Corporate Operational Underwriting Process

BUSINESS PRACTICES
IN "PLAIN ENGLISH"

THE BOND MARKET ASSOCIATION

DTCC®

Executive Summary

In response to the bond industry's desire for operational opportunities that promote efficiency in the primary markets, The Bond Market Association (TBMA) and the Depository Trust and Clearing Corporation (DTCC) developed the attached plain English documentation that describes current business practices for submitting a corporate bond issue to DTCC. The purpose of this documentation is to help identify opportunities for streamlining the operational underwriting process and to find ways to make the process more user friendly concerning new issue data.

In order to assist with the implementation of Real Time Trade Matching and related functions, DTCC and TBMA staff are working together to find new sources of securities descriptions that could be available as underwriters and their counsel submit underwriting data to DTCC. In the corporate new issue process, many of the operational steps occur simultaneously and over a relatively short timeframe. The immediacy of this process may place additional pressure on bond underwriting participants to modernize the method by which data is transmitted to the various parties involved.

According to the research that was conducted with industry professionals for this plain English document, there are opportunities to make new issue information publicly available in a common format via an industry utility. DTCC currently receives this information, confirms the data by comparing it with the issue's prospectus, and then distributes it to subscribers. In moving forward, DTCC will examine the possibility of updating the current system and process, based upon the industry's output as outlined in this document, in order to adapt to the needs of an emerging real-time environment.

Corporate Bond Operational Underwriting Process

Business Practices in Plain English

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I. Introduction

The Bond Market Association (TBMA) and The Depository Trust and Clearing Corporation (DTCC) recently commenced in an important cross market initiative to document the operational underwriting process in plain English. The purpose of this initiative is to help identify opportunities to make the end to end underwriting process more efficient and more congruent with enabling Straight Through Processing (STP). This goal is compatible with the Association's long standing effort to achieve efficiencies in the fixed income markets. The objective of documenting the underwriting process in plain English is to describe the entire current underwriting process and establish the flow of information and functionality involved in that process.

In September 2003, TBMA and DTCC jointly published the first product of this initiative, i.e. a plain English document describing the municipal operational underwriting process. This document is available on the Association's website at www.bondmarkets.com. The second phase of the initiative describes the underwriting process for investment grade and high yield corporate bonds. The Association invited bond professionals from its member firms to participate in the Corporate Bond Underwriting Focus Group, which consisted of various types of firms, from regional to bulge bracket firms. TBMA and DTCC then held focus group sessions with these industry representatives as well as, in some cases, the advisors and counsel to these representatives. The focus group meetings were supplemented by additional individual interviews. This plain English document which is based on the output of the group's sessions describes the corporate bond operational underwriting process and identifies the parties and their respective roles, the sequence of steps in the corporate underwriting process, the information flow and the role of DTCC.

II. Business Overview

The corporate bond market is a large and liquid market. In 2003 the average daily trading volume by primary dealers for bonds with maturities greater than one year was $18.9 billion. The new corporate bond issuance grew in the year 2003 13.9 percent from the previous year to $743.6 billion. With interest rates at historic lows and corporate bond spreads narrowing, corporations sought to take advantage of the favorable market environment. The Bond Market Association estimates that the total market value of outstanding corporate bonds in the United States as of December 31, 2003 was approximately $4.4 trillion.[1]

This document describes the business practices involving the operational underwriting process in connection with investment grade and high yield corporate bonds. Most corporate bonds are evaluated for credit quality by rating agencies. Bonds rated BBB- (by

[1] The Bond Market Association's Research Quarterly 2004

S&P or Fitch) or Baa3 (by Moody's) or higher are considered "investment grade" meaning that the bonds have a sound credit quality. Bonds with a rating of BB+ or Ba1 or below are considered "high yield" bonds, and their credit quality may be speculative. High yield bonds pay higher interest rates to investors to compensate for the extra risk.

III. Participants

The issuer is the corporation that raises capital through the public offering of debt. A company may have many reasons to issue a bond, such as a desire to be less dependent on bank financing or a desire to diversify the company's creditor base. For corporations, bonds can sometimes prove a lower cost source of capital than bank borrowing especially to finance long-term projects.

Broker-dealers may purchase the bonds from the issuer and sell the bonds to investors. While they do so expecting to make a profit, there is also a risk of loss, particularly if the bonds are not resold quickly and the market is drifting downward. In order to spread the risk and increase the marketing opportunity, broker-dealers often invite others to join them in "underwriting" the issue.

There may be issues where a broker-dealer prefers to be the sole underwriter of the deal and purchase the entire issue without involving other broker-dealers in pricing or marketing the issue; however, it is more common for a group of broker-dealers or "*syndicate*" to assume responsibility for underwriting an issue. One (or more) members of the syndicate group may be appointed senior manager (or co-managers) of the deal. The remaining members of the syndicate are committed to participate as underwriters through an Agreement Among Underwriters (AAU).

Other dealers may be asked to become part of a Selling Group; these firms do not share in the profit or liabilities of the syndicate account but do have an opportunity to resell a new issue on the same terms as the syndicate members.

Both the issuer and the underwriter are represented by a legal counsel to assist in the many legal aspects of the securities offerings. The respective counsels advise on regulatory matters and help with documentation throughout the underwriting process. The i*ssuer's counsel* confirms that the issuer has met all legal and regulatory requirements necessary for issuance and advises the issuer regarding the debt indenture and prospectus. *The underwriter's counsel* assists the underwriter in meeting the due diligence obligations, helps to review the prospectus for accuracy and disclosure and prepares the Agreement Among Underwriters and the purchase contract.

Corporate new issue bonds are largely bought by *institutional investors*. Underwriters develop relationships with institutional buyers through their institutional sales force, so they are able to market large blocks of bonds to these institutions in a narrow timeframe. Dealers often poll institutions before an issue is priced to assess their level of interest and pricing expectations. Institutional investors sometimes have rigid investment guidelines and compliance limitations that must be followed to meet specific investment objectives (i.e. purchase criteria may require minimum ratings, prohibit concentrations in a specific market sector or purpose, or have a preference for certain geographic locations). It is important that underwriters stay in contact with their buyers during the process to ensure that the deal is structured and priced appropriately to meet both the needs of the issuer and the investors.

