

## Understanding the Role and Value of a Municipal Advisor

One of the most important questions facing an issuer in the debt issuance process is whether to engage a Municipal Advisor (MA), an underwriter or both. Some issuers have historically conflated the two roles, a practice that was much more prevalent prior to the inception of Rule G-23 of the Municipal Securities Rulemaking Board (MSRB), which prohibits a single firm from acting as both underwriter and MA on the same bond issue. This memo will discuss the roles that each plays and why engaging an MA is beneficial for nearly all local governments in the bond issuance process, a recommendation that is endorsed by the Government Finance Officers Association (“GFOA”).

### Underwriter

Per MSRBs Rule G-17, an Underwriter’s primary role on a financing is to purchase the bonds from the issuer and re-offer them to the world of municipal bond investors. Their role is primarily a transactional one in which the underwriter acts as a principal when it purchases the bonds from the issuer. It then again acts as a principal in the subsequent transaction when it sells the bonds to the investor(s). The underwriter assumes risk in this process because it uses its own capital to purchase the bonds from the issuer.

If the underwriter cannot find investors to which they can re-offer the bonds, they will hold the bonds themselves for a temporary period of time and assume the risk of rising or falling bond prices. However, they are not in the business of investing in municipal bonds, so as they hold the bonds, they are actively looking for investors in the secondary market to purchase the bonds. It is entirely possible that they ultimately sell the bonds to investors at a price that is lower than the one at which they originally purchased the bonds, generating a financial loss for the underwriter. That is the risk they assume when they act as underwriter. Of course, the alternative is possible as well in which they sell the bonds at a price that is higher than the original purchase price and register a profit.

For any bond issue sold in a public offering, underwriters are necessary to the transaction. However, the process of engaging an underwriter differs based on the type of sale method. In a competitive sale, underwriters are selected based on which underwriter submits the best bid (highest price, lowest interest rates) for the issuer’s bonds in an auction type sale on the sale date. In a negotiated sale, the underwriter is pre-selected by the issuer well before the sale date and works with the issuer to structure the bonds and pre-market the bonds prior to the sale of the bonds. Some underwriters in a negotiated sale may also provide assistance in the rating process and other ancillary

services, however, the degree to which these services are provided varies from one underwriter to another. Please [click here](#) to see an earlier edition of our Understanding Municipal Bonds series which provides a more detailed discussion on competitive and negotiated bond sales.

Additionally, it is important to highlight the regulatory standard that underwriters are subject to during the bond issuance process. The MSRB, which provides regulatory oversight of the municipal bond industry, established the fair dealing standard under Rule G-17 to require that underwriters “deal fairly with all persons and not engage in any deceptive, dishonest, or unfair practice.”

