

May 27, 2016

Mr. Ronald W Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1300 I Street NW
Washington DC 20005



Re: MSRB Regulatory Notice 2016-11 – Request for Comment on a Concept Proposal to Improve Disclosure of Direct Purchases and Bank Loans

Dear Mr. Smith,

Charles Schwab Investment Management (“CSIM”)¹ appreciates the opportunity to respond to the Municipal Securities Rulemaking Board’s (“MSRB”) request for comment on its *Concept Proposal to Improve Disclosure of Direct Purchases and Bank Loans* (the “Concept Proposal”).²

CSIM is the investment advisor for nine Schwab municipal mutual funds representing over 153,000 retail shareholders with assets totaling over \$28 billion. As part of its due diligence process CSIM’s municipal credit team reviews all the holdings of the Schwab municipal mutual funds for financial strength and periodically finds that issuers have entered into direct placement loans with banks, either to refinance existing variable-rate debt or as a new form of medium-term financing. We appreciate the reasons that issuers utilize direct placements and bank loans rather than publicly issued debt, and do not oppose the convention as such. However, we do not think it is appropriate for debt that is on parity with public debt or, due to its structure or maturity provisions, could have a material impact on the pricing or trading of publicly issued debt, to exist in a separate and opaque universe with little transparency for public debt holders.

On behalf of the retail investors who are the shareholders of our funds, CSIM supports the MSRB’s ongoing efforts to improve disclosure throughout the municipal market. While direct placements and bank loans have come into more common use following the credit crisis and remain a small part of the overall municipal market, they represent a growing area of the market that is difficult to quantify in both size and impact, as the loans are all privately placed. While some banks require issuers to file the loan documents on the EMMA system, most do not and issuers often do not file the documents of their own accord. In addition, when asked specific questions about direct loans, some issuers reply that they cannot provide information because it would be material and non-public, creating a circular problem for the investor. For these reasons, among others, we strongly endorse efforts to enhance transparency and standardize the information made available in order to help inform the investing decisions of individual investors.

¹ Founded in 1989, Charles Schwab Investment Management, Inc. (CSIM), a subsidiary of The Charles Schwab Corporation, is one of the nation’s largest asset management companies, with more than \$284 billion in assets under management as of March 31, 2016. It is among the country’s largest money market fund managers and is the third-largest provider of retail index mutual funds. CSIM currently manages 75 mutual funds, in addition to two separate account model portfolios, and 21 ETF offerings.

² Municipal Securities Rulemaking Board, Regulatory Notice 2016-11 (March 28, 2016).

Following are CSIM's responses to some of the key questions posed by the MSRB in its Concept Proposal:

1. *Would implementation of a disclosure requirement...help protect investors and promote informed investment decisions?*

A disclosure requirement is needed as borrowers are not generally providing disclosure on bank loans and direct placements on a voluntary basis. Investors should have access to this information in order to analyze the credit quality of securities both prior to purchasing them and on an on-going basis as the failure to incorporate such information could impact trading and pricing decisions on a security. There is no question that the lack of this information prevents investors from gaining a complete understanding of an issuer's financial position as to the amount of an issuer's outstanding debt, the potential for a lender to require specific covenants allowing it to exercise remedies prior to existing public debt holders, and the impact on liquidity if the loan repayment is structured as a balloon payment.

2. *What information regarding outstanding indebtedness, such as direct purchases and bank loans, do issuers typically disclose in financial statements? What are considered industry best practices for such disclosures?*

CSIM is not aware of an industry standard for the disclosure of direct purchases and bank loans in financial statements. In our experience, issuers generally include in their financial statements the size, coupon, and maturity for direct purchases and bank loans. However, any specific covenants entered into with the lender are not typically included in financial statements. We note that the National Federation of Municipal Analysts published a paper in June 2015, "Recommended Best Practices in Disclosure for Direct Purchase Bonds, Bank Loans, and Other Bank-Borrower Agreements,"³ that discusses best practices for such loans, although such practices have not yet been widely adopted by the industry.

3. *What information does a bondholder need with respect to an issuer's outstanding indebtedness to make informed decisions about an investment?*

As with other debt transactions, CSIM thinks it is critical for issuers to release the primary lending documents between the lender and the borrower, as well as any relevant associated documents.

In the event that the parties are not willing to release the primary documents, a summary of the transaction should include the following information:

- Lender;
- Date of issuance;
- Principal amount, use of proceeds;
- Maturity, amortization, any term-out provisions related to a demand or put date;

³ Available at: http://www.nfma.org/assets/documents/RBP/rbp_bankloans_615.pdf.

