Who's looking after your firm's best interests?

New to securitisation? Then sourcing the right bankers, lawyers and accountants to meet your firm's needs is vital, says Mark Daley of Berwin Leighton Paisner.

Securitisation is a lucrative and high-profile business for investment bankers, lawyers and accountants, and can help you lower your company's cost of funds and provide accounting benefits. But this comes at a price that can be underestimated by a first-time originator at the outset of a transaction. Most first-time originators would accept that if they had realised at the beginning of a deal what they had learnt by the end, they would probably have done some things differently.

Securitisations are not – yet – familiar transactions like bank loans and eurobond issues. This partly explains why they are attractive price-wise – they exploit an arbitrage. The downside is that if you have not done one before, you will be at a disadvantage in terms of handling the transaction, negotiating the terms, anticipating developments, dealing with effective and logical sequential planning, and in judging whether it makes sense to do it in the first place.

The role of the lead manager

You can begin the process of securitisation in one of two ways. Either you will appoint your own financial adviser, who will help you conduct a beauty parade to find a lead manager for the issue. Or you will just appoint the lead manager. Let us assume you do the latter. The mandate you award (quite possibly with a success fee) to the successful lead manager requires them to try to bring about a closing in accordance with whatever heads of terms have been agreed. They are obliged to use reasonable endeavours to do this, and in practice will often usually do much more. Remember, however, that in this scenario, you are effectively appointing them to broker a deal, intermediating between you and the rating agencies, trustees and others, and probably looking for a compromise. You cannot expect them, if mandated this way, to behave differently.

Should I appoint my own advisers?

You might therefore consider appointing separate financial advisers who can provide incentive-free advice on what the lead managers are proposing, and can negotiate on your behalf. This might seem doubly attractive if your human resources are tight but your financial resources are not: you hire expert advice for the duration of the deal, rather than deploying yourself or other permanent staff on a steep learning curve.

Experience shows that this can work, but that for all its logic, it does not always do so, and can leave originators wondering whether the value added was worth the cost. The reasons for this are not necessarily the same every time. It is important to ensure that your advisers not only understand securitisation but also understand, or are willing to do so, your business the way you do – the way they need to if they are really going to make a difference. 'Cultural' issues may come into play. Experts on securitisation may not have the same degree of expertise when it comes to understanding what is involved in running your type of business. This point applies to all your advisers – take the time, and allow for it in the budget, to take them through your business slowly and carefully, so they can apply their expertise to the particular facts of your situation.

Mark Daley

Mandates: are they 'standard'?

Lead managers require mandates, and those are often very long and wordy, often containing some fairly sweeping clauses. You may be told that they are standard and cannot be negotiated. The person you are dealing with may have been told likewise that the standard form must be used and should not be amended without approval at a very high level, so that, although they may personally be very sympathetic to your requests for changes, it is not something they have the authority to approve.

At this stage, you may not have appointed lawyers and may be tempted to sign the letter as drafted. If you do, then at least consider carefully issues such as exculpation clauses, indemnities, payment of fees, exclusivity clauses and confidentiality. Also think about what your ability is to terminate the mandate (whether because you have become dissatisfied or because of changing market conditions, business or internal reasons, you decide you do not wish to proceed). If you were to terminate the mandate, what would your liabilities and other consequences be? Can you simply walk away? Can you appoint anyone else in their place? Are you liable for fees? And so on. Mandate letters can be successfully amended and the first draft is often quite heavily slanted.

Operational and IT issues

The typical eurobond covenant package does not usually impose constraints on the borrower that need to be communicated to a wide group of people on the operational side of the business. Loan covenants tend to be more restrictive than bonds and one cannot generalise so easily. However, it is probably fair to

say that they are unlikely to require the borrower to make any radical changes to the way it runs the operational side of its business.

Asset securitisation is another matter. Initially, you will probably have to supply a host of detailed internal information that your bankers and bond trustees require. How easily can you get it? Will operational colleagues (sales, relationship managers, internal accounting and so on) have to change the way they work to do this? If you have local subsidiaries with a reasonable degree of autonomy, how will they react? Banking and bond covenants rarely require you to consider these issues.