### Municipal Advisor

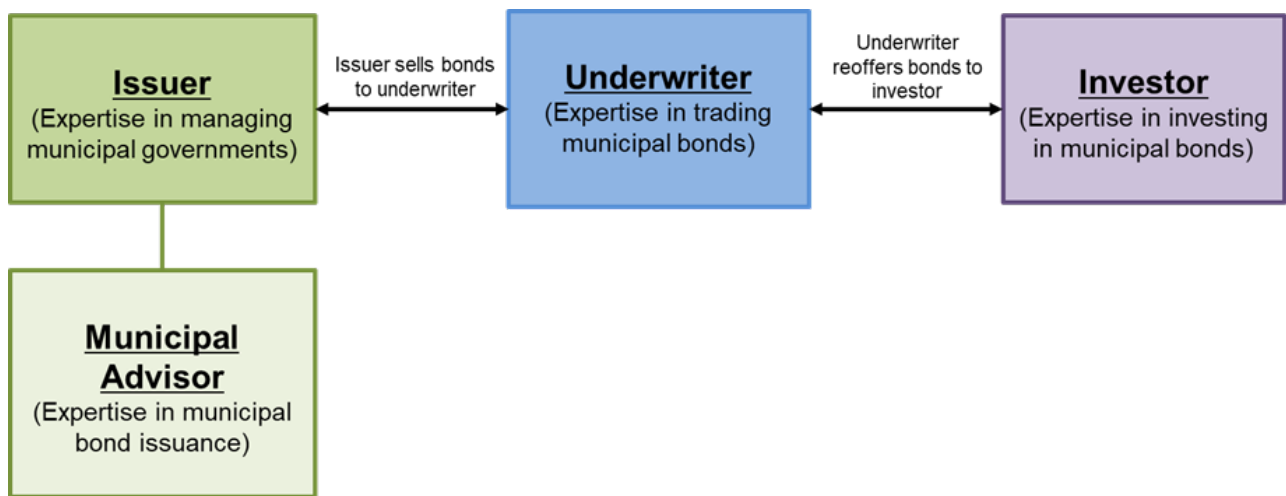
An MA’s role differs from that of an underwriter in significant and meaningful ways. First, it is worthwhile to note that a Municipal Advisor is held to a much stricter regulatory standard since it has a fiduciary duty to the issuer. MSRB Rule G-42 states that this fiduciary standard consists of a duty of care and a duty of loyalty. The former ensures that the MA has sufficient knowledge and expertise to know what is in the best interest of the issuer and that it will help the issuer consider all critical variables as it develops a financing plan. The duty of loyalty stipulates that the MA will put the interests of the issuer ahead of any others.

Second, the MA’s primary responsibility is to help secure the lowest possible borrowing cost given market conditions at the time of sale. As a result, the MA acts alongside the issuer as the primary sounding board for all aspects of the bond issue. The MA provides advice regarding the structure, timing, and terms of the bonds, as well as the sale type, the auction platform in a competitive sale, the rating process, the offering document, and in some cases the selection of other members of the financing team, including, where applicable, the underwriter, bond counsel, disclosure counsel, and paying agent. The MA does not put its own capital at risk and therefore is not a counterparty to the issuer in any part of the transaction, but instead acts solely as the issuer’s advocate.

The MA role arose out of the asymmetry inherent to the underwriting process. As detailed above, there are three main principals in an underwriting transaction: the municipal issuer, the underwriter, and the investor. The issuer sells the bonds to the underwriter, which in turn re-offers the bonds to the investor(s) and as a result, the underwriter has two clients during the transaction, which is why it

cannot be held to a fiduciary standard with the issuer. The asymmetry exists because underwriters have expertise in trading municipal bonds and investors have expertise in investing in municipal bonds. Municipal issuers, on the other hand, have expertise in managing local governments, but generally speaking, do not have expertise in the bond issuance process.

Issuers, therefore, can be taken advantage of by underwriters that charge excessive fees or purchase bonds at unnecessarily high interest rates (or both), only to make a profit by flipping the bonds at lower interest rates. This inefficiency creates an opportunity for the MA to fill a void in the bond market for two reasons: (i) the MA has expertise in the issuance of municipal bonds; and (ii) the MA has a regulatory mandate to act with a fiduciary duty to the issuer since the issuer is the MA's only client during the bond issuance process. Below is a graphic showing how the use of an MA levels the playing field in the issuance of bonds.



### Conclusion

Some have argued that municipal advisors are not necessary because they offer services that are redundant with the underwriter, except that they do not actually underwrite bonds. While it is true that the MA will not underwrite bonds, the MA role is not limited to services redundant with those offered by the underwriter. In fact, the premise of the MA role is founded upon protecting the issuer from an imbalanced process. The advice, therefore, provided by the MA can be, and often is, different than that provided by an underwriter and explains why the GFOA recommends that nearly all issuers engage an MA for their bond issues. In addition, MSRB Rule G-17 prohibits an underwriter from telling an issuer not to engage an MA.

If you are interested in discussing the role of the MA or underwriter in more detail, please contact a PMA advisor below.

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