



April 3, 2017

The Honorable Paul Curtman  
Chair, House Ways and Means  
Missouri House of Representatives  
201 West Capitol Ave  
Jefferson City, MO 65101

**RE: HB 950, To repeal section 108.170, RSMo, and to enact in lieu thereof one new section relating to the sale of public bonds.**

Dear Chair Curtman:

The Securities Industry and Financial Markets Association (SIFMA)<sup>1</sup> is a national trade association which represents hundreds of large, medium and small broker-dealers, banks and asset managers, many of whom have a substantial presence in Missouri. We are writing to provide comments on HB 950, legislation which would mandate that certain entities issue debt solely through a competitive bid process unless a municipal advisor is employed. SIFMA strongly believes that there are advantages and disadvantages to both a competitive sale and a negotiated offering and that issuers are in the best position to determine which option suits their needs. As such, we oppose HB 950 as drafted.

Specifically, HB 950 states, “Any political subdivision issuing debt shall do so through a competitive process unless the political subdivision employs the services of a municipal advisor, at which point the political subdivision may use a negotiated or competitive process.”<sup>2</sup> As you likely know, primary municipal bond offerings are effected through either a “competitive” sale or a “negotiated” offering, and while both methods of sale involve competition among potential underwriters, there are key differences. For example, a competitive sale operates like an auction. The underwriters bid against each other by submitting to the issuer on a given day at a given time sealed bids to buy the issuer’s bonds and then reoffer them to investors. The underwriter that offers to pay the lowest interest cost for the bonds will win the competitive sale.

By contrast, in a negotiated offering, where there is no sealed bid, the underwriter is chosen before the actual sale date through a competitive Request for Proposal (RFP) process in a manner similar to other state and local procurements. In recent years, issuers have routinely asked underwriters to indicate their fees in their written or oral proposals. Although the fee is usually a preliminary quote, it has the practical effect of making a “negotiated issue” extremely competitive on price.

As stated above, we firmly believe the issuer is best able to determine which option is best suited for a particular transaction. Requiring a political subdivision to hire a municipal advisor in order to engage in a negotiated offering places unnecessary and costly constraints on the process and limits

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<sup>1</sup> SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over \$2.4 trillion for businesses and municipalities in the U.S., serving retail clients with over \$16 trillion in assets and managing more than \$62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. For more information, visit <http://www.sifma.org>.

<sup>2</sup> HB 950 Line 20-23

the subdivision's ability to choose the best-suited option. This is especially concerning because, generally, municipal advisors are actually less important in a negotiated offering, where an investment banker is helping to structure the transaction. In this case, the requirement to hire a municipal advisor would only serve to increase the total cost of the sale. Limiting an issuer's option to choose between a competitive sale and a negotiated offering in this manner could have serious unintended consequences that negatively impact the offering, the entity and its residents. We have outlined the following key differences between negotiated and competitive sales which every issuer should be able to consider in their specific situation:

## **I. Competitive Bidding Advantages**

There are two distinct advantages when using the competitive bidding process. These include:

- Issuers avoid the need for an RFP process.
- Determination of who serves as underwriter is based on price and not on other factors.

## **II. Negotiated Sales Advantages**

In a negotiated offering, the issuer has greater control over the composition of the underwriting syndicate. For example, in a negotiated offering:

- The issuer and underwriter can respond to changing market conditions by altering the terms of the bonds or timing of the sale.
- The underwriter can do more presale marketing, which increases the likelihood that investors willing to pay the highest prices for the bonds will be found.
- The selected underwriter may be able to perform certain functions carried out by an outside advisor in a competitive issue, eliminating the additional cost.

Additionally, in recent years, average underwriter fees have been slightly lower for negotiated sales.

## **III. Competitive Bidding Disadvantages**

The competitive bidding process allows the issuer less flexibility and control in the transaction, and can lead to unintended consequences. For example:

- An issuer cannot change the sale date or the structure of an issue after the notice of sale is published without pulling the sale, no matter how market conditions change before the bonds are sold.
- An issuer has no control over the composition of the underwriting syndicate.
- Competing syndicates may lead to trapped bidders (members of a losing syndicate who would have paid more than the winning bid for some bonds), which prevents the issuer from getting the best possible price.

- The underwriter does not provide any value-added services such as help with structuring, interaction with rating agencies, pre-sale activities and help with timing.
- Bidders may factor in a risk premium because they do not know whether they will secure the underwriting mandate.
- Potential additional challenges considering implementation of new U.S. Treasury rules on the determination of issue price, effective June 7, 2017.

#### **IV. Negotiated Sales Disadvantages**

There are generally considered to be two disadvantages to negotiated sales offerings:

- Although underwriters compete during the selection process, there is no direct competition among underwriters in setting the terms of the offering.
- The gross underwriting spread covers additional services that may differ from one issuer to another, making it harder to compare costs to determine whether the spread is appropriate.

In addition to considering the advantages and disadvantages above, it is important to note that numerous academic studies of the relative costs of issuance have not demonstrated a clear advantage to one method of underwriting over the other. While market practitioners see merits in both methods, issues that are very large, complex or involve high-risk credits are almost always sold through negotiated underwriting.

Issuers have an incentive to choose whichever method they expect to produce the lowest cost in their specific situation, and academic research has demonstrated that local issuers tend to choose the sale method that provides them with the best outcomes. Preserving an issuer's ability to choose freely between sale methods allows them to make the choice that is best suited for their needs.

We appreciate the opportunity to provide comments. If you have any questions or if there is any further information we can provide, please contact me at 212-313-1311 or our lobbyists John Dalton and Shanon Hawk at 573-230-9069.

Best regards,

/s/

Kim Chamberlain

Managing Director and Associate General Counsel  
SIFMA, State Government Affairs