

How to live with your high yield bond

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The dust has settled and the closing dinner is over. You're back in your office and while the finance department is busy applying the proceeds of your recent high yield bond offering, you are staring at the indenture or trust deed wondering what new compliance and monitoring tasks this bond presents for your team. The good news is two fold: first, a framework for compliance with applicable regulations can be put in place to make the tasks easier and, second, despite the complex nature of the covenant package, once you identify any questions, your external counsel is available for a second opinion.

In Asia, "high yield" bonds made their appearance in the early- to mid-1990s. High yield bonds exhibit a particular set of covenants that work together to permit you to run your businesses as you expect while providing bondholders with protection against unexpected funds leaving the company during the life of the bond. The early high yield bonds suffered during the Asian financial crisis of 1997 – 1998 but high yield returned to the region later in response to various favorable conditions and made a strong comeback starting in 2003. Most of the high yield bonds issued since the reappearance of high yield are in connection with companies with operations in Indonesia and the PRC.

Key Dates to Diarise

High yield bond covenants restrict certain activities and permit certain others and are negotiated based on market convention, the industry of the issuer and the particular issuer's own needs. The covenant package is driven by the restrictions and permissions set forth in the major covenants such as

limitations on indebtedness, restricted payments, liens, affiliate transactions, asset sales, mergers and consolidations as well as change of control provisions.

Two common issues that companies run across in complying with high yield bond covenants are the ongoing reporting requirements and what happens when the company wants to form a new subsidiary or acquire a subsidiary. Our firm routinely puts together a compliance memo at the end of a transaction with a compliance checklist for new issuers that covers what actions are required and sets forth a timeline, but you can also construct one internally. Key dates for compliance with reporting requirements include the delivery dates for the financial statements for annual reports, semi-annual reports and quarterly reports and, where specified in the indenture, the accompanying officers' certificates. For issuers that are also Hong Kong or Indonesian listed companies, this process is frequently made easier by mirroring the reporting requirements and timetables of the relevant exchange but the in-house legal team of all companies, reporting or non-reporting, with high yield bonds should establish an internal system providing the legal team with enough time to obtain the necessary financials from the finance department and the executed officers' certificates and forward such items to the trustee. Frequently, reporting companies also need to provide bondholders with a copy of any other filings made on the relevant exchange so the legal team should add the task of forwarding the filings to the bond trustee to their filing checklist.



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Organic Growth

Another ongoing compliance item for in-house legal teams is the formation of a new subsidiary or the acquisition of an existing subsidiary. This is particularly important for Asian companies given the growth nature of many Asian companies. As companies grow, new subsidiaries are formed for structural, tax and corporate organization reasons.

Many in-house legal teams have their own new subsidiary checklists setting forth internal and external items in connection with new subsidiary formation such as choice of jurisdiction, the hiring of relevant outside counsel for formation and legal opinions and the filing of appropriate tax forms or in connection with acquisition of new subsidiaries. The structure of each high yield bond is different but if the high yield bond sits at a holding company level, frequently the covenant package will apply to the entire corporate group. If you have a high yield bond in your corporate structure, the typical position is that all future subsidiaries created or acquired need to become restricted subsidiaries and therefore subject to the bond covenants. As a result, you should add a task to your checklist to ensure that the company executes a supplemental indenture or supplemental trust deed at the time of the formation of a new subsidiary or the acquisition of an existing subsidiary. Given that the high yield covenants will provide flexibility for the restricted group to transact between themselves, since the covenant package operates to restrict the flow of value outside the group but not restrict activities within the group unless there is a specific reason to designate a restricted subsidiary as unrestricted, it generally makes sense to designate any new subsidiaries as restricted subsidiaries.

The Road Ahead

The timing of this designation can vary but many Asian high yield indentures or trust deeds require a new subsidiary to be designated as a Restricted Subsidiary immediately upon being formed or being made part of the group through the execution and delivery of a supplemental indenture or supplemental trust deed, the delivery of the relevant officers' certificate and the delivery of legal opinions from the relevant jurisdiction (e.g. BVI, Bermuda, Cayman Islands) to the trustee.

Compliance with the other covenants is a fact-based analysis of the particular action being taken. If your company is thinking of incurring debt, secured or unsecured, making a dividend payment, investing in a joint venture or entering into a significant transaction or series of transactions with an affiliate, take a moment to consider your high yield bond covenants. And as always, be assured that your outside counsel is only a phone call away to assist in analysis and provide guidance.

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