Session Three: The Dynamics of Underwriter Disclosures under G-17

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[Audio begins abruptly]

Mark Campbell, Executive Director, CDIAC

>> ...Major, municipal finance at RBC markets and Charles Eastern water district. Thank you for being here and I will...

David L. Cohen
Slide 1: The Dynamics of Underwriters Disclosures under G-17
>> Thanks, Mark, very much. So thank you, everybody, for listening to a third panel on G-17, today. I know we are running behind late and we are standing between, or sitting between you and lunch, so we're going to jump right in. In Jay Goldstone's presentation this morning he talked about the balance and the appropriate balance between protecting investors and issuers versus efficient municipal markets. Whether you like or dislike the underwriter disclosures to issuers, they are here to stay. And there will be more disclosures coming your way that will require acknowledgments from you. Last week's final MA rule that was passed by the SEC has a whole host of other disclosures that underwriters will be seeking from you if you have an independent FA. The MSRB had shelved its rules for MAs pending the adoption of last week's rule and you will be receiving disclosures from municipal advisors as well. And also now before the SEC are amendments to rules governing retail order periods which will require you to provide written acknowledgments to underwriters that you agree with the terms and conditions of the retail order period. We know there's been a lot of feedback, a lot of back and forth. SIFMA has been in to talk to the MSRB about the disclosures. But most importantly, if there is a chance for changes, for meaningful disclosures, that has to come from you the issuer community. Are they making, all the disclosures making sense? So I put together

a large slide deck, which you can access on the website.
We are going to jump for today just to the last page because we want this to be interactive. We have to my immediate left someone who represents an underwriter and then we have some great issuers on the panel as well. So just a high-level overview of the disclosures and why perhaps they are so long. There's a lot that the rule requires to be disclosed. They are required to be sent early in the process. Underwriters have to disclose their role--conflicts including compensation and other conflicts. And if the financing is recommended by the dealer, and the financing is complex, and under the G-17 interp everything is complex except perhaps a fixed rate deal unless you are a first-time issuer. So by default everything that's recommended requires a disclosure of the financial characteristics and the financial risks of the transaction and the disclosures must describe the magnitude of the risks. The impact of rate fluctuations for example, or the impact of termination payments is another example. And then the dealers are required to seek acknowledgment of receipt. So that's really just an intro for a launching point.

David Cohen
Slide 11: Next Steps
Let me just skip to the end. Don't try and follow this. This is just an overview. So this is really what we wanted to do today was to have a discussion, to hear from Brian and others what the impact is, what they are doing and then also hopefully we will get some questions from the audience. So, how, are underwriters, I'm sorry, are issuers receiving these disclosures and are they helpful?

Cammy DuPont
>> Good morning. My name is Cammy DuPont. And I work at LA County in the County Council's office and the LA County does, is in the market quite often as soon as the rule came out we started receiving the letters and I had put together this little matrix that I do not know what happened to it, but the letters that we've received have been anywhere from one page to four pages. Often times they lay out real specifically the sections in G-17. Interesting enough, we did receive one letter that was one page that I didn't even mention anything which I thought was incredibly important and that is that they were not acting in a fiduciary role. They completely left that out. But, the letters we received are usually about 1 to 4 pages and we've received letters from underwriters that have been two pages and in a subsequent deal it's been four pages. It is in flux. It's fluid and underwriters are really trying to figure out as they go along what other information

they really need to add to these letters. So that's what happening at LA County.

Arn Andrews
>> In San Jose our experience was similar. I think as people have already spoken to it today when we first got it, our first question was what is this? We also have an internal attorney's office, so the next question was will we sign it? We decided there's nothing in there that specifically said we were attesting to anything. So we currently do sign them. I think the way the question was posed was, you know, are they helpful and to be honest they resemble, like any other bond document when you come to market, I mean, the language is formulaic. It seems to be heavy on legalese as opposed to maybe addressing specifics. I mean, so if the letters in the form that we are getting them are meeting the intended purpose that's probably open to debate, but are we receiving them and are we signing them? The answer is yes.

Charles Turner
>> My name is Charles Turner from Eastern Municipal Water District and we've had a similar experience. We've had several issues in the last 12 months and for each of the series we've been getting several letters, sometimes duplicate letters, but almost all of them follow the same SIFMA model. And I know it's another question that we have about black-lining, but it becomes more tedious than anything. It's that we are getting the letters, we are trying to follow the letters to make sure we're not missing something when we read them, but at the same time we spend more time trying to track what's in it or not in it than we are actually trying to absorb what is a critical disclosure. So in some ways it's really nice to have a disclosure letter upfront in advance, but on the other hand as a more frequent issuer it becomes a little bit more of an administrative burden for us to sift through that to make sure we get the true essence of the document and understand what's most important for us to glean from it, versus just a typical another disclosure from one of our several underwriters for every single transaction that we do. So is it helpful? Yeah, it's a partial yes and a heavy no.

