MSRB
Municipal Securities Rulemaking Board

EDUCATION CENTER

Issuer Considerations for Distributing Bonds: Establishing Priority of Orders

Many different types of investors may wish to purchase municipal bonds in the primary market. In a negotiated bond offering, it is the prerogative of the municipal entity issuing the bonds to determine how to prioritize orders from prospective investors, which also affects the compensation earned by each firm selling the bonds. The issuer's priority of orders determines the hierarchy by which the underwriter allocates the orders for the municipal bonds, and the priority policy governs how the "takedown" or compensation may be allocated among the participating firms. These provisions are generally included in the marketing plan, which is created in conjunction with the issuer's municipal advisor, if retained, and underwriters. This plan will outline any of the issuer's goals related to the distribution of the bonds to various underwriters, which may include goals related to participation of retail investors and minority-, women- or veteran-owned firms.

PRIORITY OF ORDERS

The priority of orders provides transparency to the issuer, senior managing underwriter, and the syndicate so that each knows how orders for the bonds will be filled.

The marketing plan typically will include a priority of orders predetermined by the issuer or proposed by the senior manager (or sole underwriter). The issuer will often approve the priority of orders as part of its review of the marketing plan. The priority of orders provides the issuer with an opportunity to ensure that the issuer's bonds are marketed to its target investors and that the bond issuance supports the issuer's goals and policies. Because most of the categories of orders that are prioritized in the typical priority of orders are compensation-based categories—categories that describe how the underwriters and/or dealers will be compensated for that order—the priority of orders also plays a substantial role in determining underwriter and dealer compensation.

ESTABLISHING THE PRIORITY OF ORDERS

Issuers are free to structure the priority of orders in any manner they see fit in light of their goals and objectives for the offering. The issuer can choose one or a combination of the four different types of orders listed below in a commonly used order of priority: retail orders, group net orders, net designated orders and member orders.

- **Retail Orders**—orders in which specific eligibility criteria must be met before an investor may place the order. Retail orders are commonly thought of as orders from individual retail investors. However, an issuer may establish any criteria it sees fit for investors that may place a retail order. As a result, one issuer's retail orders may look very different from those of another issuer. For example, one issuer may determine that only individual investors that live in-state are eligible to place retail orders for their issuance whereas another may expand their eligibility criteria to other states. Others may extend their criteria to apply to separately managed accounts and money managers, as they may buy bonds to invest on behalf of individual investors or for the purpose of allocating some portion of the purchase into an individual investor's account. If an issuer decides to give priority to retail orders, for certain maturities or the entire deal, they are typically given priority over all other orders for a specified time period determined by the issuer, and the selling firm receives the entire commission or "takedown."

- **Group Net Orders**—orders in which each member of the syndicate shares the takedown on the order according to the liabilities established in the Agreement Among Underwriters (AAU), the contract between the senior manager and each co-manager that establishes the underwriting syndicate selected by the issuer to market the bonds. For example, if a member of the syndicate has a 25% liability in the transaction, per the AAU, that member would receive 25% of each group net order allocated.

- **Net Designated Orders**—orders in which the investor (typically an institution) directs that the takedown be shared only among syndicate members they choose, according to percentages specified by the investor. The direction must meet the specific priority policy established by the issuer. *See the section on "Priority Policy" for more information.*

- **Member Orders**—orders in which the selling firm receives the entire takedown. Typically, the takedown on a member order is not divided among other syndicate members. These include stock orders that firms would submit in anticipation of future sales.

Issuers are free to structure the priority of orders in any manner they see fit.

As with all of the matters set out in the marketing plan, if the priority of orders is proposed by the underwriter, it is simply a proposal. The issuer ultimately determines the final priority of orders, which could align with the underwriter's recommendation or differ substantially from it.

PRIORITY POLICY

The priority of orders is closely tied to how underwriters will be compensated. The issuer and underwriter typically include a priority policy in the marketing plan to establish a set of rules for net designated and retail orders that will be accepted during the order period and determine how takedowns may be allocated among participating firms.

This policy applies when a syndicate member or other dealer submits a net designated order to the senior manager. This policy may require that a minimum or maximum number of firms be designated on each order. Similarly, the priority policy may set forth a minimum and/or maximum percentage of the takedown on a net designated order that may be designated to any one firm. The priority policy also may require that a minimum number of firms that meet certain characteristics that reflect or promote the issuer's values or offering goals must be designated in each order. This may include firms that are historically underrepresented businesses, such as a minority-, women-, or veteran-owned business enterprises. Any changes to the priority policy must be approved by the issuer and communicated to the co-managers and other dealers.

