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March 21, 2011

Ms. Elizabeth M. Murphy
Secretary, Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: Release No. 34-63946; File No. SR-MSRB-2011-03

Dear Ms. Murphy:

The Government Finance Officers Association (GFOA), representing over 17,500 state and local governments throughout the United States and Canada, appreciates the opportunity to comment on proposed changes to Municipal Securities Rulemaking Board (MSRB) Rule G-23.

With one significant exception, the GFOA supports the proposed changes and believes they are long overdue. For many years, the GFOA has encouraged the MSRB to prohibit a financial advisor (FA) from resigning and becoming the underwriter for the transaction. The GFOA's Best Practices on Selecting Financial Advisors and Selecting Underwriters In a Negotiated Sale clearly state that governments should not allow their financial advisor to resign and become the underwriter on a transaction. We updated our position in 2007 and went further than Rule G-23 because our leadership believes it is necessary for issuers to avoid the conflicts of interests that arise when an FA resigns to become the underwriter on a transaction and to adhere by our best practice that all outside professionals – including financial advisors and underwriters - be chosen by competitive means.

GFOA Best Practices on Selecting and Managing the Method of Sale of State and Local Government Bonds and Selecting Underwriters for Negotiated Bond Sales state that when an issuer, in consultation with its financial advisor, selects the negotiated sale method, the financial advisor should advise the issuer on all terms of the deal, including the selection of underwriters and the structuring and pricing of the bonds. The financial advisor has a fiduciary responsibility in both a competitive and negotiated sale to its issuer client. An underwriter's fiduciary responsibility is to the investor – not the issuer. Prohibiting role-switching ensures that the issuer is represented throughout the transaction by a financial advisor whose sole responsibility is to the issuer itself.

A problem also is created when a dealer can serve as a financial advisor on one transaction and serve as the underwriter on a separate transaction for the same issuer. GFOA's best practices state that it is best to avoid such arrangements, as a conflict of interest may rise and the FA's fiduciary responsibility may be questioned. While this is especially true for infrequent issuers, sophisticated issuers that frequent the market and are able to manage such an arrangement more effectively also need to be cautioned. It should be noted that many issuers avoid this conflict of interest altogether by only hiring independent financial advisors, which the GFOA always recommends governments to do when contemplating and structuring a bond sale.

We do have significant concern with the "Guidance on the Prohibition of Underwriting Issues of Municipal Securities for Which a Financial Advisory Relationship Exists Under Rule G-23". This section was not included in the MSRB's original proposal that was published for comment last Fall. We do not believe that it has received the attention that it deserves with the short comment period provided for this Rulemaking.

Our initial thoughts about the Guidance are as follows, which have been broken out by type of sale in order to clearly delineate the differing issues and relationships with underwriters that are presented in negotiated and competitive sales.

Negotiated Sales

The GFOA recognizes that broker/dealers, in the course of their engagement as underwriters of negotiated sales of bonds, typically provide input into matters relating to the structure, timing and terms of the bonds. However in our view, that input should not be substituted for the advice the issuer receives from a financial advisor. When underwriter input is presented to an issuer that is represented by a financial advisor, such input should not be seen as violating the intent of G-23. In contrast, when the issuer is not represented by a financial advisor, input provided by the underwriter becomes the issuer's sole source of financial advice, even though the underwriter does not have a fiduciary duty to the issuer. This relationship may cause one firm to be the underwriter and de facto financial advisor to the issuer. This type of situation should be prohibited by G-23. The Guidance should, at the very least, require the underwriter to disclose that they are not serving as the issuer's financial advisor and has no fiduciary obligation to act in the best interest of the issuer. Issuers need to clearly understand that their underwriter is not their financial advisor and that they are not discouraged from hiring a financial advisor because of a loophole in the proposed Guidance that suggests the underwriter can perform both roles.

Competitive Sales

Issuers that have determined to sell bonds through competitive sale, irrespective of whether or not they have engaged with a financial advisor, may discuss the structure, timing, terms, and other similar matters concerning the issuance of municipal securities with a broker/dealer without creating a financial advisor relationship on the part of the broker/dealer.

