Session Two: Understanding Costs and Incentives in Municipal Bond Pricing

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Introduction Slide
Mark Cambpell, Executive Director, CDIAC

>> ….Speakers and I failed to do this can I do a quick little poll here and find out how many issuers we have by raising your hands? Excellent, well, phenomenal, underwriters, broker-dealers? Good. Bond counsel? Couple? How about FA and other municipal advisors now, consultants? But, okay. A spattering, Michael we are going to have to do better to reach out to the other consultant folks. I'm going to be a bad storyteller and sort of interrupt the process here and tell you what we are trying to do. You did sign up and are participating and I think in all fairness we should recognize there is an underlying intelligence to our curriculum. We are about as you well know if you know CDIAC is the issuer community. Our goal here is to engage the issuers in a discussion about s. In as well as the rest of the community. Really for the benefit of the issuers to better understand types of disclosures they are receiving. And what sorts of questions they should be asking if they are not asking and expecting disclosure on. So I have challenged Chris here with a very difficult task, and that is to address some elements of the market that the issuers themselves may fully understand, or it may appear a little bit opaque to them. And it relates to the G-17 disclosures with regard to rules and conflicts of interest. So, Chris has the challenge here of speaking to issues related to compensation, profit-sharing arrangements, some of which were detailed by Jay. Payments to issuer personnel, retail order. And to do that in a transparent and clear fashion. If any of you have heard Chris speak you know he is the person to do that but he did obviously have to go through his compliance folks. So where he is vague on certain issues, hit him up. Sorry, Chris. This setup is difficult I know. It is more of a lecture style setup but again throughout this program today I'm going to encourage you to ask questions and engage speakers in a discussion. This is really meant to be two-sided. We are not up here, we are intending to speak to about the issues as certainly inform people but not without openness to engage in discussions and find opportunities to advance the G-17 disclosures, the work of the MSRB in defining some of these elements and the responsibilities of the issuer community to expect full and transparent disclosures. So with that I'm to turn it over to Chris. He's got a full package of stuff. Many of you I'm sure know him. He's the chief strategist and director of the firms with Loop Capital Markets all the way from Chicago, analytic services division. He has five full-time staff professionals and it's amazing because of the volume of work they put

out. One of the largest analytic groups dedicated to public finance. You want me to read more? I abridge all of this, but it is available to you in the pamphlet and I'm very grateful Chris for taking on this difficult task.

Chris Miers, CFA-Managing Director, Analytical Services, Loop Capital Markets

>> Thank you. Good morning. I apologize for giving Mark and Linda a scare. There's always the inevitable crises of the moment in the office and you can get absorbed and get a couple moments behind time and I didn't really plan on getting here two minutes before. I was hoping to get here more like for 15 minutes before. But in any case now that I know who's in the audience it was probably also unconscious because I'm fairly certain that if I'm not careful, I can irritate, annoy, insult, or cause vexatious problems to almost everyone. Every constituency in this audience. I'm going to try to be careful but going to try to be straightforward and I'm going to try to adhere to the task that Linda and Mark gave me. Which is, you know, has a higher degree of difficulty than many of the other ones I've done elsewhere. So I am appreciative of the challenge. And I'm going to give it my best shot. Please keep it interactive. Ask questions whenever you're ready to ask questions or make comments. And, you know, we will have an exciting 40 minutes.

Now, Mark had mentioned that the compliance department had to review my presentation. So this is the only slide. Are there any questions? No, let's get started. I want to first say that there's going to be discussion if you've read the seminar discussion we talk about rewards, middlemen involved in the underwriting process, talking about distribution, how it is done, the nitty-gritty, structuring deals and the investor community which from issuers perspective the investor community is really that group that is the farthest away from the transaction and who they probably know the least about. And actually it was an area that I've spent the most time in myself. I was a buy side institutional muni and investor for many years at Kemper funds and hopefully for the issuers at least if there's questions regarding buy siders and how they react to respond to new issue underwriting I can give you a lot of detail about that part of it. I can give you less detail about the underwriting part of it for the simple reason that it's one of the few things that I haven't done. I've been a buyer, I've been a buy-side trader, I've been a credit analyst, strategist I've done a lot of different things but I really have not been an underwriter. And that is going to make it more difficult for me to get into detail on that area but certainly on the buy side stuff I'm happy to do it.

Slide One: What are the two biggest myths in Public Finance?

I'm going to start off with a very cryptic cynical joke was told to me by an investment banker and maybe you all have heard it before. The investment banker says to the issuer I am here to help you. And the issuer says I'm glad you are here and these are the two biggest lies in public finance. It kind of brings a difficult and uncomfortable picture of where we are, if this is actually representative. I don't think it is, but he probably had a bad day and lost his car in the airport and so occasionally these types of situations arise where the issuer is not as happy to see the investment banker as the investment banker would like.

Now, the process of ensuring funds from the issuer's perspective is very complex. It is very confusing. To almost everybody. Whoops, let's go back. How did I do that?

