

# Tender offers by Brazilian issuers: taking advantage of prices of debt securities to improve capital structure

The Brazilian political environment has historically influenced, and continues to influence, Brazilian economic performance

Over the last several years, there has been an increase in volatility in the Brazilian economy due to uncertainties arising from ongoing anti-corruption investigations. Several members of the Brazilian government, as well as executives from large state-owned and private companies, have been convicted of corruption in connection with their involvement in government-sponsored infrastructure projects, oil and gas companies and construction. In addition, the presidential election held in Brazil in October 2018 resulted in the election of Mr. Jair Bolsonaro, who took office earlier this year. The president of Brazil has the power to determine policies and governmental actions related to the Brazilian economy which, in turn, may affect the financial performance of companies and financial institutions. While Mr. Bolsonaro is seen as pro-market, political uncertainty still looms over Brazil, as only time will tell how his proposed changes will affect the Brazilian economy.

It is in this volatile context that Brazilian issuers are taking advantage of reduced prices of their bonds traded in the international markets to restructure their debt profile and reduce their cost of capital by repurchasing such bonds at favorable prices.

## Repurchasing debt: open market repurchases and tender offers

Two principal methods through which issuers may repurchase their debt securities are: (i) through open market repurchases or (ii) by means of a tender offer. The main differences between these two alternatives are the amount of bonds that can be repurchased, pricing, how active the issuer can be in procuring sell offers and applicable requirements under the U.S. federal securities laws.

Regardless of the alternative used to repurchase its outstanding debt securities, Brazilian issuers must always (i) verify if the relevant indenture allows

them to repurchase the debt and comply with the requirements of such indenture (e.g., cancel the repurchased bonds promptly after repurchase – a common provision in indentures utilized by Brazilian issuers), (ii) comply with applicable U.S. and Brazilian procedural and regulatory requirements (e.g., the repurchase of subordinated debt typically requires prior approval of the Brazilian Central Bank), and (iii) be aware that U.S. securities antifraud provisions may apply to any such transaction (e.g., no material misstatements or omissions may be used in the context of any repurchase).

## Open market repurchases

Open market repurchases are the quickest and easiest way for an issuer to repurchase small quantities of debt securities. While the term of the relevant indenture may allow for an optional redemption of a portion or all of the outstanding debt securities governed by the indenture, such redemptions typically require the payment of premiums and may therefore be more expensive for an issuer than purchasing the securities in the open market. An issuer may acquire its debt securities through open market purchases or in privately registered transactions (and while not necessary, sometimes with the assistance of a brokerage house). The main limitation on open market repurchases is the amount of debt securities that an issuer may repurchase at any given time (typically no more than 5-10% of the outstanding balance of the notes in any 60-90 day period is recommended) and that issuers should act more passively (i.e., acquiring lots that are made available by holders) rather than actively seeking sellers. Another important aspect of open market repurchases is the price the issuer pays. While in a tender offer the issuer can specify a



single price to be paid for all bonds tendered, in an open market repurchase the issuer pays the current market price of the bond, thus being subject to price fluctuations. In addition, most bonds issued by Brazilian companies and financial institutions are quite illiquid, so it may take a long time before an issuer is able to acquire a desired amount of its debt securities through such purchases.

It is noteworthy that, in order to provide disclosure and mitigate potential 10b-5 liability or other securities claims, certain issuers work alongside legal counsel to establish an open market repurchase program, whereby the issuer structures the repurchases in a way to avoid being deemed a “creeping” tender offer<sup>1</sup> (and, therefore, subject to Regulation 14E under the Exchange Act of 1934, as amended – the **Exchange Act**), which structure could include volume limitations, pricing guidance, cooling-off periods and disclosure through press releases.

#### Tender offers

Tender offers are used when issuers seek to repurchase a larger portion of their outstanding debt over a short period of time, as tender offers have no limit on how much can be repurchased. Although there are few specific rules governing debt tender offers, it is market practice to comply with the Exchange Act and the rules and regulations thereunder, including those applicable to tender offers for equity securities, notably Rule 14E.