Retail investors also have access to corporate bonds on the primary market, through a financial institution or via direct access programs that are currently being offered by underwriters and/or broker-dealers. The underwriting process of these programs is otherwise traditional, but the bonds are offered on a best-efforts basis to broker-dealers who ultimately sell them to retail investors who may purchase them in denominations starting at $1,000.

The *trustee* is a financial institution, usually a bank, which administers the indenture provisions of a debt issue for the benefit of the bond holders. In many cases the trustee also acts as a *transfer agent* or *paying agent* for the bonds. The transfer agent simply transfers the bonds from issuer to bond holder. The paying agent is responsible for transmitting payments of interest and principal from the issuer to the bond holders.

Regulators

SEC

The Securities and Exchange Commission (SEC) has set forth rules that place regulatory responsibility on the underwriters to ensure that the issuers whose securities are being underwritten have fully committed to provide current and ongoing disclosure of financial details and material events that may impact their ability to meet debt service requirements.

The SEC requires that the issuer files a registration statement 20 days prior to the public offering and that it is accompanied with the preliminary prospectus. The SEC also states what information is and is not required in the prospectus. The prospectus must include information such as use of proceeds, determination of offering price and plan of distribution. The time period between the SEC registration and the public offering, is called the cooling-off period. During this time, the SEC examines the registration statement and accompanying materials. In some cases, if the issuer has a record of compliance with earlier issues and if it is up-to-date in the on-going reporting requirements, the bond issue may be sold as soon as 48 hours after filing the registration statement.

There are some instances when registration with the SEC is not necessary. In 1990, the SEC approved Rule 144A, a reform that permits firms to raise capital from “Qualified Institutional Buyers” (QIB) without requiring registration of the securities and compliance with U.S. GAAP. Rule 144A allows for the immediate resale of private placements among QIBs. This rule was issued in order to improve the liquidity and efficiency of the private placement market and it is particularly important for foreign issuers because it allows them to gain access to institutional investors without having to meet strict disclosure standards that are typically required of U.S. public companies. The 144A market is currently the principal debt market for foreign issues in the United States. Regulation S (Reg S) allows U.S. companies to sell securities to persons or entities located outside of the U.S. without registering them with the SEC. Many U.S. companies utilize this regulation for their offshore offerings.

Issuers may also utilize a "shelf" registration process, where bonds are registered with the SEC but the issuer may delay making an offering (or make several offerings at various times) for up to a two year period.

SEC Regulation M regulates securities offerings by providing anti-manipulation rules. Reg M regulates the activities of the issuers, underwriting syndicate members and the securities purchasers during an offering.

NASD

The National Association of Securities Dealers (NASD) is the self-regulatory arm of the securities industry that also regulates the corporate bond markets. Under the federal law, virtually every securities firm doing business with the U.S. public is an NASD registered member firm. NASD writes rules to govern their behavior, examines them for compliance and disciplines those that fail to comply with NASD rulings.

Industry Utilities

In the securities industry, there exist several entities and utilities that are critical for corporate bond underwriting operational business practices. The Bond Market Association and DTCC's plain English on the municipal operational underwriting process outlined the role of DTCC, DTC, NSCC and the CUSIP Service Bureau. Likewise, these entities and utilities are relevant in the operational business practices of corporate bond underwriting. The aforementioned entities and utilities are required, by the rules of the SEC and/or NASD, to be implicitly involved in underwriting procedures. The details and level of involvement of industry entities and utilities are discussed further in this section.

DTCC Underwriting Procedures

The Depository Trust & Clearing Corporation (DTCC) through its subsidiaries provides clearance, settlement, custody, STP and information services for various types of securities, including corporate bonds. The Depository Trust Company (DTC) is one of DTCC's subsidiaries. DTC retains custody of some two million securities issues and provides services necessary to the maintenance of those securities. All securities offerings at DTC begin with DTC underwriting services.

DTC's Underwriting Department qualifies the eligibility of both new and old issues for DTC services and is responsible for maintaining DTC's CUSIP master file. The Eligibility section permits underwriters to distribute both new and secondary offerings of securities quickly and economically through electronic book-entry delivery and settlement while making the issue available for depository services. DTC’s Eligibility area reviews new issue documentation (such as prospectuses, official statements or offering memoranda) for corporate and municipal issues submitted by underwriters for distribution and settlement at DTC. DTC requires submission of this documentation at least 10 business days before the closing date. DTC will, however, work with underwriters when these events occur fewer than 10 business days before the closing date. For each new corporate or municipal issue being considered for eligibility, DTC requires the following documentation:

- Preliminary offering document. The lead underwriter submits a copy of the prospectus or offering statement to DTC for initial review of eligibility criteria.
- Eligibility Questionnaire. The lead underwriter submits to DTC an Eligibility Questionnaire specifying the basic details of the issue. The questionnaire requests specific information about the issue. FAX submissions are acceptable, although electronic formats are clearly preferable to avoid re-keying and the potential of input errors. PUND, a function available through DTC's Participant Terminal System (PTS), allows participants to input issue information directly into DTC's underwriting database, expediting the approval of new issues and reducing paperwork and phone communication with DTC. The Eligibility Questionnaire can also be submitted electronically through the Web Underwriting (WUN) application on DTC's Web site (www.dtc.org)

Issues are reviewed to determine whether they meet the standards of DTC's Operational Arrangements (OA) to qualify for DTC's full services. The OA specifies the requirements for an issue to become eligible for DTC services and incorporates standards for income, reorganization, and redemption payments ("Principal and Income Payments"), adopting the guidelines set by the U.S. Working Committee Group of Thirty (G-30) Clearance and Settlement Project Same-Day Funds Task Force (P Task Force).

For issues in book-entry-only (BEO) form, the issuer authorizes the deposit at DTC of one or more "global" certificates for each tranche of an issue. Ownership positions and transactions in each security are reflected in DTC's records and in the records of participating banks and brokers. For issues in book-entry-only (BEO) form, DTC requires that a Letter of Representations (LOR) be signed and submitted to DTC by the issuer and issuer's agent or agents.

Upon determining an issue can be made DTC-eligible, the securities records are added to the DTCC master file. A download of all newly eligible securities is available to DTC participants daily through a computer-to-computer facility (CCF).

Before a non-FAST issue closes, DTC updates the Underwriting database by creating a long position in Underwriting's internal account. Packaging staff verifies the amount, CUSIP numbers, form of registration, and interest rates and maturity dates, if applicable.

