FUTUREGROWTH
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Investor activism in action webinar – Q&As
Panelists: Olga Constantatos, Head of Credit & Maseabi Marageni, Head of Business Development @ Futuregrowth; Gill Raine, Senior policy advisor @ ASISA
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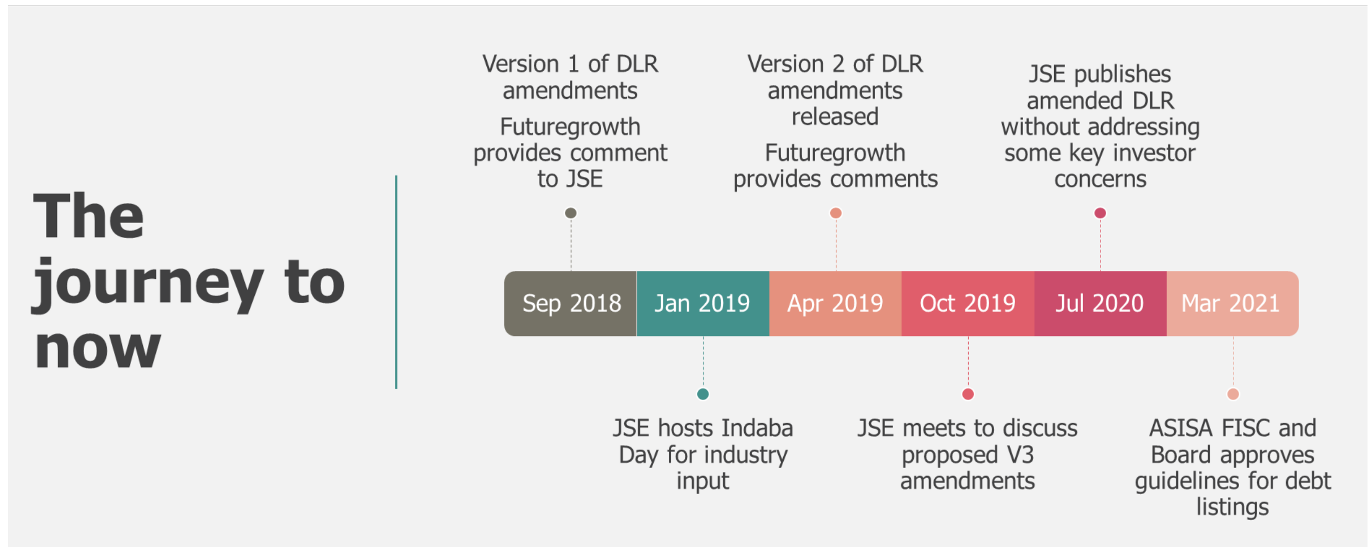


1. Why not just walk away from the deals if you do not like the JSE rules?

Bonds form an irrefutable part of an investment mandate. In addition, the regulatory environment (e.g. Regulation 28) allows for larger limits to listed bonds than to unlisted bonds. The danger is that there is an assumption (by regulators, by investors) that a listed bond is safe, tradeable, that there is price discovery and that there is liquidity. This is not the case.

It is very difficult to completely walk away from an entire asset class, like listed bonds, when the regulations and mandates are written such that they effectively prescribe investment in listed bonds. One alternative is not to invest. However, we have a closed domestic market, and the funds have to be invested per the mandates. We believe that the next best solution is to try to change the bond market - by requiring appropriate investor protections, better disclosure and transparency and, therefore, a market which is fairer and includes suitable protections for investors. This is what we are focusing on. By improving the regulatory environment, and the legal protections under which listed bonds are issued and traded, we can make it safer for investors.

2. You have negotiating power – why not put the power with the guys that are not selling?

Yes we do have that power, but 1) the investors are fragmented and the structure and historic practices of the listed bond market have meant that we have been prevented from coordinating our requirements for better protections; and 2) we are one amongst a number of investors and, in many instances, other investors are not asking for the same changes. The power is in collective negotiation. It is difficult for only one voice to bring about effective change.

3. What is the size of the credit market vs government bonds?

The bond market is worth roughly R3.2 trillion. When we speak about the credit market, we include bank bonds, securitisation, corporate bonds and bonds issued by SOEs and municipalities. The actual true corporate debt, excluding banks and structured products that are issued by banks, is worth roughly R200 billion. It is relatively small but has grown quite substantially, remembering that the first corporate bond was issued in 1992. It is wise to note that bank bonds are a significant part of the capital market at this point in time, not only through direct senior notes that are issued by banks but also through

subordinated debt, credit linked notes and securitisation paper of around R35 billion. However, the bulk of the bonds are issued by government (RSA bonds), totally about R2.8 trillion.

