Best practices

Participants in **SCI**'s latest corporate trust roundtable met in December to discuss post-closing best practices and noteholder communications. Technology and documentation challenges, as well as improvements to the clearing systems were among the topics covered.

Attendee biographies

Wendy Hewer is the managing director of transaction management group EMEA at BNY Mellon Corporate Trust. She joined the bank seven years ago, after working in legal private practice in London and Jersey. She is an English solicitor and Jersey Advocate.

Mark Jones is EMEA head of product management at Citi, a role that he has held for the past six years. He has worked for over 20 years in the issuer services industry, including time spent managing transaction management teams at Bankers Trust, Deutsche Bank and JPMorgan. He is a member of the board of the International Capital Markets Securities Association and a member of the International Securities Markets Association Group.

Helena Nathanson is a partner in structured finance at Reed Smith, with over ten years of experience. Recently, her main areas of work have included representation of a number of corporate trust service providers in transactions involving restructurings or repackagings of note issuances in connection with any bankrupt Lehman entity, addressing various liquidity problems and the exiting of other participants from the market.

Janet Oram is a director in the securitised assets investment team within BlackRock's fixed income portfolio management group. Her service with the firm dates back to 2006, including her time with Barclays Global Investors, which merged with BlackRock in 2009. Prior to joining BGI, she worked at Fitch Ratings and the Paragon Group of Companies.

Helen Tricard is head of transaction management and restructuring, corporate trust services at BNP Paribas Securities Services and a director of BNP Paribas Trust Corporation UK Limited. She works as a corporate trustee, running the transaction management and restructuring teams. She joined Securities Services in 2009 from a magic circle law firm, where she had worked as a lawyer in the capital markets departments in London and Paris for ten years.

Corinne Smith is editor of SCI.

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CORINNE SMITH, SCI: Investor concern over securitisation noteholder communications is increasing. I would like to begin by discussing post-closing best practices from a corporate trust perspective. Ideally, how should document changes, such as amendments and downgrades, be dealt with?

JANET ORAM, BLACKROCK: There is a split between pre-crisis securitisations – where amendments weren't considered in the documentation – and post-crisis deals, where mechanisms have been included in the documents for dealing with these issues. Generally, any transaction that doesn't have a mechanism for dealing with amendments can be problematic from a noteholder voting perspective. Investors still aren't receiving all the relevant notices – whether that be an issue with the clearing systems or our custodians or quite frankly our back offices.

But some of the language we've seen in documents recently gives carte-blanche for any changes to be made and we can't sign up to that. In some cases we've had such language taken out of the document and in other cases

Wendy Hewer

we've seen negative consent clauses being put in.

I don't generally like negative consent clauses, but they appear to be the most pragmatic way of dealing with amendments at present. AFME is putting together some standard language around provisions for post-close rating agency criteria changes and so on that hopefully everyone can get comfortable with. But I'm not sure if the industry will manage to get there unless someone can come up with an idea that is not based on negative consent or an unlimited and very tightly defined form of negative consent is adopted.

Negative consent

WENDY HEWER, BNY MELLON: There is a significant difference between deals that don't have negative consent built into them and those that imply negative consent. Negative consent is a pragmatic solution and gets around some of the problems we have with the delivery of notices.

> "There is a significant difference between deals that don't have negative consent built into them and those that imply negative consent"

But the chain – especially through the sub-custodian structure – can be quite complex and sometimes investors need the process to happen more quickly. We would love the ICSDs to build better technology to deal with our actions.

An ICSMA group is also trying to standardise noteholder meeting provisions, including the quorums. Once that's completed, I'd also like to see a set of standard documents for law firms which, ideally, would reduce the expense of running noteholder meetings. Law firms appear to be making a lot of money out of what should be a standard process.

HELEN TRICARD, BNP PARIBAS: There are two issues: one is trying to standardise noteholder meetings and create a more efficient process, based on electronic means. The second issue is how to make documentation more efficient in the context of amendments. We would not imply negative consent into documents that have already been signed without the inclusion of the concept.

ORAM: And if negative consent was in the documentation originally?

TRICARD: If it was included originally, is well-drafted and specific about what it covers, then that's fine. The intention of trustees is not to avoid negative consent; at BNP Paribas, we are very supportive of its inclusion, as it is an efficient way for the trustee to gauge investor feeling and frees the trustee up to deal with issues where we can really add value.

ORAM: What can investors do to help the process?

