

Bondholder communications reviewed

The ICMSA¹ discusses how the trustee community has worked to address concerns around bondholder meetings and voting mechanisms

A lively discussion between investors and trustees at the 2010 Global ABS conference was a catalyst for the ICMSA to revisit bondholder communication processes. Given the rise in bondholder meetings due to the fall-out from the financial crisis, bondholder communications were put squarely under the spotlight.

Trustees are one link of the bondholder communication chain, but are seen as pivotal as they facilitate the notice delivery and voting process. Over the last four years, they have proactively been working with the other links in the chain to improve not only bondholder communications, but also bondholder meeting provisions. The ICMSA has consequently produced a pro forma set of standard provisions for bondholder meetings and voting, which were published in April.

This article addresses the recent developments in communications and voting mechanisms, as well as the scope of trustee consent rights. These arise out of ongoing concerns that commonly used document provisions for each do not adequately address the needs either of issuers or investors in terms of ensuring that timely changes can be made to transactions.

An issuer of bonds or debt securities may, at some point, need to restructure its business or its debt financings or amend material terms of the securities for structural, regulatory or other reasons.

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Where the interests of holders of the securities are represented by a trustee, the issuer may look to the trustee to consent to its restructuring or amendment proposals without seeking the views of holders – a common discretionary power of the trustee in bond trust deeds (subject to certain limitations). Where the trustee is unable to give that consent, the issuer would seek the approval or sanction of the requisite threshold of holders to such proposals through the holder voting process.

¹ **International Capital Market Services Association (ICMSA)** is a London-based self-regulatory organisation representing international financial and non-financial institutions active in the provision of services to the international capital markets. Membership includes universal banks, registrars, stock exchanges, law firms, International Central Securities Depositories (ICSDs) and other service providers specialised in specific product segments, such as the processing of tax reclaims. The primary purpose of the association is to foster the highest standards in the practice and management of international capital market services, thereby facilitating the efficient functioning of the market.

The trustee committee of the ICMSA focuses on current market issues and events surrounding trustees.



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Bondholder voting mechanics

Bondholder voting mechanics – typically scheduled to the bond trust deed – have come in for much criticism by both issuers and holders alike in recent years, particularly in the context of corporate and debt restructurings, because of the difficulty of mobilising large numbers of bondholders to vote on restructuring proposals tabled by the issuer and inflexible and complex voting mechanisms. Having resolved to seek holder approval to its proposals (which it will inevitably want to implement in a timely and efficient manner), the issuer is then faced with the following challenges:

- communicating information to holders (chain of ownership) and
- obtaining votes from holders (voting requirements).

Taking each of these challenges in turn: first, the chain of communication from the issuer through the International Central Securities Depositories (ICSDs) in which the securities are typically held² – via custodians and sub-custodians to the ultimate beneficial holder and communication from that beneficial holder back up to the ICSDs – can be a slow and confusing process, partly because historically not all parties in the chain use real-time, electronic processing. Second, the presence of unduly complex meeting and voting mechanics is problematic.

Communication with holders

Adequate notice must be given to holders of a meeting of holders, and bond trust deeds usually provide for 21 days' notice to be given to holders of the meeting and the nature of the resolution to be considered. The terms of the securities will stipulate how and where the notice is to be published. Bond trust deeds will usually provide for notices to be published in a leading European newspaper and/or delivered to the relevant ICSDs for communication to each accountholder who is shown in the records of the relevant ICSD as a holder of an interest in the securities of that class.

Over the years, concerns have been raised by investors that such notices are not reaching them in sufficient time (or at all) to enable them to determine whether to attend the relevant meeting and vote on the proposal tabled by the issuer. This finding, if prevalent, could have adverse consequences for an issuer seeking to effect a consensual restructuring in a timely fashion.

In responding to this concern, it is worth examining the chain of ownership or entitlement of a class of securities which is represented by a global certificate held by a common depository for the ICSDs (being, for the purpose of this analysis, Clearstream, Luxembourg and/or Euroclear Bank). A typical chain of entitlement and communication for the ICSDs can be illustrated as above.

Recent developments

The ICSDs have, under the auspices of the International Securities Market Advisory Group (ISMAG) and in collaboration and conjunction with issuers, agents, common depositaries and custodians – representing the full end-to-end communication process chain – produced operational guidelines (namely, the International Securities Operational Market Practice Book) for reference and use by the various market intermediaries represented in the above diagram. The guidelines, updated annually to meet market and regulatory changes, were produced with the aim of ensuring an efficient end-to-end

communication and processing service for investors. The roles and responsibilities of the parties involved in this processing chain (including, without limitation, the information flow and expected timings) for communicating with holders are fully consistent with the guidelines, including guidelines produced by the Corporate Actions Joint Working Group, set up under the auspices of the Committee of European Securities Regulators (CESR) and which also form the European market 'baseline' model from the inception of Target 2 for Securities.

