

Spot the difference

A trust is not a legal body such as an individual or company but a set of rights and obligations that attaches to property in its widest sense. Property can either be physical (such as a house) or intangible, such as in the bond markets, a promise to pay.

The simplest way to envisage a trust is to think of a house. Party A may own the house but party B may have the right to live there. The two aspects of enjoyment of the property – ownership (A) and use of the property (B) – have been separated but they exist simultaneously. Party A can be said to hold the property on trust for party B and, as such, is 'trustee' for party B.

Translated into the capital markets, this means that an obligation, such as the repayment of borrowed money, created by an issuer in favour of a trustee – the property, if you like – can be for the benefit of other parties, such as the bondholders of a particular issue.

Bonds are issued to raise finance for the issuer. In return for receiving the issue price, the issuer issues the bonds, which contain a promise to pay the bondholders the money borrowed on a specified maturity date, and to pay interest on specified dates. The bonds may be listed on a stock exchange, are usually held in an international clearing system (typically Euroclear or Clearstream) and are freely transferable through those clearing systems. Issuers include sovereign and supranational bodies, banks and corporate entities.

BONDHOLDER REPRESENTATION In many bond issues, the issuer appoints a trustee to represent the bondholders. The trustee is the representative of the bondholders, and owes duties to them rather than to the issuer – although the trustee's fees and expenses are paid by the issuer. The bondholders who subscribe for the issue at the outset (or by subsequently purchasing the bonds in the secondary market) will have accepted that the trustee will act on their behalf.

The job of the trustee is to monitor compliance by the issuer with its obligations, as set out in a trust deed, and to take enforcement action on behalf of the holders where necessary. It also has discretionary powers which enable it to agree modifications to the terms of the debt with the issuer, and to waive defaults. (You can find out more about the role of the trustee in the event of a default in the Trusting In Your Trustee feature in the March 2004 issue of *The Treasurer*.)

In the capital markets, those countries with common law systems, such as the UK and the US, have come to dominate the law used for the documentation for the bond issues, partly as a result of the flexibility of the trust concept. The civil law systems, such as those which prevail on

STEPHEN NORTON EXAMINES THE
ROLE OF THE TRUSTEE VERSUS THE
FISCAL AGENT IN A BOND ISSUE.

the continent, have always been suspicious of trust arrangements, primarily for tax reasons – the separation between the ownership of an asset and the enjoyment of that asset has always been regarded as a method of tax evasion in much of Europe. Of course, there is nothing to preclude an issuer in a civil law jurisdiction from appointing a trustee to its bonds – the bonds will simply be governed by English law – and a great many such issuers do this.

DIFFERENT ROLES Trustees should not be confused with fiscal agents, which are usually appointed in relation to capital markets issues where there is no trustee. However, the two are very different: the trustee is appointed by the issuer of the debt, and owes their principal duty to the holders of the bonds, whereas a fiscal agent is the issuer's agent and has no contractual duty to the bondholders. There are advantages for both the bondholders and the issuer, but cost is not normally a significant issue, as the fees charged by a trustee are usually minimal within the overall context of a bond issue. That said, it is the benefits of having a trustee which may be of most interest to treasurers, and the roles can be simply differentiated as in *Table 1*.

Perhaps the most important concept to grasp is that the fiscal agent is an agent of the issuer and therefore has a principal/agent relationship with the issuer and no relationship with the bondholders. By contrast, the trustee is appointed by the issuer to represent the interests of the bondholders. The trustee has a contractual relationship through the

Executive summary

- When contemplating a bond issue, a treasurer may appoint a trustee or a fiscal agent. In many bond issues, the issuer appoints a trustee to represent the bondholders, so the trustee is the representative of the bondholders, and owes their duties to them. A fiscal agent, on the other hand, is the issuer's agent and has no contractual duty to the bondholders.

WHY CHOOSE A PARTICULAR ROUTE? It is not, in fact, obligatory to have a trustee, and many bond issuers elect to have a trustee even though they do not need to have one. There can be several reasons why they appoint one all the same:

- In some cases companies are used to having a trustee for their debt securities. The London Stock Exchange, for example, has long had a rule that domestic listed debt must have a trustee.
- In the case of a new issuer, the issuer and its advisers may consider that the market is more comfortable with a trustee, at least until the market has fully assessed the credit.
- The issuer will wish to appoint a trustee if it intends to be an actively managed company and may wish to make structural changes to its business which may require the exercise of discretion by the trustee or approval by a bondholders' meeting, and trustee guidance as to how to obtain that approval may be of great assistance. This may be particularly the case with a long-dated issue or for issuers who intend to be regular users of the capital markets and who want one focal point to deal with rather than having to deal with all bondholders individually.

However, in most cases for most types of unsecured issues there is no obligation to have a trustee. Specialist instruments, such as asset-backed securities, often have a specific provision for issues listed on selected stock exchanges. So the issuer is free to choose whether to use a fiscal agent or trustee. But the presence of trustees is increasing, for the following reasons:

- Certain types of issue, such as listed asset-backed debt, nearly always require the use of a trustee, and this market has grown exponentially over the past decade;
- There is a growing trend towards the use of trustees in sovereign issues; and
- As access to the capital markets widens, new issuers are coming forth.

trust deed to the issuer, but also a relationship with the bondholders, the beneficiaries. It does not matter that these holders may be a fluctuating group of persons, because the trustee's duty is to represent their interests – whoever they are – at all times. If a bond is bought which has a trustee for the issue, then the holder of that bond is bound by the terms of the bond and the relevant trust deed, including the fact that legal action can only be taken by the trustee.

The primary trust property is the obligation to repay principal and pay interest which the trustee holds on behalf of itself and the bondholders. To the extent that the issuer pays the holders under the terms of the bonds then the obligation under the trust deed does not require enforcement. However, if payment is not made, then the obligation under the trust deed will remain in force – and can be acted on.

Having decided to appoint a trustee or a fiscal agent, who do you choose, and how do you go about doing it? In terms of who can be a trustee there are a large number of corporate trust organisations, most of which are part of larger financial institutions that also offer the fiscal agent alternative. Most trustees are members of The Association of Corporate Trustees, and further information can be found on its website at www.trustees.org.uk/.

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Table 1. Fiscal agents versus trustees

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