Slide 2: The process of securing funds in the municipal bond market is

There we go. And it is conflict ridden, potentially. I don't think in every situation, but I think you have to be alert to complex and we will talk about those. This thing is really touchy. I'm going to put this up here. It's also full of a lot of decisions that an issuer has to make, just a ton of difficult decisions. And so I think it's natural for anybody at any level to feel a times B will look and wonder how they're going to get the most accurate information, the most timely information from their team of professionals that they put together. And how they can feel the level of confidence in the team that they really want to feel.

Slide 3: Today's Session

Now in today's session we are going to illuminate aspects of this process from the issuer's in the audience, how many of you have not been involved in the issuance of municipal bonds in over a year or two years. Okay. A couple. So, but the rest of you have done a deal with in the last three months or six months is that generally true? Raise your hands. Okay. You've done it. You've been involved. But each one is slightly different. Each one certainly has different market environments to be sold into. Different challenges. So we are going to go over and I want to gauge how much time you want me to spend on each part. But, so if there are certain parts you already know I won't go through them but we will go over the issuing chronology, the roles of the various professionals, all of whom are in the room basically at the moment. Bringing a deal to market incentives which I know is kind of a hot button for Linda and Mark had some special topics, bond pricing violations in particular Morgan Stanley's recent case. I'm not trying to pick on Morgan Stanley we selected them just because they are the most recent biggest case. Could've been any large number of really great firms, this is just the reality of our business that these things happen. Also what is not up there is the fact that the market is constantly changing. So, the way in which underwriters or investment bankers approach things changes. For example when I was learning the business there was something that was very important in the learning documentation when you read books the fundamentals of muni bonds and other kind of stuff the Eastern syndicate versus the Western syndicate. Does anybody remember the difference between the Eastern and Western syndicate which was so important 25 years ago? Anybody? Neither do I. It used to be important, though, whatever it was.

Slide 4: Negotiated or Competitive?

Now, I think one of the first tasks the first questions in front of the issuers, do I want to sell competitively or do I want to sell negotiated? And this is something that comes up all the time certainly from a banking perspective and I know that I'm always kind of drawn into questions of you, can you marshal information on the competitive process? Can you give us information on negotiated process? So this is a comparison we are not going to go to the individual parts of this. You have probably heard all of this before. But what I do want to say is because the emphasis is on incentives there's a very interesting incentive issue here. The incentive issue arises because on the left-hand side for the competitive deals, the competitive deals are more capital intensive. What that means is you are going to ultimately have less firms involved because there's only a relatively small number of firms in the industry that have had huge capital. So as an issuer you might interact with 25, 30, 35 firms there are probably 50 firms in the business for 60 but there's maybe only five, six, seven that have huge amounts of capital. So if our market were to go 80% competitive, that is going to make it a very capital intensive business and on these competitive sales there is a very small service component. You set it up, you work with your FA, you work with a bond counsel, you publish the sale, you may not interact with any investment makers or any investment banking firms at the time the bids are due, you get two or three, for bids, one bid wins, you're not getting any advice from the investment banker or getting support from the investment banker. On the right-hand side it is less capital intensive. Not that capital isn't important, because it is. But it is less of a focus. There are more firms that can participate meaningfully on the negotiated side of a transaction than on a competitive side. What that means is there is a trade-off here that I don't intend to discuss unless you want to, but it is the trade-off between at this point in where I'm at and the market we are in the market is at. Do I want to go in to the intensive capital world of competitive sale because I don't need any ideas I don't need any service, or do you want to go in the negotiated side because I want a large number of firms providing me with information, providing me with service, etc. And we will get into how that actually works.

Slide 5: Getting the lowest cost financing-it starts with the team

Now, in terms of getting going on your deal to get the lowest-cost financing I think it really starts with the team. I really mean business. The jacket is off. I think it is very very important and all of you seem to have experience in this area already but it is very very important that you establish a process and you think about the process in advance. So you are aware, you discuss with your teammates internally with your fellow staff members, with your supervisor, with your subordinates, your team members let's talk about the kind of process we want to have. Let's talk about the kind of outcomes we want to have. And review if you have an existing process, review the process. Has it worked well? Are there things we can improve, what complaints have we heard back? Are there legitimate complaints from FAs, bond counsel, underwriters council investment bankers, whatever, that we want to address? The process is going to drive the selection. It's going to drive the outcome. So establishing the right process is very very important. If you do the right process you will get more focused participation which means more ideas, more effort, hopefully more worthwhile stuff. Inevitably, more deadweight on your desk from stuff you may not need or want, but people will be trying, people will be working you may get more ideas from more firms. And remember, if you structure the price, the process right, here is an incentive for you as the issuer, if you structure the process correctly it is a great mechanism for getting tons of free information. If you broaden the participation of response and you create a process that causes a large number of underwriters to respond and you have them answer the correct or good questions in the RFP that you really want to know the answer to, you can find you will get a treasure trove of interesting, creative ideas that you might not have otherwise received if you had just gone through kind of the standard operating procedure. So it is a great tool for you if you use it right.