Timeliness of communications

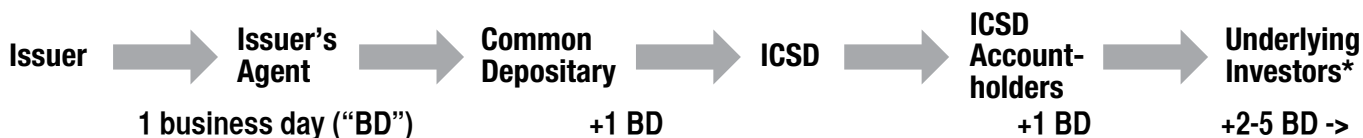
The ICSDs send corporate action notifications within 24 hours of receipt from the issuer (or its agent or the trustee) to the ICSD accountholders, who in turn usually pass on this information to the next level in the chain within a similar timeframe. In line with the guidelines, 10 days is the minimum recommended period for action or an election in the context of a corporate action event, as in the majority of cases the relevant holders are at one level below the ICSDs' immediate accountholder.

Analysis of ICSD statistical data shows that the majority of ICSD accountholders react quickly to notices and obtain the full notification from the ICSDs, with 85% of eligible holders reacting within three days of the launch of a corporate action event to obtain the full notice. Between five and seven days following launch, there is usually

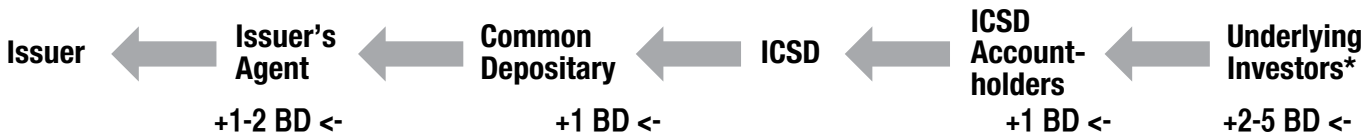
“The guidelines were produced to ensure an efficient end-to-end communication and processing service”

² This assumes the securities are immobilised in the clearing systems by deposit of a global certificate with a depository for the ICSDs (e.g. Clearstream Banking S.A., Luxembourg or Euroclear Bank S.A./N.V.), with the result that the investor's entitlement is against the depository – although, where a trustee is in place, the global certificate may provide that the trustee may treat accountholders in the clearing systems as if they were the holder of the global certificate. This is how the majority of securities traded on the capital markets are held and whether those securities are constituted under a trust deed or issued pursuant to a fiscal agency agreement.

Notification Chain



Instruction Chain



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another spike in accountholder activity, which is likely when the next level or ultimate beneficial holders receive their notifications (which underlying investors or ultimate beneficial holders receive via electronic means or, in some cases, by post, from their custodians). This process and the timings involved are illustrated in the flow chart above.

Bondholder voting requirements

Central to an effective meeting of holders and a valid resolution are voting mechanics that work both for holders and under the bond documentation. It is important to be able to identify who is entitled to attend and vote at the meeting or in respect of the resolution being proposed and that securities cannot be voted twice.

Where securities are held through ICSDs, there are two often used processes to ensure verification of voting holders. The first is 'blocking securities', where the ICSD accountholders are notified of the corporate action event and – once votes are received by the ICSDs from their accountholders – the voted position in the securities is 'blocked' from trading. The voting instruction is communicated through the custody chain (illustrated above) to the ICSDs (who in turn inform the issuer's agent/trustee) and the securities remain blocked in the clearing systems until the conclusion of the corporate action event (being the bondholders' meeting at which the relevant resolution is passed or voted down).

However, while regularly used, this process is sometimes frowned upon by investors. The process of blocking securities is exactly that – accountholders cannot trade, lend or transfer securities while they remain blocked and this ensures that securities cannot be voted twice, thereby

undermining the validity of the resulting resolution.

The second process is setting a 'record date' which is specified in the notice informing holders of the meeting, resolution and voting requirements. Once votes are received by the ICSDs from their accountholders, the voted position does not need to be blocked, but the positions are verified as at the record date against votes received by the ICSDs and only securities held by the accountholder on the record date can be voted upon and counted.

This process is favoured by holders who wish to have the flexibility of being able to trade or lend their securities. However, where a 'record date' mechanism such as this is not contemplated by the bond trust deed, there is a risk that the validity of a resolution passed on this basis may be vulnerable to challenge due to a procedural irregularity. So it is important to ensure that there is not a divergence between the bond documentation and the voting process being used.

The way forward?

