MSRB

Issuer Considerations for Selecting the Underwriting Team and Understanding the Pre-Marketing Process

Selecting an underwriter or underwriting team is the first of many phases for a state or local government that has decided to issue bonds through a negotiated primary market offering. Some issuers also retain a municipal advisor to provide advice on the bond offering.[1] This document[2] discusses the considerations for hiring an underwriting team, and reviews the components of the bond pre-marketing process.

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The Underwriting Team

When evaluating the underwriting needs for a bond offering, an issuer may wish to consider:

- Anticipated size and complexity of the structure;
- Issuer's reputation and rating in the market;
- Issuer's experience in the market and with the specific type of bonds being contemplated;
- Any relevant timing concerns;
- Issuer's goals for the offering; and
- Any policies the issuer may wish to promote through the offering, such as ensuring local investors have the opportunity to participate in the primary offering.

Selected by the issuer, the underwriting team is responsible for purchasing the issuer's bonds and selling them to investors in the primary market in an arm's length commercial transaction with the issuer. The underwriting team may consist of a sole underwriter or a group of underwriters, known as a syndicate, formed for the purpose of sharing the risk associated with the transaction. Other dealers may also be involved as selling group members. The size of the team can vary depending on the par amount of the municipal bond issue and may include some or all of the following participants:

- **Senior manager** — leads the syndicate, "runs the order books," executes the priority of orders established by the issuer, accepts orders, allocates the bonds and transmits applicable commissions and expenses to the syndicate. The senior manager shares in the profits and liabilities for the bonds.
- **Co-managers** — market the bonds and submit orders to the senior manager; co-managers are part of the syndicate and share in the profits and liabilities of the syndicate.

[1] If retained by an issuer, a municipal advisor must serve as a fiduciary to the issuer, putting the needs of its clients above its own within the scope of its municipal advisory duties. Municipal advisors may provide advice to the issuer on a wide range of matters in connection with a bond offering, including matters such as the selection of underwriters, the terms of the offering and the pricing of the bonds.

[2] This document contains only a summary of the key provisions of MSRB Rules G-17, G-11, G-8 and G-32 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 MSRB rules is available at http://msrb.org/Rules-and-Interpretations/MSRB-Rules.aspx.

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For more information on the roles of the different parties in an initial offering of municipal bonds, read Roles and Responsibilities: The Financing Team in an Initial Bond Offering.

- **Selling group members** — dealers that assist in selling and marketing the bonds in a primary market offering; selling group members typically have a contractual relationship with the senior manager and do not share in any profits or liabilities for the bonds.
- **Other dealers** — dealers that assist in selling and marketing the bonds in a primary offering; they typically have a contractual relationship, sometimes called a distribution agreement or marketing agreement, with a specific syndicate member to market the bonds on behalf of that syndicate member. These dealers do not share in the profits or liabilities of the bonds. Importantly, some underwriting team members might delegate some or all of their responsibilities to a third party under a distribution or marketing agreement, the existence of which must be disclosed to the issuer. In the event of such an agreement, an issuer may wish to evaluate the qualifications of the third-party dealer in addition to those of the other co-managers and dealers.

In the case of a bond offering with a sole underwriter, the sole underwriter has the roles of both the senior manager and the co-managers in a syndicate. Also, selling group members may be utilized in a sole-managed bond offering.

Qualifications and Roles

When selecting the underwriting team, an issuer can broaden and simultaneously target the potential investors for its bonds by selecting an underwriting team based on each member's specific strengths. Some dealers may specialize in bond sales to institutional investors such as bond or pension funds, casualty companies or trust departments, while other dealers sell bonds predominately to retail investors and may represent national, regional or local dealers. An issuer may consider the qualifications, expertise and specializations of each member of the underwriting team to determine the value added by that member and the ability of the member to achieve the issuer's underwriting needs for the bond offering.

For example, if an issuer has a strong preference that its bonds are distributed to local investors, it may wish to evaluate the extent of a prospective dealer's relationships with local dealers and investors, keeping in mind that each member of the underwriting team may have a different specialization or expertise. Similarly, an issuer may have a goal to encourage the participation of historically underutilized women- or minority-owned businesses in its bond offering.