In a tender offer, an issuer actively solicits its investors to tender their bonds in exchange for consideration (typically cash, but it can also be other debt through an “exchange offer”, or other assets), with the assistance of one or more dealer managers (usually investment banks, who assist with the determination of the price of the tender

offer and the solicitation of investors) and of a tender and information agent (responsible for the distribution of press releases, receiving tenders and assisting with clearing procedures). Some issuers also pay a soliciting dealer fee (usually a small percentage of the principal of notes tendered and accepted for purchase) to retail brokers (brokers whose clients tender bonds in relatively small aggregate principal amounts).

Engaging legal counsel is also critical in tender offers, and it is not uncommon to have both international and local Brazilian counsel for each of the issuer and the dealer managers. Legal counsel is responsible for drafting the pertinent documentation (offer to purchase, letter of transmittal, press releases, cancellation notices and a dealer manager agreement), as further explained below. Although a 10b-5 letter is not typically required in a tender offer, enforceability legal opinions are standard, especially when dealing with non-U.S. and/or regulated issuers (such as financial institutions).

A tender offer commences with the issuance of a press release to the market (through services like PR Newswire and filings with the applicable stock exchange should the notes in question be listed thereon), which summarizes the main terms of the offer and includes a reference to where a holder may access the corresponding offer to purchase and letter of transmittal. An offer to purchase is the disclosure document that contains all the terms and conditions of the tender offer which are necessary for an investor to decide whether to tender the solicited debt securities. Unlike an offering memorandum that may be used for the

<sup>1</sup> A “creeping” tender offer happens when an issuer conducts a series of, or larger, open market repurchases in a short period of time (e.g., without considering cooling-off periods – usually between 60-90 days between purchases, purchasing larger blocks of outstanding debt, actively soliciting tenders, proposing a fixed price for repurchases...) in a way that may be construed as a “de facto” tender offer, and, therefore, subject to the Exchange Act.

sale of securities, an offer to purchase usually contains very little disclosure about the issuer (typically only a few paragraphs containing a brief description of the business) and does not include financial statements or financial information. The main purpose of an offer to purchase is to provide investors with a clear understanding of how to tender their bonds, the price they will receive for tendering their bonds, the timing, the conditions, the maximum amount to be repurchased by the issuer (tender cap), proration procedures, the risks and the purpose of the offer. A letter of transmittal is an additional offering document used when at least some of the bonds in question are not held in book-entry form.

Tender offers by private issuers<sup>2</sup> for any amount less than the total amount outstanding must remain open for at least 20 business days. In order to incentivize early participation by holders, many issuers elect to pay an “early tender premium” to those holders who tender their bonds during the first 10 business days of the tender offer, and including a condition in the offer to purchase that if the tender cap is reached on the early tender date (e.g., 10 business days after the commencement of the tender offer), no bonds tendered after the early tender date but before the expiration of the tender offer will be accepted for purchase. Thus, while the tender offer will remain open for the full 20 business days, as a practical matter, holders may be limited to tendering during the early tender period, as notes tendered after such period might not be accepted if the participation level during such period results in the tender cap being reached (of course, if the tender cap is not reached by the early tender date, additional bonds could be tendered before the expiration date which would be accepted for purchase by the issuer). The use of early tender periods is very common in tender offers recently undertaken by Brazilian issuers. We note that when a tender offer has a limit (or cap) and the offer is oversubscribed (i.e., the issuer received tenders in excess of the cap), the acceptance of notes tendered will be determined using a methodology set forth in the offer to purchase (such as proration).

