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Could MSRB Review of G-23 Revive 'Shady' Practice of Role-Switching?

The Municipal Securities Rulemaking Board reopening discussion about the roles of municipal advisors and underwriters could open up a can of worms and bring back “shady” practices, issuers fear.

Members of the Government Finance Officers Association told MSRB officials about their concerns during the Saturday meeting of the GFOA’s Committee on Governmental Debt Management. The MSRB told issuers it was preparing to ask for comments on its Rule G-23 on activities of financial advisors as part of its retrospective rule review.

Kathy Kardell, senior department administrator at the Hennepin County, Minnesota Office of Budget and Finance, said she opposed reopening that discussion. It was a long battle to get G-23 amended in 2011, she said, but the MSRB landed on a solution that protects issuers.

The concern among some issuers is that prior to the amendments to Rule G-23, an underwriter firm serving as an issuer’s municipal advisor could get insight and leverage a deal, only to then resign as advisor and underwrite a transaction or at least submit a bid on a competitive deal.

Kardell called that an “inherent conflict of interest” for a municipal advisor and/or financial advisor to then go on to underwrite the bonds. The 2010 Dodd-Frank Act created the requirement that “municipal advisors” be registered and owe a fiduciary duty to their municipal clients, but “financial advisor” has remained a common term in the muni market.

On the flip side, some municipal market participants say by not allowing that broker-dealer firm to switch roles and underwrite the bonds, it takes one more firm out of the equation that can actually submit a bid.

Some issuers who primarily use competitive sales, especially small and infrequent ones, have relatively low underwriter coverage, Mike Nicholas, CEO of the Bond Dealers of America, wrote in a commentary published in The Bond Buyer last week.

“If the issuer chooses one of the possible underwriter bidders on a competitive deal to serve as FA, the issuer will get one less bid at the auction,” Nicholas wrote. “In some places in the country, that additional bid can be crucial.”

Bond dealers may be looking for more opportunities to go for bids after the loss of tax-exempt advance refunding, said Kenton Tsoodle, Oklahoma City’s finance director.

“I suspect it’s motivated by some of the decreases in volume we’ve seen,” Tsoodle said. “With the loss of advance refundings, I’m sure underwriters want to have every opportunity they can to underwrite bonds.”

Tsoodle said issuers were concerned that role-switching was harmful, especially for issuers with less

experience in the market.

“There’s just a lot of concern that, that was a really bad practice,” he said. “It took advantage of especially infrequent, smaller issuers.”

But Kardell said she doesn’t see any evidence G-23 is hurting competitive bids, and says she sees people getting competitive bids under the current rules.

“There’s no clamoring that people are losing out on their competitive sales at all,” Kardell said.

Kardell wants to see a group do an analysis that shows less competitive sales because of Rule G-23, adding that she has never seen that occur.

The BDA wants the MSRB to remove the rule’s restriction on competitively bid transactions and should consider eliminating Rule G-23 altogether, Nicholas wrote.

Issuers don’t want to see that practice making a comeback and Tsoodle said if the MSRB wants to protect issuers, keeping Rule G-23 is one way to do so.

“We don’t want to see issuers taken advantage of, and this rule is something that really helps to protect issuers,” he said.

By Sarah Wynn

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