Conflicts of Interest in Municipal Bond Advising and Underwriting

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Abstract
This paper studies how conflicts of interest between financial advisors and municipalities affect borrowing costs of state and local governments. While municipal financial advisors were historically allowed to serve a dual role as advisor and underwriter, this practice was abolished in 2011. Using a difference-in-differences approach, I compare bond issues with dual advisor-underwriters to other bond issues with independent advisors using within municipality variation. I find that bonds with dual advisors see interest costs fall by 8.15 basis points (3.7% on average) after the advisor is no longer allowed to serve as underwriter. This drop in interest costs is driven by a 16% increase in competition from non-advisor underwriters. I show evidence of information asymmetries deterring non-advisor competition pre-reform, bond structure standardization post-reform, and no change in underwriter quality.

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