We hope that the SEC will allow the municipal securities community to have further discussions on the Guidance drafted by the MSRB so that all of the proposed changes to Rule G-23 are fully considered.

Sincerely,

Susan Gaffney

Susan Gaffney
Director, Federal Liaison Center

Attachments:

GFOA Best Practice, Selecting and Managing the Method of Sale of State and Local Government Bonds (2007)
GFOA Best Practice, Selecting Financial Advisors (2008)
GFOA Best Practice, Selecting Underwriters for Negotiated Bond Sales (2008)
GFOA Best Practice, Pricing Bonds in a Negotiated Sale (2009)

BEST PRACTICE

Selecting and Managing the Method of Sale of State and Local Government Bonds (1994 and 2007) (DEBT)

Background. State and local government bond issuers should sell their debt using the method of sale that is most likely to achieve the lowest cost of borrowing while taking into account both short-range and long-range implications for taxpayers and ratepayers. Differing views exist among issuers and other bond market participants with respect to the relative merits of the competitive and negotiated methods of sale. Moreover, research into the subject has not led to universally accepted findings as to which method of sale is preferable when taking into account differences in bond structure, security, size, and credit ratings for the wide array of bonds issued by state and local governments.

Concerns have been raised about the lack of a competitive Request for Proposals (RFP) process in the selection of underwriters in a negotiated sale and the possibility of higher borrowing costs when underwriters are appointed based on factors other than merit. As a result, issuers have been forced to defend their selection of underwriters for negotiated sales in the absence of a documented, open selection process.

There is also a lack of understanding among many debt issuers about the appropriate roles of underwriters and financial advisors and the fiduciary relationship that each has or does not have with respect to state and local government issuers. The relationship between issuer and financial advisor is one of "trust and confidence" which is in the "nature of a fiduciary relationship". This is in contrast to the relationship between the issuer and underwriter where the relationship is one of some common purposes but also some competing objectives, especially at the time of bond pricing.

Recommendation. When state and local laws do not prescribe the method of sale of municipal bonds, the Government Finance Officers Association (GFOA) recommends that issuers select a method of sale based on a thorough analysis of the relevant rating, security, structure and other factors pertaining to the proposed bond issue. If the government agency has in-house expertise, defined as dedicated debt management staff whose responsibilities include daily management of a debt portfolio, this analysis and selection could be made by the government's staff. However, in the more common situation where a government agency does not have sufficient in-house expertise, this analysis and selection should be undertaken in partnership with a financial advisor. Due to the inherent conflict of interest, issuers should not use a broker/dealer or potential underwriter to assist in the method of sale selection unless that firm has agreed not to underwrite that transaction.

- The GFOA believes that the presence of the following factors may favor the use of a competitive sale:
- The rating of the bonds, either credit-enhanced or unenhanced, is at least in the single-A category.
- The bonds are general obligation bonds or full faith and credit obligations of the issuer or are secured by a strong, known and long-standing revenue stream.
- The structure of the bonds does not include innovative or new financing features that require extensive explanation to the bond market.

Similarly, GFOA believes that the presence of the following factors may favor the use of a negotiated sale:

- The rating of the bonds, either credit-enhanced or unenhanced, is lower than single-A category.

- Bond insurance or other credit enhancement is unavailable or not cost-effective.

- The structure of the bonds has features such as a pooled bond program, variable rate debt, deferred interest bonds, or other bonds that may be better suited to negotiation.

- The issuer desires to target underwriting participation to include disadvantaged business enterprises (DBEs) or local firms.

- Other factors that the issuer, in consultation with its financial advisor, believes favor the use of a negotiated sale process.

If an issuer, in consultation with its financial advisor, determines that a negotiated sale is more likely to result in the lowest cost of borrowing, the issuer should undertake the following steps and policies to increase the likelihood of a successful and fully documented negotiated sale process:

- Select the underwriter(s) through a formal request for proposals process. The issuer should document and make publicly available the criteria and process for underwriter selection so that the decision can be explained, if necessary.

- Enter into a written contractual relationship with a financial advisor (a firm unrelated to the underwriter(s)), to advise the issuer on all aspects of the sale, including selection of the underwriter, structuring, disclosure preparation and bond pricing.