If a tender offer is for the full amount outstanding of certain non-convertible notes and the consideration is for cash or Qualified Debt Securities<sup>3</sup> only, the issuer may be able to conclude the tender offer in 5 business days. The staff of the U.S. Securities and Exchange Commission (**SEC**) issued a no-action letter on 23 January, 2015,

setting forth guidance with respect to restrictions that must be complied with for an issuer to be able to conduct an abbreviated tender offer. These requirements include, in addition to the ones mentioned above, that the tender offer cannot be made in connection with a consent solicitation to amend the indenture, note or any other agreement related to the securities being repurchased, there can be no default or event of default existing under any indenture or material financial agreement of the issuer and that it cannot be connected by an issuer subject to an insolvency or bankruptcy proceeding, among others.

Tender offers are generally structured in a way to provide a good deal of flexibility for the issuer, as disclosed to holders in the applicable offer to purchase. An offer to purchase typically contains provisions stating that the issuer may amend any term of the tender offer (including, among other things, deadlines, prices, and tender caps) without providing withdrawal rights or otherwise extending the offer, unless as required by law. Rule 14e-1(b), for example, requires tender offers to remain open for at least 10 business days from the date the issuer gives notice to holders that it is changing certain critical terms such as the tender cap, consideration or soliciting dealer fee. We further note that when an issuer decides to increase the consideration payable for tendered notes during the tender offer, the issuer should pay the increased amount for all bonds tendered and accepted for purchase, regardless of when they were tendered (i.e., before the price increase), in order to avoid any potential claims by holders (although the issuer may not necessarily be under any legal obligation to do so).

With respect to pricing a tender offer, there are a number of ways an issuer and its financial advisors can determine an appropriate price to receive the desired level of participation by holders of the debt securities in question. The vast majority of recent tender offers by Brazilian issuers use a fixed consideration structure, whereby the issuer and the dealer managers determine a fixed price to be paid for each block of nominal amount of bonds (e.g., US\$850 for each US\$1,000 principal amount of bonds). Another option for determining the consideration is a modified Dutch auction, whereby the issuer provides a dollar range (e.g., between US\$800 and US\$900 for each US\$1,000 principal amount) and holders must choose at what price (if any) they are willing to sell their bonds back to the issuer.

<sup>2</sup> Issuer tender offers by foreign governments and its political subdivisions for securities that are eligible to be registered on Form 18 are exempt from the tender offer rules (Rule 3a12-3(a) of the Exchange Act).

<sup>3</sup> “Qualified Debt Securities” means non-convertible debt securities that are identical in all material respects (including but not limited to the issuer(s), guarantor(s), collateral, lien priority, covenants and other terms) to the debt securities that are the subject of the tender offer except for the maturity date, interest payment and record dates, redemption provisions and interest rate; provided that Qualified Debt Securities must have (i) all interest payable only in cash and (ii) a weighted average life to maturity that is longer than the debt securities that are the subject of the offer.” (See Five Business Day Tender Offer No-Action Letter dated January 23, 2015, available at: <https://www.sec.gov/divisions/corpfin/cf-noaction/2015/abbreviated-offers-debt-securities012315-sec14.pdf>).

A final consideration worth noting relates to rating agencies. When an issuer repurchases debt securities, it may be required to notify any rating agency rating such bonds (which agencies may also provide ratings with respect to the issuer as a requirement for rating its debt). It is important to involve the relevant rating agencies fairly early in the process to ensure that a contemplated tender offer will not negatively impact any ratings (this is especially important when the bonds are trading well-below par).

### Conclusion

Brazilian issuers – most notably financial institutions – have taken advantage of the current economic downturn in Brazil to improve their debt profile by repurchasing debt both in the open market and through tender offers. Further to the discussion herein,

there are a number of issues that must be carefully considered in order to avoid liability and successfully execute a transaction for the repurchase of an issuer's debt securities. Hogan Lovells has been one of the main players in international liability management transactions for Brazilian issuers, having participated in the vast majority of international tender offer transactions, as well as advising clients with open market repurchases and in structuring open market repurchase programs. On the ground in São Paulo and working alongside our broader capital markets team in New York, London and in several of our other offices around the globe, we have the expertise necessary to guide issuers through successful liability management solutions.

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