# Bond Case Briefs

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## George K. Baum FINRA Case Shows Excessive Fee, Bond Ballot Concerns.

WASHINGTON – The Financial Industry Regulatory Authority ordered George K. Baum & Co. to pay $270,000 for charging a Colorado school district more than four times the firm's normal underwriting fee, partly to pay for costs associated with promoting bond ballot initiatives.

The Kansas City, Mo-based underwriter, without admitting or denying FINRA's findings that it charged the district $43 per $1,000 of bonds issued for a total fee of $416,173.59, consented to the $100,000 fine and the order to pay the school district $170,000 in ill-gotten gains.

Andrew Sears, executive vice president and general counsel for Baum, declined to comment on the matter.

FINRA found that Baum had told the district in a December 2010 memo sent before the February 2011 offering of $9.67 million of general obligation bonds that the typical fee for the offering was much lower, at between $7 and $9 per $1,000 of bonds issued.

FINRA said Baum violated the Municipal Securities Rulemaking Board's Rule G-17 on fair dealing for charging a fee that was "inappropriate" and "disproportionate," given the facts of the offering.

While FINRA did not name the school district in its action, EMMA documents suggest that it is Adams County School District 1 in Colorado, known as Mapleton Public Schools. Documents show the school district issued $9.67 million of GOs in February 2011 and that the bonds were underwritten by Baum, which took $416,173.59 in underwriting fees — the same information cited by FINRA. School district officials could not be reached for comment.

The path to the large underwriter discount Baum received for the deal began in December 2007 when the firm started assisting the district in obtaining voter approval for a proposed bond issue of $65 million. If voters approved the bond issue, the firm was to underwrite it. That issue and another one planned for June 2009 were voted down despite Baum's work with the district.

In an effort to get the desired financing, the school district eventually applied to a state program for financing and, in 2010, was able to get the state to agree to match funds the district raised. In November 2010, voters gave their approval for the school district to issue $31,705,000 in debt with $22,035,000 paid through the state program.

The district then selected Baum to underwrite the remaining $9.67 million of bonds and was charged the $43 per $1,000 of bonds issued fee.

In a memo to the district superintendent in December 2010, Baum gave multiple justifications for its high fee, including that it was appropriate because it had originally believed it would be underwriting $64 million instead of $9.67 million of bonds. The firm also cited its prior work on the unsuccessful ballot initiatives and took credit for the district's success in the 2010 bond election, even though that success was in part because of the district's participation in the state program,

FINRA said. Additionally, Baum told the district that its higher fee was necessary because it was only serving as a co-manager on the state program financing and would have received higher compensation if it had been a senior manager.

FINRA found those justifications “were not appropriate given the facts and circumstances of the 2011 offering.”

Muni market participants and regulators have been concerned for several years that some dealer firms are contributing to bond ballot campaigns in return for obtaining the underwriting business that results if voters approve the bonds.

At least a dozen Wall Street and other firms and some of their executives have urged the MSRB to severely restrict such contributions to prevent pay-to-play practices, much like it restricted dealer and muni advisor contributions to issuer officials under Rule G-37. But so far, the MSRB has only required dealers to disclose bond ballot contributions as well as the deals they underwrite.

The MSRB initially began collecting quarterly dealer disclosures detailing contributions to bond ballot campaigns in 2010. Changes to Rule G-37 required firms to disclose contributions over $250 made to political action committees that were formed to raise money for ballot initiatives in states like California where voter approval is required for bond sales.

In 2013, the SEC approved expanding G-37 to require dealers to make public the timing of their contributions, the identity of the issuer of the voter-approved bonds, and any related underwriting activity.

In January of this year, California Attorney General Kamala Harris issued an opinion that said in part that it is illegal in California for school and community college districts to purposely incentivize municipal finance professionals with the promise of business if they advocate for passage of bond ballot initiatives.

A 2014 study by Todd Ely, a professor in the School of Public Affairs at the University of Colorado Denver, and Thad Calabrese, a professor in New York University’s Wagner School of Public Service, found that the underwriters that contributed to campaigns in California received higher fees in their deals and generally saw an average rate of return of $1.70 for every dollar they contributed. The study observed California underwriting activity between 2007 and 2012 and concluded the bump in fees was likely because underwriters were recouping their contributions to bond ballot initiatives.

Another study, by Marc Joffe of Public Sector Credit Solutions, examined more than 800 bond deals since 2012 and found that issuance costs averaged 1.02%, but ranged to about 10% for some California school districts. The 2015 study, published by the Haas Institute for a Fair and Inclusive Society at the University of California-Berkeley, also found that underwriter discounts made up the largest amount of total issuance costs for municipal entities. Additional data Joffe shared with The Bond Buyer showed the underwriter discount as a percentage of the face amount of the issuance exceeded 2% in a number of issuances.

THE BOND BUYER

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