BDA Bond Dealers of America

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March 15, 2022

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K St NW
Washington DC 20006

In regard to FINRA Regulatory Notice 21-40

Transmitted electronically

Dear Ms. Mitchell,

On January 18, 2022 the Bond Dealers of America (BDA) sent a comment letter on FINRA Regulatory Notice 21-40, "FINRA Requests Comment on Amendments to Rule 11880 Shortening the Settlement of Syndicate Accounts" (the "Notice"). We kindly request that you accept this supplementary comment letter with additional views and information on the Notice. BDA is the only DC-based organization exclusively representing the interests of securities dealers and banks focused on the US fixed income markets. This letter represents the views not only of BDA's member firms but also a coalition of minority-, women-, and veteran-owned broker-dealers with whom we are working.

FINRA received a comment letter on the Notice from Cleary Gottlieb Steen & Hamilton LLP on behalf of multiple parties[1] (the "Cleary Letter"). This letter includes a number of unsupported claims and statements which are inconsistent with the experiences of our firms in the corporate bond new-issue underwriting business. We appreciate this opportunity to address those statements.

Multiple lead managers

The Cleary Letter attempts to distinguish municipal underwriting transactions from corporate underwriting explaining that "In syndicates involving municipal debt, it is typical market practice to assign only one active manager with responsibility for all principal syndicate functions, including documentation, marketing and billing and delivery." Municipal underwriting syndicates can and do have multiple lead managers. In municipal syndicates, like corporate syndicates, there is typically one bookrunning manager who assumes all the administrative functions of the syndicate, including processing expenses and allocating revenue to comanagers. In both corporate and municipal offerings, any member of the syndicate can submit valid expenses to be paid from the syndicate account. The existence of multiple lead managers does not prevent municipal syndicates from paying deal revenue to comanagers within 30 days or 10 days for designated orders. The process for settling syndicate accounts

[1] Letter from Jefferey D. Karpf, Cleary Gottlieb Steen & Hamilton LLP, to Jennifer Piorko Mitchell, FINRA, January 18, 2022, www.finra.org/sites/default/files/NoticeComment/Jeffrey%20D%20Karpf_Cleary%20Gottlieb%20Steen%20%26%20Hamilton%20LLP_1.18.2022%20-%20Comment%20Letter%20-%20Regulatory%20Notice%2021-40%20%2801.18.2022%29.pdf.

for municipals and corporate is virtually the same, regardless of how many lead managers are on the deal.

The Cleary Letter next contends that the complexity associated with multiple lead managers "is compounded in multi-tranche offerings of investment grade corporate debt." In reality municipal securities are more structured and complex than many corporate transactions, where single bullet maturities are the standard. A significant majority of municipal bond new-issues are sold as "serial maturities," meaning the transaction is structured with sequential annual maturities in order to give the issuer level debt service payments over the life of the bond. Municipal transactions can include 20 or more separate maturities each with its own CUSIP. None of this prevents municipal bookrunners from complying with the MSRB's syndicate settlement rule.

In addition, FINRA received a comment letter on the Notice from Mizuho Securities USA LLC[2] (the "Mizuho Letter"). The Mizuho letter states "The type of corporate offerings, whether investment grade or non-grade, or the number of tranches in the offering, etc. are not concerns with regards [sic] to the 30 days settlement window."

Aftermarket support and overallotments

The Cleary Letter states "Syndicates in corporate debt offerings routinely engage in aftermarket support through short covering purchases in the secondary market. Syndicates create the short position by overallotting a percentage of the securities being offered." This is true. However, the Cleary Letter also states "the amount of the short position varies from offering to offering, and it is fairly common for this to be more than a couple of percent of the offering." We are not sure what the letter means by "fairly common," but in our experience, it is rare for syndicate short positions to exceed a few percent of the deal. Moreover, the letter states that expenses associated with hedging cannot be allocated to comanagers until "after the short is fully covered, a period generally ranging from a couple of days or more in investment grade debt offerings to up to 30 days or more in high yield debt offerings." In our experience, shorts arising from overallotments typically take place during the first few days after pricing. It is exceedingly rare for short positions to extend past a week, and almost unheard of past 30 days. Overallotments are not a barrier to a 30-day syndicate settlement deadline. The Mizuho Letter states that overallotments are "Not a major factor for our firm."