TRICARD: I think you've got the clout to influence the clearing systems. While trustees will do anything we can to keep pushing the issue of investor communication, not much will change until investors demand that the clearing systems improve their systems.

HEWER: From my perspective, clearing systems need to invest in technology to enable messages to be made available quickly and easily. This would help reduce the time it takes for everyone in the transaction to make a decision.

HELENA NATHANSON, REED SMITH: Of course, depending on the transaction, you are contractually bound to maintain a 20-day notice period if there are any dissenting noteholders in the deal.

HEWER: This is especially problematic where documents are poorly drafted. We've seen deals, particularly older ones, in both DTC and in Euroclear where the meeting provisions don't work for both.

That's why bondholder meeting documents should be standardised. Why should issuers pay law firms each time to produce what should be an industry-standard document for a set of meetings in DTC and Euroclear? Electronically-written resolutions would be more efficient for everyone, but the technology used has to catch up with how we operate across the rest of our businesses.

ORAM: Is there any reason why the quorum and the voting requirements for a written resolution are different to an extraordinary resolution done via a meeting? I've seen documents recently where a 100% consent is required for a written resolution, as opposed to an extraordinary resolution through a meeting.

HEWER: As I understand it, there were concerns on the legal side about whether noteholders would actually receive the notice through a written resolution, whereas at a meeting everyone can turn up and have their say. But I agree with you: there should be consistency between the two.

ORAM: There's no difference from my perspective. But the requirement for a 100% resolution means that it is unlikely to pass because a block of noteholders is necessary.

HEWER: It's got to be consistent, at a reasonable level and reflect the input of both arrangers and investors.

Dissenting noteholders

NATHANSON: Going back to dissenting noteholders, what can be done when they are having to be dragged along? How can a trustee protect itself in those circumstances?

We've seen situations where we've had to create a reserve fund. We've had to assess the likely amount of the liability and then compare that to a reserve fund, which is where the trustee indemnifies itself from, because the noteholders are often funds that can't actually provide an indemnity at all. This leaves us in an invidious position somewhat.

ORAM: So, do you need something in the transaction that actually allows you to create a reserve?

MARK JONES, CITI: It's becoming increasingly more difficult to get that feature built in.

Mark Jones

Helena Nathanson

NATHANSON: We're having to be increasingly creative about how trustees can be indemnified, so that the transaction can progress when you can't get all of the noteholders onboard.

HEWER: It's important to look at the circumstances at the time. What is a trustee being asked to do?

One of the key things for us as a trustee is to know exactly what the amendment is about. Then you know which way it is likely to go. Getting all the information upfront reduces the legal costs.

JONES: I think many law firms share that frustration as well: they don't deliberately set out to keep the language as it is.

NATHANSON: Definitely not. And I can't tell you how frustrating it is to be running noteholder meeting after noteholder meeting.

Investor notices

ORAM: Issuer services companies insisting that notices have to be distributed via the clearing system and not on Bloomberg, for example, is another frustration.

NATHANSON: That's not helpful.

> "Some custodian agreements state that they will only process corporate actions that require action and so they aren't actually getting to investors at all"

ORAM: No. For at least two different deals, we found out that there's a notice but couldn't access it because they could only be distributed through clearing systems. It would be much more straightforward if documents stipulated that notices had to be posted on Bloomberg, as well as put through the clearing system.

No-one does that, but it should be a standard procedure. Even if a notice progresses through the clearing systems and the custodians, it then gets to the back office.

The back office has an awful lot to process and ABS is an odd little sector. As such, the back office doesn't understand the nuances of the notices all the time and so they don't always get to me. But if a notice is on Bloomberg, I will see it.

HEWER: The other problem is if it doesn't require an answer or is a request for disclosure of holdings. When it is a 'you don't need to reply' notice, some sub-custodians or back offices will bin it, when actually it could be the most important notice for the transaction. Often notices don't get to the right decision-makers in the investor base.

TRICARD: Generally, trustees now put out 'pointer' notices on Bloomberg to indicate that a notice has been published via the clearing systems. Investors can then request the notice directly or ask the trustee for a notice and, providing they can prove their holding, the trustee will email a copy of the notice.

Also, we've had to play with the system a bit in terms of when asked whether a notice is 'action' or 'no action'. Even if it is 'no action', we tend to flick the switch to 'action' to ensure that there's more of a chance of it getting through to the end investor. Because otherwise notices can get blocked by a blanket instruction to custodians to only send notices requiring action to the beneficial owner.

