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Conflicted Counsel: The MSRB Cautions Against Issuer Selection of Underwriter's Counsel.

Long-time municipal market insiders can recall an era when pay-to-play was rampant and kickbacks were just the cost of doing business. But with the advent of rules of professional conduct and greater transparency, today's municipal market participants operate with competence, accountability and integrity. The Municipal Securities Rulemaking Board (MSRB) carefully monitors market practices to identify threats to market integrity. One troubling practice from the market's opaque past has persisted—the practice known as “issuer designation of underwriter's counsel.”

Underwriters' counsel are important members of the deal team. They assist underwriters with due diligence responsibilities, including conducting thorough and independent reviews of municipal securities issuers' offering documents. The heightened regulatory scrutiny on the adequacy of due diligence performed by underwriters of municipal securities in the wake of the Securities and Exchange Commission's Municipalities Continuing Disclosure Cooperation (MCDC) initiative underscores the importance of underwriters retaining independent, expert counsel.

Yet some municipal securities issuers designate the counsel of their underwriters, or exert undue influence in the selection. When counsel is selected by—and perhaps beholden to—the issuer, the counsel's allegiance and ability to scrutinize the issuer's documents with the necessary independence, rigor and expertise are called into question. Ultimately, there is the potential for investor harm if important and material information about the municipal securities or the issuer is misrepresented or omitted, whether purposefully or unintentionally. The underwriter also may suffer financial loss, reputational harm and fraud liability if it relies on insufficiently qualified or potentially conflicted counsel.

The MSRB first shone a light on this practice in 1998, articulating the view that underwriters “must be free to select counsel in whom they have confidence and who are free of the possibility of any conflicting allegiances to other parties involved in the underwriting process.” Since that time, several industry groups have offered best practices encouraging less issuer involvement in the selection of underwriter's counsel. The MSRB has issued a market advisory to restate its concerns about the practice.

The MSRB recognizes that issuers often have compelling reasons for their involvement in selecting underwriter's counsel, such as managing costs, retaining counsel already familiar with the issuer's operations and finances and, in some cases, supporting women- or minority-owned firms. However, this practice gives rise to real or perceived conflicts of interest that undermine the integrity of the municipal market. This practice should not be a part of public finance.

The Bond Buyer

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