For a FAST issue, the transfer agent confirms the CUSIP number and the amount of the issue via the PTS function FRAC (FAST Reject and Confirmation). The FAST agent must confirm the balance as early as the opening of business, but no later than noon, for DTC to credit securities to a participant's account on the closing date of the issue. FAST is an arrangement between DTC and transfer agents to eliminate the movement of securities certificates. By signing an agreement with DTC (the Balance Certificate Agreement), agents agree to maintain DTC-eligible inventory in the form of jumbo certificates registered in the name of DTC's nominee name, Cede & Co. DTC and FAST agents electronically reconcile the results of participants' daily deposit and withdrawal activities. Over 90% of corporate bond deals are done as FAST issues.

The lead underwriter's participant account is credited on settlement date with the position for the new issue. Position is moved from a DTC internal account to the lead underwriter's participant account for book-entry delivery and settlement upon notification by both the issuer (or its agent) and the underwriter that an issue has closed.

In a one to two week period following closing, DTCC verifies all the details of the new securities against the final official statement and Bloomberg's system, paying particular attention to the data related to asset servicing. Any discrepancies found are resolved with DTCC calling the issuer's paying agent.

In establishing a new issue under DTC's book-entry process, DTC effectively becomes the single registered bondholder to whom the issuer's assigned paying agent will make all interest and principal payments on the bonds, according to the issuer's instructions. Therefore, DTCC requires a high degree of accuracy on all information that will impact its ability to service the beneficial bondholders over the life of the securities, including providing correct and timely payment of interest, redemption at maturity, calls and refundings.

SEC Exempt Issues

Securities eligible for resale under Rule 144A are exempt from registration with the SEC. These securities can be sold (under Rule 144A) exclusively to qualified institutional buyers (QIB). To make a Rule 144A issue eligible for DTC services, the lead underwriter must:

- Submit the appropriate Letter of Representations, including a rider titled "Representations for Rule 144A Securities."
- If the security is not investment grade debt or preferred stock, the issue must be made eligible with the National Association of Securities Dealers' (NASD) PORTAL system.
- If a Regulation S offering is made in conjunction with a Rule 144A offering and the securities are not subject to precisely the same restrictions on transfer, obtain separate

identification numbers (CUSIP or CINS) for the Rule 144A security and the Regulation S security. In this case, a Regulation S rider should also be included in the appropriate Letter of Representations.

International Depositories: Euroclear and Clearstream Procedures

The choice of where to deposit securities depends on both the target investor base and the features of the securities offering. U.S. debt securities targeted at an international investor base in addition to U.S. investors necessitate that the securities be made eligible for Euroclear and Clearstream, two International Central Securities Depositories (ICSD) based in Belgium and Luxembourg, respectively. The ICSD support two structures: a) deposit of securities with a local depository or Central Securities Depository (i.e., DTC); and b) deposit of securities with a Common Depository, a bank jointly selected by the ICSD to hold securities in global form on behalf of the participants of both systems. Regardless of the structure chosen, lead managers and issuing agents use their New Issues Distribution Accounts at the ICSD to facilitate the distribution of new securities.

For securities deposited with DTC, ISIN numbers are assigned by the CUSIP Bureau. (See next section for background information on ISIN.) ISINs generally have a "U.S." prefix and contain the CUSIP in the body of the 12 alpha-numeric code. In these cases, Euroclear and Clearstream will only allocate Common Codes. ("Common Codes" is a 9 digit numbering system for internationally-traded securities which are specific or "common" to both Euroclear and Clearstream.) For securities targeted to an international investor base and deposited with a Common Depository, an ISIN number with a prefix of "XS" and a Common Code will be assigned by Euroclear and Clearstream. As soon as eligibility has been established, the Lead Manager will communicate these codes to its direct counterparts for trading**.**

Euroclear and Clearstream perform legal, fiscal and operational eligibility reviews prior to accepting securities into their systems. In addition to pricing details and other security specific features like options, corporate actions, income events, etc, special attention is paid to the tax treatment of a security for non-resident holders. It is therefore crucial to send a draft Offering Memorandum that is sufficiently explicit on the above-mentioned elements. For a security being distributed through DTC, the draft Offering Memorandum should be sent to Euroclear and Clearstream no later than three business days before closing date to new_issues@Euroclear.com and newissueslondon.cb@clearstream.com. An electronic copy of the final Offering Memorandum needs to be provided to Euroclear and Clearstream within five days following the closing date.

In certain cases, Euroclear and Clearstream may require specific indemnification such as in a situation where a U.S. issuer will solely target Qualified Institutional Buyers via a security issued under Rule 144A.

ISIN

ISIN (International Securities Identification Number) is a unique international code which identifies a securities issue. The Association of National Numbering Agencies (ANNA) is an organization of international members that handle the functions of various national numbering agencies that assign ISINs to securities and other financial instruments. Specifically in the U.S., it is the ANNA Service Bureau that is charged with the responsibility of assigning ISINs. The ANNA Service Bureau was developed and is currently managed by Standard & Poors and Telekurs. In addition to assigning ISIN numbers, the Service Bureau is tasked with improving upon all aspects of the timely, accurate and standardized identification of securities as well as the equitable distribution of this information. Accordingly, the Service Bureau is a step toward facilitating the bond industry's movement toward straight through processing (STP).

The ANNA Service Bureau operates as a central hub to receive and consolidate ISIN data from its members and disseminates this information to the market via FTP and web-based solutions. The ISIN number is the only ISO-certified (ISO 6166) securities identifier for cross-border transactions and is supported and maintained by the recognized global numbering agencies that comprise ANNA. ANNA ISIN products were created in order to provide the financial industry with the most comprehensive and timely ISIN data for financial firms' STP processing needs.

CUSIP

A CUSIP number identifies most U.S. securities, including stocks, government, municipal and corporate bonds. The CUSIP numbering system is owned and was developed by the Committee on Uniform Securities Identification Procedures of the American Bankers Association. The purpose of the CUSIP number is to aid in accurate and efficient clearance and settlement of securities as well as back-office systems. The CUSIP Service Bureau, which is operated by Standard & Poor's, assigns and distributes the CUSIP numbers.