Internally you really want to avoid groupthink. So if you're part of a team of five, six, eight people making the decision, it's very easy to get in the groupthink process where everybody says oh, gee, we like that firm. The firm has been with us for five, six deals now. You know, Joe is a great guy and everything is terrific and you want to avoid that. You want to create if you are sort of the group leader or the person marshaling the resources to make the decision about how the process should work you want to make sure you're getting most of the internal teammate so you can get everybody's real opinion. These scoring systems can be effective in trying to keep things in a sense quote unquote fair and quantitative. You know, you didn't get the transaction Mr. investment banker because your firm had a 37 and the other firm had a 38. But they are dangerous for that very reason because inevitably at the end of the process there's going to be people on your team that say maybe attribute shouldn't have been scored on a scale of 1 to 5, maybe it should have been scaled 1 to 10, or maybe it was less important than we thought. So I encourage you to consider qualitative and quantitative ways of scoring the investment banking proposals, and going through a process of eliminations--like a high school soccer team goes through cuts. And get the full participation of whomever your input team happens to be.

Slide 6: Advisors and Other Consultants

Now, FAs, I've never been an FA so forgive me if I butchered this. I think one thing I want to mention here is that we know what they are I believe I don't have to define that, but as a have their own beliefs and biases perspectives, opinions just like investment bickers underwriters or anybody else in the business so it is important to know what those are. That doesn't necessarily change who you select. You might feel great about your FA, but it is important to note that the FA has a belief system about how things work or don't work. And you may accept their advice most of the time but there may be an occasional time when you choose not to. So really get to the bottom of what that belief system is just like you should with the investment bankers that you deal with. The FA provides a certain type of insurance to an issuer which I think is very worthwhile. It is called CYA insurance. And if I was an issuer and I was afraid that there might be constituencies, taxpayers, people, external or internal to the government I'm working for that would have a motive or a desire to scrutinize beyond good practices my decision-making, that would probably be reason enough alone for me to hire an FA. You want to know why I do this? Why I selected eight syndicate members instead of seven? Go talk to my FA. So I think FAs are a practical reality. Certainly in the world that I traffic in, there's virtually always a financial advisor. I can't think of a circumstance when there hasn't been.

The other thing that I wanted to mention is and I will just tell you straight off I'm behind the curve on this, but in the old days, FAs didn't get paid unless there was a bond deal and they basically got a percentage of the bond deal. It was kind of a primitive way of doing business and the various regulatory authorities didn't like that for obvious reasons. And so there are many new ways to compensate FA's that make more sense for you and actually for the FA, too. There are times when your professionals are under compensated on a transaction. Remember that they sign on to a deal with an expectation of what the effort and workload involved is and if you hit a bump in the road for any reason, their efforts, the hours put in by them and their staffs could double, could triple and in many cases, at least under the old regime they may not have been paid anymore. Hourly fees, contingency fees retainers there's a lot of good ways to do it now--that I do not know a ton about. That if you are not familiar with you should make sure that, A that your professionals get properly paid, and B that they have the right incentives. It's just like with my dentist, I don't want to underpay my dentist because I know I'm going to be lying on my back with his drill in my mouth. So you want to make sure that the professionals are paid I think appropriately or at least in accordance with the agreement.

Slide 7: Selecting the Finance Team and Preparing for the Financing

Now selecting the finance team and preparing the financing. Since it seems like everybody has done this, you don't really need to go through all the various components of the professionals. I think this is a nice chart. You may want to save it for if you have to present it to the city executive or whatever. Because I think it is a nice chart. I think the key thing that I would advise to you is that from your perspective as an issuer, this is about setting a tone. You've got a kickoff meeting, you've made your selections, you've got a lot of people in a room or on a conference call, how you handle this call will in part dictate how things go for the next two or three months until the transaction is concluded. If you have a firm control, if you focus on drawing out positive contributions from all the professionals, if you focus on teamwork and making sure teamwork happens, and if you allow for differences in opinion appropriately expressed, you are going to get a lot more out of this group of people. Along the way you will probably have to resolve conflicts. But I think the big thing to be concerned about is the participation and involvement of everybody. Once somebody is selected and they are in a deal, the burden of effort improving their value goes down a lot, but a little bit. They are in the deal now. Clearly they have to do a good job. They have to please you. They have to do the right things, but you want to make sure that no one person or firm goes to sleep on the transaction. You want to make sure they are still involved. You want to get the best out of them. So you're really the coach in the situation and there are some key decisions that you are going to need to make like the role of the syndicate members and how the pricing transpires and a whole array of other things that we will touch on.

Slide 8: Deal Participants and Responsibilities

This is a basic outline of the deal participants. Issuer, underwriter, FA, rating agencies. The rating agencies are really part of the team they are really kind of the adversaries in a lot of ways. One more than others. I'm not going to mention who they are. And they know it, too. I asked them, don't you guys feel a little uncomfortable nowadays. I mean, it seems like, they didn't want to answer the question.