Syndicate expenses

The Cleary Letter states "In syndicates offering corporate debt, these [roadshow, legal and other] expenses are not known up front and must be submitted, collected, and allocated in a process that typically continues until 60–90 days after closing." This is the weakest argument in the Letter. Submitting, collecting, and allocating routine syndicate expenses never has to take 90 days. It takes this long only because bookrunners typically do not even begin the process of collecting expenses until near the end of the 90-day window provided in Rule 11880. Implementing a 30-day syndicate settlement deadline would largely be a matter of adapting processes to accommodate the revised standard. Bookrunners will need to demand that law firms and other vendors submit invoices earlier and begin soliciting comanagers' expenses earlier. There is nothing inherent about the process of settling corporate underwriting syndicates that demands 90 days.

[2] Email from David Wong, Mizuho Securities USA LLC, January 18, 2022, www.finra.org/sites/default/files/NoticeComment/Mizuho%20Americas_David%20Wong_1.18.2022%20-%20Regulatory%20Notice%2021-40%20-%20Comments%20from%20Mizuho%20Securities%20USA%20LLC.pdf

Cross-border offerings

The Cleary Letter states "A number of additional settlement complexities are introduced in cross-border offerings of corporate debt. For syndicates offering corporate debt, the legal work generally is more complex and therefore typically is billed on an hourly basis." As we stated in our January comment letter, "In our experience, however, invoices from law firms and other vendors in Europe tend to arrive even faster than from vendors in the US. Moreover, taxable securities sold to international investors have become much more prevalent in the municipal market in recent years, and international distribution has not affected the ability of municipal bookrunners to settle accounts according to MSRB requirements." The Mizuho Letter states "For international participants, same issue with regards to expenses and ensuring they submit reimbursable expenses timely," suggesting that cross-border offerings do not burden the syndicate settlement process.

Complex legal work

The Cleary Letter states "For syndicates offering corporate debt, the legal work generally is more complex and therefore typically is billed on an hourly basis. Counsel invoices are necessarily received after closing and must be reviewed and approved by the syndicate lead manager before being factored into the settlement process. This often takes well over 30 days post-closing." The Cleary Letter offers no support for why reviewing and approving legal expenses takes this long, perhaps because review and approval of law firm invoices does not take "well over 30 days post-closing." It may take, generously, perhaps a few hours. Municipal securities transactions also entail complex legal work. There are often multiple lawyers involved in a transaction: tax counsel, underwriters' counsel, disclosure counsel, etc. It is typical for municipal transactions to have multiple tranches, as already described, and for municipal securities to be distributed outside the US. None of this prevents municipal lead managers from complying with the MSRB's 30-day deadline.

Investor carve-out letters

The circumstance described in the Clearly Letter where "investors may deliver letters requiring that an underwriter not be compensated on the investor's participation in the offering, in compliance with Rule 17d-1(a) under the Investment Company Act" is not unique to corporate bond offerings. The Cleary Letter, referring to ERISA-related letters that some investors must send to the syndicate, states "For corporate debt offerings, these letters are often delivered by investors well after closing, sometimes very close to the 90th day post-closing. For municipal debt offerings, investor practice is to inform the lead underwriter by the trade date, consistent with the practice that all costs or other factors affecting settlement are known prior to closing."

This is an excellent example of how changes in processes can shorten the syndicate settlement time. Investor carve-out letters arise in the municipal market as well. And similar to the corporate world, before the MSRB shortened its syndicate settlement time, investors transmitted these letters close to the syndicate closing deadline. When the deadline was shortened and investors recognized the need to transmit these letters earlier, they did. The same will happen in the corporate underwriting world.

Travel

The Cleary Letter states "Personnel from a syndicate member may travel for multiple deals at a time, and expenses may not be compiled and submitted until after that travel ends. Expenses are then collated, coded, and approved before they are finalized." In practice, travel expensing is a trivial function

presenting no hurdles to a 30-day settlement deadline. “Collating, coding, and approving” travel expenses are not time consuming tasks.

Vendor billing

In several places the Cleary Letter makes a point that vendor invoices are out of the control of syndicate managers, that bookrunners have to simply accept vendor invoices whenever they arrive. Underwriters are not beholden to vendors with respect to invoices. As clients of law firms and other vendors, bookrunners can request invoices whenever they want and specify to vendors that invoices must be received within an appropriate window after closing to ensure prompt compliance the proposed 30-day time period to close the syndicate. There should be no doubt vendors will invoice sooner if it means getting paid earlier.

