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January 18, 2022

Submitted electronically to: pubcom@finra.org

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 21-40 – FINRA Requests Comment on Amendments to Rule 11880 Shortening the Settlement of Syndicate Accounts

Dear Ms. Mitchell:

On behalf of BofA Securities, Inc., Barclays Capital Inc., Citigroup Global Markets Inc., Credit Suisse Securities (USA) LLC, Deutsche Bank Securities Inc., Goldman Sachs & Co. LLC, Jefferies LLC, J.P. Morgan Securities LLC, Morgan Stanley & Co. LLC, RBC Capital Markets, LLC, UBS Securities LLC, and Wells Fargo Securities, LLC, we appreciate the opportunity to comment on Financial Industry Regulatory Authority ("FINRA") Regulatory Notice 21-40 ("Notice 21-40") regarding proposed amendments to Rule 11880 shortening the settlement of syndicate accounts (the "Proposal").[1] While we understand the concerns underlying the Proposal, we do not agree the proposed amendments offer a workable solution. Our comments are intended to clarify that the reasons justifying a shortened syndicate settlement period for syndicates offering municipal securities do not apply to syndicates offering corporate debt securities and to ensure FINRA understands that pursuing a one-size-fits-all approach will likely increase the number of resettlements[2] and otherwise have a deleterious effect on the sound administration of the syndicate settlement process. Our principal additional comments explain

[1] The Proposal is available at https://www.finra.org/rules-guidance/notices/21-40.

[2] Resettlement refers to when the billing and delivery lead bank in the syndicate is required to invoice all syndicate members to recoup syndicate expenses not known when settlement of syndicate accounts first occurs. This is a much more burdensome process than the initial settlement for all syndicate members, because it involves not only invoicing each syndicate member for its share of the previously unknown syndicate expenses but also each syndicate member having to make the required payment back to the billing and delivery bank. These repayments may be received on different dates and require a greater administrative effort at both the billing and delivery bank and each syndicate member.

why certain offerings are particularly unsuited for a shortened syndicate settlement period, and why we believe a two-stage syndicate settlement approach would be a much more appropriate solution to the problems articulated by FINRA in Notice 21-40.[3]

1. Settlement Mechanics of Syndicates Offering Corporate Debt Securities Are Not Amenable To 30-Day Settlement Periods

There are a number of important differences between the settlement mechanics of syndicates in offerings of corporate debt and those of syndicates in offerings of municipal debt. These differences, which are described below, stem largely from the difference in complexity involved between the two offering processes and the economics necessary to facilitate these offerings. Ignoring these differences risks a number of consequences that could undermine the sound administration of the syndicate settlement process.

Currently, the settlement of offerings of corporate debt securities typically utilizes the full 90-day settlement period. During this period, expenses are collected from different groups within the billing and delivery bank, from other syndicate members (who are also themselves collecting expenses before passing them on to the billing and delivery bank), as well as from various third-party vendors. Those expenses must be collated, checked, and double-checked by front office personnel with knowledge of the offering in question, as well as back office personnel, sometimes leading to follow up with other syndicate members and third-party vendors resulting in a readjustment of expenses, all to ensure the sound administration of the settlement process.

Given the myriad components of this process and the need for involvement of the billing and delivery bank's front office and back office personnel, automation cannot significantly shorten the settlement period. As such, imposing a shortened settlement period for syndicates in offerings of corporate debt may make resettlements the norm rather than the exception, as settlement payments will be required far more often before all syndicate costs and expenses can practically be determined. A shortened settlement period also will constrain the diligence necessary to ensure the accuracy of final settlements.

- Multiple Syndicate Lead Managers. 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. This manager incurs out-of-pocket expenses that are then readily allocated among the syndicate members after closing. Other members of a municipal syndicate typically do not incur expenses.