HEWER: Yes, some custodian agreements state that they will only process corporate actions that require action and so they aren't actually getting to investors at all.

Voting

SMITH: Without you having to breach any kind of confidentiality, what have been the practical implications to your institution when this doesn't work?

ORAM: We've missed out on votes and we've seen amendments go through that we would have objected to.

HEWER: From the trustee side, we're faced with late votes and dealing with that only adds to the legal costs.

ORAM: If it's a notice requiring investors to disclose their holdings so a restructuring can be discussed, we want to be involved. It really irritates me when I hear issuers complaining that noteholders don't care and never vote.

HEWER: Statistically, it's not true: in the last two years, it is very rare for an adjourned meeting to fail for want of a quorum. This perception that noteholders won't vote is totally wrong.

JONES: Certainly it is post-crisis.

Notice periods

SMITH: Are you finding that notice periods are coming under pressure?

NATHANSON: Over the last year we've been asked on many occasions to reduce the notice period in order to speed up the process and allow decisions to be made, not only on old deals but also on new ones. In restructurings it always seems to be noteholders pushing for it, which is odd in some cases because it's also the noteholders that then resist the process.

It comes back to the contractual point that in some consent solicitations there must be a required period for noteholders to review the documents. But it has been suggested that this should be reduced to seven days, although I haven't actually seen this in practice.

ORAM: I can understand that there's no reason to wait for 21 days in a restructuring where all the noteholders are identified and there is a quorum. In certain circumstances, reducing the notice period would work because it's imperative to get things done and it can be frustrating otherwise. But if there is no direct contact with the person that's going to make the decision, I don't see how the period can be shortened.

NATHANSON: The difficulty is that the majority of documents allow trustees the discretion to make amendments like this. But, on balance, we've come to the conclusion that it probably isn't worth taking the risk.

HEWER: If shorter notice periods become standard, the technology will have to catch up.

TRICARD: And the communication will have to be better.

ORAM: Or perhaps it's the other way around.

Clearing systems

JONES: It seems to me that there's a consensus here: everybody wants change. What are the barriers we need to overcome?

TRICARD: For me, it has to be the clearing systems working in a different way; for example, if the clearing systems sent notices directly to the beneficial owner.

ORAM: The problem is not to do with any one point in the process; the problem is that there are too many different links in the chain. Another problem is being able to prove we're a noteholder if we want to talk to a trustee. I'm not always able to send a SWIFT message, for example.

JONES: The clearing systems need to work with trustees to help identify the actual beneficial holder, as opposed to simply disseminating information to the custodians.

ORAM: Yes, beneficial owners should be able to get the information and vote directly.

HEWER: Maybe we need to completely change the voting process and take the clearing systems out of it.

JONES: Disintermediating the clearing systems is hugely political. I don't think it would help nor work.

HEWER: As long as trustee houses can be sure it's a valid resolution, anything should be possible in theory. But it has to be a market-wide initiative.

Rating agency confirmations

SMITH: Away from noteholder communication, rating agency confirmations were a concern last year. Has that situation improved?

TRICARD: I'm not sure that it has improved. Interestingly, documentation is increasingly being drafted to deal with the rating agencies not giving RACs and effectively stating upfront that if a rating agency declines to comment, then it will be interpreted as a confirmation rather than everything grinding to a halt. It's more of a shift towards recognising that rating agencies aren't necessarily going to play ball, rather than the situation improving.

HEWER: But it's also only one of the factors that have to be taken into account when exercising discretion. RACs are useful, but they've never been the deciding factor.

The rating agencies have an inconsistent approach to RACs. Realistically, they are simply an indication of their views.

JONES: We maintain an ongoing dialogue with the rating agencies, not just when an issue arises with a deal. We find it really helps to know their views – and they're quite happy to talk.

TRICARD: Rating agencies are regularly represented at the ICMSA Trustee Subcommittee meetings. They have been remarkably open and willing to discuss issues, such as the differences in approach between various analysts and so on.

HEWER: Analysts in Europe tend to take very different approaches in different countries and that has caused us issues. A more consistent approach would be helpful to the market.

Janet Oram

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Helen Tricard

TRICARD: There's also inconsistency in terms of what the issuer can pass on from the rating agencies to the trustee, which isn't acceptable or helpful.