Brian Hellberg
>> From an underwriter's perspective, and my firm RBC Capital Markets actually does more deals than anybody else each year, we don't necessarily, we're not first in the league tables in terms of our amount but we do about 700 deals a year and we have 90 senior bankers across almost every geography. And I think what people don't realize so

much about the municipal markets is the practices are very geographic. And what you folks do in California is very much different from what they do in Pennsylvania for example or Texas. And the level of sophistication or the role of the issuer is different in every jurisdiction. So at the SIFMA level, in working on the draft letters, I think probably at the MSRB level in terms of drafting the guidance and now at the dealer level, the challenge is the disparate nature of these issuers. And Jay Goldstone mentioned it as the current share of the MSRB. One size does not fit all. And from my point of view, getting these letters out the door literally every day in our firm, the challenge is we need to get to a better place so that it's not one-size-fits-all. I think of the letters having four major parts. The first two parts are simple. What is our role? We are dealer. We are an intermediary. We are between buyers and sellers we cannot owe either one of you a fiduciary duty. It would be inconsistent with fiduciary duty standards. We are dealing. We're trying to find the current market level and I think as Chris pointed out extensively, it's about trying to get two parties that are reasonably happy but neither one, you know, slapping high five and quite frankly, that is the typical role of a dealer, is to manage those two conflicting interests between investors and issuers. The second part of the letter is the conflict regarding compensation. Again, yeah, it's a contingent fee. That means we don't get paid unless we get it across the goal line and everybody gets that. My personal view is that we don't need to say that in every single letter going forward to every issuer. Particularly this kind of group of issuer, which is a large, or frequent issuer group generally. But the rule says, the underwriter shall make the following disclosures.

David Cohen

>> And just to jump in for a sec, so to Brian's point, many in this room might not consider that to be a conflict. The larger the bond deal, the more bonds that are sold and there is a per bond fee, and that is how dealers are compensated. But, that is a mandated conflict that must be disclosed pursuant to the guidance. That one is not optional. It's not murky. It's one the dealers have to say.

Brian Hellberg

>> And so point one and two in the letter are very much, from my perspective, I feel like an SEC lawyer, I should say these aren't necessarily the views of my firm, but they are boilerplate, let's face it. The language literally comes right out of the notice in almost every letter you see. Where I'd like to see more attention both regulatory, at the dealer level and quite frankly at the client level, is when we get down to disclosing the unique conflicts of interest if any that a dealer has in working on that transaction and more

particularly the disclosures regarding the risk and material characteristics of a complex financing. I do expect our issuers to call back one of my senior 90 bankers who does business across these United States and say, you know hey, what the heck did you put this disclosure in there about a conflict. Explain to me exactly what you mean by that. Part three and four are really where we work hard as a firm to analyze each issue and each transaction to figure out what we need to put in that letter. That is sort of the underwriter's perspective and where we put our energy and time on these things and it is not inconsequential. I'll tell you that.

David Cohen
>> For the issuers on the panel, would you like that model that Brian just described, a back and forth quote negotiating the G-17 letter? Is that a helpful use of time when there are other documents simultaneously that you are working on such as the POS and the OS?

Cammy DuPont
>> Well I think one, it's one of the things that, I mean, you want to deal with as soon as possible. As a side note, I will say the county recently had a meeting with a underwriting firm and it was a marketing meeting and they asked the client to sign a G-17 letter and my client was emphatic. They're like we're not even working on a transaction, why would we do an acknowledgment of a G-17 letter when we're not on a specific transaction. But that being said, I think the sooner you get that out there and you do need to have that dialogue if there is something, I think there's a lot of boilerplate but what I've seen in the letters we've received the county is when you do get into the section where it is the conflicts and going back looking at the letters we've had it's not always clear what the conflict is that they are saying. It is very general and how they say we have conflicts, we are a multinational bank, or we have other interests. What are those specific interests that conflict with what you are doing here? That's what we're not getting the letters. So I think one, the reality for us is the onus is really on the underwriters. This is an obligation that they have, but if we're to acknowledge, and for us we are only acknowledging receipt of the G-17, there's the whole issue of what's in there and sometimes when they do the conflicts it's not necessarily clear specifically what those things are.

