

Law Debenture

Trustee or Fiscal Agent

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Bond issuers and their advisers are often faced with the choice between appointing a trustee or a fiscal agent. A fiscal agent has the superficial attraction that the role is carried out by the principal paying agent for little or no extra cost, whereas a trustee charges a fee. However, an experienced trustee offers substantial advantages.

In particular, the trustee:

- has none of the conflicts of interest that a fiscal agent, as agent of the borrower, may have;
- can be vested with extensive discretionary powers which may avoid the need to call a bondholders' meeting; and
- can restrict individual bondholders from taking disruptive individual action. These advantages can make the cost of the trustee – small in relation to the overall cost of the issue – money well spent.

Situations in which a trustee can prove invaluable

Inflexible terms

Restrictive covenants, negative pledges, events of default, provisions to protect conversion and exchange rights, and the imposition of withholding tax – all of these can be inflexible and may restrict a borrower's business development without

the exercise of discretion on the bondholders' behalf by a trustee. Comparable powers, if vested in a fiscal agent, can only give rise to conflicts of interest.

The holding of security

Negative pledges often contain a provision that if security is given for other issues it must also be extended to the bondholders. A trustee can hold security on the bondholders' behalf – whereas providing each one with an individual security interest would be impractical. It would be difficult to achieve the same result with a fiscal agent.

Covenants

Certain restrictive covenants – for instance, compliance with negative pledges and the provisions restricting the disposal of the borrower's assets – can only operate effectively with an independent trustee.

Waivers and modifications

It is impossible to legislate in the bond documentation for every possible eventuality. A more practical solution is to vest power in the trustee to agree to changes or to waive or authorise proposed breaches provided these are not materially prejudicial to the interests of the bondholders. The trustee can even consent to the substitution of a different borrowing entity. Any such modification, waiver, authorisation or substitution is, where a trustee is used, binding on all bondholders.

Role/Position	Fiscal Agent	Trustee
Legal position – agent of borrower?	Yes	No
Overriding duty	to the borrower	to the bondholders
Discretionary powers	Not significant	Yes – can be significant
Monitoring duties	No	Yes
Position of bondholders	Can take action individually	Trustee takes action on their behalf and trustee's action binds all bondholders

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Events of default

A trustee may be able to prevent an event of default from triggering repayment of the bonds if the effect is not materially prejudicial to bondholders. With a fiscal agent it is possible for bonds to become repayable if a single opportunistic bondholder detects a minor event of default that cannot be cured quickly, even if the damage caused to the borrower and the remaining bondholders is potentially enormous (e.g. through triggering cross-default provisions in other financing agreements).

Enforcement

Bondholders can be better off under a trust arrangement if the borrower does default. First, the trustee can require payments to be made directly to it for the bondholders' benefit; by contrast, funds held by the fiscal agent may be at risk of attack from a liquidator. Second, a trustee can ensure that all bondholders are treated equally, so avoiding a scramble by bondholders to start individual proceedings in different jurisdictions to establish preferential claims to the borrower's assets.

Crisis management

Perhaps the single most important role that an experienced trustee can play is in crisis management. Credit standing is a matter of market confidence. A trustee can act behind the scenes in helping a borrower to overcome potential events of default. A trustee can provide an accurate gauge of bondholders' likely reaction to a proposed course of action.

Avoiding the need to call bondholders' meetings

In the absence of a trustee, a borrower may have to convene a bondholders' meeting to agree even minor changes in the issue terms or to waive insignificant breaches of covenant. Such a meeting can be difficult to arrange, expensive to hold, and the outcome may be uncertain if the borrower has been unable to communicate with bondholders in advance. The convening of a meeting

can also have an adverse impact on the borrower's market standing and leaves the borrower vulnerable to the short term whims of aggressive bondholders. Use of a trustee can avoid this expense and uncertainty.