But anyway I want to give you a personal example. This presentation will not be complete without a couple personal anecdotes and I was functioning in my role as a research nerd and I was presenting with my team of virtually all investment bankers. I, by the way, am not in the investment banking group at Loop. I am an independent group, not in investment banking but occasionally they will bring me to presentations on orals on deals, this was an oral for a top 10 issuer in the country. Huge issuer one of the most sophisticated and I had killed myself on the project that I knew would be of interest to them based on what they had told me. And it was based primarily in econo- metrics and statistics. So, charts, graphs. And my boss turned the presentation over to me. I was featured as kind of the number two or number three guy up on the list rather than my normal spot as the last guy on the list. So I knew my boss thought I was important. And before I had eight words out of my mouth, the financial advisor kind of leaned back, interrupted me and said I don't believe in statistics--which really blew a hole in the group's presentation. And ultimately more importantly than that, it prevented their client from getting the benefit of something that may or may not have been very important to them. How does this person know that what I am about to say will not be of extreme interest to the client? And I am not allowed to say it during the allocated 40 minutes we've been given because this person doesn't like statistics? He got a big laugh. Some of the client members probably enjoyed it. But it really killed our presentation and it didn't give us a fair chance. And I think as an issuer, and I'm sure this works, believe me FAs, I'm sure bankers have done the same thing or worse, so I am not picking on you guys, but as an issuer whether it's coming from a bank or FA, rating agency or anybody else, you do not want one of your professionals, no matter who they are, to hijack an important meeting where you're going to form an evaluation over 30, 40 minutes on whether somebody's going to be part of your team or not. So that is a suggestion.

Slide 9: Deal Participants and Responsibilities (Cont.)

Now let's talk about the deal participants and responsibilities. I'm not going to go through this. I hope this is a good resource document for all of you and certainly FAs and bond counsels, when you're interacting with clients who maybe have not come to market in two, three, five years this would be something there could be a great resource for them. Because there is a fair amount of detail but this doesn't seem obvious to me that we need to go into at this point. So keep that in mind I hope it is useful for you down the road. The thing about, one comment, and again this is an area that I am not an expert, so I have to be careful, but there does seem to me to be a conflict of interest between bond counsel and underwriters counsel and the way this was handled. If in fact the underwriters counsel is the underwriters counsel, then they should be selected by the underwriter and probably paid by the underwriter unless that is negotiated out. I know typically it would be paid out of proceeds, it would be the issuer's cost. But maybe that is not the best way to do it. When an underwriter is given and underwriter's council, these days with all the level of compliance and regulatory focus and concern and monitoring SEC, MSRB, everything, you are really kind of handcuffing them in a kind of way and clearly you are concerned about fees and my suggestion would be, you can use the underwriting counsel that I have selected for you who charges X, or you can choose your own and if it costs more, you can pay the difference. That way you are not paying anything more. But they are getting the council that they think they want. Everybody in this business from the banking side has doubled, tripled, quadrupled their compliance department over the past five, six, seven years so the costs are going up big time and you need, from our perspective, the protection.

For some reason I thought about BABs (Build America Bonds) when I put this chart together and the reason I thought about it is we can look back and these are the basic deals participants. There are some issuers who sold BABs that they didn't know they were making a trade-off, but they were. They were told if they were a large issuer, they were told, look, you cannot sell a traditional taxable muni bond into the taxable bond market. These corporate guys want to make cold calls, they want bullet maturities like threes, sevens, tens, maybe 30s. They do not want oddball serials. They want bonds that go in to the corporate bond index, taxable index and this is the way you've got to do it. And that wasn't necessarily wrong. There were also issuers that were given the advice that you can sell your bond as a taxable muni. Taxable munis have been around since if I remember right, I probably don't, but I think at least the early 90s, mid-nineties? So it was a market that was small but definitely around for quite some time. So at the end of the day from the issuer’s perspective, who makes out? Well if you were an issuer who had a call feature, a traditional muni call future, you probably didn't pay more initially unless you were kind of a local issuer that enjoyed great local support from institutions in the area and retail in the area. So that 10 year call is going to hurt you. There is no doubt about that. But on the other hand if you get to call your bonds and refinance because of some crazy problem that really none of us anticipated, the whole sequestration and haircuts on subsidies, than, gee, even if it was a lucky bit of advice is certainly was a good bit of advice to maintain that possibility.

Slide 10: The Syndicate

Okay let's get into the syndicate. Now, there's a lot of factors in this so you will know and it depends on the size of the offering. If the syndicate is too big relative to the size of the pie that gets split up from a compensation standpoint. That is a motivation reducer. If it is too small, it may be, you may be selling yourself short in terms of the assistance you can get in marketing your deal. So it is a balance and not surprisingly the senior management says you know, we don't need 10 firms, we really just need us, and two or three others. Two or three others would be good. And of course the small fry, which may or may not include my firm is on the other side you know, hey, it doesn't really cost you anything to address it because we can do this and this and this for you that that they may not be able to do. And whose hide does it come out of? It comes out of not necessarily the senior manager; it might come out of the co-senior or the top bracketed folks that get higher participation rates. So I think it is very important to listen to both sides and strike the balance that makes sense for you.

