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Markup or Markdown: National Underwriters' Exit and the Changing Landscape of Municipal Finance

Abstract

Both the increased transparency and the institutionalization of the municipal bond market have led to dramatic declines in the profits of underwriters, especially so for those whose underwriting activity is national in scope. Using comprehensive data on all trades, all bonds, and all underwriting spreads available between 2005 and 2023, we show that underwriters facing increasingly informed investors in the primary market are unable to capture high markups from investors but are also unable to raise costs to issuers. Using a structural model to examine trading, we document underwriters are half as likely over the time span of our sample to encounter an uninformed retail investor when selling an issue, and the markups they can charge these dwindling investors have fallen by a third. Increased transparency has not benefited issuers but has led to a decline in profitability for the largest municipal underwriters, several of whom have announced their departure from the market.

Read the Paper.

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