NSCC Procedures

National Securities Clearing Corporation (NSCC), a wholly owned subsidiary of DTCC, is a central counterparty that provides centralized clearance and settlement for virtually all broker-to-broker equity, corporate bond and municipal bond, exchange-traded funds and unit investment trust (UIT) trades in the U.S.

To begin the clearance and settlement process, the managing underwriter submits corporate syndicate trades to an automated comparison system that is operated by NSCC. This NSCC system is known as the Fixed Income Transaction System (FITS). FITS prepares the trade for settlement and reports the results of that process to the appropriate counterparties. In this capacity, FITS standardizes and automates the processing of transactions for both corporate and municipal bonds and Unit Investment Trusts (UITs).

By standardizing and automating the transaction process, FITS is able to provide participants with timely trade comparisons. In addition, FITS helps reduce risk and inefficiencies in the settlement process by identifying and then resolving any discrepancies early in the settlement process.

NSCC also assists dealers in satisfying the NASD requirements for transaction reporting. Presently, the NASD requires transmission of all secondary corporate bond trades into its

Trade Reporting and Compliance Engine (TRACE) within 30 minutes of the trade. The NASD is planning to reduce the time period for reporting transactions in TRACE-eligible securities from 30 minutes to 15 minutes effective July 1, 2005.

NSCC plans to implement a Real-Time Trade Matching (RTTM) system in the future to provide participants with Straight Through Processing (STP) capabilities and to meet T+1 settlement initiatives. RTTM has been developed by the Government Securities Clearing Corporation (GSCC) and is in production for U.S. government securities that settle in a T+1 cycle. RTTM will provide a single pipeline to the clearing corporations and use standardized, interactive messaging formats via an MQ communications link.

Information / Service Vendors

There are several commercial vendors that have developed products and services that the corporate bond underwriting community utilize to facilitate the issuance, syndicate process, sale and settlement of corporate securities. Several service vendors and information providers are used in effect, as standard business practices for the securities industry.

Syndicate Information Services

The syndicate members can utilize commercial systems that were set up to ease the underwriting process. The two main service offerings are Dealogic (previously known as Commscan) and i-Deal. Both of these systems cover many aspects of managing the syndicate process, from book-running (and book sharing) to recording underwriting amounts and calculating fees. These systems are also utilized for intra-syndicate communications such as sending syndicate invitations, pricing wires, orders, allotments, and other syndicate information. These systems also provide mechanics to distribute issue-related documentation electronically.

Rating Agencies and Credit Enhancers

As a basic indicator of credit risk, ratings are an important point of information to underwriters and investors alike. For underwriters, an issue's rating influences pricing decisions on a new issue. Therefore, an issue's rating (or lack of a rating) may well have the single greatest impact on the interest cost.

The major rating agencies for corporate bonds are Standard and Poor's, Moody's Investor Services and Fitch. The ratings that these agencies assign reflect the agencies current opinion as to the credit worthiness of the issuer; that is the willingness and ability of the issuer to make timely interest payments according to schedule, and meet its debt service requirements as outlined in the bond indenture. To accurately rate a corporate bond, an agency will review the corporation's financial statement in order to gain a general sense of the corporation's soundness. Periodically, a rating agency may adjust an issue's rating in accord with a change within the issuing company.

It is the responsibility of the issuing company to apply for a rating. After the rating agency assigns a rating, it forwards the rating and any other relevant information to the appropriate information service providers.

In some instances bonds may not be rated. In this case, the bond would carry the letters "NR" for "not rated". A "NR" bond does not necessarily mean that the issue has a high credit risk or that it would be rated at less than an investment grade rating. However, an issuer that has the potential to receive a high or moderate investment grade rating will often apply for a rating since the issuer may save a significant amount of money in interest payments by obtaining the credit rating. In general, a bond issue with a lower credit rating would need to offer a higher interest rate in order to attract investors. The higher interest rate compensates investors for the greater risk associated with investment in a lower rated issue as compared with investment in a higher rated bond issue.

In order to improve the attractiveness of its bonds and the issue's credit rating, a corporation may purchase bond insurance or institute several features that enhance either its creditworthiness or the appeal of the security itself.

Bond insurance "guarantees" an investor timely receipt of principal and interest payments in the event of the issuer's default, but does not insure against fluctuation in market value.

IV. Corporate Bond Underwriting Process

A. Presale Activities

When a corporation decides that it needs to raise capital through a bond offering, it retains an investment banker to underwrite the bonds. This securities firm or bank is called the Lead Manager or Managing Underwriter. The investment bankers of the managing underwriting firm work with the issuer, the issuer's counsel and the underwriter's counsel to develop the structure and price of the bond issue. The issue structure consists of information such as the bond's maturity and the coupon it will pay. The bond will be priced after gauging investor interest in the deal and adjusting the yield so that it is attractive for both the issuer and the investor.

Due Diligence

While the issue details are being planned by the issuer and the underwriter, a due diligence process takes place. In doing the due diligence, the underwriter's counsel investigates the issuer to ensure that the prospectus is complete and accurate. In a *Due Diligence Meeting* held with the issuer, issuer's counsel, lead underwriter, and underwriter's counsel, the terms of the final agreement are reviewed. The participants examine the registration statement that will be filed with the SEC and discuss any information that needs to be included in the final prospectus.

Registration with the SEC

The issuer files a *Registration Statement* with the SEC[2]. The SEC has a provision for shelf offerings, where an issuer may register a new debt security without selling the entire issue at once. The issuer can sell portions of the issue over a two-year period without re-registering the security or incurring penalties. The corporation must still file the required annual and quarterly reports to the SEC. With a registration "on the shelf" the corporation may go to market very quickly when market conditions become favorable. "On the shelf" registration significantly shortens the time period required to underwrite a new issue and I one of the key differences in corporate underwriting. Currently, there is no "on the shelf" registration option in the municipal underwriting process.

Red Herring

The issuer prepares a preliminary official statement known as a *Red Herring or Prospectus* with the help of the issuer's counsel. The Red Herring includes information about the issuer, such as what the issuing corporation does and historical financial information. The Red Herring also includes a brief section on the underwriting itself, describing the structure of the offering.

The Red Herring is sent to the underwriter's counsel for legal review. After reviewing the document, the underwriter's counsel sends it to the investment bankers (at the managing underwriter) for review; who then forward it to the capital markets desk or the syndicate operations group for proofing of the style. Each underwriting firm has a unique style in which the prospectus is printed.