Can your IT systems cope with it? Is an IT refit or reconfiguration budgeted for, and are there any internal or external obstacles to it? Can it be done in the required timescale?

Of course, an IT upgrade could be very beneficial. One treasurer put it very simply: "The choice is, do I want to know what's happening in my business or not?" However, the ramifications should be considered in advance. If not, they can only be considered as they arise, during the deal itself.

Securitisation will probably change the way in which you can manage your own cash. Indeed, often it will no longer be your cash. If you have sold the receivables the cash collected, it will belong to the special purpose vehicle (SPV) which has been set up to issue securities and use the proceeds to buy them. It can change the relationship between you and your bankers, particularly those overseas. For example, a daily cash sweep will mean that they can no longer play with value dates.

Check whether you will have to notify your customers of the securitisation and also consider what their reaction would be if they hear from third-party sources (or from reading your accounts, once the securitisation is reflected in them) that you have securitised. Debt factoring does not have a good reputation in some circles. Will your securitisation be viewed any differently?

There are many other issues that can also interfere materially with operational issues and create internal stresses as a result. Take time to identify what they might be in your case.

Dealing with your accountants

Your accountants could be relevant in up to three areas: in advising what is necessary to achieve the right accounting treatment; in providing opinions or information to all parties on your business, and perhaps in advising on tax. If they are being asked to provide any opinions or certificates, check whether they are willing to do so. If they might be, under what terms? Remember, they are likely to want to limit their liability, so check whether this might be an issue for the lead manager, a rating agency or the bond trustee.

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Sticking to timetables

Typically, the company will want to have the securitisation done quickly, and may well then compound this by announcing to the lead manager and lawyers an even more aggressive timetable (to allow for some 'slack'). A typical response is "it's tight but achievable so long as …", here citing a number of things that are most unlikely to occur in the envisaged timescale. This response should be not be surprising since no one in a service-oriented business wants to let it be thought that they lack either the resources or the commitment to meet tight deadlines.

In due course, it becomes apparent that the timetable is too tight and a more realistic one is produced. But it may take another one or two goes to get it right, and towards the end it may be abandoned in favour of ad hoc arrangements, often because everyone concerned is working flat out anyway. For example, because a real deadline such as a balance sheet date (the originator's or the lead manager's) is approaching. It is unusual (to say the least) for a first-time securitisation to be completed in accordance with the original timetable I have never known it to happen.

Reeling them in

One lead manager said to me once: "It's like fishing. You can't tell the originators everything at the beginning. You have to reel them in gently!" That was said in jest. Nevertheless, to be forewarned is forearmed. Lead managers should not be blamed for adopting this approach if their mandate is to get a deal done. If a company wants disinterested advice, it needs to find someone who is indifferent to whether the deal is done or not, and, with the best will in the world, it is difficult for anyone working to a success fee to be entirely indifferent to the outcome. Some element of sucess fee may make sense, but beware the downside. And the nature of the transaction – the cost, time and the huge effort on the financial, operations and IT sides – means that once you are more than a few weeks in, you would be brave to abort the deal and take those costs into the current year's P&L rather than amortising them as a handful of basis points over a period of years.

Level of involvement with ratings

This leads on to the role of the rating agencies. They are a proxy for the investors and take their responsibilities very seriously. They cannot be expected to give a reliable indication as to their thinking until they have done extensive financial and legal due diligence, which can take weeks or months from beginning to end. Accordingly, their requirements can often only finally be made late in the day, and if these then result in a change to the deal or the cost of funds (perhaps an extra cash reserve being created in the SPV, or the elimination of a degree of flexibility you had particularly valued), it is probably too late to do anything except about it. So, as far as possible, their requirements need to be anticipated.

The same applies to your human resources. Stay involved in, or at least close to, the dialogue with the agencies, so last-minute nasty surprises are less likely. When you are negotiating terms with your lead manager, be aware of anything that is agreed by them but has not been signed off by the agencies – it could easily be snatched away nearer to closing on the basis that 'the rating agencies will not agree to it'. ■

Mark Daley is a Partner specialising in banking and securitisation at Berwin Leighton Paisner.
mark.daley@berwinleighton.com
www.berwinleighton.com