Make Whole Call (MWC)

Overview

Hervé Labbé

13th February 2014

The French Bond Association
Comité de Normalisation Obligataire

Paris, France

I. What is a Make Whole Call ?

- The Make Whole Call is originally an option in the "final terms" of some of US bonds. This option entitles the issuer to redeem all or part of the bonds prior to maturity at a margin known from the origin.

- The margin of redemption (Make Whole Margin) is calculated, once the margin of the issue against the U.S. Treasury has been defined, during the pricing of the bond.

- The Make Whole Margin is equal to 15% of the original margin against U.S. Treasuries. This rule is widely followed by issuers.

- The rounding is done in multiples of 5.

- Example : if the calculation is 17 bp then the retained margin will be 20 bp.

- The concept of MWC is widely used in the United States, almost all "Investment Grade" public bonds contains a MWC.

II. The MWC, an interesting clause for issuers : the american example

- The Make Whole Call brings flexibility to the debt management.
- The exercise of a MWC answers to the following three reasons (1):

  1. Refinancing the debt (35%) : the idea is to refinance the debt at a lower coupon and is usually due to a sharp decline of interest rates. The average residual maturity of bonds in this case is 1,8 year while the average maturity of the new bond is 8,1 years. The extension of the maturity of the funding is clearly the motivation.
  2. 28% of MWC exercises occurred after a M&A operation
  3. 19% of transactions are used to reduce the leverage of the company

  (since all companies have not given their motivation the sum of the answers is below 100%)

- The interest of a MWC compared with a classical repurchase transaction or exchange is obvious: the company knows the price and the amound that may be repurchased from the start without surprise.

(1) The statistics comes from the article : "The life cycle of Make Whole Call Provisions" by Scott Brown and Eric Powers – Septembre 8, 2012. This study concerns only bond issues above 10 million USD issued by US corporate between 1995 and 2010.

III. Investors Side : American example

- Why do investors accept this clause?

- The culture of cash management is much more developed in the United States.

- The US Investors recognize that companies need to manage their liquidity gaps "actively". The exercise of the MWC is a sign of "good management" for investors.

- The depth of the primary U.S. corporate bond market is around three times higher than the European market and in addition the secondary market is much better organized and liquid (see TRACE). Having to "sell" the paper before maturity is not disruptive for the managers: they are sure to find on the market other investment vehicles.

- The MWC generally includes a clause not to buy the emission below 100 or 101.

III. Investors Side : American example

- Brown and Powers in their paper find that 37% of the bond issues contained a MWC clause. If the study had focused on the bond issues above 500 million dollar, this percentage would have been much bigger.

- Furthermore a precision is required : The MWC are mostly for "Net Investment Grade" companies

- Classical buybacks allow to cancel 61% of outstanding bonds against 94% in the case of MWC exercise

- They also found that over this period, 326 billion dollars were prepaid in the bond market.
  38% through the exercise of MWC
  62% through buybacks.

IV. Legal framework to comply

- The issuer must notify the decision to prepay early investors between 30 and 60 days before the redemption date

- The issuer must notify the paying agent several days before reporting to investors (usually 15-20 days)

- In case of a partial repurchase the issuer must inform investors by mail between 30 and 60 days before the repurchase date.

V. Adaptation of the MWC clause to the euro market

- AT&T introduced a MWC in a euro bond issue in 2001.
- Despite this, the principle of MWC has developed itself on the euro market only in 2012 with issuers such as Pirelli, Vivendi, Michelin, France Telecom, Accor, BASF, ASF, Roche ....

What should we choose as reference for the Make Whole Margin Call?

- On the secondary market the reference is the Bund, so a majority of MWC are linked to the Bund curve
- Some French issuers such as France Telecom and Nexity have decided to take the OAT curve as a reference
- Given the strong correlation between corporate bonds and their sovereign debt we can understand this logic: the investors 'benefit' of a premium indexation on the sovereign on the issue so it makes sense to have the same situation in case of early redemption.
- The benchmark mid-swap could have been considered due to the fact that the primary issue is quoted with this reference.

Appendix: Example of exercise of MWC on U.S. bond market

Coupon of the France Télécom USD 1st of March 2011	7.75%	
Notification of the MWC to theTrustee	45 days before the redemption date	
Notification of the MWC to the SEC 6K	7-Sep-10	
Notification / minimum payment period	30 days	
Date of payment	8-Oct-10	
Reference Rate	Tbonds	
Weekly average of the previous week payment	0.19%	
Margin defined in the Final Terms	0.30%	
Yield of the repurchase	0.49%	
amount prepaid	3 374 170 000	
Date of last coupon payment	1-Sep-10	
Coupon frequency	semi annual	
accrued interest	26 876 201.32	
Future cash flows:		
01-mars-11	103 872 886.18	interest
01-mars-11	3 374 170 000.00	principal
amount discounted with the yield repurchase	3 471 288 109.22	
Total amount of the prepayment	3 498 164 310.54	
Repurchase price	103.67	
Price excluding accrued interest	102.88	

The French Bond Association
Comité de Normalisation Obligataire

Appendix 2: Example of a MWC option in the final terms of a bond issued by Orange in September 2013

1	Issuer		Orange
2	(a)	Issue Date	3 September 2013
	(b)	Interest Commencement Date	Issue Date
3	Maturity Date		3 September 2018
4	Interest Basis		1.875% Fixed Rate
5	Redemption/Payment Basis		Redemption at par
6	Change of Interest Basis or Redemption/Payment Basis		Not Applicable
7	Put/Call Options		Make-whole Redemption by the Issuer (further particulars specified below)

Appendix 2: Example of a MWC option in the final terms of a bond issued by Orange in September 2013

(c)	Benchmark Security:	The *Obligations assimilables du Trésor* issued by *Agence France Trésor* due 25 November 2018 (ISIN: FR0011523257) or any other *Obligations assimilables du Trésor* issued by *Agence France Trésor* maturing on or about the Maturity Date in the event that the *Obligations assimilables du Trésor* issued by *Agence France Trésor* due 25 November 2018 (ISIN: FR0011523257) are no longer in issuance.
(d)	Make-whole Margin:	0 per cent. per annum
(e)	Timing for calculation of Benchmark Security Price	11:00 a.m. Central European time (CET) on the Calculation Date.