The services obviously you are getting structuring advice, coupons, call features, maturities, you know, if you have multiple indentures, which one would command the best price in the marketplace and of course it gets tremendously complicated. You start getting into tobacco bonds and things like that it is amazingly complicated. And then there is increasing focus unit with the volatility we've had in the last few years and the market disruptions and the Meredith Whitney situations and the big mutual fund disgorgements of shares, excuse me, it's been a tough environment and many many issuers are doing new things that they have done for a long time, or maybe ever with respect to investors roadshows. How to do them. Doing them differently. I mean, our firm has been on taxable deals we have been to China, we've been to Europe, issuers have divided it up. They said okay the book runner is going to do the US, one co-senior is going to do Europe and Loop capital is going to do Hong Kong. And that is trying to use your team to the best of your advantage in those kinds of situations. The nature of roadshows, you know you can't just put up a PowerPoint on your website anymore. You look at some of these websites, Commonwealth of Massachusetts. Is anybody connected with the Commonwealth Mass? They've put a ton of money into their website. It updates automatically, you can put their link in your Excel sheet to their site, you get the data as soon as they put it up. It is unbelievable. But it always comes down to time and efficiency. I was talking to an issuer last two or three weeks ago and they said we really want to do more. We haven't done enough. We feel that we haven't done enough. We think we can benefit but there are two of us and time is a real problem, efficiency, cost. There's a limited travel budget. How do we do it? So you have to really rethink this whole process even from quarter to quarter to quarter. The roadshow that may be good for ABC issuer right now could be a lot different than the one from six months ago. Particularly given what's happening to the mutual funds.

How to distribute the bonds. You don't need, it's like in fantasy football, if any of you do that. You don't need five great running backs to win in fantasy football or in real football. What you need is balance in every position and strength in every position. So in many cases big issues, you know, New York City is bringing a deal, they're going to need the big guys, the big bracket underwriters. But they're also going to need people that are capable of getting their bonds into new sources of buying. There are players out there who haven't bought in New York that might buy in New York. So, the issuer I think is well advised to take in terms of what is this team going to look like? Who's going to be the best firm to getting new buyers who have never bought my name before? Who's going to be the best firm at getting into New England where I don't have strong following? Who's going to be good with, you know, whatever it is. You know. You name it. Retail. Medium-sized PNC's, you can really get into a lot of depth here. And I think it is well advised.

As an example, the University of Illinois which is a AA rated credit we have a database that looks at all of this very very carefully. And there is essentially no ownership in Boston of the University of Illinois. I live in Chicago, obviously. My son goes to the University of Illinois, my brother went. I think of it as a decent, highly ranked institution plus is AA rated. And the idea that there would be one firm in one of the largest concentrations of dollars to spend on Muni bonds in the entire country, probably the second largest, is amazing to me. It is like a cultural problem that has not been penetrated yet. And I've been really counting on them to say look, let's go there, let's find out about what the issues are, what the concerns are. All right, the students there don't walk around with tweed jackets and smoke pipes, but the university is AA rated. And yeah, the state has got problems, but the state is not the whole show there. So anyway, lots of considerations. I will leave the rest of the slide to you. I want to make sure I have plenty of time for questions.

Slide 11: Additional Syndicate Considerations

Additional considerations. I mentioned about the roadshows you know, special status considerations. If you're going to have somebody lead a roadshow to Boston and somebody who's going to do the West Coast and somebody who's going to do the software whatever you know it made may make sense to divide that up appropriately with thinkers that can do it, firms that conduct. And treat those firms as a bracket unto themselves because they are providing extra service. Let me see what else we have here. I have a good example. I think this really make sense. New York MTA. Does anybody here associated with them as a banker, bond counsel, FA? Tell them how admiring of them I am. Please. I think they actually do something good it is a strategy that the user and has made a lot of sense. Every three years ago through a rotation they select I think 10 firms to be a senior manager of pool and those firms rotate to manage a deal. However, they retain the right to not use you even if you are in the pool. So what does that do to the investment banking firm? It does two things because they are in the pool and because they have a higher expectation of being a book running manager on a big deal, it means it means they're going to work incredibly hard to make sure they get a deal. So many firms, maybe even most firms have people committed to just that issuer. Because they feel like I'm in now, I'm in the 10 person group for three years. I just need to contribute and show the effort and I'm going to get my opportunity. So that's a big issue or strategy that will not work for medium sized or smaller issuers. There's the issuer of the national retail or in-state retail.

Slide 12: Distribution Agreements

I want to make sure I leave time here so I'm going to roll through some of this. I don't know if distribution agreements are an issue for anybody. I'm not aware that they should be. The agreements are agreements between investment banks that don't have retail distribution systems and firms that have retail distributions but don't have investment banking. And they form an agreement between each other and they act as kind of a single unified firm and an underwriter in the agreement has to be disclosed to the issuer and the issuer at their option may or may not disclose it in the prospectus. I've seen it both ways. So, is it good or bad for the issuer? I think it is at worst neutral and probably good for the issuer.