  Syndicates offering corporate debt, and particularly investment grade corporate debt, generally involve multiple active lead managers incurring and submitting out-of-pocket expenses for allocation among the syndicate members, contributing a degree of complexity that necessarily adds to the time needed before final syndicate settlement. This complexity is compounded in multi-tranche offerings of investment grade corporate

[3] *See infra* Section 7.

debt where a different active lead manager frequently is responsible for billing and delivery of each tranche in contrast to multi-tranche offerings of municipal debt where a single syndicate member is typically responsible for billing and delivery for all tranches. For multi-tranche offerings of investment grade corporate debt, this results in multiple active lead managers having to coordinate and pool expenses and report them to the billing and delivery manager collecting all syndicate expenses.

- Aftermarket Support. 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. The Master Agreement Among Underwriters used by all firms allows the lead manager of the syndicate to sell short for the account of the syndicate up to a specified percentage of the offered securities (generally up to 20%). Although corporate debt syndicates typically do not sell short to this level, 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. This activity, intended to promote greater aftermarket stability and liquidity, results in losses or gains when the short position is covered, which must be allocated among syndicate members. That allocation can only be effected 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, subject in each case to market conditions. Further complicating the settlement process in this respect is that in investment grade debt offerings the syndicate short position is initially allocated to each of the active lead managers to effect the short covering purchases, thus requiring multiple managers to tally the losses or gains incurred in connection with their respective short covering and report them to the billing and delivery manager collecting all syndicate expenses or income.

  By contrast, syndicates offering tax-exempt municipal debt, which comprises a substantial majority of municipal debt, do not overallot. This is largely because the IRS recognizes the tax-exempt status of interest payments only on the municipal debt originally issued by the municipal issuer. Accordingly, IRS rules do not allow both a lender and a borrower of municipal debt securities to claim tax-exempt status for interest payments on the municipal debt securities. Rather, if firms were to engage in short selling tax-exempt municipal debt securities, they would be required to send taxable "substitute interest"[4] to the securities lender, which is a complexity that has deterred short selling by syndicates offering tax-exempt municipal debt securities.

- Interest Rate Exposure Hedging. Unlike syndicates offering tax-exempt municipal debt, which do not overallot, syndicates offering corporate debt generally will hedge the interest rate exposure on the syndicate short position through the purchase of U.S. Treasuries. This hedging activity often gives rise to syndicate expense or income that must be factored into the syndicate settlement process. In addition, investors in corporate

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[4] *See, e.g.*, Regulatory Notice 15-27, *Guidance Relating to Firm Short Positions and Fails-to-Receive in Municipals Securities* (July 2015) (reminding firms of their obligation to inform parties of these tax implications).

debt could also seek to hedge the interest rate exposure on their purchase by selling U.S. Treasuries to the syndicate at the time of pricing, which could result in additional income or expense affecting the syndicate settlement process.

- Expenses Are Not Known Up Front. In syndicates offering municipal debt, roadshow, legal and other expenses are generally agreed upon up front with the issuer. In syndicates offering corporate debt, these 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. For the reasons explained above and below, expenses for syndicates offering corporate debt cannot easily be estimated and agreed upon up front, as they typically are for syndicates offering municipal debt.

- Cross-Border Offerings. A number of additional settlement complexities are introduced in cross-border offerings of corporate debt. Even when denominated in US dollars, these offerings involve multiple sets of legal counsel (e.g., transaction counsel and local counsel) in multiple jurisdictions representing the underwriters. The work associated with these syndicates often is novel and more time-consuming. When these offerings involve multiple currencies, they also give rise to inter-syndicate complexities, where separate syndicates are used for placements outside the United States. These syndicates are subject to different settlement procedures in each applicable foreign jurisdiction. Given the underlying tax rationale for the issuance of tax-exempt municipal debt, those securities are not typically offered outside the United States.