David Cohen
>> Those aren't at the SIFMA models. Arn?

Arn Andrews
>> I was going to say this is probably one of the only times we have three issuers and one underwriter. So we are going to take full advantage. Usually it's three underwriters to every issuer. So we were talking earlier and one of the areas that we found interesting that is in G-17 but it isn't really addressed anywhere is the whole concept of fair pricing. You know, that for myself as an issuer more than anything else will be interesting to see how that concept kind of evolves through G-17 and how it manifests itself either in a letter or how it manifests itself in either some form of process or procedure because you know, when you read G-17, the letters they clearly go straight to the concept of are there third-party conflicts and things like that and I do agree with Cammy, there's nothing in there that really starts to define what those are. They say they exist but there's nothing there that says what it actually equates to from a monetary value and in terms of the transaction. But I think it's going to be very interesting to see where this discussion and where G-17 goes in terms of the whole concept of fair pricing and transparency.

Charles Turner
>> And from my perspective, I think everyone in the room can attest to no matter what side you're on, we are all busier than we've been and from an issuers perspective it's getting more and more challenging to keep up with not just the rules and coming to conferences and making sure we are all staying in tune that but getting back to your desk and you've got these letters coming in, just how do I sift through all these things to make sure I'm not missing the key ingredients. So to me the conflict section is actually the most important. I want to make sure if there's any red flag I find that first. So that's where I go. I go to page two normally on the letter and I say where's the conflicts and yeah, you go to the big bank and they probably have tons of them that are these real general statements. I want to know what is the really true conflicts though and that would be an enhancement I would recommend for the forms going forward. It would be a little bit more like, as issuers we have to file under the fair political practices, the form 700, and say okay if we have any conflicts it's a certain form and there's a box and you check it and you have to put a dollar amount on there. It's real clear. There's nothing in these letters that says that and if you want to make something clear, just throw a table in there and make them have to check a box that says, do you have a conflict or not? Does it violating anything that's real specific to any other G rules and I can find it at the top of the page and it gets my attention. But I don't see anything of that nature so it kind of gets buried in this language and you have to do all these follow-up phone calls. So I think

that the original question was do we like to have a give-and-take? I personally don't like the give and take. I want it to be really clear then I know which ones I need to focus on. The rest I realize is not that much of a concern. And I kind of already know that they are not my municipal advisor and I kind of already know that they have an inherent bias, or conflict they have to deal with in being a middle broker. That's just the nature of being a broker. So not so concerned about those issues. It's really that conflict.

Arn Andrews

>> And I will just add one more thing. You also don't want to go too far. You know, earlier Cammy mentioned that just to have a cold call they required a G-17 and I will say that while my calendar would probably love not having cold calls anymore, the reality is that while a lot of it is repetitive we also glean a lot of really interesting information out of cold calls that we get from underwriters. Often times there are some interesting insights that either staff hasn't thought of or even our financial advisors haven't thought of. So I think you can go too far the other way. I mean we do get a lot of value out of the cold call that come our way and you know, the books and the structures that come our way. So I think you have to find whatever that balance is.

David Cohen

>> Right. So I think some of the cold, the cold calling letters and the cold calling disclosure comes out of a different MSRB rule. It comes out of MSRB rule G-23 which prohibits underwriters from serving as both, or dealers serving as both an underwriter and a financial advisor in the same transaction. That's a change to the rule that went into effect about a year and a half, two years ago. Previously a dealer could serve as FA and then resign and then become your underwriter. So in order to clarify those roles there is under rule G-23 some disclosure that at the earliest possible time a dealer should tell you what their role is that they're seeking. The G-23 disclosures, some of which are duplicative of the G-17 disclosures, do not need to be acknowledged. It's the G-17 disclosures that need to be acknowledged. I was wondering if Brian, since they, our senior manager on over 700 transactions can talk little bit about their process for the letters so the issuers can sort of hear what the dealers are going through in trying to get letters to you that meet the letter and spirit of the rule.

