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New Model for Syndicated Closings in the ICSDs

NEITHER THE ICMA NOR ANY MEMBER ENDORSES THE PROPOSED NEW MODEL FOR SYNDICATED CLOSINGS. THE OBJECTIVE OF THIS PAPER IS TO FACILITATE THE TRANSITION TO THE NEW MODEL AND TO MINIMISE DISRUPTION TO MARKET PARTICIPANTS. Market participants will need to undertake their own analysis of: (i) internal changes required to accommodate the new model; (ii) readiness for adoption of the new model to ensure no disruption to settlement process and in particular issuer receipt of funds in a timely manner; (iii) anticipation of any additional costs necessitated by adoption of the new model.

Introduction

On 21 April 2021, the two International Central Securities Depositories (ICSDs), Euroclear and Clearstream, announced that implementation would go ahead[1] of a new model for the delivery vs payment (DvP) closing of syndicated bond issuance settling within the two ICSDs.[2]

This paper aims (i) to very briefly describe the new model (in contrast to the current model) and particularly (ii) to suggest how transaction documentation can be consequently modified for a vanilla Reg S bond[3] involving an underwriting syndicate and their issuer client.

The current and new syndicate closing models

Under the current closing model, and following a 'green light' from the settlement bank[4] regarding satisfaction of applicable conditions precedent:

(a) a duly executed and authenticated global bond (representing the entirety of a new bond issue) is delivered on the issuer's behalf (usually by its agent) to a common depositary (CD) or common safekeeper (CSK) for the ICSDs[5], against the CD / ICSDs' common service provider (CSP) delivering its advice of irrevocable payment instructions (payment advice) concerning payment of the issue proceeds to the issuer's order[6];

[1] Exact date to be confirmed.

[2] The new model will apply equally in the Reg S and 144A contexts (and for that matter in the SEC-registered context, if clearing in the ICSDs on a syndicated basis). Though most ISINs settling within the ICSDs have an "XS" prefix, certain other ISINs can settle within the ICSDs (e.g. notably domestic ISINs in the case of some convertible bonds and "EU" ISINs). Non-syndicated closings in the ICSDs, free of payment (FoP) closings in the ICSDs and closings in the Euroclear and Clearstream domestic CSDs are not concerned by the new model.

[3] Whilst the new model will apply equally in the Reg S and 144A contexts, this paper only contemplates changes to Reg S transaction documentation that tends to be relatively more harmonised. That said, this paper can be used for inspiration on considering changes to 144A transaction documentation.

[4] The member of the underwriting syndicate selected to coordinate settlement with the issuer on behalf of the syndicate.

[5] Most often the issuer's agent and the CD/CSP are the same legal entity, albeit acting in different capacities.

[6] The CD/CSP payment advice is based on an irrevocable commitment to pay (CTP) received from the ICSDs (that is based on certain cash reservations and/or credit lines within the ICSD systems) and is preliminary to subsequent execution of cash payment from the new issues syndicated account in step (d).

(b) the bonds are then created in the new issues syndicated account of the settlement bank[7];

(c) settlement instructions previously entered by the settlement bank and allocated investors (and any intermediate account holders[8]) are then executed (by the ICSDs) on a DvP basis for value on the settlement date (mostly within minutes, through a few instructions may be subject to some technical delays that may take longer to clear as between the underwriting syndicate and the investors concerned).

(d) the previously submitted cash payment instructions are then executed (by the ICSDs and CD/CSP) for payment of the issue proceeds from the new issues syndicated account to the issuer's order.

In this respect, the CD/CSP is able to deliver its payment advice on the basis of an ICSD irrevocable commitment to pay (CTP) the CD/CSP. The CTP is based on certain cash reservations and/or credit lines within the ICSD systems – notably blocking the cash and/or credit capacity of the settlement bank (since it generally delivers the bonds via its own trading account) so that it can honour its contractual obligation (under the subscription agreement) to pay the issuer. The intra-day liquidity/collateral requirements involved are becoming an increasingly material fetter on clearing efficiency and liquidity as syndicated bond issuance transactions (and so intra-day credit exposures) continue to grow in number and size.[9] The new closing model proposes to address this, by effectively moving the entirety of the closing process into the ICSDs' books.