4. Given the experience at Land Bank, where the situation of investors has not been addressed, how would the changes you mentioned have made things better?

If we had been able to negotiate the terms of the loan agreement when Land Bank issued its bonds, or if the regulations had included the investor protections we have been long asking for, we could have been in a position to ask for better investor protections – including default interest (i.e. an increased interest rate when Land Bank defaulted on its obligations), an up-to-date list of investors (this is needed to meet and vote on actions and resolutions), the appointment of an independent investor representative (to manage the investor body, collate advice and act as a Chair for investor meetings) and an obligation on Land Bank to pay for the legal costs of investors in navigating this event of default and the various solutions proposed to resolve it.

As but one example, the updated DLRs now have a requirement for issuers to keep an up-to-date register of noteholders. The fact that we did not have this at the time of the Land Bank event of default, made it very time consuming to track down the manager of each holder of Land Bank paper. When an entity is in distress, it is very important that investors are able to make timeous decisions and our inability to even know who the other investors in Land Bank paper were made this a very difficult task and (unnecessarily) elevated the risks faced by investors.

5. Why is the Land Bank issue proving so intractable?

The Land Bank event of default and the resolution thereof has been through three proposed solutions since Land Bank defaulted in April 2020. We spent the better part of 2020 negotiating the first proposed solution (which included the partial government guarantee). As you will recall, Land Bank's shareholder withdrew that proposal in early 2021.

We are currently on version 3 of the proposed solution and, as we have noted in many updates to our clients (see latest update here), in our view, the current proposal remains unworkable in many respects. Further compounding the delays have been the long decision-making processes, the proposed change in Land Bank's mandate (which fundamentally changes creditors' risk profile) and the lack of timely up-to-date financial information (which investors need to make decisions).

6. Are other lenders suggesting similar changes? (If not, why not?)

We can't comment on what other managers may or may not be doing. What we do know is that the ASISA Guidelines were formulated by a sub-committee of nine institutions, and the Guidelines were unanimously approved by the ASISA FISC[1] and approved by the ASISA Board. Based on that, we believe that there is substantial industry buy-in and support for meaningful bond market reform.

7. Why can the JSE not appoint a legal advisor that represents bond investors' interests?

As part of our submission and engagements with the JSE on bond market reform, we asked them to make it a regulatory requirement that issuers (borrowers) of debt are obliged to appoint a legal advisor *in an event of default or credit event* to advise noteholders. This is a standard term of almost every syndicated loan transaction.

The response from the JSE was that they believed this requirement was not an appropriate provision to be included in the regulations but that it is rather a matter for commercial negotiation, which we fundamentally disagree with.

[1] Fixed Income Standing Committee

Regardless, we have included this requirement in the ASISA Guidelines, to give investors an appropriate platform to negotiate for this very important protection.