Brian Hellberg

>> Well and the challenge of course is every jurisdiction is different and every issuer is different. There are some issuers that put pools together and you're in the pool. There's

other issuers that you're out trying to win business who you've never called on before, you don't have an underwriting team or a deal team and it's very challenging. And I want to go back to one other quick thing on the conflicts issue. There's meaningful debate in the underwriting community whether we should give what I refer to as boilerplate conflicts disclosure. I'm a dealer, I might trade your bonds and those sorts of things. Since we send out hundreds of these letters every year I don't think it's a secret, our firm does not use the boilerplate language, but most of the bulge bracket firms do include that in their letter. I think the smaller regional firms don't include it. And I think our sense from the MSRB is they didn't want these letters to become filled with boilerplate conflicts disclosure. *They expected us to do a real analysis of what our responsibilities are for you and then what conflicts we might have*. And quite frankly, for a large commercial blank like mine that has 70,000 employees across the world and has, I don't know, seven or $8 billion of credit out to municipal entities in the US, we make disclosures all the time that says look, our bank, the Royal Bank of Canada has provided letters of credit to you and as a credit provider has rights against you as more fully provided for in those letters of credit and might actually someday try to enforce those rights as a creditor against you as a municipal issuer. If for example you do not meet your debt obligations. And to me when our industry has all these different roles and can take on those different contractual rights against you as municipal entities, that's where we want you to understand that, yes, today I am here as your underwriter and I want to do a fixed-rate bond deal, but last year we did a variable rate deal for you and my bank provided $200 million worth of a letter of credit. And you know if you do not meet your bond covenants, our bank might become your worst enemy. Because they might be enforcing their rights as a creditor. And I say that and people kind of smile a little bit, but that is the reality of our role as a dealer, as an intermediary and where I think these letters should have value. I would hope that issuers who have those kinds of other products from their dealers understand that different entities within a banking organization, someday might be hiring lawyers to enforce contractual rights against you. I don't want to scare anybody. But that's the reality of the business.

David Cohen
>> Thanks. For Cammy, Arn and Charles, are you the representative of your issuer that signs the letter?

Cammy DuPont
>> No. I'm in the County Council. One of the Assistant Treasurers, Glenn Byers, who

also over in the finance department.

David Cohen
>> So it is the same person every time?

Cammy DuPont
>> Every time, yes.

David Cohen
>> How about you guys?

Arn Andrews
>> Either the director or myself as a designee.

Charles Turner
>> Yeah, if I get the short stick that day I sign and if not, my boss signs them.

David Cohen
>> And we've heard anecdotally that there are some issuers that are refusing to sign the letters as a matter of policy. Either they cannot be bothered or they are concerned about waiving rights. Have you heard much about that? Is that a common practice here in California? Does anybody who represents an issuer, is that your policy? Not to sign them at all? Must be East Coast/ West Coast.

Brian Hellberg
>> We see that about one out of 100 times. So if we are involved in 100 transactions we might have one out of 100 issuers that either says everything from we've received your letter but we're not acknowledging it, which I'm not sure what that means exactly, to we are not waiving any of the conflicts that you've disclosed by acknowledging receipt, or various variations of that. And let's face it, neither the MSRB nor the SEC has any rights to tell you what you have to do or what you don't have to do under the Tower amendment. So we as a regulated entity have to exercise reasonable efforts to gain an acknowledgment, but if you refuse to or don't acknowledge it after reasonable efforts we are still permitted to proceed as your underwriter. And that should be clear to everybody. I would prefer if you just sent back the e-mail and say we don't acknowledge these

because I will stick that in your file and we are done. If that is your policy and that is what your board or governing body decides to do, it's not for me or our firm or industry to step in front of that. Nor do I think it is for our regulators to step in front of that.

David Cohen
>> So, more to Cammy, Arn and Charles. Brian and I were part of a SIFMA working group that put together the model documents.

Brian Hellberg
>> I don't like to admit that.

David Cohen
>> Sorry. Reading through the interpretive notice and putting together for dealers what we thought would be a starting point for the disclosures. We've been in to the MSRB as I'm sure the issuer groups have as well talking about the good and the bad, knowing that the disclosures are here to stay. What would you like to see? I think the concern is, or it would be helpful that the issuers, the disclosures are going to continue for the most part I think to have the same look and feel unless there's additional clarifying guidance from the MSRB, because the dealers are concerned that FINRA is going to come in and examine them and that the disclosures are going to be inadequate, let alone the risk of a rift between dealer and you, their clients. So, what suggestions would you have to the MSRB, perhaps, to make the disclosures whether shorter, or more meaningful and how that perhaps could look in additional guidance from them?

