The Credit Roundtable
In association with the Fixed Income Forum

January 11, 2018

Dear Sir or Madam:

The Credit Roundtable[1] appreciates the opportunity to discuss the evolving indenture language related to Special Mandatory Redemption provisions and provide our recommendation for industry best practices. We believe the timing of our recommendation is important as we expect a significant increase in merger and acquisition related funding over the next several months as well as continued uncertainty around the near-term trajectory of interest rates.

Increasingly, mergers and acquisitions (M&A) are pre-funded in the public debt markets with Special Mandatory Redemption (SMR) clauses in the event the deal falls through and the funding becomes unnecessary. As noted in the deals below, typically the SMR provision requires redemption of the series at a fixed cash price of 101% instead of the more conventional spread based redemption price of the investment grade market if the M&A deal is terminated or not completed during a specified time period.

In the last 3 years, we have seen a significant increase in the number of proposed transactions that are terminated. After just one deal failing to close in 2015, we have now seen six deals terminated (with potential for another two). The amount of debt that has been redeemed from client accounts has reached close to $28 billion, with potentially another $34 billion at risk. Recent examples of failed deals include:

- <u>Sysco/U.S. Foods (SYY)</u>
    - To pre-fund a prospective merger, SYY issued $5.0bn of senior unsecured notes on 12/2/14 with a 101% Special Mandatory Redemption clause for a one-year time period. Prior to the anticipated transaction being terminated in June 2015 and bonds being redeemed at $101, the long dated SYY 2044 SMR bonds traded above $113.

[1] Formed in 2007, The Credit Roundtable ("CRT"), organized in association with the Fixed Income Forum, 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 $3.8 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.

- Lam Research/KLA-Tencor (LRCX)
    - To pre-fund a prospective merger, LRCX issued $2.4bn of senior unsecured notes on 5/23/16, of which $1.6bn had a 101% Special Mandatory Redemption clause and a 7 month time frame to close or terminate the transaction. Prior to the transaction being terminated in October 2016 and bonds being redeemed at $101, LRCX's 2026 SMR bonds traded near $107.

- Halliburton/Baker Hughes (HAL)
    - To pre-fund a prospective merger, HAL issued $2.5bn of senior unsecured notes on 11/5/15 with a 101% Special Mandatory Redemption clause for a one year time period. Prior to the transaction being terminated in April of 2016 and the bonds being redeemed at $101, the HAL 2022 SMR bonds traded above $102.

- Aetna/Humana (AET)
    - To pre-fund a prospective merger, AET issued $10.2bn of senior unsecured notes on 6/2/16 with a 101% Special Mandatory Redemption clause and an initial 6.5 month time frame to close or terminate the transaction. However, the SMR clause language was modified to allow for unlimited extensions of the SMR provided the merger agreement was extended by mutual agreement between AET and HUM. Prior to the transaction being terminated in February 2017 and bonds being called at $101, AET's long-dated 2046 SMR bonds traded near $108.

- Great Plains Energy/Westar (GXP)
    - To pre-fund a prospective merger, GXP issued $4.3bn of senior unsecured notes on 3/6/17 with a 101% Special Mandatory Redemption clause and a 10 month window in which to close and/or terminate the transaction. Unlike the AET example above, the indenture did not include an extension option to the SMR time frame. The GXP 2047 bond traded as high as $105 before the likelihood of the deal closing was cast in doubt, and the bonds were redeemed at $101.

- Walgreens Boots Alliance/Rite Aid (WBA)
    - To pre-fund a prospective merger, WBA issued $6bn of senior unsecured notes on 5/26/17, of which $3.5bn had a 101% Special Mandatory Redemption clause and a 1 year window in which to close and/or terminate the transaction. The indenture did not include an extension option to the SMR time frame. The WBA 2023 bond traded as high as $102.5 before the likelihood of the deal closing was cast in doubt, and the bonds were redeemed at $101 more than 7 months later.

AT&T/Time Warner (T) - PENDING

- To pre-fund a prospective merger, T issued $30.0bn of USD and non-USD senior unsecured notes on 7/27/17 with a 101% Special Mandatory Redemption clause and an initial nine month window in which to close and/or terminate the transaction. The indenture does not include an extension option to the SMR time frame.

Unlike traditional call options, which are priced based on prevailing market rates and credit spreads, the SMR's value is dependent upon regulatory and/or shareholder decisions. This makes it difficult for a bond investor to hedge, especially since they have no visibility into the progress of those discussions between the issuer and regulators and/or shareholders. Moreover, bond investors are subject to significant reinvestment risk in the form of: 1) market risk (rates and spreads), and 2) replacement risk (i.e., ability to redeploy capital). Another complicating factor is the evolution or inconsistency of the SMR clause in the deals noted above.