The issuer may want to choose a printer for printing (and in some cases, distributing) the Red Herring. The Red Herring is then distributed to potentially interested investors. Each underwriting firm maintains distribution lists for different types of offerings to match potential client interest. The underwriting firm may e-mail a pdf copy of the Red Herring to clients, provided that the email delivery adheres to the SEC guidelines regarding notification and consent. Sometimes an underwriting firm may outsource the distribution responsibility to a vendor such as ADP or i-Deal Prospectus. Final prospectuses are delivered to investors in hardcopy.

Underwriting Syndicate

The lead manager invites other investment banking firms to participate in the deal as members of an *underwriting syndicate*. This may happen via a wire that is sent through Dealogic or via an email message sent through an electronic (web based) syndicate platform such as I-Deal. Going forward, the lead manager and syndicate members communicate through the electronic syndicate platforms or wire services. A Telex machine may also be used for communication among the syndicate members, particularly on some international deals.

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[2] If the new issue security is classified as exempt, then a SEC registration is not required.

Some issuers may ask the lead manager to invite certain members to be a part of the syndicate based on their relationship, such as a banking relationship. If the issuer comes to market regularly, it may expect to use a certain syndicate group that remains intact to underwrite all the firm's offerings. In cases like these, the syndicate members may rotate in the role of the lead manager/agent. This type of arrangement is particularly common in connection with MTN (Medium Term Note) programs.

The issue is considered to have been "launched" or "announced" as the syndicate invitations have been sent.

Syndicate members accept the invitation and notify the managing underwriter of any exceptions or conditions via the e-syndicate platform or wire service. The lead manager's master Agreement Among Underwriters (AAU) needs to be signed by each syndicate member, and the syndicate members are then bound by it. Selling group members however, do not sign nor are bound by the AAU. The selling group simply, as the name implies, assist in selling the securities to institutional (or retail) clients. The selling group does not have any financial liability in the underwriting process. Instead of signing an AAU, the group signs a Selected Dealer Agreement or a Selling Group Agreement which dictates that the selling group member may acquire new issue securities from the underwriting syndicate at a discount.

The order period begins when the deal launches. During the order period, the underwriter's sales force markets the issue and accepts "Indications of Interest" known as IOIs from clients. IOIs are considered preliminary orders since the price of the security has not been established.

After the deal has been launched and all the details about the issue structure are known, the managing underwriter applies for the CUSIP number and/or the ISIN number. (Some lead managers may apply for the CUSIP number as soon as the Red Herring is available.) The lead manager has the option to apply for the CUSIP number through the CUSIP Service Bureau's web interface at www.cusip.com or by emailing or faxing the request to the CUSIP Service Bureau with the appropriate documentation. Listed on the request form are several types of securities and the corresponding types of documentation that CUSIP requires in order to process the request. The CUSIP Service Bureau will not process a request for a CUSIP number until the supporting documentation is sent via email or fax. In order to encourage underwriters to submit requests via the internet-based system, the CUSIP Service Bureau offers a 10% discount off the processing cost. One of the benefits of sending a request for CUSIP numbers electronically is that underwriters can check on the status of the CUSIP in real-time. After the CUSIP Service Bureau processes the underwriter's request, it sends the CUSIP numbers via both email and fax back to the lead manager's Operations Department. The CUSIP number is then used to identify the issue in communications between parties. This is the first time in the process where information is solicited from an outside participant. The lead manager has an obligation to give the final offering details (such as the pricing information) to the CUSIP Service Bureau, which is usually done by distributing the final prospectus as it becomes available. Note that in a shelf-takedown, applying for CUSIP numbers occur after pricing.

There are some new issue securities that are exempt from registering with the SEC. These securities are known as “restricted” or “non-registered” securities, such as 144A securities. For these non-registered securities the lead underwriter submits an application for NASD’s PORTAL (Private Offerings and Restricted Transfers through Automated Linkages) symbol, which is needed for DTC eligibility of non-investment grade securities. The application may be faxed or emailed to NASD, along with any offering documentation. NASD notifies DTC with a letter stating that a particular issue has obtained the PORTAL symbol and may now become DTC eligible.

Pricing

After the deal has been launched and preliminary orders are being accepted, the lead manager’s capital markets desk begins the process of pricing the issue with the issuer and respective counsels. The pricing process continues over the course of the underwriting process until all preparatory actions are completed, after which time a final price is established. The managing underwriter then determines the appropriate allotments to the underwriting group and the customer orders are executed.

During the pricing process, the lead manager emails the terms of the deal, i.e. all the descriptive data (which include preliminary pricing information), to Bloomberg and other information service providers. This is important in preparation for the beginning of the secondary market trading in the new security. If the issue is exchange listed, data is also distributed (typically via fax) to the exchange so that the new issue information can be entered in the internal systems of the exchange.

A *registration letter* is sent to the trustee by the lead manager. The purpose of this letter is to inform the trustee of the terms of the issue. This information is typically submitted electronically, unless a page has a signature. In such a case, the page with the signature is faxed to the trustee. The trustee is the financial institution that acts in a fiduciary capacity for the benefit of the bondholders in enforcing the terms of the issue.

After the registration letter is sent to the trustee, the underwriters and the issuer together finalize pricing. As soon as the final price for the issue is established, the preliminary orders (previously IOIs) are executed and the trade occurs.

The following steps happen simultaneously immediately following the initial pricing of the issue:

TRACE

Descriptive and preliminary pricing information regarding the new issue is submitted to TRACE. The secondary, over the counter market trades of corporate bonds are reported to the NASD through its Trade Reporting and Compliance Engine (TRACE) for regulatory and surveillance purposes. TRACE was created to improve transparency in the corporate bond markets, and most U.S. dollar-denominated bonds fall within the TRACE eligibility, whether the issuer is domestic or a foreign corporation. The public TRACE web site displays the bond transaction's execution time and date, quantity, price and yield. Currently this free of charge information is publicly displayed on a 4-hour delay. TRACE information is also redistributed by information vendors who may enhance the data to add value to their customers.