- More Complex Legal Work Is Not Compatible With Fixed Legal Fees. For syndicates offering municipal debt, legal fees are sufficiently predictable to permit fixed legal fees, which are invoiced prior to closing. 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. This problem is only heightened as offering structures become more complex. Examples of corporate debt offerings with significant complexity include cross-border offerings, as noted above, high yield offerings with multijurisdictional guarantees or collateral packages or highly negotiated covenant arrangements, and hybrid debt offerings with significant structural subordination. Further, in offerings of secured debt, perfection of the security interests often occurs after closing of the offering. Although issuers often pay this expense, that is not the case in all offerings of secured debt securities. In those offerings where the syndicate bears some or all of the collateral-related expenses, these expenses may not be fully known, much less invoiced, 30 days post-closing.

- Investor Carve-Out Letters. In syndicated offerings, 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. Investors may also deliver letters identifying a conflict with the ERISA requirement that underwriting firms advising or managing the assets of a plan not cause the plan to pay these firms without approval of an independent fiduciary or an applicable exemption. These letters require reallocation of syndicate economics. 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.

These factors illustrate the many ways settlement of syndicates offering corporate debt differs in material ways from settlement of syndicates offering municipal debt. They demonstrate the critical distinction between the municipal debt context, where typically substantially all syndicate costs and other factors affecting settlement are known prior to closing, and the corporate debt context, where virtually none of those costs or other factors are known until well after closing, with enormous variation that is offering-specific. Trying to reduce the settlement cycle by two-thirds can readily be expected to substantially increase the need and burden of resettlements and unduly shorten the time required to effectively diligence proposed syndicate expenses consistent with the sound administration by FINRA member firms of the syndicate settlement process.

2. Automation Is Not Sufficient To Support Reducing the Settlement Cycle From 90 Days to 30 Days

Notice 21-40 states that the proposed amendments are made, in part, "[i]n light of the technological advancements since 1987 that improve the efficiency of the settlement process,"[5] and invites comment on whether technology has emerged that can support syndicate managers in syndicate account settlement for corporate debt securities.[6] Notwithstanding certain efficiencies that have helped in reducing settlement timing for generally less complex municipal debt offerings, the syndicate settlement process for typically more complex corporate debt offerings involves substantially more manual inputs, many of which are beyond the control of syndicate managers. For example:

- 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.

- Certain third-party vendors used by a syndicate, whose practices ultimately are outside the control of syndicate members, may only bill the syndicate on a monthly or quarterly basis. In addition, it is the practice of some third-party vendors to deliver bills aggregated to cover multiple deals, which must be disaggregated and allocated to the appropriate deals by the recipient syndicate lead or other member.

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[5] *See* Proposal, at 3.

[6] *See* Proposal, at 10 (asking "[w]hat technology has emerged that can support syndicate managers in syndicate account settlement billing and payment for corporate debt securities?").

- Expenses must be reviewed manually by front office personnel familiar with the offering, who can recognize outliers, as well as back office personnel, who can follow up with other syndicate members before final settlement to ensure settlements are accurate.

Accordingly, the technological advances that helped to facilitate a more efficient but generally less complex municipal debt settlement process, thus enabling a 30-day maximum settlement period, cannot be expected to expedite, to nearly the same degree, the settlement process for corporate debt offerings.

As a consequence of a substantially shortened settlement period, syndicate managers will need to hire and train a significant number of additional employees to help collect, process, collate, check and track expenses, in an effort (which still may not be successful) to complete the settlement process in this significantly truncated settlement period. These additional costs will be passed on to the syndicate, which will reduce the net earnings from participation.

3. Asset-Backed Securities Should Be Excluded From The Proposal

Notice 21-40 invites comment on whether there are types of corporate debt offerings that could not settle in 30 days.[7] In particular, Notice 21-40 asks for comment on how certain types of corporate debt are more complex and require a longer settlement period.[8] Offerings of Asset-Backed Securities ("ABS"), including Mortgage-Backed Securities, often involve more complex structures than offerings of corporate debt described above. The complexities relevant to the syndicate settlement period include:

- ABS offerings are often comprised of multiple tranches. In addition to added complexities for syndicates involving corporate debt with multiple tranches, described above, these multi-tranche offerings may include high yield and even equity offerings in lower-rated tranches. The settlement timing for the ABS offering syndicate is therefore dependent on the settlement timing for these lower-rated tranches.

