



Switching Horses

Considerations when Changing the Trustee

May 2017

Switching Horses Midstream

Considerations when Changing the Trustee on a Debt Transaction

In recent times there has been an increase in instances of trustees being changed on debt deals. As this phenomenon becomes more widespread, we look at some of the issues and processes that need to be taken into account when issuers, investors or trustees themselves are considering making a change

Something needs to change here

The impetus for considering a change of trustee can vary, but usually will be down to some change in circumstances affecting the deal or the parties.

Trigger	Details
Default	<p>The trustee's role comes under the spotlight if a default has occurred on the debt (or is expected to occur). The trustee is empowered both to accelerate the debt and also to take steps to recover value for investors. A default on the debt may cause investors to re-evaluate whether the incumbent trustee is best placed to take such actions.</p> <p>A particular consideration can be the expected terms of any indemnity (and/or pre-funding) that the trustee may require before it accelerates or takes recovery action. There have been examples of investors changing a trustee where an alternate provider agrees to more limited indemnity and pre-funding requirements. Although an important consideration, the indemnity requirement should not be the sole determinant - many investors will still want to be satisfied that the replacement trustee will act when required to do so.</p>
Intercreditor Dispute	<p>Another trigger event may arise where different classes of creditors come into actual or potential conflict with each other, usually where the expected recoveries will be insufficient to discharge all outstanding claims. In these scenarios, investors may want the trustee to ensure their claims are preserved and protected even before a default is looming. As with a default, this may be a time where investors think about replacing the incumbent trustee with a trustee they consider more ready to act if needed.</p>
Restructuring	<p>A change of trustee may arise where debt is being restructured. It is often the case that existing debt securities will be exchanged for new debt securities reflecting the amended terms of the debt. Some issuers and investors may use this as an opportunity to switch the trustee for a preferred provider or for a lower cost provider.</p>
Conflict	<p>It is a fundamental requirement of acting as trustee that the trustee should ensure that its own interests do not conflict with its duties as trustee. If a conflict does arise, usually because of a commercial relationship, the trustee may need to resign and find a replacement.</p>
Legal Sensitivities	<p>From time to time there may be circumstances where different trustee providers have different views on the type and form of comfort they require in order to execute amendments to a transaction (e.g. legal opinions, fairness opinions and</p>

	certificates of fact). If the incumbent trustee is unwilling to accept a qualified opinion on the validity of a bondholder resolution (for example), a replacement trustee may be installed if it is able to accept such a qualified opinion in those circumstances.
Changed terms	The issuer and investors may be pushing to change the terms of the transaction documents in a way which the incumbent trustee is concerned about (e.g. because the discretions afforded to the trustee would increase) but with which a replacement trustee is comfortable.
Ratings Triggers	Although the financial well-being of the trustee is rarely a key consideration in it being appointed, on structured deals where affiliates of the trustee entity are providing cash management, account or custody roles, those roles may be subject to the maintenance of minimum ratings. If those ratings thresholds are breached, investors or issuers may look to change the trustee role at the same time the account bank, custodian or cash manager is replaced.

Making the change

The trust document should contain express provisions detailing how the trustee is changed. The provisions may differ depending on whether the incumbent trustee voluntarily resigns and where it is forcibly removed from office. The summary below is based on market standard provisions – the actual provisions would need to be checked in the deal documents.

English law Trust Deed	
Resignation	<ul style="list-style-type: none"> – Trustee can resign on 90 days' notice. – Resignation does not take effect until a replacement trustee is appointed. – Replacement is appointed by the issuer. – If issuer fails to appoint replacement, trustee may nominate a replacement. – Appointment of replacement must be ratified by holders of debt. – Replacement trustee must usually be a qualified 'trust corporation'. – An alternative route may be for the trustee to appoint a co-trustee to act alongside it, and for the original trustee to then resign leaving the co-trustee in office. Some analysis will be required as to whether such a change requires investor ratification.
Removal	<ul style="list-style-type: none"> – Investors can remove a trustee by passing an extraordinary resolution. – Removal does not take effect until a replacement trustee is appointed. – Will require a meeting of investors: <ul style="list-style-type: none"> – A 4-6 week process. – May be convened by Noteholders if they hold not less than 10%. – Could be done more quickly where the investors can pass a written resolution.