Slide 13: Underwriter's Compensation

Underwriter compensation. This can get progressively more complicated to more complexity of the deal like I mentioned tobacco bonds. There may be more management fees because there may be more banking and research involvement, data analysis involvement, structuring, but basically as I think all of you know it is a management fee. Underwriters risk a takedown which is a selling concession for the salesperson. And to some extent expenses that are charged in by the syndicate.

Slide 14: The Underwriting Process

This is kind of the typical process by which a deal goes. The issuer decides to sell the bonds. There is a working group, a preliminary plan of financing, maybe the rating agency documents drafting credit enhancer if appropriate. Finalize documents, but there is one thing that is not on here that goes beyond the pricing and the sale, and that is the review, the review that the issuer should make in terms of evaluating what went well, what didn't go well, both internally and externally. What went well within my organization as an issuer? Were we on the ball, did we really be where we needed to be, did we have all the information we should have had, did we use all the information and then of course externally do the bankers and underwriters and salesmen do what we needed them to do? How would we do it differently? Certainly I think most firms are more than glad to have feedback. You know, particularly if it is along the lines of you can help yourself next time by doing X because firms want to do better for the issuer. We want repeat issuers.

Slide 15: Pricing Timeline

Now there is a pricing timeline. I'm not going to go through it. But I'm going to cover something that hopefully gets back to where we started which use incentives and interpreting information. On the day after pricing or two days after pricing you're going to have a written award and the syndicate manager is going to make a determination of when the bonds are free to trade. And they will announce that time to the syndicate and then when that occurs you or the marketplace will start to see offers and bids pop up in the two-sided markets on various maturities of your particular bond issue. Now, you can watch that transpire if you want to just look on EMMA and it is updated every 15 minutes. So you could be sitting, you know the bonds they are free to trade and watched the bonds trade. Beware of the fact that the initial trades will be on the full underwriters discount because they will show up as what the underwriter paid for the bonds. But after that you're going to see where the bonds are trading and it raises an interesting question. As an issuer, are you better off if you see your bonds trade down, which might imply that you got a good price. Or, are you better off if your bonds trade up? Which might make you feel uncomfortable about the price you got. And the answer is, it's like a lot of things. It is unclear. You really want buyers to feel good about your bond issue especially if you are a repeat issuer. You want them to feel like when they do deals they are done well, they are placed well, they perform adequately in the secondary market, they trade well and that positive association will get them to take a very close look at your bonds the next time around.

On the other hand, let's say, I had this happen to me as a buyer, I had an issuer go through two re-pricing, two bumps, the deal was massively oversubscribed. They bumped it up, meaning they lowered yields once, they got some drops but not enough drops, still oversubscribed, they bumped it up the second time which is just absolutely not unprecedented, but extremely rare. I cannot tell you the bad taste it left in my mouth as a buyer. It is kind of like you are not necessarily mad at the issuer specifically but the feeling is like this. I gave this book running manager through his salesperson an order two days ago. You re-priced it the day after. Then you come back to me after it again and re-priced it again. If I choose to stay, then we know I might get a huge allocation. Or you might get almost nothing. I don't know. It puts a bad taste in your mouth and the next time around you're not going to be as enthusiastic about that issuer's deal. So you have to keep these things in mind.

Slide 18: How can issuers know if they got a good price for their bonds?

I want to get on to some issues of importance that I know Mark and Linda wanted me to cover. I don't know if I've stirred up enough controversy. Apparently not. I haven't had anything thrown at me. So maybe I can do that in the last couple minutes. How do issuers know if they've had, if they got a good price for their bonds? One way to know is let's say the deal is priced at a certain yield level and you get a massive cascade of incoming bond orders within 30 minutes and you've got five times oversubscription and you've got speculators, you've got all kinds of people that you would not normally expect to have. You are a AA rated issuer and you have XYZ ultra fund in there. That would tell you that the underwriter probably priced it too cheap, but not necessarily because of any mal intent on their part. There is one job that is a tough tough job in this business and that's the underwriter to stand between the issuer and the buyer and make both parties happy and make both parties feel like they got a fair price is an incredibly difficult job. There's over a million CUSIPs in the business. There's thousands of issues done every year. To suggest that you can sit down and write a scale on maybe 30 serials that would be the exact level that's going to get you one and a half times over is just too much to expect. On the other hand, if the yields were too low, of course, the order period ends and you do not maybe it is half subscribed or there are holes at certain maturities, no orders in 2018, 19, 20-- institutions that you typically have on your previous are not involved. But, if there's anything to focus on from my perspective is that the difference between too high and too low can be amazingly small and there's a powerful incentive on the part of an underwriter which is to strike that balance and to keep both opposing parties happy-- When their predisposition is for one to feel better than the other. It is not an easy job. It is not a job that I would want, certainly. How was pricing transparency achieved?

Slide 19: How is pricing transparency achieved in the markets?

