Increasing visibility

Representatives from leading corporate trust service providers met with **SCI** late last year to discuss the post-financial crisis trustee and agency landscape. Regulatory and market infrastructure challenges were at the forefront of their minds

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Attendee biographies

Gary Burns is head of business development, corporate trust and loan agency (CTLA) – Europe at HSBC. He joined HSBC in 1987 and has over 25 years' banking experience, working initially in HSBC's corporate & institutional banking division as a global relationship manager, with particular focus on the financial institutions group sector. Burns has been in HSBC's CTLA team for over 12 years, working primarily in business development.

Dean Fletcher is business executive for BNY Mellon's corporate trust franchise in EMEA. As regional executive, he manages a portfolio of business lines that provide a full range of trustee, agency and administration services across the debt capital markets. Prior to joining BNY Mellon in 2008, Fletcher worked at Barclays Capital Services, JPMorgan Chase Worldwide Securities Services and Arbuthnot Latham Banking Group.

Mike Hellmuth is head of UK corporate trust services at BNP Paribas, responsible for all aspects of service delivery for the corporate trust business within the UK. Following five years at JPMorgan, Hellmuth joined Wachovia in October 2004 to set up a European CDO administration business that successfully transitioned to BNP Paribas Securities Services in May 2006. He is a corporate trust industry professional of over 25 years' standing and a member of the BNP Paribas Securities Services UK executive committee.

Corinne Smith is editor of SCI.

The role of the corporate trust service provider

CORINNE SMITH, SCI: Increased volume of stressed and distressed securitisations has put the spotlight on corporate trust service providers in recent times. I would like to start by discussing how their role has developed since the financial crisis. Is there a better appreciation of corporate trust service providers' abilities now?

DEAN FLETCHER, BNY MELLON: The trustee role has definitely become more visible since the financial crisis and therefore there is a better awareness and understanding of what corporate trust providers do. That said, it varies from issuer to issuer and from one investor community to another. In terms of how the emphasis has changed, clearly default and restructuring work is now top of all of our workloads.

At the same time, investors – because they've had their fingers burned – have become more proactive. Again, generally it varies in terms of approaching trustees and seeking out guidance or discussion around enforcement and restructurings and so on.

MIKE HELLMUTH, BNP PARIBAS: Pre-financial crisis, the focus was on standard transaction management – on closing deals and negotiating transaction documents. What we have seen since is a big shift in our time towards dealing with requests for amendments.

Clearly the financial crisis has brought certain pressures to bear on market participants and that has resulted in a significant increase in the number of amendments being requested. We have dealt with that by shifting resources from dealing with transaction-based documentation to dealing with amendments and restructurings.

FLETCHER: And with that has come a bigger push for trustees to exercise discretion.

GARY BURNS, HSBC: Just to reaffirm, the role of the trustee has not changed, but the work that the trustee does has changed. Issuers and investors have a better appreciation of the scope and the responsibilities of the trustee.

Although they may want more from a trustee, they now better understand the concept of a trustee's fiduciary duties. The fact remains that trustees are there to act on the investors' and other secured creditors' behalf to represent their interests.

SMITH: We've touched on how the investor perspective has changed, but what about from an issuer's point of view?

FLETCHER: The nature of the relationship has changed markedly: we've put more resources into legal work and changed the whole construct of our front-end, in terms of the sales and relationship manager functions. Whereas pre-crisis the environment was more product-driven and price was often the only differentiator, now we find for relationships that are working well we are talking broadly around funding needs. We're talking to an issuer about how they're going to fund over the next 12 months and it has become much more strategic with respect to what a trustee and agent can offer.

SMITH: What sort of services are they asking for typically?

FLETCHER: It is still the same trustee and agency services, but we're talking to treasury divisions a lot more, as well as heads of desk. Treasurers are trying to work out how to hit their capital targets and which of their programmes they can actually go out and sell to investors in advance.

The need for 'pre-close expertise', which was never a big feature in the past, is also increasing. Previously, sales won the deals; now, transaction managers tend to get involved up-front because issuers want to get more comfortable with documentation.

HELLMUTH: There has been a watering-down of experience in the market. As we have seen in previous downturns, the investment banks have laid off a lot of people in the last three years and typically those people have been very experienced.

Consequently, the people under pressure to bring deals to the market don't necessarily have all the answers, so they seek to benefit from the corporate trust provider's experience and knowledge. Experienced people have typically remained in the corporate trust industry and clients have been able to benefit from that continuity of service over the last three or four years. We have lived through the financial crisis and learnt a lot from the challenges this has thrown up and are now well-placed to provide additional support to investment banks in terms of structuring transactions.

BURNS: We at HSBC are certainly a lot more relationship-focused. Our business model has evolved from being primarily transaction-driven, as we look to understand more about our clients' needs and requirements.