- Due to inherent conflicts of interest, the firm acting as a financial advisor for an issuer should not to be allowed to resign and serve as underwriter for the transaction being considered.

- Due to potential conflicts of interest, the issuer should also enact a policy regarding whether and under what circumstances it will permit the use of a single firm to serve as an underwriter on one transaction and a financial advisor on another transaction.

- Issuers with sufficient in-house expertise and access to market information may act as their own financial advisor. Such issuers should have at least the following skills and information: (i) access to real-time market information (e.g. Bloomberg) to assess market conditions and proposed bond prices; (ii) experience in the pricing and sale of bonds, including historical pricing data for their own bonds and/or a set of comparable bonds of other issuers in order to assist in determining a fair price for their bonds; and (iii) dedicated full-time staff to manage the bond issuance process, with the training, expertise and access to debt management tools necessary to successfully negotiate the pricing of their bonds.

- Remain actively involved in each step of the negotiation and sale processes in accordance with the GFOA's *Recommended Practice, Pricing Bonds in a Negotiated Sale*.

- Require that financial professionals disclose the name(s) of any person or firm compensated to promote the selection of the underwriter; any existing or planned arrangements between outside professionals to share tasks, responsibilities and fees; the name(s) of any person or firm with whom the sharing is proposed; and the method used to calculate the fees to be earned.

- Review the "Agreement Among Underwriters" and ensure that it governs all transactions during the underwriting period.

- Openly disclose public-policy issues such as the desire for DBEs and regional firm participation in the syndicate and the allocation of bonds to such firms as reason for negotiated sale; measure and record results at the conclusion of the sale.

- Prepare a post-sale summary and analysis that documents the pricing of the bonds relative to other similar transactions priced at or near the time of the issuer's bond sale, and record the true interest cost of the sale and the date and hour of the verbal award.

<u>References</u>

- *Competitive v. Negotiated Sale Debt*, Issue Brief No. 1, California Debt Advisory Commission, September 1992.
- *Competitive v. Negotiated: How to Choose the Method of Sale for Tax-Exempt Bonds*, GFOA, 1994.
- *Debt Issuance and Management: A Guide for Smaller Governments*, James C. Joseph, GFOA, 1994.
- GFOA Best Practice, "Preparing RFPs to Select Financial Advisors and Underwriters," GFOA, 1997.
- GFOA Best Practice, "Pricing Bonds in a Negotiated Sale," 2000.
- GFOA Best Practice, "Debt Management Policy," 2003.
- *An Elected Official's Guide to Debt Issuance*, J.B. Kurish and Patricia Tigue, GFOA, 2005.
- "Who are the Parties in My Deal? What are Their Roles? How Do I Sell My Bonds?" Julia H. Cooper and David Persselin, *Government Finance Review*, April 2006.

Approved by the GFOA's Executive Board, October 19, 2007.

BEST PRACTICE

Selecting Financial Advisors (2008) (DEBT)*

Note: This Best Practice (BP) is one of a group of five relating to the sale of bonds. These five BPs should be read and considered in conjunction with each other because of the interaction of the processes to which they apply. The five BPs are:

Selecting and Managing the Method of Sale of State and Local Government Bonds
Selecting Financial Advisors
Selecting Bond Counsel
Selecting Underwriters for Negotiated Bond Sales
Pricing Bonds in a Negotiated Sale

Background. State and local governments employ financial advisors to assist in the structuring and issuance of bonds whether through a competitive or a negotiated sale process. Unless the issuer has sufficient in-house expertise and access to market information, it should hire an outside financial advisor prior to undertaking a debt financing. A financial advisor represents the issuer, and only the issuer, in the sale of bonds. Issuers should assure themselves that the selected financial advisor has the necessary expertise to assist the issuer in selecting other finance professionals, planning the bond sale, and successfully selling and closing the bonds. In considering the roles of the financial advisor and underwriter, it is the intent of this Recommended Practice to set a higher standard than is required under MSRB Rule G-23, because disclosure and consent are not sufficient to cure the inherent conflict of interest.

Recommendation. The Government Finance Officers Association (GFOA) recommends that issuers select financial advisors on the basis of merit using a competitive process and that issuers review those relationships periodically. A competitive process using a request for proposals or request for qualifications (RFP) process allows the issuer to compare the qualifications of proposers and to select the most qualified firm based on the scope of services and evaluation criteria outlined in the RFP.