- ABS offerings must often navigate novel, multi-jurisdictional legal issues. These issues require the services of multiple legal counsel and are often complex and necessarily add to the time required to calculate syndicate costs for settlement purposes.

For these reasons, ABS offerings are particularly not well suited to a reduced settlement period. We also understand that excluding ABS offerings from these amendments should not cause difficulties associated with inconsistent settlement processes, because settlements for syndicates offering these structured products are often conducted by dedicated groups separate from those

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[7] *See* Proposal, at 9 (asking, among other things, "[a]re there some types of corporate debt offerings that could not settle in 30 days?").

[8] *See* Proposal, at 3 ("FINRA is requesting comment on whether 30 days is feasible for all types of corporate debt offerings or whether there are some that are more complex and would require a slightly longer timeframe, for example, an offering with an overallotment option.").

that are responsible for settlement of syndicates for corporate debt offerings other than structured products.

4. Syndicates Offering Securities That Include an Overallotment Option Should Be Excluded From The Proposal

Notice 21-40 invites comment on the impact the exercise period for overallotment options would have on shortening the syndicate settlement period.[9]

We do not support making syndicates whose offerings include overallotment options subject to any shortened settlement cycle adopted by FINRA. Although these options are most frequently included in offerings of common stock, as well as offerings of debt or preferred securities convertible into common stock, they also are often included in offerings of $25 par value preferred stock or $25 denominated bonds (so-called "baby bonds"), which are publicly offered to the retail market.

Overallotment options typically have an exercise term of 30 days (45 days for SPAC and certain other offerings) and generally have legal and other expenses associated with their exercise and subsequent closing. These options typically permit the syndicate to purchase additional securities (up to 15% of the committed securities) from issuers or selling securityholders at the public offering price to cover overallotments effected during the distribution.[10] These options substantially mitigate the risk to the syndicate of overallotment and thus facilitate the aftermarket trading that promotes market stability and liquidity. Should syndicate offerings including these overallotment options be required to settle within 30 days following the closing date, the option period would necessarily be reduced because it would be impossible to simultaneously exercise and close the overallotment option and settle with the syndicate. This would reduce the risk-mitigating benefit of these important options and make the market more volatile and less liquid. Accordingly, Rule 11880 should not be amended to require syndicates offering securities that include an overallotment option to settle on a time period shorter than 90 days.

5. Syndicates Offering Equity Securities Should Not Be Included In The Proposal

Notice 21-40 invites comment on whether the Proposal should be expanded to include settlement of syndicates offering equity securities.[11]

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[9] *See* Proposal, at 10 (asking "[w]hat impact, if any, would the exercise period for overallotment options have on shortening the period for final settlement of syndicate accounts for equity offerings?").

[10] *See* Proposal, at 3 n.8.

[11] *See* Proposal, at 10.

Settlement of syndicates offering equity securities, including debt convertible into equity securities,[12] is likely to be more complicated than settlement of syndicates offering straight debt securities. Syndicates offering equity securities, particularly IPOs, generally require more diligence and marketing than for offerings of corporate debt securities. Therefore, third-party expenses are likely to be much larger and more prevalent than for syndicates offering corporate debt securities. In addition, as described above, offerings of equity securities typically have overallotment options, further complicating the syndicate settlement process. As a result, the risk of resettlement would be substantially greater, adding unnecessary expense and complexity and jeopardizing the sound administration of syndicate settlement. Further, a shortened settlement period for syndicates offering equity securities will not generate efficiencies if included with other types of syndicate offerings because these syndicate accounts often are settled by different groups within syndicate managers. Accordingly, Rule 11880 should not be amended to require syndicates offering equity securities to settle on a time period shorter than 90 days.