Under the new closing model:

(a) the duly executed and authenticated global bond is delivered free of payment to the CD/CSK, but conditionally (i) on the bonds being credited only to an ICSD account (a 'commissionaire account') nominally for the benefit of the settlement bank[10] but over which the issuer has third party rights[11] and (ii) on the bonds being released from this commissionaire account only on a DvP basis and in their entirety;

(b) on the 'green light' from the settlement bank, the bonds are created in the commissionaire account[12];

(c) the settlement instructions previously entered by the settlement bank and allocated investors (and any intermediate account holders) are then executed on a DvP basis (again expected to be within minutes, and again with the underwriting syndicate covering for any technical delays regarding the settlement instructions of some allocated investors[13]); and

(d) the previously submitted cash payment instructions are then executed (by the ICSDs) for payment of the issue proceeds from the commissionaire account to the issuer's order.

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[7] Following CD/CSP confirmation to the relevant ICSD of receipt of the global bond and instructing consequent account crediting.

[8] Generally, the settlement bank delivers the bonds via its own trading account (that is thus the nominal initial 'allottee' facing the new issues syndicated account from the ICSD perspective) to the billing & delivery bank (the member of the underwriting syndicate selected to coordinate settlement with the investors on behalf of the syndicate) and thence to allocated investors - either directly (where the billing & delivery bank has a KYC relationship with them) or otherwise via the account of another syndicate member (that does have such a KYC relationship).

[9] From one or two transactions per day of a few hundred million euros-equivalent each some years ago, to a dozen daily transactions reaching into the billions (if not tens of billions) of euro-equivalent each today.

[10] This is because issuers generally do not have their own accounts within the ICSDs. (Technically the account is in the name of the selected ICSD acting as commissionaire for the account of the settlement bank.)

[11] The ICSDs have sought to do this by including in their commissionaire account terms a third-party beneficiary clause (*'stipulation pour autrui'*) within the meaning of Article 1121 of the Belgian Civil Code (in the case of Euroclear) and Article 1121 of the Luxembourg Civil Code (in the case of Clearstream). In this respect, the settlement bank is the stipulating party (*'stipulant'*), the relevant ICSD is the promising party (*'promettant'*) and the issuer is the third-party beneficiary (*'tiers bénéficiaire'*).

[12] Again following CD/CSP confirmation to the relevant ICSD of receipt of the global bond and instructing consequent account crediting.

[13] Delivery from the commissionaire account will again be indirect, initially generally via the settlement bank's own trading account that will have a sufficient cash balance (and/or ICSD credit line) to top up the cash amount needing to be credited DvP to commissionaire account to cover the entirety of the issue.

The new model eliminates the ICSDs' CTP and reduces intra-day cash/credit requirements, with only a potential residual need for settlement bank cash/credit to top up the cash amount needing to be credited DvP to the commissionaire account.

The timeframe for completion of steps following the green light is expected to be unchanged under the new model. Issuers will continue under the new model to look to their underwriting syndicates to ensure payment as required under the subscription agreement.

Where pre-closing is currently required, this would continue to be the case under the new model.

Suggested amendments to vanilla Reg S transaction documentation

Regarding debt issuance programmes, the following suggested modifications to vanilla Reg S transaction documentation do not require a programme update, as they only impact drawdown documentation for syndicated issues.[14]

1. For inclusion in the **subscription agreement**[15] to govern the position between the issuer and the settlement bank:

   "[*The settlement bank*] or such other [Joint Lead] Manager as the [Issuer may direct / Managers may agree] to settle the Bonds (the "**Settlement Bank**") acknowledges that the Bonds represented by the [Global Bond] will initially be credited to an account (the "**Commissionaire Account**") for the benefit of the Settlement Bank the terms of which include a third-party beneficiary clause (*'stipulation pour autrui'*) with the Issuer as the third-party beneficiary and provide that such Bonds are to be delivered to others only against payment of the net subscription monies for the Bonds (i.e. less the commissions and expenses to be deducted from the subscription monies[16]) into the Commissionaire Account on a delivery against payment basis.

   The Settlement Bank acknowledges that (i) the Bonds represented by the [Global Bond[s]] shall be held to the order of the Issuer as set out above and (ii) the net subscription monies for the Bonds received in the Commissionaire Account (i.e. less the commissions and expenses deducted from the subscription monies) will be held on behalf of the Issuer until such time as they are transferred to the Issuer's order. The Settlement Bank undertakes that the net subscription monies for the Bonds (i.e. less the commissions and expenses deducted from the subscription monies) will be transferred to the Issuer's order promptly following receipt of such monies in the Commissionaire Account.

