

# **Bond Case Briefs**

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## **Why Bond Trustees Are Often Frustrated, Powerless in Today's Debt Environment.**

PHOENIX — Bond trustees are proving to have less power than some investors expect as debt distress has become a more persistent concern for municipal bond investors.

Bond trustees are responsible for ensuring that the bond issue is administered according to the deal structure as agreed upon by the issuer and other members of the financing team. While the underwriter, bond counsel, and other members of the team generally move on after closing, the trustee remains involved with the bonds for as many years as they remain outstanding.

"We're the only professional that stays in the transaction from the beginning to the end," said David Lonibos, managing director for U.S. Not For Profit at BNY Mellon in New York. "The role of the trustee is pretty simple," Lonibos said. "We look out for the bondholder."

But David Fernández, a shareholder at Buchanan Ingersoll & Rooney in New York and Philadelphia, said that trustees have become marginalized to the point that their ability to help structure bond documents and act in the event of a default is limited.

"They've been beaten into submission," Fernández said.

The role of the trustee is spelled out in an indenture or resolution, and their conduct is not governed by the Municipal Securities Rulemaking Board the way the conduct of underwriters and municipal advisors is. Corporate bond trustees are subject to the Trust Indenture Act of 1939, but that law includes a specific exemption for muni bonds. That law requires all corporate bond issues over \$5 million to be governed by a formal indenture and administered by a trustee, but a majority of muni bond issuances of size have trustees despite the lack of a federal law mandating it. According to data from Thomson Reuters about \$2.1 trillion of muni bond issuances since 2006 have had trustees, of the slightly less than \$3.8 trillion total. The two biggest trustee banks in the muni world by far are BNY Mellon and U.S. Bank, which combine to own more than 39% of the market share.

Terry McRoberts, executive vice president of Global Corporate Trust Services at U.S. Bank, said that he has noticed a trend towards issuers choosing and sticking with a trustee for all their work.

"We have seen more bias by issuers to use one trustee rather than to spread it around," McRoberts said. He said his bank views public finance as "very local," and that trust account managers may be handling a certain issuer for many years.

"They have a relationship," McRoberts said.

While the trustee's duties are primarily ministerial, including duties like collecting and disbursing payments and document review, it is their roles when issues become distressed and default that has drawn some increased attention as the industry has increasingly grappled with the implications of distress due to the ongoing struggles of Puerto Rico and a few high-profile municipal bankruptcies. The trustee is supposed to act as an agent for the bondholders, enforcing their rights under the

indenture and attempting to get them their money. Both McRoberts and Lonibos said their banks have separate groups that administer an issue once it defaults, and Lonibos said that the industry took default among muni bonds lightly for years because of its relative rarity compared to corporates.

"A lot of us have been guilty of a 'well, that will never happen' attitude," he said.

Investors have sometimes expressed frustration when their trustee doesn't seem to be acting to protect their rights, or seems to be acting too slowly. Last month, a major investor in several defaulted Florida housing bond issuances said its trustee, Bank of Oklahoma Financial, was not moving quickly enough to secure the firm's rights. BOKF maintained that it was taking action.

"The role of the trustee is finally getting some attention," Fernández said. "They are the most ignored member of the deal team."

Fernández, a longtime trustee counsel, said that trustees are generally selected by issuers via a competitive bidding process that results in very low fees for their work and are often brought to the table after all the bond documents, including the crucial indenture that governs them, have already been written.

Fernández said this treatment of a trustee can result in simply a "cursory" review of the documents that later leads to confusion about what is expected of them. Fernández added that when a trustee is viewed as being asleep at the wheel, it is often the case that they were brought in late and that any suggestions the trustee firm had about what to put in the indenture were ignored.

"They've basically become the orphan stepchild of the bond business," he said.

While bond counsel and the underwriter generally walk away from a sizable bond deal with six-figure or larger earnings to show for it, trustees get only a nominal administrative fee of some \$1,500 in many cases, Fernández said. And once a bond issue does default, he said, the trustee may have much more limited power to act than one might think.

"The actions that they take are irrevocable," Fernández said. "Once that money is out the door, it's gone. It's not coming back. Especially in a situation like Puerto Rico or a distressed debt situation where that money is going to get sucked into a vacuum."

Because of those implications, Fernández said, trustees that aren't able to garner agreement from 100% of bondholders about what actions to take in a default scenario may be more inclined to just wait for a court order to decide what they should do.

"They've become a reactive institution, not a proactive institution," said Fernández.

Lonibos said what a trustee will do is based on the interpretation of the indenture, and at his firm is done by a group who was not previously involved with the deal.

"Trustees do their best to interpret the document," he said.

## **The Bond Buyer**

By Kyle Glazier

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