We look to provide solutions, rather than just offer products. This has required us to widen the scope of what we discuss with select issuers and orginators, meaning we are more holistic in our thought process as we look to also understand their financing requirements. Sales and transaction management now work even more closely together; this is where we've really been seen to add value when talking with issuers and other select third parties, such as rating agencies, law firms and originators.

SMITH: In terms of pre-close expertise, what are the hot-button issues at the moment?

FLETCHER: Well, there has been a lack of appreciation of the consequences of having prescriptive language in deal documents – and I am talking about hard-wired downgrade triggers, which did and still do catch counterparties off-guard in

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terms of the sheer volume of deals this impacts and the remedial action that needs to be undertaken. Now, there is much more up-front consideration of how programmes could be amended, for instance, and what the trustee position would be on that. It is a more forward-looking conversation – we're trying to anticipate these kinds of issues up-front.

Industry consolidation

HELLMUTH: Another aspect that clients are interested in now when they are making their selection of corporate trust service provider is their rating and financial stability. Prior to the financial crisis, unless there was an existing relationship, appointments were generally a pricing-driven decision.

Now, the rating is very important. Nobody wants to have the hassle associated with changing service provider because they are suffering financially and their rating may drop below the required threshold.

Smaller corporate trust providers and corporate administrators have struggled to cope with the volume of amendments and restructurings that followed the financial crisis. This presents an opportunity for some of the larger corporate trust providers to step in.

FLETCHER: Yes, we have seen some smaller players exiting the market. This could become a theme, given the drive towards post-trade harmonisation in the markets more generally, which is putting pressure on pricing and will involve more investment by trustees and agents in order to stay in the game. We anticipate that ultimately a nucleus of big providers with critical mass will be left.

HELLMUTH: Five or ten years ago, a number of big corporate trust service providers had active acquisition programmes. I suspect that the amount of money required to do that is not as readily available anymore, so it will be interesting to see how the terms of these acquisitions change.

BURNS: It will also depend upon the individual corporate trust shop's business model and whether it is looking to further develop its product offering/capabilities into new areas/sectors. Because of current market conditions, we have positioned our business for potential downgrade and successor account business. We have also looked to widen/develop our product offering into other new potential industry sectors; for example, 'European Insurance Trust'.

FLETCHER: It becomes more of an overall funding issue. We're finding that we need to be able to provide services around any types of funding arrangements.

SMITH: Has that driven a rationalisation of agency functions?

FLETCHER: Issuers, particularly the big banks, are scrutinising more closely their own business activities. Pre-meltdown, the focus was on getting products to market and the agency functions were sometimes a bit of an afterthought. Now, everyone is rationalising their cost-base and moving these functions to dedicated players.

SMITH: Scalability must have increased in importance as well.

HELLMUTH: The number of tasks corporate trust service providers are being asked to undertake now has increased significantly. The majority of transactions now have unique aspects to them, requiring us to adjust the precise services that we offer.

Pricing a deal now is a far bigger challenge because we have to understand the costs behind the services that we are being asked to provide, when we are dealing with more inexperienced people who do not necessarily fully appreciate the finer details. Flexible technology is key in ensuring our industry can overcome these challenges.

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Documentation issues

SMITH: I'd like to move on to whether new issue documentation is providing better direction for corporate trust service providers to act. Do you have any thoughts on how documentation can be improved further?

HELLMUTH: We work in an environment where documents are created from precedents and that is unlikely to change any time soon. The selection of the precedent is, of course, very important and there have been improvements in some of the specific clauses that we had issues with during the financial crisis.

But, as an industry, we still have a long way to go. Transaction documents still refer to definitive registered notes, for example, which frankly is language from 15 or 20 years ago. Unless there is a widespread overhaul – and we would need to engage as an industry with the law firms in getting that done – pockets of pre-crisis language will remain and these will continue to provide challenges for trustees in particular.

BURNS: The increased risk profile of transactions over the last few years means that we as a house have continued to evolve our documentation standards and promote these in conjunction with certain forums, such as ISMAG, TACT and the ICMSA. This is a positive step forward and meaningful progress is being made on the documentation front.

FLETCHER: Much of the evolution in terms of documentation has been driven by the issuers, which, of course, has resulted in variation from one house to another regarding the sort of protections that need to be built in. Consistency would be great, but realistically it is going to be a slow process involving many players.

SMITH: So, what needs to happen for a widespread documentation overhaul to occur?

HELLMUTH: It is only going to happen if it is driven by the industry, via the ICMSA, for example. Work is being done towards this goal, but it requires a significant investment of time from all of us and let's not forget the role the corporate trust providers play in the documentation process. We are generally the last deal party to see the documents, so our opportunity to fully amend them is often limited.

