



ROLES AND RESPONSIBILITIES OF THE MUNICIPAL TRUSTEE

Todd Duncan
Vice President and Deputy Director
The Bank of New York

Editor's Note: Periodically, CDIAC invites guest authors to contribute articles on topical issues of interest to the public finance community. CDIAC publishes these articles as educational resources for local governments and does not specifically endorse any of the tools or products described within them.

Municipal bond issues have become increasingly complex over the last few years, as the issuance volume has increased dramatically over the time period. At the same time, the municipal bond trustee industry has been challenged by a dramatic consolidation of the number of trustee providers. Despite all of the change, the municipal trustee continues to serve as an intermediary between issuers of debt securities and the investors (bondholders). The integrity of the debt-financing transaction still depends on the deal structure being strictly adhered to throughout the life of the transaction. It is the duty of the trustee to ensure that the bond issue is administered according to the deal structure as envisioned by the issuer and the original financing team and memorialized in the financing documents.

Generally, after the closing of the transaction, the financial advisor/investment banker, bond counsel, and other members of the financing team move on to the next deal. However, the issuer and the municipal trustee have agreed to a potentially decades-long relationship. The municipal trustee is positioned to work with the issuer to ensure that the repayment of the debt, with interest, to the bondholders occurs pursuant to the terms and conditions of the indenture or other financing documents and that the proceeds from the sale of the bonds is used for the stated purpose.

Document Review in the Pre-Closing Process

While a smooth and trouble-free bond closing is probably first and foremost on the minds of the financing team associated with a transaction in the pre-closing process, other important factors are critical to the success of the financing as well. Given the long-term nature of the relationship between the issuer and the municipal trustee, attention to the language contained in the financing documents during the document review process prior to the transaction's closing is critical. The issuer and trustee will have to adhere to these documents for many years and the appointment of the trustee early in the

process is essential for proper review of the documents. The trustee will be particularly interested in reviewing the establishment of funds and accounts and the waterfall of revenues or monies through them, document and invoice requirements surrounding disbursements for construction funds or other disbursements, the permitted investment language, and compliance requirements.

After the Closing

Under normal circumstances, the municipal trustee performs many administrative and ministerial duties in support of the issuer once the bond issue closes. If, for example, the bond proceeds are earmarked for the completion of a construction project, the trustee acts as the fund accounting manager and disbursement agent for the payment of requisitions to build and complete the project. The set of circumstances under which a requisition will be paid for project costs is governed by the financing documents, and the requirements are quite precise. It is the trustee's duty to ascertain and enforce the provisions of the financing documents to ensure that bond proceeds are disbursed under the circumstances prescribed in the documents in order to fulfill the purpose(s) of the financing.

The municipal trustee is also responsible on an on-going basis for various other duties including invoicing debt service, collecting revenues or payments for payment of principal and interest to bondholders, and maintaining the bondholder records. Furthermore, the trustee has the very important responsibility of acting as custodian and safekeeper for the bond proceeds and the administration of the funds and accounts established under the indenture, including the aforementioned construction funds. The preservation of the security interests in assets and property assigned to the bondholders is a very important responsibility of the trustee, as well as monitoring and enforcing compliance with the provisions of the financing documents in order to protect the bondholders.

Beyond the "four corners" of the financing documents, the trustee should be viewed as a "partner" with the municipality or issuer's finance, treasury or other department(s) to assist in effectively managing and administering the municipality's debt for the ultimate benefit of the bondhold-

ers. What the municipal trustee must bring to this partnering relationship beyond the specific skill set needed to administer the bond issue within the context of the indenture is responsiveness, communications skills, and a genuine desire to provide exemplary service to the issuer and protect the interests of the bondholders.

As we have seen over the last decade or so, tax-exempt and taxable municipal transactions, particularly in California, have become more and more complex, requiring a more sophisticated approach by the municipal trust industry. The duties and responsibilities of a municipal trustee may in theory have remained relatively unchanged in a classic sense, but these duties now come imbedded in ever more complex financing arrangements involving sophisticated investment of bond proceeds, benchmarks and thresholds requiring constant monitoring, trigger dates for important action or events, innovative deal structures like auction rate securities, etc.

As a result of the increased complexity and sheer volume of business, committed municipal trustees have substantially increased their reliance on technological tools to deliver the service to the marketplace. These tools include the use of complex mainframe systems for asset tracking and a range of recordkeeping functions, use of web-based information delivery systems to clients, bondholders and professionals, dramatically increased use of spreadsheets and database programs for pools and other complex financings and use of webcasting and other technology based tools for staff and client related training and/or tutorials. Now, more than ever, trustees must have the depth and breadth of organizations committed to the municipal trust business to provide the professional staff, systems, infrastructure, training and the long-term view required to deliver consistent, high-quality service to the municipal issuing community.

The Future

It goes without saying that the municipal finance industry will continue to change, and by extension, the municipal trust industry also will continue to experience change. It is believed that the industry consolidation of the municipal trust business will continue into the foreseeable future, as well. Certainly the transactions will get more complex requiring a greater degree of expertise from all members of the financing team, including the municipal trustee. New regulatory requirements have surfaced, like the USA Patriot Act, and the complexity of the systems will undoubtedly increase. However, the basic function of the municipal trustee will remain the same – that is, maintaining the structural integrity of the bond financing over the life of the issue for the benefit of the bondholders and as a service to the issuer and the marketplace

What the Issuer should expect from the Trustee

The typical Indenture or Trust Agreement calls for the municipal trustee, among other things, to:

- ensure that the compliance requirements and covenant restrictions are met,
- invoice debt service and collect revenues or payments for payment to the bondholders,
- ensure that the security interests in assets and property granted to bondholders for their benefit are preserved,
- ensure that bond proceeds are invested per the terms and conditions of the Indenture or Trust Agreement,
- ensure that the required calculations and other operationally oriented tasks required in the administration of the issue are done timely and correctly,
- administer project/construction funds including the documentation requirements relating to the disbursement of funds for project costs, and
- ensure the proper operation of the funds and accounts established in the financing documents and that the “waterfall” of revenue or payments through those funds and accounts occurs as envisioned.

This Offprint was previously published in DEBT LINE, a monthly publication of the California Debt and Investment Advisory Commission (CDIAC). CDIAC was created in 1981 to provide information, education, and technical assistance on public debt and investment to state and local public officials and public finance officers. DEBT LINE serves as a vehicle to reach CDIAC's constituents, providing news and information pertaining to the California municipal finance market. In addition to topical articles, DEBT LINE contains a listing of the proposed and final sales of public debt provided to CDIAC pursuant to Section 8855(g) of the California Government Code. Questions concerning the Commission should be directed to CDIAC at (916) 653-3269 or, by e-mail, at cdiac@treasurer.ca.gov. For a full listing of CDIAC publications, please visit our website at <http://www.treasurer.ca.gov/cdiac>.

All rights reserved. No part of this document may be reproduced without written credit given to CDIAC. Permission to reprint with written credit given to CDIAC is hereby granted.