All the trades can post on EMMA, you can see that every 15 minutes. You can sit in your office and watch your bonds trade. At settlement you're going to see everything, closing you will see the relevant documents, you will be there with your attorney, your attorney can explain any unusual discrepancies, charges, fees, anything on there that you do not understand, the deals are covered by the financial media and that has grown. You don't have the bond wire anymore. You've got Reuters, you've got Bloomberg, you've got Bond Edge, I think a number of them, a number of media outlets that are watching this stuff and of course you have the investors. The investor feels like he or she has been taken advantage by the banker or the investment banking firm they are going to let you know directly or indirectly. If there's something that they didn't like or was unfair or was wrong they are going to let you know, believe me.

Slide 20: Is there such a thing as a “Perfect Deal” where every party is satisfied?

So is there such a thing as a perfect deal and I think the answer depends on how you frame the question. If your question is how do I know that I've got the perfect price, the right to, theoretically the correct price? The answer from my opinion is there is no theoretically correct price for anybody's bonds at any point in time there is none. Not even in the stock market. You don't even know if your trading General Motors that you're going to get unless you have a purchaser limit so that requires the pricing level you don't know exactly what level you're going to get if you require a market order. So if the question is theoretical there is no perfect price. If your question is practical, then I think what it is is if you have a deal where, and you may not necessarily know this completely directly, but if the issuer and the buyers are relatively equally happy and equally unhappy then you probably have had a pretty good transaction. And that is probably about as good as an investment bank or an underwriter can do.

Slide 21: Why do institutional buyers receive better pricing than retail buyers?

Do I have a couple minutes? I will try to wrap things up. Is this an important issue, retail and institutional and the kind of thing? One thing I would recommend this I saw a job that I was going to talk about, Monroeville. It had discussion on definitions of what retail orders were and what they worked and what the size was and blah blah blah that went on for two thirds of the page so this issue is not being driven by anyone's specifics. You know, mal intent or motivation. You know, there is a real confusion and question about how to handle this aspect of demand. Okay.

Slide 23: The motivations of the participants

Okay, the motivations. Basically everyone wants a deal. Everybody wants the deal completed including the issuer. They want their funds, they want to go ahead with their highway project. Now maybe the bond counsel these days get paid from hourly fees and so, they get paid regardless but that wasn't always the case. Same with FAs, that wasn't always the case-- but the investment banking firm doesn't get paid unless there is a deal so they want a deal. So they will try to get your bond issue into the market. Clearly, just like a realtor, like the person at the bottom, they want to sell a house. And the other thing you should be aware of and I'm sure you observe this all the time, is that these people many times know each other. They've had prior experience with each other which could be good or bad, and they expect to have future experience with each other, both on your issues as well as some other issuer. So, you should be aware that there is an aspect of this where relationships exist that you may not completely know about. And, that there is nothing particularly necessarily bad about that. But, just be aware that your FA, or your investment banker has to think, has to modify their behavior to account for the fact that they know they may run into this individual in the future and the FA at times once the investment banker to speak very well about them, the clients they don't have, and vice versa. It is a terrible job. You don't want to do it. Believe me. It is impossible. And just one final, one added position, the issuer do not lose control of the transaction. You can have as much information as you want. I would suggest the use of the sales floor while the deal is being priced because that is just going a little too far but you can get updates, you can find out who's in on the deal, you can find out who's not on the deal you can see how the bonds are allocated. You can get the information you want if you ask for it and make it clear to the senior manager upfront.

Finally, maybe this is a pitch or a defense of any public finance, but keep in mind like on the new Verizon deal that just came, corporate bond issues get done with about 7 ½ dollars per bond in them and they have constituencies too. They have shareholders instead of taxpayers. And they freely choose to pay that price and they choose their own investment banking groups, and, now they have been, our fees have been sliding for a long time and part of it is because of the transparency. Because there's freedom of information, because this information is out there for the public to see and view, which is a good thing. The issuers are the beneficiaries of increased competition that you do not see on the corporate side. We are not getting 7 ½ dollars a bond. So hopefully that's been interesting. Love to open it up for questions, discussions. Let me have it. Yes, sir.

Question:

>> First as an investment banker I'd like to [inaudible]

> And I am glad you are here.

>> To touch briefly on the distribution agreements [inaudible] unless they are really bad or I think the important part for the issuer to know is what [inaudible] selling for versus the underwriter that is as important as disclosing that you have it.

Answer: Chris Mier

>> I don't know how that works and just to be completely candid, and maybe you know this loop has one of these, so maybe you are aware of that. With J.P. Morgan, that is, I'm sorry, with UBS. With UBS. That we occasionally operate with. And I honestly do not know how that works. There is some kind of fee sharing, I don't know if they get the full takedown. I don't know if there is a split arranged, but I bet any issuer who wants to know can find out. I mean there is no question about that. The ability to get that information is not difficult.

Question:

>> [Inaudible] talking about incentives that issuers are aware of.

Answer: Chris Mier

>> I wouldn't disagree, yeah. I mean, issuers by all means, ask. Yes?