The priority policy also applies when an issuer includes retail orders in their priority of orders, either in a stand-alone retail order period or when retail is given priority over other orders. The policy may include a limitation on the size of the orders and specify whether additional information may be required when submitting a retail order (e.g., zip codes).

An issuer's priority policy can influence the performance of syndicate members and other dealers. It also permits an issuer to reward all or certain dealers in a manner that it sees fit. As with each of the decision points leading to the pricing of the issuer's municipal bonds, the priority policy generally is guided by the issuer's goals and any policies that it may wish to promote.

LIABILITIES AND THE AGREEMENT AMONG UNDERWRITERS (AAU)

The AAU is the contract between the senior manager (the lead underwriter that runs the order book) and each co-manager. This contract establishes the underwriting syndicate, the group of underwriters formed together for the purpose of sharing the risk associated with purchasing and selling the issuer's bonds in the primary market. The AAU typically establishes the specifics of the relationship among the syndicate members and authorizes the senior manager to act on behalf of the group in many respects. The AAU also lays out each underwriter's liability assignment, or the share in the profits and losses of the syndicate. The AAU also may address a variety of other matters relating to trade practice and applicable rules of the MSRB. Syndicate members generally return executed copies of the AAU to the senior manager approximately two days before pricing. At or about the same time, the issuer may wish to schedule a call with the senior manager (or sole underwriter) and, if desired and applicable, with the co-managers to review the issuer's goals for the bond issuance.

An issuer's priority policy can influence the performance of syndicate members and other dealers.

SELLING GROUP AGREEMENT

A group of dealers known as a selling group also may assist in the distribution of a new issue of municipal securities. Selling group members execute a selling group agreement with the senior manager whereby the dealers participate in the distribution of a new issue of municipal securities. However, selling group members do not have a liability for any unsold balance in the new issue and do not participate in residual syndicate profits or losses in the transaction.

COMMUNICATION, ALLOCATIONS AND OTHER ISSUER CONSIDERATIONS

Upon issuer approval, the senior manager must communicate the issuer's terms and conditions, including its priority of orders, retail order period requirements and priority policy to all syndicate and selling group members. The senior manager also must communicate any change in the priority of orders or priority policy. This information is typically included on the pricing wire.

After pre-sale marketing, the order period will commence at a date and time decided by the issuer, in consultation with the underwriter and municipal advisor, if any.

Once the order period commences, any co-manager or dealer that submits an order to the senior manager will also indicate into which of the priority of order categories the order fits. This information will be necessary for determining the allocation and the takedown due to each co-manager and dealer (if any).

The issuer utilizes the priority of orders and priority policy to meet specific goals they want to achieve in their bond offering. These goals may include greater participation from retail investors in the offering and/or representation from minority-, women- or veteran-owned firms in the syndicate. The priority of orders could result in greater or lesser compensation to syndicate members, and such compensation to that firm may not align with their initial liability. The issuer has the ability to monitor each syndicate member's performance in relation to their liability in the transaction.

Applicable Rules

MSRB Rule G-11, on primary offering practices[1], establishes basic standards applicable to the priority of orders so that underwriters honor an issuer's priority of order instructions. Issuers should understand this and other key rules applicable to priority provisions to be aware of underwriters' obligations.

Among other requirements, MSRB Rule G-11 requires specific communications between the senior manager and the syndicate. For example, it requires the senior manager to furnish to the syndicate and selling group members certain information related to the issuer's requirements, priority provisions and order period.

MSRB Rule G-8 requires the senior manager to maintain specific books and records for all pricing information and records relating to the primary offering, including information specific to each order submitted during a retail order period.

MSRB Rule G-32 requires underwriters to report certain information to the MSRB, including basic information if an issuer has elected to give priority to retail investors during an order period.

MSRB Rule G-17 establishes that dealers, including underwriters, have a duty to deal fairly with all persons.

This fair dealing obligation requires an underwriter to follow an issuer's directions in a retail order period. It also requires underwriters to take reasonable steps to ensure that orders submitted during a retail order period in fact meet the issuer's conditions.

These basic regulatory standards promote greater transparency and dealer accountability for adherence to an issuer's chosen priority of orders and related requirements. Senior managers must communicate the issuer's terms and conditions and related information to the syndicate and selling group members to permit them to solicit compliant orders. In turn, syndicate and selling group members must record and communicate to the senior manager specific information about certain orders to facilitate compliance audits by the issuer. Lastly, senior managers must retain these records and report basic information about the offering, including that related to a retail order period, if any.

1 This document contains only a summary of the key provisions of the MSRB Rules G-32, G-17, G-11 and G-8 with respect to priority provisions as of the date of the publication of this document and should not be relied upon as a substitute for careful review of the rules themselves. The complete text of the rules is available at https://www.msrb.org/Rules-and-Interpretations/MSRB-Rules.