TRACE requires the new issue information before 5:00 p.m. the day before secondary trading in the new issue begins so that the TRACE operations center may set up this information in its system. The managing underwriter contacts TRACE in writing, either via email of fax. A common practice is to send a pricing sheet via fax. The information to be submitted should include CUSIP numbers, issuer's name, coupon rate, maturity, brief description of the issue and whether the issue is a private placement issued pursuant to Rule 144A. Also required is information that will help NASD to determine if the issue is subject to dissemination, i.e. ratings and the original issue size. Under NASD Rule 6260, managing underwriters are required to make a good faith determination that the security is TRACE eligible before submitting information, however, TRACE eligibility is determined by NASD, accordingly, unless a security is clearly ineligible (e.g. a municipal bond), the information should be submitted to TRACE.

DTC Eligibility

The managing underwriter applies for DTC eligibility, which means that the new issue will be qualified to receive DTC's distribution, settlement and depository services, which are described earlier in this document. The lead manager sends the completed Eligibility Questionnaire to the underwriting department of DTC. The information that is requested in the questionnaire includes issue information such as the asset class and whether the issue is exempt from SEC registration under Rule 144A or Reg S; issuer name and issue description; contact information for underwriter, transfer agent (trustee) and issuer's counsel; and delivery instructions such as whether the issue is a FAST issue. The hard copy questionnaire may be sent electronically via fax or e-mail, provided the document has a signature affixed to it. However, the preferred method of submission is via the PTS function PUND or the web application WUN as this streamlines the process and creates greater processing efficiencies. DTC sends an electronic confirmation to verify that the issue was received.

DTC expects to receive the questionnaire along with the preliminary offering documents (prospectus or private placement memorandum) as early in the process as possible so that basic information can be set up. Pricing information and/or changes made to the preliminary information should be communicated to the Underwriting department as soon as that information is available.

B. Closing Date ("Settlement")

The lead manager prepares for settlement by determining allocations to the underwriting group and setting up delivery instructions of the allotments to the accounts of syndicate members. The lead manager verifies it has instructions from the issuer regarding where the funding is to be sent (wired). The lead manager also arranges for funding internally. The lead manager's treasury department then calls DTC to confirm that the issue is eligible.

To make sure that all parties are in agreement of the closing terms, there is a conference call with the issuer's counsel, underwriter's counsel, transfer agent (usually the same as trustee) and lead manager to discuss the final terms of the deal, which are then documented in the "*closing memo*". This conference call is known as a "*closing call*".

Following the closing call, the funds are released to issuer with proof that money was sent. The lead manager and the issuer or its agent (either trustee or the paying agent, which often are the same financial institution) instruct DTC to release the bonds. DTC then places the bonds in the lead manager's account, after which it is the responsibility of the lead manager to deliver the bonds to the syndicate members' accounts. The delivery is done electronically through DTC. The syndicate members then deliver the bonds to the investors' accounts.

C. Syndicate Processing Activities

There is a significant amount of syndicate processing activities that take place during the order period, as well as on and after the trade date and settlement date. During the order period the lead manager allots bonds to other syndicate members, who in turn take orders from institutions for the new issue. Right after the issue has been priced, the syndicate members process the IOIs (preliminary orders) and allocate bonds to institutions and their sub-accounts. If the underwriting syndicate uses a *pot system* to distribute bonds, all or a specified percentage of the securities are allocated to institutions by the lead manager who is in charge of running the central order book for the syndicate. Syndicate members contribute orders to the pot, but it is the lead manager that controls the final allocation of the bonds. The pot system is currently used for most institutional corporate bond deals in the U.S. and it is gaining popularity in European syndicates.

After the settlement, the lead underwriter has up to 90 days to close the syndicate account and compile all deal expenses. The lead underwriter usually sends a settlement letter, along with an expense summary to the members of the syndicate. The lead underwriter also sends a check to the syndicate members for their participation in the deal less any applicable expenses (i.e. legal expense, CUSIP, DTC).

V. Conclusion

The Bond Market Association and DTCC will continue to work together in identifying possible market efficiency opportunities. By virtue of this plain English document, the industry can be further educated on the processing of new issue corporate bonds. In addition, the Association and DTCC believe that by leveraging automated processes, significant cost savings can be achieved and operational risk mitigated.

Appendix 1

This plain English document is based on conversations and interviews conducted by The Bond Market Association and DTCC staff with members of the Corporate Bond Underwriting Focus Group. The goal of this focus group, which consists of Association members and others named below, was to create a document describing the corporate underwriting process that would help to streamline current industry practices in connection with the process. The focus group is enthusiastic to continue to offer their input and to help analyze any opportunities that would make the underwriting process more efficient. Anyone interested in learning more about this focus group or willing to participate should contact Association Executive Vice President Joseph Sack at tel. 1-646-637-9265.

The Bond Market Association and DTCC would like to thank the following Association members for their input and dedication to this industry initiative:

Mary Ann Cribbin, A.G. Edwards & Sons, Inc.
Sean McClenin, ABN AMRO Inc.
Liz Chan, ABN AMRO Inc.
David Herman, Citigroup
Anna-Maria Freeman, Merrill Lynch
Ben Bartolotta, Morgan Stanley
James Gannon, Morgan Stanley
Michael Torregrossa, Morgan Stanley

The Association and DTCC would also like to thank the following individuals for their input:

Janet McGrath, Euroclear
Jeff Delaney, Pillsbury Winthrop

The Association welcomes any comments and feedback regarding this document. To offer your input please contact Elisa Nuottajarvi of the Association's staff at enuottajarvi@bondmarkets.com.

Appendix 2

Corporate Operational Underwriting Process
Business Practices Flow Chart Diagram
(please see next page)