FLETCHER: Given that most of the structured markets are effectively closed, it will be interesting to see – at such time that structured vehicles return – whether this will drive an improvement in the docs.

Counterparty criteria changes

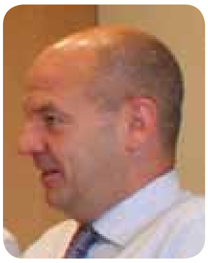
SMITH: Rating agency counterparty criteria changes and the confirmations process also remain somewhat contentious issues. How have they impacted corporate trust service providers and capital market deals more broadly?

HELLMUTH: We are all grateful that we work for highly rated organisations. We have seen an influx of account bank appointments following the financial crisis as rating agencies have downgraded a large number of counterparties and corporate trust service providers in the last three years.

BURNS: There will, by definition, be a concentration risk issue as the number of experienced institutions who have the requisite rating is dwindling. Trustees, issuers and cash managers thus have to be very alert to rating triggers within the documentation and act accordingly.

HELLMUTH: This is true, yet clearly risk is playing a more important part in that investment decision. Four or five years ago, it was heavily biased towards the rate of return that you got on your money and now it is more focused on the risk.

BURNS: Yes, there has been a real shift there.



Dean Fletcher

HELLMUTH: Rating agencies are also pushing for corporate trust service providers to pay the cost of our own replacements in certain circumstances. We are talking about roles that are not highly remunerated, so I can see the industry consolidating around fewer, more highly rated organisations. But I agree this could also lead to increased systemic risk.

Market infrastructure

SMITH: Significant efforts to improve the market infrastructure are underway. How are developments in pre- and post-trade processing, for example, impacting corporate trust service providers?

FLETCHER: What we anticipate is a disintermediation of agents as the European markets harmonise. That means, as agents, we need to be thinking about a long-term strategy, given that margins are being squeezed and that isn't about to change.

Providing you have scalable platforms, does that mean it should be possible to benefit from increased volumes? Or does it mean that you have to expand your range of services because it's no longer sustainable to only offer the basic paying agency-type services ahead of T2S and the other industry initiatives?

HELLMUTH: Clients are placing greater emphasis on hypothetical trade turnaround times. I think it is important for us to keep pace with their demands and obviously technology is our friend in helping us to achieve that.

Technology will continue to play an important role in differentiating corporate

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Mike Hellmuth

trust providers and, again, the bigger players are able to invest more. The more flexible your technology platform is, the better your ability to help clients in a cost-effective way.

SMITH: So, which aspects of technology are being strengthened in order to achieve this?

FLETCHER: We're investing in client gateway solutions, which provide clients with a single interface that then allows – as far as is possible – direct primary issuance. Again, the challenge is that different issuers have slightly different preferences around what they want because their own systems need to join it.

HELLMUTH: Internet portals are very important: clients want 24/7 access to data; they want to play with that data and report on it. Clients want to be able to access all their data in one place and have the flexibility to manipulate it as they see fit. This is being driven by the desire for increased transparency, as a result of the financial crisis.

BURNS: Yes, clients are actually relying more on that information now to assist them to manage and understand their funding profile.

Noteholder communications

SMITH: Moving on to noteholder communications. How can they be improved in practise? Should the industry try to come up with an alternative to the clearing systems, for instance?

HELLMUTH: Some small improvements have been made; for example, negative consent. In terms of improving the probability of an investor receiving notification of an amendment, we've also started alerting via Bloomberg as many of the bigger investors use Bloomberg to get their information. But the industry still faces a significant challenge: individually, custodians are all doing the job that they are required to do, but the process as a whole still isn't as effective.

The clearing systems have recently said that they have no immediate plans – certainly not in 2012 – to come up with a solution. However, the ICMSA is looking at some alternative solutions.

SMITH: Including deadlines in bondholder notices, for example.

HELLMUTH: Yes. One of the things that we can do when we're communicating with noteholders through the clearing system is put deadlines on notices, even when there is no deadline required, because that has a greater success rate in getting the notice through to the end investor.

The ICMSA is also considering whether it is possible to build a technological solution that bypasses the clearing systems. But the challenge for trustees is to be completely comfortable that you are contacting 100% of the investors.

My own personal view is that if we don't do something now, we'll be having the same conversation in 10 years' time. I hope the corporate trust industry will sponsor finding a more effective method of communicating with its investors.

FLETCHER: I agree that the biggest challenge is getting comfortable that we are communicating with 100% of the noteholders. My preferred solution is to come up with an agreement within the industry because it will have more traction. If we can't find an agreement within the industry and we individually try to find a better solution, could that provide a competitive advantage?

BURNS: It has to be a collective industry discussion. I think the desire is there; it is just a matter of getting the traction to drive it forward, which – hopefully – we will get.