6. A 30-day Settlement Period Will Cause More Frequent Resettlements

For the reasons explained above, Notice 21-40's proposed amendments to Rule 11880 will result in more frequent resettlement of syndicate expenses after final settlement. These resettlements will be necessary to properly allocate late-arriving invoices or other, manually compiled, expenses among syndicate members. These are burdensome processes that contribute to uncertainty and serve as a counterweight to the benefit of a shortened settlement period. In any event, should FINRA proceed with the proposed amendments, the final notice adopting the amendments should be explicit in recognizing the permissibility of the resettlement process.

7. Alternative Two-Stage Syndicate Settlement Approach Is Preferable

Notice 21-40 invites comment on whether there are additional approaches that FINRA should consider to accomplish the goals of the Proposal.[13] Specifically, the release asks for commenters' views on a two-stage syndicate account settlement approach, whereby the syndicate manager must remit a percentage of the gross underwriting spread from the offering within 30 days of the syndicate settlement date, with the balance due to syndicate members by a later date.[14]

We believe the two-stage syndicate settlement approach, as described in Notice 21-40, is a superior alternative and one that can be implemented far faster and more prudently than a 30-day

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[12] For the avoidance of doubt, offerings of convertible debt securities should be excluded from the Proposal because they share characteristics of equity securities offerings, including overallotment options and heightened execution complexity.

[13] *See* Proposal, at 10 (asking "[a]re there additional approaches that FINRA should consider to accomplish the goals of this proposal?").

[14] *Id*.

final settlement period. In this connection, 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. Importantly, this approach would accomplish FINRA's goal by allowing syndicate members to use a significant portion of these earnings as allowable assets for the Net Capital Rule, to participate in new offerings, to offset expenses related to the syndicate offering or to otherwise operate their business. Equally importantly, this alternative would continue to allow syndicate managers to retain a sufficient amount of syndicate funds to effect timely and accurate settlements, thus avoiding burdensome resettlements, and would obviate the need for syndicate managers to hire additional staff and incur additional expenses that would be passed on to the syndicate (including the syndicate members who need access to these earnings) to manage a full syndicate settlement within 30 days. We believe this alternative strikes an appropriate balance among the needs of all different sizes of syndicate members and strongly encourage FINRA to adopt this alternative in lieu of the Proposal.

8. Amending Rule 15c3-1 Would Address FINRA's Concerns

Notice 21-40 recognizes that syndicate members may not treat syndicate receivables as allowable assets for purposes of the Net Capital Rule. This is because non-municipal syndicate receivables are carved out from the general treatment of commissions receivable from other brokers and dealers and instead treated as an unsecured receivable under a different section of the Net Capital Rule. In contrast, receivables due from participation in municipal securities underwriting syndicates are treated as allowable until 60 days from settlement of the underwriting with the issuer.

Notice 21-40 suggests that this treatment of syndicate receivables may disproportionately constrain smaller firms that may not be as highly capitalized as larger firms. However, the Proposal will have a number of unintended consequences, as described above, that will have a deleterious effect on the sound administration of the settlement process and, insofar as it would constrain the ability of syndicates to provide aftermarket support for a new issue, sacrifice market stability and liquidity.

The goals of the Proposal can be achieved without these consequences by the Securities and Exchange Commission ("SEC") amending the Net Capital Rule to allow receivables due from participation in corporate debt securities underwriting syndicates to be treated as allowable assets until 90 days from settlement of the offering. This net capital treatment would be similar to that afforded to syndicate members in municipal securities underwritings, but recognizes the greater complexities inherent in underwriting corporate debt securities. By amending the Net Capital Rule to introduce a similar allowance for receivables due from participation in syndicates offering corporate debt securities, the SEC could remove these barriers for smaller firms without creating new barriers to syndicate participation or the unintended consequences described above.