October 2004

Corporate Operational Underwriting Process

Draft Flowchart Diagram of Business Practices

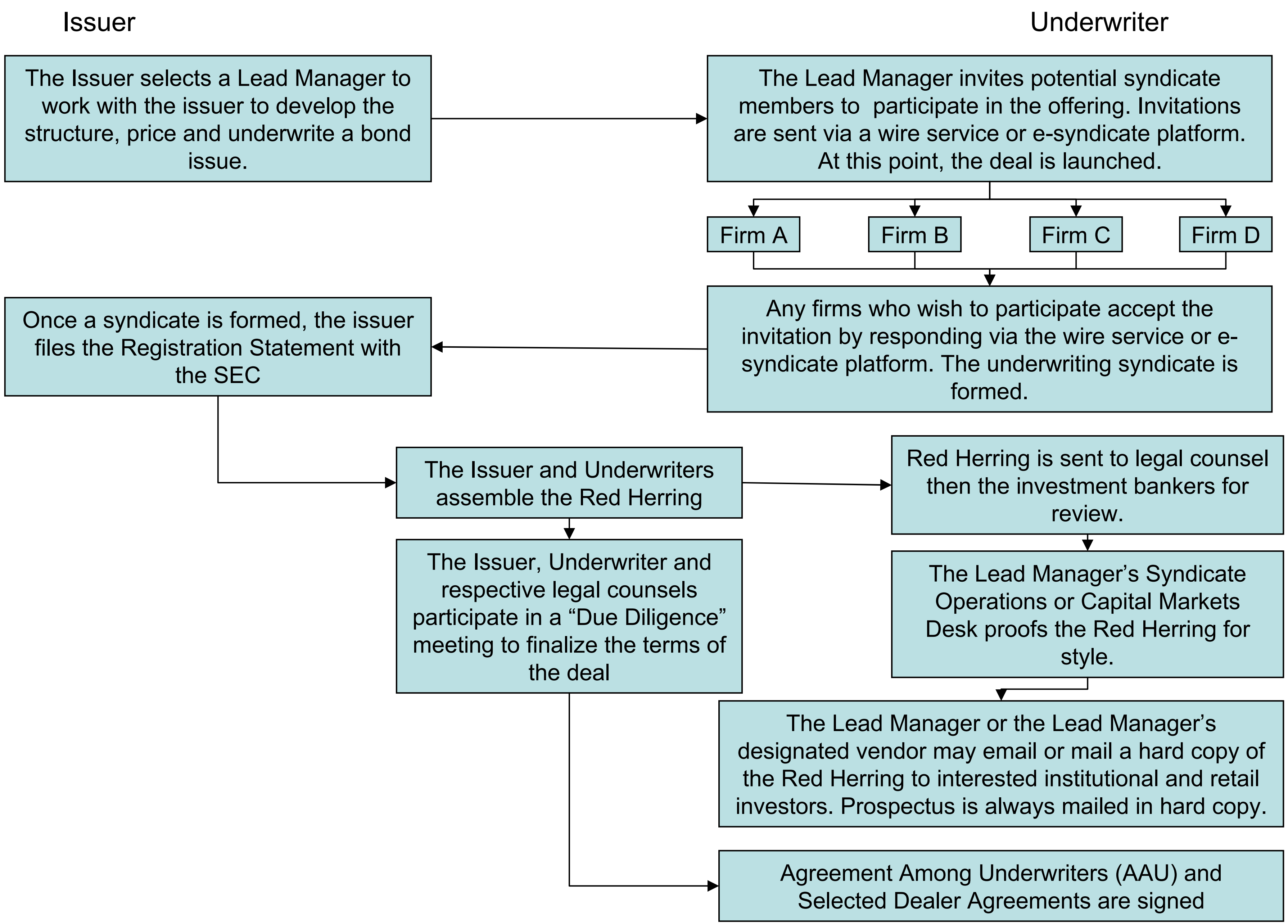
Introduction

The Bond Market Association (TBMA) and The Depository Trust and Clearing Corporation (DTCC), in conjunction with industry firms, have created this flowchart to help individuals and firms understand the corporate bond underwriting process. This flowchart is based upon TBMA and DTCC's Plain English document (copy attached) that depicts the underwriting process.

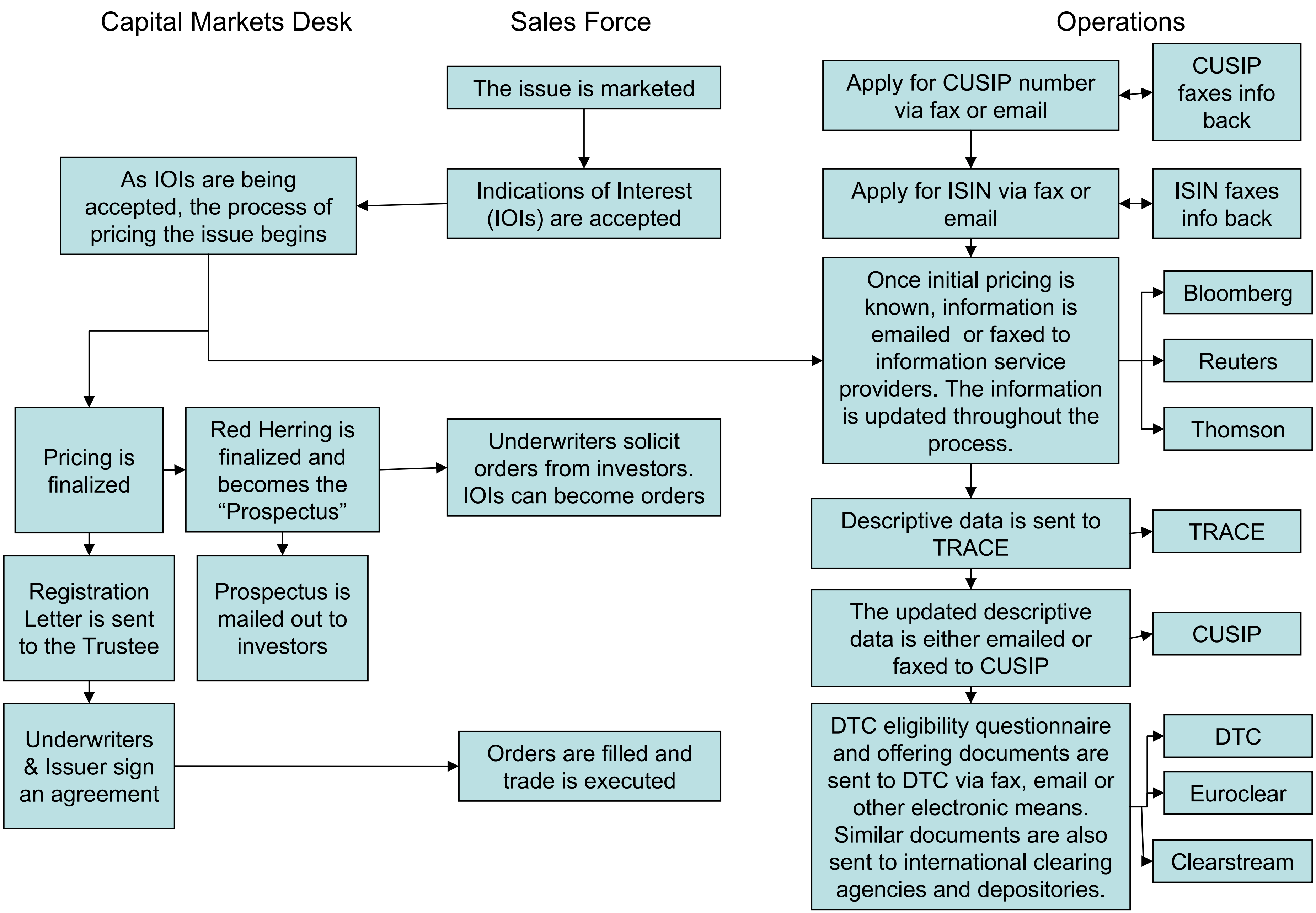
This flowchart diagrams the role of the underwriter and issuer, the sequence of steps in the corporate bond underwriting process, the means of communication between parties and the flow of information between issuers, underwriters and utilities.