   The Issuer acknowledges and accepts the benefit of the third-party beneficiary clause (*'stipulation pour autrui'*) pursuant to the [Belgian/Luxembourg] Civil Code in respect of the Commissionaire Account."[17]

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[14] Though ICMA will consequently update paragraph 1.5 in the introductory text preceding the ICMA Agreement Among Managers Version 1 in the ICMA Primary Market Handbook, there are no consequential modifications to the actual ICMA Agreement Among Managers (Versions 1 and 2).

[15] Or, failing which, in a side letter.

[16] Such commissions and expenses to be further specified in the subscription agreement. (Though generally bonds are released against the net subscription moneys as provided for here, if the transaction parties have agreed the bonds are to be released against the gross subscription moneys, they should advise the ICSDs of the appropriate gross amount due for DvP settlement with the commissionaire account and draft the subscription agreement and instruction/confirmation letters accordingly.)

[17] The third-party beneficiary clause (*'stipulation pour autrui'*) is technically subject to revocation by the settlement bank as stipulating party unless (i) the clause is formally accepted by the issuer as third-party beneficiary (as provided for here) or (ii) such revocation is formally waived by the settlement bank (this is also provided for in the commissionaire account terms and conditions the settlement bank has entered into with the relevant ICSD).

2. For inclusion in the **issuer's instruction letter to the agent**:

"In connection with the issue of the Bonds, we hereby authorise and instruct you as our agent to authenticate the [Temporary Global Bond and the Permanent Global Bond] relating to the Bonds (or to cause them to be authenticated on your behalf) and to deliver the [Global Bond[s]] to the ICSDs' common depositary/common service provider ("**CD/CSP**"), for the CD/CSP to instruct the relevant ICSD to credit the Bonds free of payment to the commissionaire account of [*settlement bank*] (the "**Settlement Bank**") or of such other [Joint Lead] Manager as we may direct to settle the Bonds.

Please notify us and the Settlement Bank promptly if CD/CSP advises you that the Bonds cannot be credited to the commissionaire account of the Settlement Bank as per their instruction to the CD/CSP. Once notified, we shall forthwith nominate another [Joint Lead] Manager to settle the Bonds.

Please acknowledge this communication.

Yours faithfully
[*Issuer*]
…………………………."

3. For inclusion in the **settlement bank's instruction letter to the common depositary/common service provider**:

"Pursuant to the terms of the subscription agreement entered into between the [Joint Lead] Managers and the Issuer, in connection with the issue of the Bonds, we instruct you, on behalf of the Issuer, to instruct [*relevant ICSD*] to credit free of payment [our commissionaire account / *include account identifier*] (the "**Commissionaire Account**") with the Bonds represented by the Global Bond[s]. The terms of that account (i) provide that such Bonds are only to be delivered to others against payment of the net subscription monies for the Bonds (i.e. less the commissions and expenses deducted from the subscription monies) to the Commissionaire Account on a delivery against payment basis and (ii) include a third-party beneficiary clause (*'stipulation pour autrui'*) with the Issuer as the third-party beneficiary.

Please (i) notify us when you have confirmed receipt of the Global Bond[s] to the relevant ICSDs and instructed consequent Commissionaire Account crediting and (ii) notify us and the Issuer's agent promptly if the Bonds cannot be credited to the commissionaire account as per our instruction.

Please acknowledge this communication, on behalf of yourself and of [*relevant ICSD*].

Yours faithfully
[*Settlement Bank*]
…………………………."

4. Format[18] for the **issuer's payment instruction to the settlement bank**:[19]

"In connection with payment of the net subscription monies for the Bonds (i.e. less the commissions and expenses deducted from the subscription monies) to your Commissionaire Account on a delivery against payment basis, please make the following payment[s[20]].

Value Date: …………………………

[18] This instruction might be given informally, e.g. by e-mail.

[19] The settlement bank then directly executes payment out the commissionaire account using ICSD formatted inputs.

[20] Further instructions to be added as necessary.

Cash currency and Amount:	………………………..
Intermediary Bank Name (if applicable):	………………………..
Intermediary Bank SWIFT BIC:	………………………..
Beneficiary Bank Name:	………………………..
Beneficiary Bank SWIFT BIC:	………………………..
Final Beneficiary Name:	………………………..
Final Beneficiary SWIFT BIC (if applicable):	………………………..
Final Beneficiary account number (IBAN):	………………………..

Please acknowledge this communication.

Yours faithfully
[Issuer]
……………………….."

5. For inclusion in the body of the **signing and closing memorandum**:

"The steps necessary for the creation of the Bonds (in particular the crediting of the Bonds to the relevant securities account(s) and the execution of the payment instructions to the Issuer and/or as directed by the Issuer) are deemed to take place simultaneously."