Consistency and transparency are cornerstones of an efficient market. The goal of our proposed SMR language is to utilize investment grade pricing conventions and reduce complexity in order to improve market efficiency and facilitate flexible M&A pre-funding in the unsecured markets. We propose the following Special Mandatory Redemption language as a standard for best practice for bond indentures containing Special Mandatory Redemption provisions. It is modeled after the "Optional Redemption" language that is currently standard in virtually all new issues, and has precedence as well (e.g., Alcan Inc.'s $1.25 Billion offering in 2003 to pre-fund the acquisition of Pechiney).

We believe the proposed language addresses security holders' interest rate risk on SMR bonds through the greater of spread-based Special Mandatory Redemption price (based on relevant Treasury rate plus [90.0%] of New Issue Offer Spread) or a pre-set percentage of par, such as 101% as noted in the examples above.

Further, we believe the proposed language will limit the Special Mandatory Redemption timeframe by (i) allowing [180] calendar days for a specified transaction to close and/or be terminated under the Special Mandatory Redemption clause and (ii) by prohibiting free and/or unlimited extensions of the Special Mandatory Redemption timeframe without recourse for security holders.

Proposed Special Mandatory Redemption Language

If the [Issuer]'s acquisition of [Target company] (the "Acquisition") is not consummated on or prior to the date that is [180] calendar days from the issue date of the Notes (the "SMR Deadline") or, if prior to such date, the Merger

Agreement for the Acquisition is terminated (each, a "Special Mandatory Redemption Event"), then in each case [Issuer] will be required to redeem all of the Notes at a special mandatory redemption price ("Special Mandatory Redemption Price") equal to the greater of (i) [101%] of the aggregate principal amount of the Notes, plus accrued and unpaid interest to, but excluding, the Special Mandatory Redemption Date (as defined below) and (ii) the sum of the present values of the Remaining Scheduled Payments discounted to the Special Mandatory Redemption Date on a semi-annual basis (assuming a 360-day year consisting of twelve 30-day months) at the Reinvestment Rate, together with accrued interest on the principal amount of the Notes being redeemed on the Special Mandatory Redemption Date.

"New Issue Offer Spread" means, the difference in basis points, as of the pricing date of the Notes, between (i) the yield on each applicable series of the Notes and (ii) the yield on a respective United States Treasury security with an actual or interpolated maturity comparable to the remaining term of the Notes (as such, the "Treasury Rates") as selected by [Issuer] or an Independent Investment Banker appointed by [Issuer]

"Reinvestment Rate" means, [90.0%] of the New Issue Offer Spread plus the arithmetic mean of the yields under the respective headings "This Week" and "Last Week" published in the most recent Federal Reserve Statistical Release H.15 that has become publicly available prior to the date of determining the Special Mandatory Redemption Price (or if such statistical release is no longer published, any such other reasonably comparable index which shall be designated by us) under the caption "Treasury Constant Maturities" for the maturity (rounded to the nearest month) corresponding to the then remaining maturity of each series of Notes, as applicable. If no maturity exactly corresponds to such maturity of the Notes, as applicable, the applicable Reinvestment Rate will be obtained by linear interpolation (calculated to the nearest one-twelfth of a year) from the yields for the two published maturities most closely corresponding to such maturity of the Notes, as applicable.

"Remaining Scheduled Payments" means, with respect to each series of Notes to be redeemed, the remaining scheduled payments of the principal thereof and interest thereon that would be due after the related call event date or redemption date, as the case may be, but for such redemption; provided, however, that if such call event date or redemption date, as the case may be, is not an interest payment date with respect to such Note, the amount of the next succeeding scheduled interest payment thereon will be reduced by the amount of interest accrued thereon to such call event date or redemption date, as the case may be.

Upon the occurrence of a Special Mandatory Redemption Event, [Issuer] will promptly (but in no event later than (5) business days following such Special Mandatory Redemption Event) notify the trustee in writing of such event, and will, no later than 5 business days following such notice to the trustee, mail a notice of redemption to the registered address of each holder of the applicable series of the Notes (such date of notification to the holders, the "Redemption Notice Date"), that the Notes will be redeemed on the 30th business day following the Redemption Notice Date (such date, the "Special Mandatory Redemption Date"), in each case in accordance with the applicable provisions of the indenture. [Issuer] will notify each holder in accordance with the applicable provisions of the indenture that all of the outstanding Notes of the applicable series shall be redeemed at the Special Mandatory Redemption Price on the Special Mandatory Redemption Date automatically and without any further action by the holders of any series of the Notes to be redeemed. At or prior to 12:00 p.m. (New York City time) on the business day immediately preceding the Special Mandatory Redemption Date, the Company shall deposit with the trustee funds sufficient to pay the Special Mandatory Redemption Price for each series of Notes to be redeemed. If such deposit is made as provided above, all of the Notes to be redeemed will cease to bear interest on and after the Special Mandatory Redemption Date.

For purposes of the Notes, a business day means a business day in The City of New York.

Thank you for this opportunity to provide comments. We also welcome the opportunity to discuss our concerns, opinions and proposal in greater detail. Please direct any questions to Cathy Scott, Director of the Fixed Income Forum, on behalf of The Credit Roundtable.

Kind Regards,

Cathy Scott

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