.³ To illustrate this point, let's assume that bonds to be reopened in December 2016 mature on June 15, 2046, and the original bonds were issued on June 1, 2016. The bonds have 29 complete years before the maturity date. Using the OID formulation above, 29 is multiplied by 0.25%, resulting in 7.25%. The OID must be less than (but not equal to) 7.25%. On a recent reopener (in a volatile bond market), one basis point in the floor price mattered.

The tax considerations for a reopening are more complicated if either the original issuance was issued with OID or the reopened bonds will be sold with more than a *de minimis* amount of OID. For a discussion of such circumstances, see "Recent Financing Trend: Reopening Previous Issues of Debt Securities" in the June 2012 issue of Baseload.

³ 26 U.S. Code Section 1273(a)(3).

December 2016						
Sun	Mon	Tues	Wed	Thurs	Fri	Sat
				1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	31

January 2017						
Sun	Mon	Tues	Wed	Thurs	Fri	Sat
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30	31				

February 2017						
Sun	Mon	Tues	Wed	Thurs	Fri	Sat
			1	2	3	4
5	6	7	8	9	10	11
12	13	14	15	16	17	18
19	20	21	22	23	24	25
26	27	28				

March 2017						
Sun	Mon	Tues	Wed	Thurs	Fri	Sat
			1	2	3	4
5	6	7	8	9	10	11
12	13	14	15	16	17	18
19	20	21	22	23	24	25
26	27	28	29	30	31	

Count this day 3 times

SEC Proposes Additional Event Disclosures under Rule 15c2-12

On March 1, 2017, the SEC proposed¹ adding two new event notices to Rule 15c2-12.² Under Rule 15c2-12, issuers and other “obligated persons” are required to provide investors with continuing disclosure of annual financial information and certain other enumerated events.

The SEC adopted Rule 15c2-12 in 1989. Under current Rule 15c2-12, a dealer that acts as an underwriter in a primary offering of municipal securities with an aggregate principal amount of \$1,000,000 or more is prohibited from purchasing or selling municipal securities in connection with an offer unless the underwriter has reasonably determined that an issuer of municipal securities, or an obligated person for whom financial or operating data is presented in the final official statement, has undertaken in a written agreement or contract for the benefit of holders to provide to the Municipal Securities Rulemaking Board (MSRB) in a timely manner not in excess of ten business days, notice of certain events listed in Rule 15c2-12. In December 2008, the SEC adopted amendments to Rule 15c2-12 to provide for the Electronic Municipal Market Access (EMMA) system. The EMMA system is established and maintained by the MSRB and provides free online public access to disclosure documents.

Specifically, the proposed amendments would require issuers (or other obligated persons) to provide event notices to EMMA upon occurrence of the following two events (Proposed Events):

- the incurrence of a financial obligation of the obligated person, if material, or agreement to covenants, events of default, remedies, priority rights or other similar terms of a financial obligation of the obligated person, any of which affect security holders, if material; and
- default, event of acceleration, termination event, modification of terms or other similar events under the terms of a financial obligation of the obligated person, any of which reflect financial difficulties.

¹ SEC Release No. 34-80130

² 12 C.F.R. § 240.15c2-12.

The SEC is also proposing a new definition of “financial obligation” intended to capture debt obligations of issuers that are not otherwise reported to the MSRB under the EMMA system. The proposed definition of “financial obligation” broadly “means a (i) debt obligation, (ii) lease, (iii) guarantee, (iv) derivative instrument, or (v) monetary obligation resulting from a judicial, administrative, or arbitration proceeding” but does not include municipal securities for which a final official statement has been provided on EMMA.

As discussed above, issuers or other obligated persons would be required to post an EMMA notice of the Proposed Events described above within 10 business days of the actual incurrence of such financial obligation or occurrence of default.

The SEC proposes that such event notices should include a description of the event and the consequences of the event, if any. Comments on the proposed rule amendments are due on or before May 15, 2017.³ If the SEC approves the proposed amendments, the amendments could become effective three months after final adoption of the rules.



³ SEC Release No. 34-80130



SEC Adopts T+2 Settlement Cycle

On March 22, 2017, the Securities and Exchange Commission (SEC) adopted a rule amendment to shorten the standard settlement cycle for most broker-dealer securities transactions from three business days after the trade date (T+3) to two business days after the trade date (T+2).¹ The adoption amends Rule 15c6-1(a) of the Exchange Act of 1934.² The effective date for the amendment is September 5, 2017.³

The amendment prohibits a broker-dealer from entering into a contract for the purchase or sale of a security (with certain exceptions⁴) that provides for payment of funds and delivery of securities later than two business days after the trade date, unless otherwise expressly agreed to by the parties at the time of the transaction. However, the amendment does not affect the existing exceptions under Rule 15c6-1. Notably, firm commitment underwritings registered under the Securities Act that price after 4:30 P.M. (EST) are still permitted to settle as late as T+4, unless otherwise expressly agreed to by the parties. Furthermore, Rule 15c6-1(d) provides an extended settlement provision specific to

primary firm commitment offerings. Rule 15c6-1(d) provides that parties to a contract shall be deemed to have agreed to an alternate day for payment and delivery for a contract for the sale for cash pursuant to a firm commitment offering if the managing underwriter and the issuer have agreed to such date and the parties to the contract have not expressly agreed to another day for payment and delivery. Thus, the amended rule will apply primarily to secondary market trading. And issuers will continue to have flexibility to extend the settlement schedule for most primary offerings.

The SEC believes that shortening the settlement cycle to T+2 will reduce credit and market risk exposure related to unsettled trades and reduce liquidity risk among derivatives and cash markets, which will result in greater efficiency in the clearance and settlement process and reduce systemic risk for the US market participants. Furthermore, the adoption of the T+2 settlement cycle harmonizes the U.S. market with the markets in the European Union, Australia and New Zealand. Japan and Canada are also considering a transition to a T+2 settlement cycle.

The SEC has also directed the staff to prepare a report on the implementation and the impact of the T+2 standard by September 5, 2020. This report, among other things, will include an analysis of moving to an even shorter standard settlement cycle of T+1.

¹ Press Release, Securities and Exchange Commission, SEC Adopts T+2 Settlement Cycle for Securities Transactions, available at <https://www.sec.gov/news/press-release/2017-68-0>.

² 17 C.F.R. § 240.15c6-1.

³ Press Release, Securities and Exchange Commission, SEC Adopts T+2 Settlement Cycle for Securities Transactions, available at <https://www.sec.gov/news/press-release/2017-68-0>.

⁴ Government securities, municipal securities, commercial paper, bankers' acceptances, commercial bills or exempted securities under the Exchange Act. 17 C.F.R § 240.15c6-1(a).

New Partner Announcement



The Energy and Infrastructure practice at Hunton & Williams LLP is delighted to announce that the firm has promoted S. Christina Kwon to partner. Christina focuses her practice on capital markets transactions for energy and utility issuers.



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BASELOAD is prepared from time to time to provide general information about selected power and energy capital markets developments and issues for attorneys at Hunton & Williams LLP, and is provided to clients and friends of Hunton & Williams LLP.

It is not intended to provide legal advice or legal opinions and must not be relied on as such.

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