Sovereign bond offerings and liability management exercises – U.S. perspectives

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With recent increased activity in the area of sovereign bond offerings (including a rise in issuances of "green bonds") and liability management transactions, we thought it might be helpful to highlight certain U.S. legal considerations relevant to such transactions. This memorandum provides an overview of the options available to non-U.S. government issuers planning to issue debt in the international capital markets or refinance their existing indebtedness.

Bond Offerings by Foreign Governments

Schedule B offerings

Schedule B to the Securities Act of 1933 (the "**Securities Act**") provides a relatively quick and streamlined route for foreign government issuers to conduct offerings of securities in the international capital markets that target the U.S. investor base. There is no specific form on which such securities must be registered. Instead, the registration statement must include the disclosures required by Schedule B, which contains a relatively short list that has not changed since the Securities Act was first adopted. In addition, market practice – driven largely by investors' expectations and general liability considerations – has evolved over the years to also include certain supplemental disclosure, such as political, economic, budgetary and statistical information relating to the issuer.[1]

Who can issue securities using Schedule B?

Schedule B is available to foreign governments and their political subdivisions, such as states, provinces and municipalities.

In addition, several multilateral organizations and development banks register securities on Schedule B pursuant to a long line of no-action letters issued by the U.S. Securities and Exchange Commission (the "**SEC**"). These organizations include the Nordic Investment Bank, Euratom, the European Investment Bank, the Central American Bank of Economic Integration and a number of other issuers. On a case-by-case basis, the SEC may also allow certain other entities – such as issuers of government-guaranteed securities and other issuers closely aligned and identified with a sovereign – to use Schedule B. On the other hand, corporations which are controlled or owned by the state (such as state-owned oil companies) are generally not eligible for this registration process simply by virtue of such control or ownership.

"Shelf" registration allows quick access

"Shelf" registration allows issuers to access the capital markets on short notice, which means they are well-placed to issue securities when market conditions are attractive. Although Rule 415 under the Securities Act, which provides the basis for "shelf" registration, explicitly carves out foreign governments from its scope, the SEC has adopted a procedure that allows sovereign issuers to use a substantially similar framework.

This process is (with narrow exceptions) only available to "seasoned" Schedule B issuers, *i.e.* issuers

[1] If securities issued by a foreign government are being listed on a U.S. securities exchange, they will also need to be registered on Form 18, which generally requires the same disclosures as those set forth in Schedule B.

that have made one or more offerings of registered securities (or that have registered guarantees of securities of another issuer) under the Securities Act within the preceding five years and have not defaulted on any principal or interest.

Under the "shelf" procedure, a foreign government can register the amount of securities it reasonably expects to issue over a two-year period by filing with the SEC a base prospectus containing the information specified in Schedule B as well as other information deemed material to investors. At the time of a "shelf takedown", the issuer is required to prepare and file a prospectus supplement that includes the pricing terms, the terms of the securities being offered and a description of any material recent developments.

Over time, a further streamlined version of this procedure has been developed, which permits "seasoned" Schedule B issuers to incorporate disclosure by reference in a manner similar to that in which foreign private issuers use Form F-3 registration statements. Under this "enhanced" framework, a foreign government can voluntarily file with the SEC annual reports using Form 18-K and then update them, as needed, throughout the budget year by filing amendments on Form 18-K/A. The annual report must contain the information required by Form 18-K as well as all the disclosures required by Schedule B. The report then gets updated during the year as and when material new information (such as revised budget estimates or new economic data) becomes available. This provides an efficient and cost-effective way of updating the "shelf" registration statement. Since the registration statement already contains a base prospectus (which incorporates by reference Form 18-K together with any amendments), at the time of a "shelf takedown" the sovereign is only required to file a prospectus supplement with a description of the securities offered. This streamlined procedure is only available to issuers which have requested and received an interpretive letter from the SEC.

Rule 144A/Regulation S alternative route

Many foreign governments choose not to go down the Schedule B route and instead rely on the exemptions from the U.S. registration requirements provided by Rule 144A and Regulation S under the Securities Act, in particular if they access the capital markets on a relatively infrequent basis. Such Rule 144A/Regulation S sovereign offerings can either be structured as standalone one-off issuances or form part of the issuer's medium-term note (MTN) program. While there are no specific disclosure requirements applicable to such offerings, the content of the offering document – largely driven by liability considerations and market practice – will in practice be similar to that used in a Schedule B offering. However, sales to U.S. investors in a Rule 144A/Regulation S offering are limited to "Qualified Institutional Buyers" (generally speaking, large institutions with at least $100 million of securities under management).

Liability Management Transactions

Sovereigns benefit from increased flexibility…

Tender offers in respect of the securities of foreign governments and political subdivisions of foreign governments that are eligible to be registered on Form 18 are exempt from the operation of the U.S. federal tender offer rules.[2] These rules, along with related SEC guidance, contain a number of timing, procedural and structuring limitations that are often perceived by market participants (particularly those outside the United States) as onerous and burdensome to comply with. For example, tender offers that are subject to the U.S. tender offer rules are generally required to stay open for 20 U.S. business days.[3] In addition, various structural constraints apply to such transactions – for instance, while "modified" Dutch auctions (which are common in Europe and Asia) are permitted, they must fit

[2] *See* Rule 3a12-3(a) under the Exchange Act of 1934.

[3] *See* Rule 14e-1(a) under the Exchange Act of 1934. In practice, the use of certain structural features can effectively result in tender offers being substantially complete in 10 U.S. business days. In addition, any-and-all cash tender offers for non-convertible debt securities that satisfy certain criteria can be conducted in as little as five U.S. business days. See our client memoranda **New Procedures for Shortened Debt Tender Offers** (Jan. 23, 2015) and **SEC Issues Guidance on 5-Day Debt Tender Offers** (Nov. 21, 2016).

into a narrow range of parameters defined by the SEC, and “unmodified” Dutch auctions are not permitted at all. As a result, since the U.S. tender offer rules generally apply to all tenders extended into the United States (even in a scenario where the issuer is a non-U.S. company and there is only a small number of holders in the United States), they often dictate the timetable and structure of many liability management projects in Europe, Asia and elsewhere.

Sovereign issuers routinely take advantage of the flexibility provided by the exemption discussed above, which allows them to execute liability management transactions on a short timetable, thereby minimizing market risk. Such tender offers – even if they include bondholders in the United States – are typically only open for a few days and, increasingly often, for just one day (such as the accelerated “switch tender offers” by the Philippines, Chile and a number of other sovereigns).

There is no requirement for the sovereign bonds targeted in a tender offer to be registered on Form 18 in order to be exempt from the application of the U.S. tender offer rules – it is sufficient that the issuer is *authorized* to use it in respect of such securities. Consequently, bonds issued by sovereign issuers are exempt from the U.S. tender offer rules even if they were issued pursuant to an exemption from the registration requirements of the Securities Act (for example, in a Rule 144A/Regulation S offering).

On the other hand, while the SEC has allowed certain supranational and other organizations to use Schedule B, it has generally avoided directly answering the question of whether such organizations are “foreign governments or political divisions thereof” within the meaning of Section 7 of the Securities Act. As a result, determining whether a particular organization or quasi-sovereign issuer may be exempt from the application of the U.S. tender offer rules will typically require a fact-intensive case-by-case analysis and frequently involve conversations with the SEC Staff.

… but antifraud provisions still apply

Last but not least – even if a tender offer is exempt from the application of the tender rules discussed above, it will still remain subject to the antifraud provisions of the U.S. securities laws.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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