HELLMUTH: If the solution is fully publicised and disclosed in offering circulars and documentation, and we can get comfortable with it as an industry, it is reasonable to assume that everybody will be comfortable with it. But we have to be sure it captures secondary trading activity: just because you know the investors today, doesn't mean you will tomorrow.

The solution needs to be flexible enough to deal with all of the trading that takes place and it needs to be accessible to everybody. We continue to see exponential improvements in technology and we should embrace that.

Regulatory pressures

SMITH: Looking ahead, how is regulatory change likely to impact the way issuers fund and, consequently, the utilisation of corporate trust service providers?

FLETCHER: New capital rules, as well as the introduction of centralised derivatives clearing and so on are all pushing towards increased collateralisation – which, in turn, creates opportunities from an agency perspective. Where there is collateral, there is a need for monitoring and reporting. A number of collateral transformation initiatives are currently being looked at, as a result.

HELLMUTH: Certainly the regulatory environment is creating difficulties in Europe at the moment. New regulation has been introduced following the financial crisis, but it is not yet fully effective and I don't think it is achieving what it set out to do. It was inevitable that the regulatory

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environment would change significantly following the crisis and make it harder for the markets to recreate the yields of the past.

Basel 3, for example, won’t be fully implemented until 2019 and so the regulatory environment will continue to change over the next decade. Consequently, as corporate trust providers, we need to listen to our clients’ needs and requirements, and have a flexible infrastructure to deal with every new business opportunity that arises. Again, our knowledge and expertise will become ever-more important as the market moves through this period of regulatory change – albeit I’d personally like to see the changes happen quicker.

The first steps have been taken and it is now important for us as an industry to focus on what the next steps are going to be. How do we move the regulatory environment from where it is today to a position where responsible issuers can tap the structured finance markets in a responsible way?

Broadly speaking, governments view securitisation as a positive tool. It may look a little different and be called something different, but I’m fairly certain that we’ll see the securitisation market return.

BURNS: There is certainly a place for the securitisation market in the future, to sit alongside the loan and bond markets. Future deals will most probably need to go back to their more simple form; a high level of transparency will also be required, especially in regard to the receivables to be securitised.

As select securitisation transactions are brought to market, the focus on the underlying assets will be significant and will be reflected in more prescriptive documentation. This, in turn, will create opportunities in terms of gate-keeping – keeping track of which assets go in and come out for each deal. There will also need to be very clear reporting, so that investors know exactly what is in the asset pool.

FLETCHER: There is a lot of talk, particularly in the UK market, regarding the re-emergence of a number of RMBS issuers and that market should come into play in Q1 or Q2 next year. There is certainly appetite for the right deals.

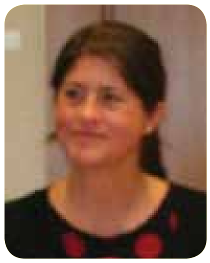
The future

SMITH: Are you seeing any other noteworthy new trends or issues within the industry?

BURNS: The project and export finance market will be a definite growth area in 2012 and beyond, from the traditional facility agent, account bank and trustee roles, to the expected growth in project-related bonds. The UK Chancellor has just recently lent his support to public infrastructure projects via the capital markets and there is also the EIB’s European 2020 Project Bond Initiative. In addition, there are a number of high-profile and valued projects expected to come out of the Middle East in the near term, which should result in both conventional and Islamic-related business opportunities.

FLETCHER: The other major trend that we are seeing is liability management, where we act as the exchange and tender agent. I expect that source of income to continue for a while.

HELLMUTH: We are entering survival-of-the-fittest mode and the definition of the fittest will be those highly rated corporate trust service providers with a global reach and cutting-edge technology that can turn their hands to a wider variety of opportunities in the future. The traditional corporate trust new business opportunities will remain, but we won’t see 2006/2007 issuance levels any time soon – in my opinion, not in this decade – so we’ll have to explore new areas of opportunities too.



Corinne Smith

Looking outside of the traditional client base, at hedge funds for example, a number of new agency and administrative roles may be created. Requirements for carrying out independent checks and validations on data will also increase, and corporate trust providers are well placed to perform them.

Corporate trust service providers will always be required, no matter what the market looks like – the skill-sets that we have will continue to be sought after.

FLETCHER: Put simply, we will not accept trustee and agency roles unless we can understand the whole deal, for reputational reasons. Therefore, over the years you do build the intellectual capital where there are real experts on the deals themselves. I think that often surprises the market

HELLMUTH: Yes, we’re asking an ever-increasing slew of questions in relation to financial crime, source of funds and so on. And, of course, that increases our costs in terms of having more administration and research to do. There is no commercial upside for us in doing that; it is all about mitigating operational and reputational risk.

BURNS: We each have to undertake a significant amount of product and market research/development, to ensure that we are correctly positioned and understand where the market is headed and where the next business opportunities are to come from. SCI