Arn Andrews
>> I think I would just echo what Charles said earlier. Just making the conflict section a little more robust. And by robust that doesn't have to mean pages, it could be the table he referred to, but just something that tries to get at the heart of what it is that you are saying. It says all sorts of things, the party of the third part, and we have affiliates and stuff like that but there's nothing in there that actually gets to the essence of how can this impact the transaction? What does this mean to me from the day of closing when we go to market? There's nothing there that creates that nexus. It says it exists but it doesn't give you anything to quantify what it's going to mean to you at the end of the day.

Cammy DuPont
>> Right, and I don't know if you necessarily need to go back that far. Really it's your

relationship with the underwriter. So if there is something, then you should go to the underwriters and say what exactly are you talking about and I mentioned that earlier. Just when you say we have a conflict, tell me exactly what you're talking about. So I don't think we necessarily have to go there, but I think your relationship with your underwriters if you are an issuer is to seek further clarity from the underwriter on those issues.

Brian Hellberg

>> And I would encourage all the issuers in the room, if a conflict is stated but it doesn't tell you why it's a conflict you should go back and have that answered. We've worked hard in our language, and again I have 90 senior bankers running around the country doing business, so we have relatively standardized stuff, but it's tailored fairly often to the to the particular needs. But we've tried to write our conflicts to say and because we're providing a letter of credit our parent bank has rights against you and may enforce those rights. We are trying to say out loud in sort of layman's terms to the best of our ability what it means for our commercial bank to provide a letter of credit to you as a municipal entity for example and that's an easy one to pick on. But you should insist upon your underwriters finishing that disclosure with what the conflict is and why it's important I think.

Cammy DuPont

>> I will add one other thing. When we do put a syndicate together we normally get one letter from the senior and the expectation is we're going to sign that. And only in a few instances have we received a G-17 letter from, say, a co-senior, or someone and they're laying out the conflicts that their particular bank has. So there's no expectation, we expect one letter, except if there's a conflict with another bank then they have a responsibility to lay that out to us as well.

David Cohen

>> Yes that's part of the rule. So, I hear the biggest rub is around the conflict section. Any suggestions or issues with respect to the transaction part, the disclosure of the risks or of the characteristics?

Charles Turner

>> Yeah, the conflict obviously is a clear high note on this, but you talk about a layout of this, most of them are pretty generic. We're talking about the SIFMA model is pretty

much 90% of what we get. So to me that should be exhibit A. We know we're going to get that, so just start with hey, remember what you just saw last time in the deal, you've got another one of those this time. Now tell me what is the real meat, and that should be the substance of the letter, which would say, here is the potential conflicts that we see unique to this transaction with this firm or these other firms that are within this transaction. And then the second section ideally if I had my magic wand to change it would then say, now, quite frankly we say we split it in the G-17 and say this is either a routine transaction or a complex transaction. Well, there is no routine transaction anymore. We talked about competitive sales earlier and I don't even know anyone in this room still doing any competitive sales unless they are obligated to. Things are getting so complicated you need so many specialized elements within your project that, in effect, every bond is now complex. We've got embedded options within these bonds already with a call feature. You already have a lot of structures that are unique to your deal. How could that just be routine. Unless you were an active participant day in and day out everything in my mind is already a complexity. So it should just be a section that says, here's your complexities that we envision on this transaction and we're going to lay them out and if we can spell those two pieces out, I think you've covered the whole base of what the intent is with this ruling, which is let's be clear that you know what you're getting yourself into and here's the conflicts that could exist, and then here's what we are proposing on this structure and this is how complicated this may be. Fair warning though, later on if something goes awry everybody knows you were aware of this at the very beginning. So I would rather have that on the one pager on the front and the exhibit, all the boilerplate on the back.

David Cohen
>> Cammy, Arn?

Arn Andrews
>> I would just say I agree. Unless if you're coming to the market with a GO or a nice clean revenue bond, nothing is routine anymore. I mean, some of the last times we've come to the market in the last two years we had one issuance that took three days to price and that was kind of unheard of for myself and also for the participants at the table and you know, we thought going into it that we would've never seen anything quite like that. So I think complexity, it's one thing to tell, and all of us are large issuers it's one thing to tell a small issuer it's complex, but even as large issuers if the intent is to notify of the complexity even if we work through it as we go through whether it's the financing

structure or the bond documents they probably should verbalize it in the documents and that mention at least high level what the complexities are if that is the intent of the letter.

Cammy DuPont
>> I was just going to say I agree with that.

David Cohen
>> We have a few minutes left which we reserved for questions. So questions from the floor, anything that we can help with or haven't answered, or think would be helpful? All right, well see you at lunch. Thank you.