



# NEGATIVE COUPON

FULLY AUTOMATED HANDLING OF  
NEGATIVE COUPON AT VP SECURITIES



# VP SECURITIES is at the fore-front in handling negative coupon

## Background and objective

Since the autumn of 2012, VP has had a contingency plan to handle negative coupons, which was prepared in cooperation with the mortgage credit sector in Denmark.

The contingency plan outlined several alternative solutions for the handling of floating-rate bonds in VP's infrastructure in situations where the bond had a negative coupon rate, and a payment should therefore be made from investor to issuer. These solutions were largely based on existing functionality.

VP has handled negative coupon payments in accordance with the contingency plan since July 2015. Even though these solutions met the basic needs for the mortgage credit institutions, the manual handling left room for improvement. From the end of September 2016, VP will therefore have a solution to make it even easier and simpler for issuers as well as investors. The solution is prepared in cooperation with the Danish mortgage credit sector to ensure the best possible solution as part of the harmonized redemption system in VP.

The solution is available for bonds that:

- Are floating rate,
- Where the interest rate is known at the beginning of each term and
- Are annuities or bullet loans (not possible with index-linked bonds).

## 3 models for negative coupon

At creation, the Issuer Agent will choose among three different models as well as variables dependent on the chosen model:

1. **Pre-payment Model** – where VP on behalf of the issuer calculates an additional nominal amount to be redeemed to offset the value of the negative coupon payment. This is included in the ordinary nominal amount to be redeemed.
2. **Liquidity Model** – where the negative coupon payment is deducted from the planned payment of the ordinary redemptions. In this model, it may be necessary to redeem an additional amount from investor to cover the negative coupon in case of insufficient funds from the original redemption payment.
3. **Zero Floor Model** – when the interest on a bond is floored at zero percent.

When additional redemption is possible (Pre-payment Model and Liquidity Model), the issuer Agent will choose the type of price to be used for such a redemption:

- At par or
- Market price (to be supplied by Issuer Agent).

## Pre-payment Model

VP, on behalf of the Issuer Agent, will handle a negative coupon on an annuity by calculating an additional amount to be redeemed to compensate for the negative coupon. For this purpose VP will use the above-mentioned price type that is specific for each bond. The redemption will be an ordinary redemption and include both amount for redemption reported to VP by the Issuer Agent as well as the amount calculated by VP on behalf of the Issuer Agent to compensate for the negative coupon.

On the last term, additional redemption will not be possible. Hence, VP will offset any negative coupon in the proceeds from the remaining redemption.

Please note: Before the last term if the total redemption should exceed 100%, the Issuer Agent will shorten the maturity, and the negative coupon will be offset in the redemption proceeds.

A negative coupon with a bullet bond will be handled by a redemption to offset the value of the negative coupon to be paid by the investor. On behalf of the Issuer Agent VP will calculate the nominal value to be redeemed based on the negative interest rate and selected price type.

## Liquidity Model

A negative coupon on an annuity will be offset in the proceeds from redemption. VP will on behalf of the Issuer Agent calculate the negative coupon and offset it in the proceeds from the ordinary redemption. If the funds from the redemption are insufficient, VP will on behalf of the Issuer Agent calculate an additional redemption to compensate for the remaining value of the negative coupon. This additional redemption will be in accordance with the chosen price type. No additional redemption will be possible at the last term.

A negative coupon with a bullet bond will be handled by a redemption to offset the value of the negative coupon to be paid by the investor. On behalf of the Issuer Agent VP will calculate the nominal value to be redeemed based on the negative interest rate and selected price type.

## Zero Floor Model

The Zero Floor Model is characterised by the Issuer Agent setting the interest to zero percent. In such situations, VP will have no interest calculation or other handling of the interest. Any redemption will take place as normally.



### Publication day

Along with the redemption amount, VP will deliver a redemption-percentage to Nasdaq - if the bond is listed. For other receivers of preliminary and final redemption-percentage, VP will split up the percentage for the Pre-payment Model and Liquidity Model for different redemption - including any additional redemption. The redemption-percentage will be a sum of the individual redemption-percentage.

In case the Issuer Agent has chosen the price type to be Market Price in the Pre-payment model, the publication will be moved to three days before due date. If the price type is set to Market Price in the Liquidity Model, it will be up to the Issuer Agent to move the publication day, if VP shall calculate and make any additional redemption to compensate for the negative coupon.

The conditions by the issuer describes which market price to use. However it should be available no later than three settlement days before due date. If earlier publication is wanted, the Issuer Agent must move the publication day. The date of market price shall make sense in relation to the publication date for redemption percentage (preliminary and final).

### Tax treatment

VP will collect and report the negative interest for the Pre-Payment Model as well as the Liquidity Model to the Danish Tax Authorities (SKAT). The negative interest will have a procced type 8. This type 8 is not for use for payments, but for information and reporting of negative interest to SKAT.

### Information to account and right holders

To help inform account and right holders, VP will deliver information on:

- Redemption amount,
- Redemption percentage,
- Negative interest (amount),
- Any paid-out redemption proceeds,
- Prices used in calculation of any additional redemption.

### Implementation of automated negative coupon

On 17 May 2016, new fields will be available in vp.ONLINE to register chosen model etc.

On 15 August 2016, the extended calculation of redemption percentage will be available. The new version will coexist with the old version until 19 September 2016, where the new version will become mandatory.

On 19 September 2016, the functionality for calculating and handling the negative coupon will be implemented.



## Contact us



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