HEWER: Better disclosure of the information would be helpful to everybody.

JONES: It remains a work in progress, but the barriers are being broken down. We all speak to each other – trustees and rating agencies – a lot more than we did a few years ago.

Rating agencies are increasingly receptive to understanding our concerns and issues, so we're moving in the right direction. But there's still a way to go.

FATCA

SMITH: In terms of documentation, is FATCA proving to be a challenge for corporate trust service providers?

NATHANSON: FATCA is kind of invasive. One area we've been struggling with is including FATCA language in trust deeds. I'm not convinced about the need for this at all.

HEWER: Obviously we want to see FATCA mentioned in the agency agreement because it impacts the ability to withhold. In situations when a trustee has to step in and make payments, it needs to know it can withhold. But it's probably sufficient to include FATCA language in the paying agency agreement.

NATHANSON: I think it's yet another knee-jerk reaction: people just panic and want to put it in, when it isn't necessarily applicable. Then, before we know it, it will become the norm.

JONES: It's certainly costing banks a lot of time and resources to stay on top of this.

HEWER: It's also problematic getting law firms to agree whether a transaction is compliant in the first place. There doesn't appear to be a consistent approach yet, which isn't helping and is also driving up legal costs.

NATHANSON: Well, it also needs to include an element of accountant involvement because it's one thing understanding what FATCA does, but another to be compliant with it. So it is not solely in the hands of lawyers or banks; it is an industry-wide issue.

JONES: We have similar concerns about the European financial transaction tax as well. It captures virtually every type of security and the touch points seem to be broker-dealers and custodians, but the impact generally to the market and its participants would be huge.

HEWER: There is FATCA, Dodd-Frank and potentially the FTT: it is increasingly a much more regulated environment. But, as a result, documentation may end up being inconsistent at the beginning while law firms and different trustee houses arrive at a more standardised approach. And when you're trying to do an amendment in a hurry, you can see how this is a barrier to efficiency.

SMITH: Is that also a function of the regulations not being particularly clear themselves?

JONES: Yes, they can be somewhat opaque at times.

NATHANSON: Well, it's been discussed in the ICMSA until the cows come home. It would be great if at least that body agreed a consistent approach that could be reflected everywhere else.

HEWER: When we do DTC deals under New York law, we have a consistent set of documentation. But the Eurobond market does not have a consistent set of documentation, to the investor's detriment.

Coupon smoothing

SMITH: Another challenge is the emerging requirement for trustees to provide coupon smoothing to mitigate defaults.

JONES: Coupon smoothing is linked to the wider challenges we're facing with CLO 2.0 deals generally. CLO managers are asking us to make whole any shortfalls on funds that come in to support the interest on a given interest payment date.

The request is coming through the trustee channel rather than to the treasury groups of banks, which means they're asking the trustee to build the role into its own pricing. They're leveraging on the relationship: to access the right people within our bank to put a liquidity facility in place.

Obviously it's important to remain competitive from a pricing perspective, so we anticipate that there will be some pricing compression appearing down the road. If it does, we will have to take a view on whether we want to support that and whether our liquidity teams at Citi actually have the appetite for providing what are fairly small amounts.

ORAM: It might not be economically worth it.

JONES: Another challenge in the CLO space is the re-emergence of pre-enforcement caps, which expose trustees to some risk, especially as the cap can be used up fairly quickly. For instance, in the case of a restructuring, it's not inconceivable to see it vanish within a six-month period and then you're left with half of the cap for the remainder of the year. As a house, we've taken the view that we'll work on a set number of deals during the course of a year and then assess whether we want to continue working on CLOs, given the risks associated with caps.

> "CLO managers are asking us to make whole any shortfalls on funds that come in"

Indemnities

A further challenge involves CLO managers' increasing reluctance to provide indemnities to trustees. We've found that the trade-off is that, if you do want to push the point of getting an indemnity from them, CLO managers will often insist on assuming the right to defend any litigation in your name.

SMITH: Why is that?

JONES: So that they can exercise control. They've got skin in the game and therefore a vested interest in the outcome of any dispute. Although it's yet to be tested, the idea of forgoing that right has caused us some difficulties.

TRICARD: It's very difficult because the likelihood of an institution agreeing to a third party litigating in their name is virtually zero. It's not only a matter of how the

litigation is run and the fact that it's in your name, but there's also a regulatory angle. In other jurisdictions we have seen this cause issues in terms of the treatment of the proceeds of the litigation.