New York law Indenture	
Resignation	<ul style="list-style-type: none"> – Trustee can resign at any time by giving notice to the issuer, typical notice provisions vary between 0 and 60 days. – Issuer is obliged to appoint a successor. – Outgoing trustee may petition a court to appoint a successor, or, in certain instances may appoint the successor if the issuer fails to do so, provided successor is reasonably satisfactory to the Issuer. – Resignation takes effect when successor delivers a written notice of appointment. – Outgoing trustee continues to enjoy benefit of trustee's lien.
Removal	<ul style="list-style-type: none"> – Holders of a majority of principal amount of the debt can remove the trustee and appoint a successor. – Issuer may remove trustee if the trustee has acquired a conflicting interest, becomes insolvent or is otherwise incapable of acting as trustee.
Eligibility	<ul style="list-style-type: none"> – Transactions which are required to be TIA compliant will likely require that the trustee meets minimum eligibility requirements, including having a specified minimum capital and surplus.

The divorce settlement

Although the change can usually be effected without undue formality, there are inevitably some other issues to consider. These will include:

Issue	Details
Choosing a replacement	<p>Some analysis should be carried out as to the ability of the replacement trustee to pick up the reins, particularly where the change is being effected with an expectation that the new trustee will take some sort of enforcement or corrective action. While such things as indemnity requirements may have driven the need for change, investors will want to satisfy themselves that the replacement will be able to act effectively and is robust enough to withstand the rigours of a contested enforcement scenario or Intercreditor dispute. A thinly capitalised trustee may require less indemnity, but may also be found wanting at the point investors most need the trustee to be there.</p> <p>The investor group that drives the change need to take account of the risk that minority investors may hold them accountable if the replacement trustee fails to deliver.</p>

Security	Where the trustee holds security interests, it may be necessary to transfer those security interests to the new trustee. Local advice will be needed with respect to any formalities and any implications, including the possible recommencement of hardening periods or priority risks. Consent from other secured creditors may be required.
Notifications	<p>Careful review of the documents will be required to identify any notification requirements where a trustee is changed. Notifications may be required to be given to other investors, other creditors, rating agencies, liquidity providers, other service providers, stock exchanges, clearing systems etc.</p> <p>Under a New York law governed Indenture, there will typically be a requirement for the replacement trustee to mail a notice of its succession to investors.</p>
Indemnity rights	A trustee will likely be entitled to continue to enjoy its indemnity entitlement in respect of any liability incurred while it was in office, even where that liability only becomes apparent subsequent to it leaving office. The outgoing trustee may want to have this right re-affirmed at the point it exits, or require that adequate provision is made in the future cash flows to cover it against expected liabilities.
Transaction documents	<p>The trustee may be party to transaction documents other than the trust deed or indenture, and the new trustee may need to become party to those documents. Often succession language will ensure that any replacement trustee automatically becomes party but this should be checked.</p> <p>The replacement will likely want to receive a set of documents (including, for English law deals, signed originals) as well as any transaction books and records.</p>
Other roles	Where the entity that is the outgoing trustee or its affiliates also have other roles such as paying agent, registrar etc, it is not essential but it may be convenient for the incoming trustee or its affiliates to assume these roles if it is able to do so.
Delegation	If a change needs to be made quickly, it may be possible for the incumbent trustee to delegate its key functions to the successor ahead of the formal change being made.
Vesting of Trust Property	For English law deals, in circumstances where the outgoing trustee and incoming trustee are not cooperative, there are helpful provisions in the 1925 Trustee Act which operate to vest the trust property in the replacement trustee without additional formality.

Advisory input

A change of trustee should not be undertaken lightly. The incumbent trustee, the successor trustee, the issuer and the investors should all take advice with respect to their roles and possible liabilities in effecting a change. The Hogan Lovells trustee practice has extensive experience of advising on trustee changes. Given the timing pressures that are normally present in these processes, it is not unusual for the same firm to advise the incumbent and the replacement – this provides continuity and assists in getting the replacement trustee up and running.

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