It is generally accepted that the mechanisms for voting are in need of review, but a significant overhaul should not be necessary. In response to concerns raised by market participants about practical issues arising from bondholder meeting and voting mechanisms, ICMSA – through its Bondholder Communications Working Group – has reviewed these mechanisms and, following consultation with its members, has produced a pro forma set of standard provisions for meetings and voting in relation to securities which can be used or adapted for use on capital markets transactions. A copy of the pro forma is available on the ICMSA website: <http://www.icmsa.org/news/111/113/ICMSA-Bulletin-with-respect-to-publication-of-a-pro-forma-set-of-Standard-Provisions-for-Meetings-and-Voting-in-relation-to-Bonds-Notes-for-use-on-capital-markets-transactions.html>.

The pro forma is intended to streamline and simplify bondholder meeting and voting mechanisms and includes the following key features:

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- the ability to cancel a meeting after it is convened but before it is held by notice to holders;
- where securities are cleared through The Depository Trust Company (DTC) and, in the context of a consent solicitation, are eligible for DTC’s Automated Tender/Offer Programme (ATOP), holders may vote on the resolution the subject of a consent solicitation electronically through ATOP;
- where securities are held through ICSDs, resolutions may be passed by holders of the requisite percentage of principal of the securities approving such resolution by way of electronic consents communicated through the clearing systems within a specified timeframe, without the need for a meeting; and
- flexible procedures for passing written extraordinary resolutions where securities are held through ICSDs.

By publishing the pro forma, ICMSA is seeking to establish a market standard for bondholder meeting and voting provisions that may be used on or applied to any issue of debt or equity-linked securities under English law. ICMSA believes that the pro forma will benefit its members and market participants by standardising and simplifying traditional bondholder meeting provisions and providing voting mechanics which aim to achieve speedier and effective decisions by holders.

Model wording

Discretionary powers of the trustee are typically limited to the ability to effect amendments that will not be materially prejudicial to the interests of defined beneficiaries or are of a formal, minor or technical nature or made to correct a manifest error. The power to effect the latter types of amendments is much less commonly

invoked than the power in connection with the former types of amendments. For trustees and issuers, there are challenges in assessing the impact of certain categories of amendment on relevant beneficiaries’ interests.


Examples of amendments that have caused particular difficulties in the market include those arising from changes to rating agency criteria, affecting common transaction parties such as account banks, liquidity providers and swap counterparties, as well as changes to law or regulation or the introduction of new regulatory requirements. The aim of market participants – including ICMSA, in consultation with its members – who have been involved in formulating standard provisions (model wording) for inclusion in structured finance/bond documents has been to provide trustees and issuers with an objective means by which each can overcome such difficulties by removing the need in certain circumstances for trustees to exercise discretion when agreeing modifications.

The model wording does not replace discretionary consent provisions, but sits alongside them for defined categories of modification, notably those relating to rating agency criteria and regulatory change. The menu of circumstances in which an issuer might seek to hardwire the consent has been the most debated of the provisions within the clause and will require agreement on a transaction-by-transaction basis. All of the language will require agreement on a transaction-by-transaction basis as certain trust houses will have their own comments.

Readers’ attention is drawn also to the wording within the provision, included at the request of certain institutional investors and which is commonly referred to as a negative consent mechanism. This protection for investors requires the issuer to give advance notice of any change proposed

under the mandatory consent provision to investors and prescribes a period during which investors holding a specified percentage of the most senior class of notes (10% under the model wording) may respond with their objection (which would result in the proposal failing). If insufficient objections are received within the prescribed period, investors are deemed to have no objection and the trustee will give effect to the proposal, assuming other relevant conditions are met.

The model wording retains the concept of ‘reserved matters/basic terms modifications’, for which an issuer must still seek beneficiary approval. Otherwise the trustee is entitled under the provision to disregard the effect of the proposed change on the interests of its beneficiaries.

The ICMSA is committed to helping improve bondholder communication, alongside other industry participants. The Association has listened, taken feedback on board and published recommendations, with the aim of setting and maintaining market standards for the benefit of all parties. 



The ICMSA trustee committee is currently chaired by Jillian Hamblin, Director, Citicorp Trustee Company Limited, and supported by Sally Easton of the ICMSA. The committee monitors and participates in market events and issues affecting the trustee community.

Contributors to this article include the following members of the ICMSA Bondholder Communications Working Group:

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Please refer to the ICMSA website for current bulletins: www.icmsa.org

Bondholder meeting provisions – Bulletin 140501/28

Mandatory Consent – Bulletin to be published shortly

Bondholder Communications – Bulletin 111101/18

ICSD websites for ISMAG:
www.clearstream.com/ismag
www.euroclear.com/ismag