Suggestions or questions regarding this diagram should be submitted to Fitz Haney of DTCC at shaney@dtcc.com or Elisa Nuottajarvi of the Association at enuottajarvi@bondmarkets.com.

Launching the Deal



Underwriting Steps leading up to Trade Execution



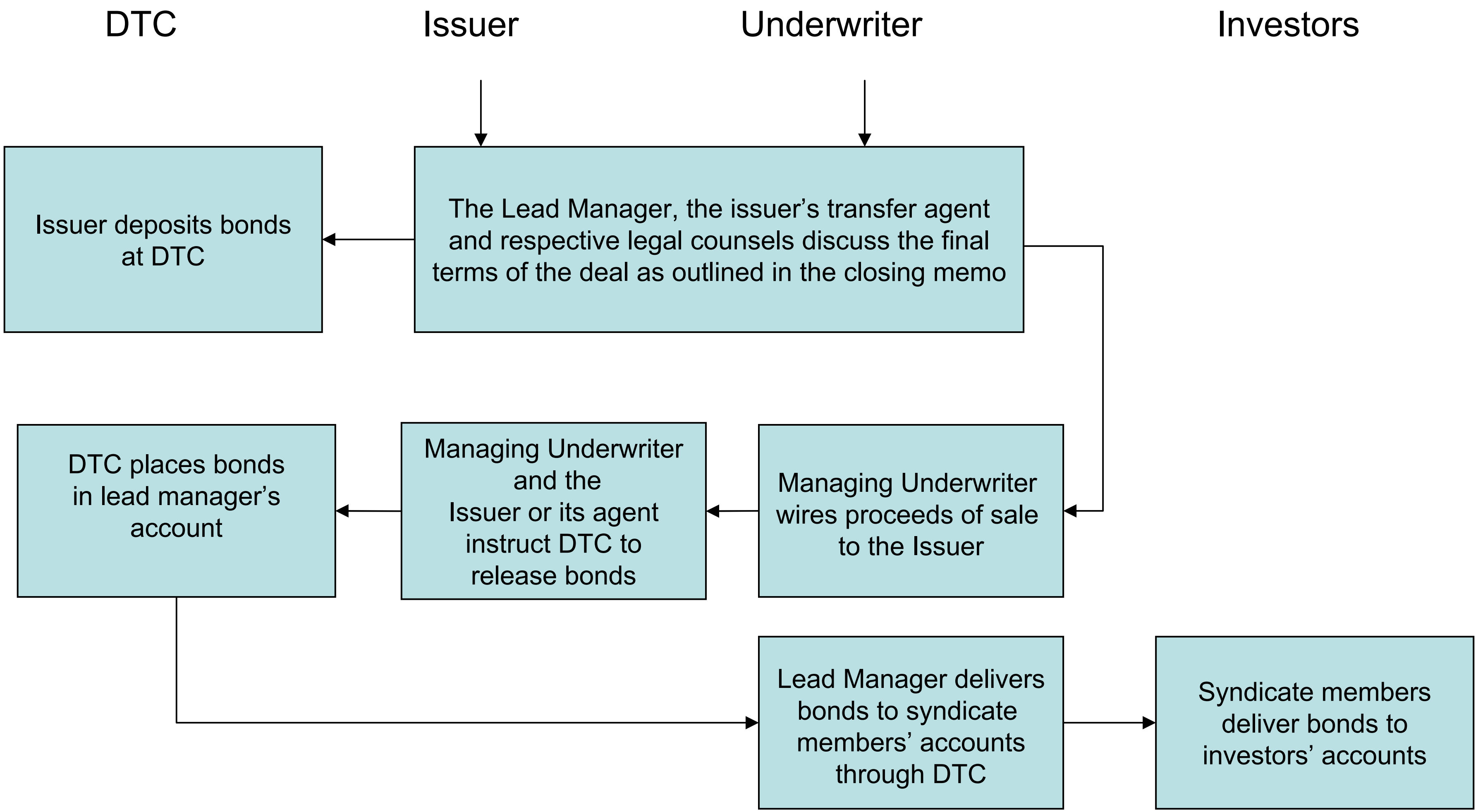
Post-Trade/Pre-Settlement Steps

Lead Manager determines allocations to the underwriting group and sets up delivery instructions of allotments to the syndicate members' accounts.

Lead Manager verifies it's instructions from the issuer regarding where the funding is to be sent. HOW is the info verified? A phone call?

Lead Manager's Treasury Department calls DTC to confirm that the issue is DTC eligible.

Settlement



Note: Approximately 30-60 days later, the Managing Underwriter closes out the underwriting account.

The Bond Market Association and DTCC would like to thank
The Corporate Underwriting Focus Group and the following Association members
for their input and dedication to this initiative:

Robin Bainlardi, DTCC
Ben Bartolotta, Morgan Stanley
Liz Chan, ABN AMRO
Mary Ann Cribbin, A.G. Edwards
Jeffrey Delaney, Pillsbury Winthrop
Anna-Maria Freeman, Merrill Lynch
James Gannon, Morgan Stanley
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David Herman, Citigroup
Javette Laremont, DTCC
Sean McClenin, ABN AMRO
Janet McGrath, Euroclear
Elisa Nuottajarvi, TBMA
Denise Russo, DTCC
Joseph Sack, TBMA
Douglas Taggart, TBMA
Michael Torregrossa, Morgan Stanley