Issuers may wish to request that their senior manager (or sole underwriter) articulate with specificity the value added. For more information on the roles of the different parties in an initial offering of municipal bonds, read Roles and Responsibilities: The Financing Team in an Initial Bond Offering.

The Marketing Plan

In a negotiated primary market bond offering, the senior manager, once selected by the issuer, typically develops and presents a marketing plan to the issuer for comment and approval prior to pricing. In the case of a primary market bond offering that involves the use of a syndicate, the marketing plan will typically reflect input from both the senior manager and the co-managers.

The marketing plan typically identifies the target investors to whom the bonds would be marketed; details the proposed marketing strategy; indicates any proposed use of retention (discussed below); may describe the proposed priority of orders for the issuer approval, which may include a retail order period; sets forth a proposed designation policy — indicating the liability assignment for each syndicate member; may propose the use of a selling group; and provides the use of distribution agreements, if permitted by the issuer. Each of these elements of the marketing plan can support achieving the issuer's goals.

The marketing plan identifies the target investor groups for the bonds.

Target Investors

In general, the marketing plan identifies the target investor groups for the bonds, which may be different for each maturity range. The target investors set forth in the marketing plan reflect the underwriters' professional opinion as to the investors that are likely to be interested in the bond offering; this list should reflect the issuer's goals and objectives for the bond offering. Thus, for example, an issuer with a stated objective to increase the participation of retail investors (as defined by the issuer) in its primary offering, would prefer a marketing plan that lists retail investors as a target investor group.

The universe of target investors will determine the appropriate marketing strategies for the offering; thus it is imperative that this section of the marketing plan accurately captures an issuer's requirements. The marketing plan may also discuss possible structuring and couponing scenarios or other recommendations with the goal of obtaining the best price for the bonds. The marketing plan may also indicate the existence of any arrangement between a co-manager or selling group member and another dealer whereby the dealer agrees to distribute or market the bonds on behalf of that party.

Marketing Strategy

The proposed marketing strategy will explain the methods through which the syndicate plans to reach the target investors. These methods may include notices published in financial or local publications, radio advertisements, investor conference calls or internal sales memorandums, among other methods. Depending on the target investors, different methods may be utilized for different investors. Marketing to target investors typically begins before the start of an order period.

Liabilities

Also, typically the senior manager will recommend to the issuer a proposed liability assignment for each syndicate member. Liability assignments typically reflect the underwriting capabilities of the syndicate members to whom they are assigned such that underwriters that are likely to sell more of the bonds to investors will be assigned a greater percentage of the liability for the bonds than other underwriters in the syndicate. The issuer may determine a revised liability structure or may approve the senior manager's proposed structure. While each offering and underwriter liability structure is different, the senior manager generally retains the largest liability for the bonds.

Retention

If the senior manager proposes to hold back any bonds from the syndicate members in favor of retaining them for sale to institutional investors or allocation to selling group members, this recommendation would typically be included in the marketing plan. The marketing plan may also describe the proposed par amount of the bond offering that would be retained by each syndicate member. If the senior manager proposes the use of retention but does not recommend any retention assignments in the marketing plan, the senior manager would discuss with the issuer the retention assignment before pricing and before any retention would be applied. An issuer that believes that there may be significant institutional interest in its bonds or that wishes to utilize a selling group might consider using retention in order to ensure sufficient selling group access to its bonds and to encourage and reward selling group participation in the bond issue.

Questions for Issuers to Ask During the Selection and Pre-marketing Process

- What are the goals of the offering?
- Who are the target investor types?
- Are there policies of the issuer to promote through the offering such as ensuring local investors have the opportunity to participate in the primary offering?
- What are the distribution capabilities of the underwriting firm(s)?
- What is the proposed marketing strategy for the offering?
- Does the priority of orders provide incentives for the syndicate to perform?
- What should be the proportionate share of the bonds assumed by the members of the syndicate?
- What is the basis for retention?
- What is the basis for bond allocation?