Technological solutions

The Cleary Letter references “the technological advances that helped to facilitate a more efficient but generally less complex municipal debt settlement process.” We are not aware of any technological advances specific to the municipal underwriting process which have facilitated the transition to 30 days. The technology available to municipal underwriters is the same as that available to corporate underwriters. The solution to shortening the settlement time is process change, not technology. Request and process invoices and expense reports sooner. There is no more work involved in settling syndicate accounts within 30 days versus 90 days. The work is simply more compressed. Any expenses associated with transitioning to a 30-day deadline will be minimal.

In referencing ostensible expenses bookrunning managers would incur in implementing a 30-day deadline, Cleary Letter states “These additional costs will be passed on to the syndicate, which will reduce the net earnings from participation.” We remind FINRA that comanagers’ net earnings from participation in corporate syndicates are already being reduced as a result of the obsolete 90-day deadline, and we challenge the notion that compliance expenses will even be significantly higher.

Asset-backed securities

The Cleary Letter offers two reasons why ABS should not be subject to a 30-day deadline. First, the Letter states that ABS generally come in multiple tranches. The second is that ABS transactions “must often navigate novel, multi-jurisdictional legal issues.” Neither of these reasons hold water.

Municipal securities are often sold with a dozen or more distinct maturities or tranches. And many securities offerings also involve multiple legal jurisdictions. The US municipal market is global, and municipal underwriters face the same multijurisdictional issues as ABS underwriters do. In short, the process for collecting syndicate expenses and paying out transaction revenue is exactly the same for ABS as for municipals and corporates. There is nothing unique about ABS that would prevent bookrunners from meeting the 30-day deadline.

Resettlements

The Cleary Letter in several places argues that a 30-day deadline would cause more frequent resettlements where bookrunners must invoice comanagers for expenses that came in after the syndicate account was closed. Resettlements are not “burdensome processes” as the Cleary Letter characterizes them. They do not happen frequently, but they represent a normal occurrence that is built into the syndicate settlement process. We do not believe that reducing the syndicate settlement time to

30 days will result in a significant increase in resettlements. We believe that the corporate market will absorb a 30-day settlement deadline just as the municipal market did. Nothing opponents to FINRA's proposal have offered suggests otherwise. But a marginal increase in resettlements should not prevent FINRA from adopting a 30-day deadline in any case. Resettlements are not overly costly or burdensome.

Two-stage settlement approach

The Cleary Letter states "we support a requirement that the syndicate manager remit 50% of the gross underwriting spread within 30 days of the syndicate settlement date, with the balance due to syndicate members within 90 days of the syndicate settlement date." However, the letter offers no support for why a 50-50 split is necessary or warranted. What data or evidence are there that 50 percent of syndicate expenses arrive more than 30 days after closing and cannot be accelerated? The Cleary Letter presents none. The 50-50 approach suggested by the letter is arbitrary and unsupported.

Counterparty credit risk

One issue completely ignored in the Cleary Letter is the inordinate counterparty credit risk—the risk that a bookrunning manager could fail to pay revenue due to a comanager when due—posed by the current obsolete syndicate closing rule. This risk is real, and in our January letter we cited examples of how this risk has played out in our members' experience. Reducing the syndicate deadline to 30 days would significantly reduce counterparty credit risk associated with corporate bond underwritings and would represent a major benefit of the amendments proposed in FINRA Regulatory Notice 21-40.

As the Mizuho Letter states, "This proposal will have minimal impact on large investment banks as (1) they are likely in the Lead role, so they have collected all the cash from the issuer and able to recognize the regulatory capital earlier anyway, (2) they have sufficiently over capitalized their broker dealers so the timing of regulatory capital recognition is not material to them, and (3) they have sufficiently invested in their technology systems to allow for shorten settlement period." For these reasons and others, a 30-day syndicate settlement deadline is eminently feasible.

BDA appreciates the opportunity to provide additional comments on the Notice. We look forward to working with FINRA and other stakeholders to ensure that a 30-day syndicate settlement deadline is implemented as efficiently as possible. As always, please call or write if you have any questions.

Sincerely,

Michael Decker
Senior Vice President