SMITH: Do you feel that CLO managers are forcing you into this situation?

JONES: No. Their starting point is that they don't want to indemnify us as trustees. We're pushing back on this issue, but CLO managers appear to be adopting a more forensic approach.

HEWER: CLOs are a partnership between the portfolio administrator and the collateral manager, which depends on the information flows between the two. It has to be a collaboration that works effectively and that's why historically the indemnities have been available.

SMITH: Moving on, let's discuss some of the lessons learnt from 2013. The Debussy DTC CMBS, for example, was interesting because the role of the issuer was minimised.

NATHANSON: Yes, there was a limitation to the trustee's powers, with most of the post-closing monitoring of the transaction handed to the servicer. I would have thought that this would be resisted by the trustee. But, given that the trustee and servicer typically represent different interests, there's only so far you can go with such an approach.

HEWER: Also, that particular transaction was not a classic structure and was very much investor-led. I don't think we'll necessarily see many more deals adopting a similar approach.

Green shoots

JONES: My message for lessons learnt in 2013 is that the concept of indemnities doesn't fly under Kazakhstan law, so tread carefully if you're looking at that jurisdiction.

In terms of green shoots, the Russian regulators are amending the civil code for securities financing and from 2015 there will be a mandatory requirement for all domestic and international debt issued out of the country to have a bondholder representative akin to the role of a trustee on the deals. It's necessary to have a licence and be registered and operating in Russia to provide that role. Given the size of that market and the volume of deals placed domestically, we see Russia as a real opportunity.

Elsewhere, Africa remains a puzzle: you have to be selective about the markets and the deals you go after there. It's such a huge continent; you can't afford to simply spread your net wide and hope to be successful. Research the markets you want to go after and then drill down.

When entering an emerging market, one concern for us is the finite resources in terms of legal representation on the ground. If you're working on a multi-party deal that gets into difficulties, you can find yourself without representation because all of the other parties have nabbed the top-tier law firms.

So we look to forge good working relationships with the local law firms in any given jurisdiction. We have business development managers that are operating in strategically identified places across the EMEA region and, as well as driving business opportunities, their role is to extend our network of contacts and relationships.

> "When entering an emerging market, one concern for us is the finite resources in terms of legal representation on the ground"

TRICARD: Looking ahead, I expect the trend for trustees limiting their discretion on certain matters to continue to grow. The typical indenture trustee in the US exercises no discretion. I don't believe we'll go that far, but in some respects the industry seems to be moving in that direction.

In terms of green shoots, we're seeing a lot more business from Turkey. I expect high yield bonds to carry on rolling in and infrastructure/project bonds should tick up. Also, it will be interesting to see the impact of the UK government's national infrastructure plan, which is targeting £375bn of public and private sector investment over 15 years.

Another interesting area is Islamic finance. Shariah-compliant issuance increased in 2013 and the UK government's plans for a domestic market could provide some opportunities.

JONES: Non-bank lending is another theme, with private equity firms and hedge funds increasingly moving into this space. Some of the lending will be bilateral and some of it will be syndicated. Trustees might be needed to support the syndicated lending, in terms of taking security and so on.

Wild cards

SMITH: Are there any potential wild cards that the market should be aware of going into 2014?

HEWER: I would say regulation. We know what's coming down the pipe, but the issue is getting enough notice to ensure that it doesn't affect the markets.

SMITH: New items keep getting added to the agenda as well.

NATHANSON: From our perspective, of course, that results in an awful lot of fees.

JONES: That's an interesting point: you must be coming up against having to put a cap on your fees all the time.

NATHANSON: Absolutely, and we're happy to do that, depending on the transaction. But there needs to be a high degree of honesty in terms of what the transaction could evolve into.

JONES: Are you managing your clients' expectations in that regard? I've had some bitter experiences with other law firms in the past, where one week our cap was set at a certain level and then two weeks later the law firm has breached it but failed to inform us. We also discover that multiple lawyers are assigned to deals, which seems to me to be an inefficient use of time and resources.

NATHANSON: Yes, we try to be transparent about it and keep the client informed. But if a deal comes in at 5pm on a Friday and something needs to be in an agreed form by 9am on the Monday, it's going to cost more because either a senior person will have to do it or I'll have to allocate more staff to get it done. Being innovative about pricing in general is key and, of course, it's easier to be innovative with clients that give you repeat business. SCI