Notice 21-40 also invites comment on whether it would be feasible to adopt an SEC staff interpretation under the Net Capital Rule that provides that syndicate receivables may be considered an allowable asset to the extent a creditor issues a sole recourse loan to the syndicate member secured by the syndicate receivable.[15] We do not believe this approach would provide a workable solution to FINRA's concerns. For the same reason a syndicate manager cannot determine all possible expenses within 30 days, that manager will not know the amount required for such a loan because it will not know the net amount ultimately to be paid to each syndicate member. Because the amount required will not be known, syndicate managers will not know whether the receivable adequately secures any such loan. Syndicate managers also need to treat unsecured and partly-secured receivables as unallowable assets, and this approach would cause uncertainty with regard to net capital for syndicate managers. Because syndicate managers would not be able to extend sole recourse loans to syndicate members secured by the syndicate receivable without creating their own net capital uncertainty, this approach would not provide a workable solution to FINRA's concerns.

9. The Proposal Would Substantially Alter Settlement Practices And, If Adopted, Merits An Adequate Period Of Transition

As we have explained above, the reasons justifying a shortened syndicate settlement period for syndicates offering municipal securities do not apply to syndicates offering corporate debt securities. A sharp reduction in settlement time from 90 days to 30 days for syndicates offering corporate debt can be expected to increase the number of resettlements, have a deleterious effect on the sound administration of the syndicate settlement process and insofar as it would constrain the ability of syndicates to provide aftermarket support for new issues, sacrifice market stability and liquidity. In the absence of SEC action to amend Rule 15c3-1, we believe the two-stage approach described above is the best alternative to address FINRA's main concern – namely, the effect of the net capital calculation on the capital of less well-capitalized members of the syndicate.

However, in the event FINRA concludes that reduction in the settlement period for syndicates offering corporate debt securities is the most appropriate way to address this concern, then we urge FINRA to implement a phased reduction in the length of the settlement period (either as part of the two-stage syndicate settlement approach or standing alone) to minimize the risks described above.

In that circumstance, we suggest FINRA begin with a reduction to 75 days, with an implementation period of at least nine months. Looking specifically to the evolution of Rule 11880, FINRA did not propose reducing the original, 120-day settlement period until it reviewed syndicate settlement practice for more than one year before concluding that a 30-day reduction to the current, 90-day period was feasible.[16] By contrast, the Proposal would reduce the settlement period far more dramatically and without any empirical evaluation of feasibility.

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[15] *Id*. (asking whether adopting the SEC's staff interpretation is a feasible approach).

[16] *See* Regulatory Notice 85-59, *Effectiveness of Amendment to the Uniform Practice Code to Require Prompt Settlement of Syndicate Accounts* (Sep. 9, 1985) (announcing 120-day settlement period with re-evaluation after one year before reduction to 90 days).

As described in detail above, the syndicate settlement process for corporate debt involves multiple inputs from multiple sources, including third parties over which syndicates have little control, and is heavily manual. It simply would not be prudent to require a significant change to this complex process without providing adequate time for implementation. Past rule changes with pervasive effects on practice, such as Rule 2711 regarding research or the significant changes made to Rule 5110, provided for at least a six month implementation period, and the history of Rule 11880 highlights the need for even greater time to ensure a smooth transition of the syndicate settlement process to its shorter timeframe.

Following that initial step down of the syndicate settlement period, FINRA and the industry would then be in a better position to evaluate the feasibility of a further reduction, although, for the reasons discussed above, we believe reducing the settlement period to less than 60 days would be extremely problematic.

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We appreciate the opportunity to comment on Notice 21-40 and FINRA's consideration of our views. We look forward to continuing dialogue with FINRA on amendments to Rule 11880 shortening the settlement of syndicate accounts. If you have questions or would like additional information, please contact Jeffrey D. Karpf or Leslie N. Silverman, at (212) 225-2864 or (212) 225-2380, respectively.

Very truly yours,

Jeffrey D. Karpf