Breaking the Bond: The Effect of Banker Turnover on Municipal Bonds

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*The views stated herein are those of the authors and are not necessarily the views of the Chicago Fed or the the Federal Reserve System.

Summary

- What is the value-add of bankers in underwriting relationships?
  - Are banking relationships primarily with bankers or banks?
  - Exploits the 2021 Texas underwriting ban, forcing 5 large underwriters to exit the state
  - The Texas ban forces some bankers to switch underwriters
- Following bankers alleviates the yield increases as a result of the underwriter ban:
  - Larger gains for informationally opaque issuers
  - Following your banker results in ≈$290,000 in issuance costs savings
  - It is the bankers that add value not the banks!

Comments

- Comment 1: Issuer-bank relationships
- Comment 2: Cost savings associated with keeping your banker
- Comment 3: Identification

Comment 1: Issuer-bank relationships

- Banking relationships are valuable, but where does value come from?
  - The challenge: issuer-banker relationships arise endogenously
  - Karolyi (2018); Drexler and Schoar (2014); Hertzberg, Liberti, and Paravisini (2011); Fisman, Paravisini, and Vig (2017): loan officers/bankers are at the core of banking relationships
- Most prior studies unable to "switch" bankers across institutions
  - Disentangling the effect of banks from bankers difficult
  - This paper does exactly that—forced switch of bankers to institutions that remain in TX
- What is the bank portion of relationships worth then?

Comment 2: Cost savings of keeping your banker

- Spread increases concentrated among issuers losing their banker.
- Does following your prior banker mean net cost savings?
  - The base effect on spreads is 4 bps, while that of keeping your banker is -20 bps
  - Need to reconcile the remainder, is this low-balling a là Sharpe (1990)?
  - Triple-diff regs show a similar discrepancy
- Test for low-balling with a longer time series:
  - Bank by year FEs may absorb some of that effect
  - A good chunk of issuers will return to market within 5 years
- Reconcile effects across the credit risk spectrum

Comment 3: Identification

- The TX shock affects underwriter competition and negotiation (Garrett and Ivanov 2024)
  - The IV has to affect underwriter spreads only through following your banker
  - Other (direct) channels are problematic
- Is banker switching endogenous to the banker's client base?
  - Is a star banker with a lucrative client base more likely to switch in-state?
  - Are there any non-compete agreements that bind bankers?

Comment 3: Identification

- What happens when banks re-enter Texas several years later?
- Do we have the appropriate definition for bankers, VPs/MDs$\neq$relationship holder
  - 244 seems to low of a count for switchers
  - Are you able to observe lower-level bankers?
  - Portable human capital in the financial industry low (Gao, Wang, and Wu 2024)
- Bankers as relationship holders with funds seems implausible
  - Any evidence to back that claim?
  - Dan and I found placement patterns change around the TX shock

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