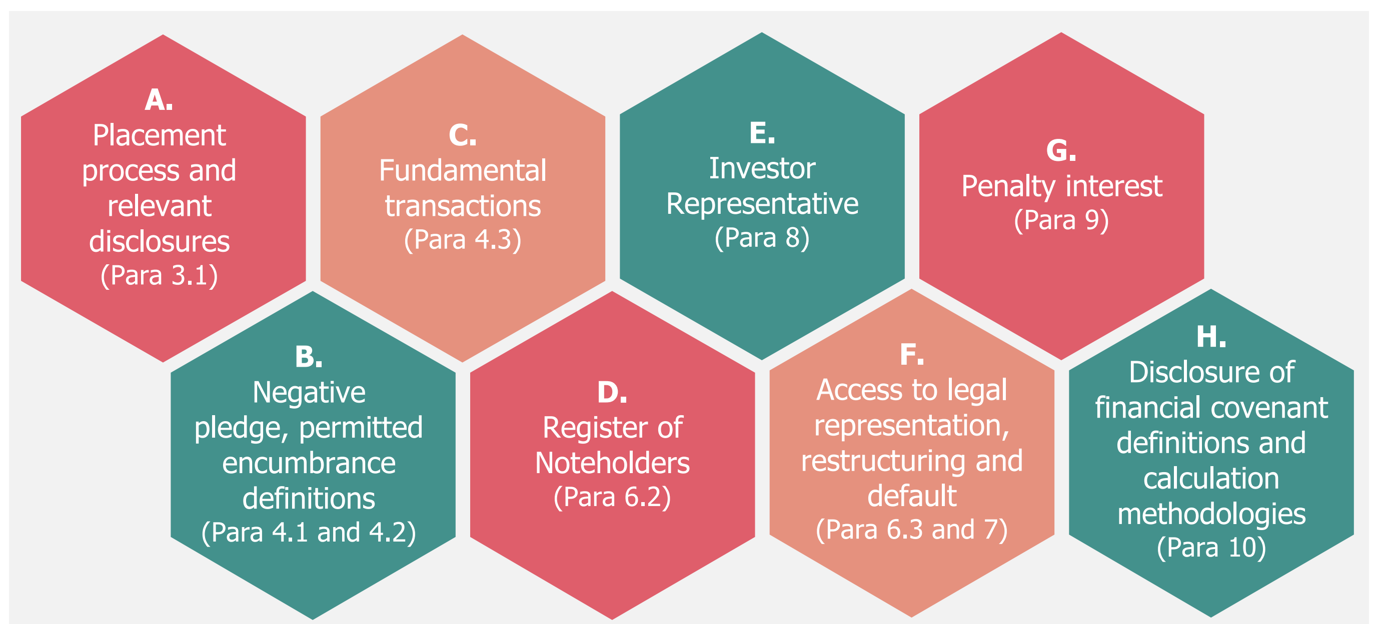
8. Can you explain how the arrangers actually divide the potential investors to try and weaken the position of the lenders at the negotiating phase?

When issuers want to issue a listed bond (effectively borrowing money from the institutional capital market), they go on a roadshow where they make appointments to see each potential investor (usually an asset manager) on an individual basis. At that meeting, they will discuss the proposed bond, the financial results of the issuer, the proposed terms of the loan, the auction process and other matters. To the extent a potential investor raises questions or expresses concerns about the proposed terms and conditions, and tries to negotiate for better protections or amendments to those proposed loan terms, the rest of the market has no way of knowing this. And so, it is very easy for the arrangers and issuers to "divide and conquer" by telling each potential investor that they are the only ones asking for these changes and (usually) using that as a basis to decline the proposed amendments. What we find out subsequently, at ASISA FISC meetings, is that the arrangers have not always been fully transparent – often, there is more than one investor asking for better protections and terms. We have tried to address this by requiring issuers to disclose, on a no-names basis, the details of when investors have asked for amendments or changes to the proposed legal agreement – to ensure that the rest of the market knows that others may also be asking for the same things and in that way, create a better platform for investors to negotiate for better terms and conditions under which our clients' money is invested.

9. Have the proposed DLR Guidelines already been approved by ASISA? (to address the shortcomings)

Yes they have. They were presented to, and approved by, the ASISA investment Board in March 2021.

ASISA Debt Listing Requirements (DLR) Guidelines



10. Considering the risks you highlight with listed bonds, are trustees of pension funds aware of the risks (as their fiduciary responsibilities) – and could they also add pressure?

Given where bonds are placed in the capital structure of a business, they are less risky than equities. Nonetheless, there is a need for appropriate investor protections. We believe that in addition to the counterparty credit risk, much of the risk investors face arises from the current structural unfairness of the market and the lack of sound lending principles in loan terms and conditions. This is what we are trying to highlight and to improve.

11. What is the role of arrangers?

The role of the arranger is to work with the issuer, in terms of the prospectus content, and to organise roadshows to engage with investors. The arranger is responsible for documentation and process, as well as understanding which investors have an appetite for particular types of debt.

12. How did you consult with issuers? What is their response?

Futuregrowth has started a process to engage with each JSE listed bond issuer and arranger. Our aim is to communicate, on a per issuer basis, what specific investor protections we think should be included in the legal documents, and engage with each issuer on these issues. We understand that this is a process that is going to take time and engagement to get to an appropriate outcome.

13. Is this an issue of an exchange or lack of transparency in the bond issuance process by issuers and arrangers - or investor failure to assess inherent risk?

It's possibly all of the above. We believe that the current regulatory framework is structurally biased against investors, and that the market structure and practices have historically violated most of the basic principles of sound lending. Further, we believe that the market has not evolved in response to real defaults and credit events, nor have the established market practices allowed for appropriate negotiation of better terms to enable investors to protect their clients' money. Investors and regulators have also, we believe, mistakenly assumed that "listed" somehow means safer, which has not been the experience.

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