Before starting the RFP process, issuers should decide whether the financial advisor will assist the issuer for a single bond sale, for a multi-year engagement or whether the issuer seeks to establish a qualified pool of financial advisors to choose from for future bond sales. The RFP then can be carefully written in order to result in the form of relationship desired by the issuer. Additionally, issuers should write the RFP to comply with applicable procurement requirements.

If an issuer is contemplating the possibility of selling bonds through a negotiated sale, the financial advisor should be retained prior to selecting the underwriter(s). This allows the issuer to have professional services available to advise on the appropriate method of sale, and if a negotiated sale is selected, to prepare the underwriter RFP and assist in the evaluation of the underwriter responses.

No firm should be given an unfair advantage in the RFP process. Procedures should be established for communicating with potential proposers, determining how and over what time period questions will be addressed, and determining when contacts with proposers will be restricted.

Due to potential conflicts of interest, the issuer also should enact a policy regarding whether, and under what circumstances, it would permit a firm to serve as an underwriter on one transaction and a financial advisor on another transaction. Additionally, it is recommended that when an issuer has a financial advisor contract with a firm that also is a broker-dealer, there should be a lockout period from the time that the financial advisor contract ends to the time when the broker-dealer can serve as a negotiated underwriter for the issuer.

Request for Proposal Content. The RFP should include at least the following components:

1. A statement from the issuer stating that due to inherent conflicts of interest, the firm selected as financial advisor will not be allowed to resign in order to serve as underwriter for the proposed transaction (See GFOA Recommended Practice, *Selecting and Managing the Method of Sale of State and Local Government Bonds*).
2. A clear and concise description of the scope of work, specifying the length of the contract and indicating whether joint proposals with other firms are acceptable.
3. Clarity on whether the issuer reserves the right to select more than one financial advisor or to form financial advisory teams.
4. A description of the objective evaluation and selection criteria and explanation of how proposals will be evaluated.
5. A requirement that all fee structures be presented in a standard format. Issuers also should ask all proposers to identify which fees are to be proposed on a “not-to-exceed” basis, describe any condition attached to their fee proposal, and explicitly state which costs are included in the fee proposal and which costs are to be reimbursed.
6. A requirement that the proposer provide at least three references from other public-sector clients, preferably from ones that the firm provided similar services to those proposed to be undertaken as the result of the RFP.

Requested Proposer Responses. RFPs should request relevant information related to the areas listed below in order to distinguish each firm’s qualifications and experience, including:

1. Relevant experience of the individuals to be assigned to the issuer, identification of the individual in charge of day-to-day management, and the percentage of time committed for each individual on the account.
2. Relevant experience of the firm with financings of the issuer or comparable issuers and financings of similar size, types and structures, including financings in same state.
3. Discussion of the firm’s financial advisory experience necessary to assist issuers with either competitive or negotiated sales.
4. Demonstration of the firm’s understanding of the issuer’s financial situation, including ideas on how the issuer should approach financing issues such as bond structures, credit rating strategies and investor marketing strategies.
5. Demonstration of the firm’s knowledge of local political, economic, legal or other issues that may affect the proposed financing.
6. Discussion of the firm’s familiarity with GFOA’s Recommended Practices relating to the selling of bonds and the selection of finance professionals.
7. Disclosure of the firm’s affiliation or relationship with any broker-dealer.
8. Analytic capability of the firm and assigned individuals and the availability of ongoing training and educational services that could be provided to the issuer.
9. Description of the firm’s access to sources of current market information to assist in pricing of negotiated sales and information to assist in the issuer in planning and executing competitive sales.
10. Amounts and types of insurance carried, including the deductible amount, to cover errors and omissions, improper judgments, or negligence.
11. Disclosure of any finder’s fees, fee splitting, payments to consultants, or other contractual arrangements of the firm that could present a real or perceived conflict of interest.
12. Disclosure of any pending investigation of the firm or enforcement or disciplinary actions taken within the past three years by the SEC or other regulatory bodies.

