

December X, 2019

Mr. Paul Matthews
Director, Corporate Financing
FINRA
9509 Key West Ave.
Decoverly Building
Rockville, MD 20850

Dear Mr. Matthews,

BDA supports in principle a request pending at FINRA to amend FINRA Uniform Practice Code Rule 11880 ("Rule 11880") to reduce the maximum time to settle syndicate accounts from the current 90 days.¹ We believe reducing the time to settle syndicate accounts would streamline the corporate bond and equity issuance process and reduce counterparty credit risk and we urge FINRA to act on this request promptly.

Background

Groups of dealers form underwriting syndicates in order to mitigate the risk associated with buying and reselling a new-issue security. All syndicate members must pledge capital to support the underwriting transaction. However, even after the issuer transaction has closed, the Rule permits the syndicate account manager to continue to hold syndicate member capital in the syndicate account until such syndicate account is closed, at which time the underwriting compensation is distributed to the syndicate members.

Rule 11880 sets a deadline of 90 days after deal closing to settle new issue underwriting syndicate accounts for corporate securities. The 90-day settlement requirement, finalized in 1987, is designed to balance two issues regarding new issue syndicates. The first is to provide enough time for the bookrunner to process and pay all expenses associated with the transaction before closing the syndicate account. The second is to ensure that capital is returned promptly to syndicate members, since the bookrunner earns the "float" on other syndicate members' capital while the syndicate account is open. The capital of syndicate members held by the bookrunner represents an unsecured receivable to syndicate member firms and is treated as such in accounting and capital rules. In practice bookrunners on corporate bond and equity underwriting transactions nearly always hold syndicate accounts open for the full 90 days permitted in the rule. If syndicate members' funds are returned by physical check, it could be 95 days or more before syndicate members have full use of their capital.

Problems with current rule

Rule 11880 raises two significant issues. First and most important is that it extends for longer than necessary the counterparty credit risk associated with pledging capital to a syndicate transaction. While defaults on syndicate accounts are rare, they are not unprecedented. When Lehman Brothers filed for bankruptcy in 2008, many of the firm's unsecured creditors were other broker dealers owed funds as a

¹ Letter from Stephen Berkeley, Chief Compliance Officer and Regulatory Counsel, Loop Capital, to Paul Matthews, Director, Corporate Financing, FINRA, June 20, 2019.

result of capital pledged to syndicate accounts or other reasons. FINRA in its “2019 Risk Monitoring and Examination Priorities Letter” highlighted counterparty credit risk as a key issue in examinations for this year and stated that it “will review firms’ policies and procedures for identifying, measuring and managing credit risk” and “assess the extent to which firms identify and address all relevant risks when they extend credit to their customers and counterparties.”² One way that FINRA could reduce counterparty credit risk on a market wide basis would be to reduce the deadline for settling syndicate accounts.

The other key issue associated with Rule 11880 is fair treatment for syndicate members. For the first 30 days that a syndicate members’ capital is tied up in a syndicate account, those funds can be counted as regulatory capital under the SEC Rule 15c3-1, the Net Capital Rule. After 30 days, unsecured receivables become seasoned and can no longer be counted towards compliance with Rule 15c3-1 and of course cannot be used to support other business activities. For the last 60 days of the 90-day syndicate settlement period, syndicate members’ capital is tied up in the syndicate account earning interest for the bookrunning manager and unable to be used by the syndicate members for other business or counted towards regulatory compliance.

The 90-day settlement deadline was put in place in 1987. Since that time, obvious advances in trading and communication technology have streamlined the new issue underwriting process significantly. The 90-day deadline is anachronistic and inefficient. In 2009 the Municipal Securities Rulemaking Board amended its Rule G-11, the rule that governs syndicate settlements for municipal bond underwriting syndicates. In changing Rule G-11 the MSRB cited improvements in communication and payment technology that permits syndicate managers to process syndicate expenses more quickly than previously. The MSRB also cited the reduction in counterparty credit risk that has resulted from shortening the syndicate settlement deadline. While the process for processing syndicate expenses differs somewhat in the markets for products other than municipal securities, there likely would be opportunities to settle accounts more quickly if FINRA rules mandated it.

The 1987 deadline of 90 days for settling syndicate accounts under Rule 11880 is outdated and inefficient. It ties up dealers’ capital much longer than necessary and creates superfluous, systemic counterparty credit risk. We urge FINRA to review Rule 11880 with the goal of reducing the time permitted to settle corporate underwriting syndicate accounts.

Sincerely,

Mike Nicholas,

CEO, Bond Dealers of America

² FINRA, “2019 Annual Risk Monitoring and Examination Priorities Letter,” January 22, 2019, www.finra.org/rules-guidance/communications-firms/2019-annual-risk-monitoring-and-examination-priorities-letter.