Question:

>> Natalie Brill, the City of LA. I'm glad you made it to Los Angeles, Chris, and I have three comments. One has to do with the role of the financial advisor that you mentioned. I have heard a lot of times that smaller issuers have said that they are not necessarily needed and I disagree. I think the role of the financial advisor especially on negotiated deal, I mean I understand the role in a competitive deal it is very important because even a city like us that's in the market a lot, you still need that independent advice on the

pricing itself. When you talk about the pricing and how important it is. Even though we read Bloomberg and keep track of what pricing so I think the financial advisor really does provide a really good voice in helping cities, issuers do that. I know that a lot of issuers don't believe it's necessary but I'm a strong believer that financial advisors are necessary. As far as the pricing goes I mean we are one of those issuers who have dropped prices twice. For whatever reason because the market shifted and you know, our philosophy is why should we pay more, or have higher interest rates if we know the market has shifted. So, sometimes you do go out and pre-price and get involvement from your buyers and then the market moves. So, we do push for, as a city we do push very hard on pricing because we do see where the market is. On the other hand I've had pricings go the other direction where I've had to lower or raise my interest rate three or four times because the market shifted. So it moves both ways. The third one I can't remember. It will come to me.

Answer: Chris Mier

>> Let me get started on the first two. I think the way I view the FA decision from the issuer standpoint is this, in my opinion it is a very low cost relative to a lot of risk reduction. You are not paying these folks a lot of money and yet the potential is for them to save you a tremendous amount of headache conceivably for bond issue that could be out there for 30 years. So as I'm making that decision it is the classic penny wise pound foolish situation. Do you really want to do it by yourself and not have the benefit of the expertise just because you can save yourself a relatively small amount of money? So I do agree with you there. I think I should've maybe caveated my remarks and buyers notice if the market is changing dramatically. They understand. Particularly now they understand that if the market is rallying like crazy and issuers repriced it once and the 10 year treasury is up another couple points that there's got to be another re- price so they understand. What I'm talking about is, and you don't see this too often, but every once in a blue moon you see sort of a milking situation from either side and the buyers can do it to you guys too, when they want to do it to you guys, too. They want to maximize their advantage over your situation so that is something to keep in mind when you're interacting with the underwriter because a certain insurance company or the certain fund may have given kind of a little bit of nuanced read on the interest in an attempt to confuse the underwriter, improve the pricing so that when that underwriter comes in to you and says well I don't think these five firms are going to participate and then they all show up it's not because the person is a dummy, you know, it's because there are negotiating games going on that you may not be fully aware of, but I appreciate both of your points. Have you remembered the other one? Oh, okay, well, hopefully we have

time.

Question: Lakshmi Kommi

>> David, depending on the bond issue, we are glad too, that you are here. As a banker. On Natalie's point, if you just could you know, clarify on that, sometimes the pricing two times of repricing may not be driven by the market shift alone. It could be if the buyer sees that there is no mal intent with the underwriter, the property manager the initials cannot be reflecting the market state as the day of, so from the issuer standpoint repricing, don't take it personal. We have to go down that path. There's really no other way for us, with or without market shifts. So you need to ensure from a buyer standpoint I suppose the underwriter as in partnering with the issuer. Need to convey the right message to the buyer. Under what circumstances the underwriter on behalf of the issuer is correcting the price.

Answer: Chris Mier

>> You are absolutely correct. I mean a lot of this process goes more smoothly if there is good communication. It's not necessarily abundant communication, but just good clear communication that gets passed through from both sides. Both sides have legitimate reasons to want what they want. The issuer wants the lowest possible cost and the issuer can, should and usually does apply maximum pressure to get the lowest yield. And that is perfectly right. The underwriters get that, totally. And the buyers conversely want a good deal they don't necessarily they are not concerned with Akron, Ohio and whether they have to pay another basis point for their sewer or whatever it is. Hopefully there's nobody from Akron here. But they're going to negotiate, too. So what does a good underwriter do? A good underwriter understands the perspectives of both sides. Appropriately communicates only what is necessary and professional to each side. Tries to bring them together and tries to get a price that satisfy the objectives of both and gets the deal done. So, there's a lot of art to it. And it can be difficult. You know if you are in issuer and your bonds haven't been traded in six weeks and you have to go buy comps and maybe there are not a lot of great comps relative to your particular type of community or municipality or rating level or whatever you know you're really trying to kind of triangulate into a pricing level and all your issuers and FAs have seen the range of preliminary scales or suggested scales that the syndicate moves in. It's a pretty wide standard deviation you know part of that is maybe some games playing and part of that is people don't completely know where the exact market is yet. Anything else? Well thank you very much. I appreciate your attention.

[Applause]

Mark Campbell

>> All right. We're going to take a break here. Just housekeeping. I think there's a restroom right around the corner here, left, left. I also want to make sure to mention all of our slides are available on the CDIAC website. Typically we provide access to those in advance, or we have wired, Wi-Fi in the meeting room. We don't here, so I apologize for that. We're going to come back and speak to some of the underwriter issues that Chris brought up and I want to thank Chris. I think this is the only week in Chicago that you have nice weather, right? So we are fortunate to have him here. Thank you again. We're going to come back in 5 minutes. We are a bit late, so I challenge you to get back to your seats. We are putting in some extra seats. There are a few available up front so feel free to make yourselves comfortable.