Additional Considerations. Issuers should also consider the following in conducting the financial advisor selection process**:**

1. Take steps to maximize the number of respondents by using mailing lists, media advertising, resources of the GFOA and applicable professional directories.
2. Allow adequate time for firms to develop their responses to the RFP. Two weeks should be appropriate for all but the most complicated RFPs.
3. Establish evaluation procedures and a systematic rating process, conduct interviews with proposers, and undertake reference checks. Where practical, one individual should check all references using a standard set of questions to promote consistency. To remove any appearance of a conflict of interest resulting from political contributions or other activities, elected officials should not be part of the selection team.
4. Document and retain the description of how the selection of the financial advisor was made and the rankings of each firm.
5. Consider whether to require disclosure of gifts, political contributions, or other financial arrangements in compliance with state and local government laws or other applicable policies.

Basis of Compensation. Fees paid to financial advisors should be on an hourly or retainer basis, reflecting the nature of the services to the issuer. Generally, financial advisory fees should not be paid on a contingent basis to remove the potential incentive for the financial advisor to provide advice that might unnecessarily lead to the issuance of bonds. GFOA recognizes, however, that this may be difficult given the financial constraints of many issuers. In the case of contingent compensation arrangements, issuers should undertake ongoing due diligence to ensure that the financing plan remains appropriate for the issuer's needs. Issuers should include a provision in the RFP prohibiting any firm from engaging in activities on behalf of the issuer that produce a direct or indirect financial gain for the financial advisor, other than the agreed-upon compensation, without the issuer's informed consent.

Form of Contract. As part of the RFP package, the issuer may also include a "Form of Contract" which incorporates elements and provisions conforming to prevailing law and procurement processes and requires RFP respondents to comment on the acceptability of the Form of Contract. The comments on the acceptability of the Form of Contract should be part of the evaluation process. The contract development process should allow for reasonable negotiation over the final terms of the contract. A final negotiated contract should make clear those services that will be included within the basic financial advisor fee and any services or reimbursable expenses that might be billed separately.

References

- *Preparing Requests for Proposals*, Issue Brief No. 3, California Debt Advisory Commission, October, 1994.
- *Debt Issuance and Management: A Guide for Smaller Governments*, James C. Joseph, GFOA, 1994.
- *A Guide for Selecting Financial Advisors and Underwriters: Writing RFPs and Evaluating Proposals*, Patricia Tigue, GFOA, 1997.
- GFOA Best Practice, "Pricing Bonds in a Negotiated Sale," 2008.
- GFOA Best Practice, "Selecting Bond Counsel," 2008.
- GFOA Best Practice, "Selecting Underwriters for Negotiated Bond Sales," 2008.
- GFOA Best Practice, "Selecting and Managing the Method of Sale of State and Local Government Bonds," 2007.
- Municipal Securities Rulemaking Board Rule G-23, *Activities of Financial Advisors*,http://www.msrb.org/msrb1/rules/ruleg23.htm.

* This Recommended Practice, along with the Recommended Practice on Selecting Financial Advisors, replaces the 1997 RP, Preparing RFPs to Select Financial Advisors and Underwriters.

Approved by the GFOA's Executive Board, October 17, 2008.

BEST PRACTICE

<u>Selecting Underwriters for Negotiated Bond Sales (2008) (DEBT)*</u>

Note: This Best Practice (BP) is one of a group of five relating to the sale of bonds. These five BPs should be read and considered in conjunction with each other because of the interaction of the processes to which they apply. The five BPs are:

Selecting and Managing the Method of Sale of State and Local Government Bonds
Selecting Financial Advisors
Selecting Bond Counsel
Selecting Underwriters for Negotiated Bond Sales
Pricing Bonds in a Negotiated Sale

<u>Background</u>. State and local governments select underwriters for the purpose of selling bonds through a negotiated sale. The primary role of the underwriter in a negotiated sale is to market the issuer's bonds to investors. Assuming that the issuer and underwriter reach agreement on the pricing of the bonds at the time of sale, the underwriter purchases the entire bond issue from the issuer and resells the bonds to investors. In addition, negotiated sale underwriters are likely to provide ideas and suggestions with respect to structure, timing and marketing of the bonds being sold.