- Method of computing interest rate to include any default rates;
- Information on any related swaps or other products used to hedge the loan;
- Security pledge and its position in relation to other outstanding debt (parity, subordinate, springing lien);
- Compliance with applicable additional debt tests;
- Covenants, events of default, or remedies;
- Disclosure of “most favored nation” clause, if any; and
- Ratings, if assigned.

4. *Do any market participants currently have more or more timely information about issuers’ direct purchases or bank loans than other market participants?*

Rating agencies receive information regarding these transactions in the course of conducting surveillance or reviewing a new issue for sale. If the information regarding a transaction of this type impacts the rating agency’s view of the issuer’s credit to the extent that a rating action could occur which may impact the pricing and trading of the issuer’s public debt, then certainly this information should be required to be provided to the investing public as well to allow them to make their own independent assessment of the financial position of the issuer.

5. *Would the information available to a municipal advisor when advising on or negotiating aspects of a direct purchase or bank loan be useful to the investing public?*

Yes, just as the investing market considers it critical to be made aware of a new public debt issuance, so do we consider a private loan transaction to be critical to our understanding of an issuer’s financial position and credit quality.

6. *What activity should trigger the disclosure requirement discussed in this concept proposal?*

The closing of a private loan or direct purchase transaction should trigger the requirement to disclose the terms of the transaction.

7. *How expansive should any proposed disclosure be (e.g., only if material to the financing on which the advice is being given; all alternative financings outstanding, regardless of materiality to current transaction)?*

The comprehensiveness of any proposed disclosure should take into consideration the size and complexity of the alternative financing. At a minimum, the disclosure should reflect any change in amount or characteristics of indebtedness. Materiality to the current transaction is less important, as alternate financings that may not appear material based on current valuations (such as swaps) could have a material impact on the borrower’s financial condition in the future.

8. *What specific information regarding the direct purchases and bank loans should be required to be disclosed? What information is important to investors? Is there any particular document typically used in these types of transactions that contains any or all of this information?*

Please see the answer to question #3.

9. *Are there alternative methods the MSRB should consider for obtaining and publicly disseminating material information related to an issuer's direct purchases and bank loans?*

While we think the MSRB's attempts to obtain and disseminate information to the public related to an issuer's direct purchases and bank loans is an important step to improving disclosure in the municipal market, we are concerned that the proposal may not cover all transactions as an advisor may not be involved in each direct placement or bank loan transaction. We urge the MSRB to engage with the SEC to reopen Rule 15c2-12 to add the issuance of any additional debt to the list of reportable material events.

10. *Should such a disclosure obligation also apply to dealers broadly or in certain circumstances?*

We believe a broad requirement would be most effective in generating the widest compliance possible.

12. *How might such a disclosure requirement economically impact issuers of municipal securities and current investors?*

We believe that more robust disclosure will facilitate the most efficient pricing and trading of securities, as well as help bolster liquidity.

14. *Is there additional information an investor may need in order to have a complete picture of an issuer's overall financial condition?*

In many states, larger entities such as the state, counties or cities provide back-up guarantees for debt issued by an agency or issuer within that governmental unit's jurisdiction. For example, many counties in New Jersey provide guarantees backing the debt of local agency projects to enhance the credit quality of the local agency's debt. However, there is little information available at the county level which aggregates the amount of these guarantees, although each of them could result in a call on the county's financial resources. We believe that more specific information regarding these guarantees should be provided by the guarantor, as well as an explanation as to how the guarantor monitors the local agency's financial condition in order to prepare for a possible call on the guarantee.

15. *In addition to direct purchases and bank loans, what other types of debt financings do municipal entities use as alternatives to the issuance of municipal securities for which disclosure would be useful to investors?*

We request that the disclosure requirements contemplated in this Concept Proposal be extended to include all non-publicly issued debt instruments.

17. Please provide current or historical data, studies or other information relevant to evaluating the number, value and terms of outstanding municipal entity direct purchases and bank loans. Additionally, please provide the number and value of municipal entity direct purchases and bank loans originated annually.

As these transactions are private in nature between the banks and the borrowers, there is not a market source for the number or value of bank loans and direct purchases. Most publicly available information is based on surveys of the banks that participate in this market but it is neither specific nor trackable.

We applaud the MSRB for considering a proposal to expand disclosure on bank loans and direct purchase transactions, a part of the market which has been growing in size and opacity. On behalf of our over 150,000 shareholders, CSIM hopes that our comments will help the MSRB move forward to improve disclosure in this area of the municipal market, either via its own rulemaking or in conjunction with the SEC in improving Rule 15(c)2-12. Individual investors would benefit from increased transparency.

Sincerely,

A handwritten signature in black ink that reads "Marie Chandoha". The signature is written in a cursive, flowing style.

Marie Chandoha
President and Chief Executive Officer
Charles Schwab Investment Management, Inc.