ROLES – FINANCIAL ADVISOR; UNDERWRITER/BANKER

MSRB –G-23

The Municipal Securities Rule Board (MSRB) of the Securities and Exchange Commission (SEC) has a rule in place (G-23) which is aimed at protecting debt issuing governments from actual and perceived conflicts of interest. Financial advisors are deemed by the SEC to be fiduciaries to issuers while underwriters/bankers are not. A review of this rule was conducted in early 2006 with a recommendation from the National Association of Independent Public Financial Advisors (NAIPFA) that dealers should be required to advise issuers affirmatively that several actual conflicts of interest may exist and that these should be disclosed to the issuer by the dealer. It was stated that underwriters have fiduciary, statutory and regulatory obligations to their investors, whose interests often differ significantly from the interests of issuers.

The direct cost of an independent public financial advisor is more than offset by the lower interest rates paid compared to a sale where no independent third party exists to document that sale price and sale terms are 'fair' to the client and 'fair' to the underwriter for the securities being issued.

Price Competition – Interest Rates

Bankers often argue that an independent public financial advisor is an unnecessary cost, but this is far from the truth. Given the complexity of the market, the normal self-interest of bond purchasers and lack of market knowledge and expertise by some issuers, this does not logically hold up.

In the 143 competitive sales held by Speer Financial, Inc. in 2005, the average interest rate variance between the low bidder and the high bidder was 0.3294%. Of the 100 competitive sales with an official statement, the average high/low variance was 0.2409%. As can be seen, a wide range of where "the market" is, is held by a number of firms. When the buyers compete, the issuer wins through lower lifetime borrowing costs.

The wide variance of opinion on the cost of money over time between banks that openly compete exists and is documented. When open competition does not exist among banks, and no independent pricing verification exists, the final terms frequently vary dramatically from other recent and similar issues, the sale results of which the issuer was not made aware of by the purchaser of the securities. Selective comparables versus the full universe of comparables is unfortunately more the rule than the exception.

Best Practice

Governmental shopping (for the lowest priced contractor or supplier that meets the bid specifications) is a "Best Practice" governmental business standard. The lowest cost of money is just an extension of this best practice business principle. In a bond issue, the fact is that there may be two to four digits in front of the comma that represents the interest cost savings realized by finding the lowest cost lender.

In Speer's 2005 competitive sales, the most active bidder participated in 99 of the 143 sales (69%) as the lead manager (none as a syndicate member). They won 30.3% of the times they bid. The second most active underwriter bid 59 times (41%) as a bond manager and another 43 times as a syndicate member. They won 7.84% as the syndicate leader and 20.59% as a syndicate member where another underwriter led. While good relationships with potential purchasers of your bonds is a good business practice, no vendor for any product or service should feel immune from price competition.

Bidding bonds should be a standard business practice. Circumstances occasionally do override and call for a negotiated sale. An analysis of this large number of competitive sales finds a wide divergence of opinion exists in pricing bonds. Issuers need to realize that this divergence of opinion exists and that winning 30% of the time may be good if you're a baseball batter, but it's not so good when you have a fiduciary responsibility and you're supposed to protect your taxpayers' interests 100% of the time.