Issuers must keep in mind that the roles of the underwriter and the financial advisor are separate, adversarial roles and cannot be provided by the same party. Underwriters do not have a fiduciary responsibility to the issuer. A financial advisor represents only the issuer and has a fiduciary responsibility to the issuer. In considering the roles of underwriter and financial advisor, it is the intent of this Recommended Practice to set a higher standard than is required under MSRB Rule G-23, because disclosure and consent are not sufficient to cure the inherent conflict of interest.

The issuer's goal in a negotiated bond sale is to obtain the highest possible price (lowest interest cost) for the bonds. To maximize the potential of this occurring, the issuer's goal in the underwriter selection process is to select the underwriter(s) that has the best potential for providing that price. Those underwriters are typically the ones that have demonstrated both experience underwriting the type of bonds being proposed and the best marketing/distribution capabilities.

<u>Recommendation</u>. The Government Finance Officers Association (GFOA) recommends that unless the issuer has sufficient in-house expertise and access to market information, it should hire an outside financial advisor prior to undertaking a negotiated debt financing. The financial advisor can lend objective knowledge and expertise in the selection of underwriters for negotiated sales. GFOA recommends that a firm hired as a financial advisor should not be allowed to resign in order to underwrite the proposed negotiated sale of bonds.

GFOA further recommends the use of a Request for Proposal (RFP) process when selecting underwriters in order to promote fairness, objectivity and transparency. The RFP process allows the issuer to compare respondents and helps the issuer select the most qualified firm(s) based on the evaluation criteria outlined in the RFP. An issuer and its financial advisors should have a clear understanding of the issuer's underwriting needs and should carefully develop an RFP that complies with state and local bidding requirements (including the use of regional, local or disadvantaged firms if deemed appropriate by the issuer).

A negotiated bond sale does not entail the purchase of any goods or services by an issuer from an underwriter. Therefore, an RFP process for underwriters should not be treated as a procurement process for goods or services, notwithstanding the obligation of the issuer to comply with state and/or local procurement requirements. The only legal relationship between the issuer and an underwriter is created by a Bond Purchase Agreement signed at the time of the pricing of the bonds, wherein the issuer agrees to sell the bonds to the underwriter at an agreed upon price.

An RFP process can result in selection of one or more underwriters for a single transaction or result in identification of a pool of underwriters from which firms will be selected over a specific period of time for a number of different transactions. Each issuer should weigh the advantages and disadvantages of each type of arrangement with the assistance of their financial advisor.

No firm should be given an unfair advantage in the RFP process. Procedures should be established for communicating with potential proposers, determining how and over what time period questions will be addressed, and determining when contacts with proposers will be restricted.

Request for Proposal Content. The RFP should include at least the following components:

1. A clear and concise description of the contemplated bond sale transaction.
2. A statement noting whether firms may submit joint proposals. In addition, the RFP should state whether the issuer reserves the right to select more than one underwriter for a single transaction.
3. A description of the objective evaluation and selection criteria and explanation of how proposals will be evaluated.
4. A requirement that all underwriter compensation structures be presented in a standard format. Proposers should identify which fees are proposed on a “not-to-exceed” basis, describe any condition attached to their fee proposal, and explicitly state which costs are included in the fee proposal and which costs are to be reimbursed.
5. A requirement that the proposer provide at least three references from other public-sector clients, preferably clients where the firm provided underwriting services similar to those proposed to be undertaken as the result of the RFP.

Requested Proposer Responses. RFPs should include questions related to the areas listed below to distinguish firms’ qualifications and experience, including but not limited to:

1. Relevant experience of the firm and the individuals assigned to the issuer, and the identification and experience of the individual in charge of day-to-day management of the bond sale, including both the investment banker(s) and the underwriter(s).
2. A description of the firm’s bond distribution capabilities including the experience of the individual primarily responsible for underwriting the proposed bonds. The firm’s ability to access both retail and institutional investors should be described.
3. Demonstration of the firm’s understanding of the issuer’s financial situation, including ideas on how the issuer should approach financing issues such as bond structures, credit rating strategies and investor marketing strategies.
4. Demonstration of the firm’s knowledge of local political, economic, legal or other issues that may affect the proposed financing.
5. Documentation of the underwriter’s participation in the issuer’s recent competitive sales or the competitive sales of other issuers in the same state.
6. Analytic capability of the firm and assigned investment banker(s).
7. Access to sources of current market information to provide bond pricing data before, during and after the sale.
8. The amount of uncommitted capital available and the ability and willingness of the firm to purchase the entire offering of the issuer, if necessary, in the case of a firm underwriting.

9. Any finder's fees, fee splitting, or other contractual arrangements of the firm that could present a real or perceived conflict of interest, as well as any pending investigation of the firm or enforcement or disciplinary actions taken within the past three years by the SEC or other regulatory bodies.

Additional Considerations. Issuers should also consider the following in conducting the underwriter selection process:

1. Take steps to maximize the number of respondents by using mailing lists, media advertising, resources of the GFOA, resources of the financial advisor and applicable professional directories.
2. Give adequate time for firms to develop their responses to the RFP. Two weeks should be appropriate for all but the most complicated RFPs.
3. Establish evaluation procedures and a systematic rating process, conduct interviews with proposers, and undertake reference checks. Where practical, one individual should check all references using a standard set of questions to promote consistency. To remove any appearance of a conflict of interest resulting from political contributions or other activities, elected officials should not be part of the selection team.
4. Document and retain the description of how the selection was made and the rankings of each firm.

Underwriter's Compensation. The underwriter in a negotiated sale is compensated in the form of an underwriter's discount or "spread", which consists of the negotiated difference between the amount the underwriter pays the issuer for the bonds and the amount the underwriter expects to receive selling the bonds to investors. The underwriter's discount includes up to four components: the management fee, takedown, expenses and underwriting fee. The only component of spread that can be fixed in a proposal is the management fee. The management fee compensates the investment bankers for the time and expertise brought to the negotiated sale by the investment bankers. It is appropriate to ask the proposer for a firm management fee quote, although its weighting in the evaluation criteria should be low. In addition, issuers may want to leave room to negotiate this fee lower or higher, depending on the actual complexities of the transaction.

The remaining components of spread, as noted below, should be determined through the negotiation process.

1. Expenses – includes various fees and overhead expenses and also should not be part of the RFP evaluation criteria. However it is important to note that all underwriter expenses be clearly identified and defined at the appropriate time during the bond negotiation.
2. Takedown – is the "sales commission" of the deal. Current market levels of takedown can be determined by the issuer or its financial advisor just prior to the time of negotiation. The takedown is the principal component of the potential profit to an underwriter in a bond sale. The issuer must weigh the impact of takedown on the resulting true interest cost to the bond issuer. An inadequate takedown may result in less aggressive marketing of the bonds and a higher interest cost to the issuer. A fair balance must be struck between a "market rate" takedown and the cost to the issuer in future interest costs.
3. Underwriting Fee – is almost never part of the final underwriter's discount and should not be part of the discussion at the RFP stage. Discussion of the payment of an underwriting fee may occur during pricing negotiation, but only to the extent the underwriter agrees to underwrite a substantial amount of unsold bonds.

Issuers should include a provision in the RFP prohibiting any firm from engaging in activities on behalf of the issuer that produce a direct or indirect financial gain for the firm, other than the agreed-upon compensation, without the issuer's informed consent. Procedures should be established for communicating with potential proposers, determining how and over what time period questions will be addressed, and determining when contacts with proposers will be restricted.

References

- *Preparing Requests for Proposals*, Issue Brief No. 3, California Debt Advisory Commission, October 1994.
- *Debt Issuance and Management: A Guide for Smaller Governments*, James C. Joseph, GFOA, 1994.
- *A Guide for Selecting Financial Advisors and Underwriters: Writing RFPs and Evaluating Proposals*, Patricia Tigue, GFOA, 1997.
- GFOA Best Practice, "Selecting Bond Counsel," 2008.
- GFOA Best Practice, "Selecting Financial Advisors," 2008.
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- Municipal Securities Rulemaking Board Rule G-23, *Activities of Financial Advisors*, http://www.msrb.org/msrb1/rules/ruleg23.htm.

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Approved by the GFOA's Executive Board, October 17, 2008.