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SEC Cracks Down on Disclosure in Municipal Bond Sales.

The Securities and Exchange Commission is cracking down on municipalities that it suspects of hiding information from investors when they sell bonds to them, with more cases expected to be announced in the coming months.

The effort reflects the agency's frustration about its limited authority in a market that's especially popular with ordinary Americans, who don't pay federal taxes on interest on municipal bonds. Today, retail investors directly hold about half of the $3.7 trillion in municipal debt, which is used to finance schools, roads, hospitals and other projects.

While the SEC oversees the investment banks that localities hire to make bond offerings, it does not directly oversee the municipalities or review the bonds before they're offered to the public. Last year, the agency urged Congress to grant it more muscle in that arena.

But with congressional action nowhere in sight, the agency has turned to the most powerful tool in its arsenal: enforcement actions. After creating an enforcement unit devoted solely to muni bonds in 2009, the SEC ramped up its scrutiny of the market.

The agency filed its first securities case against a state in 2010, charging New Jersey with misleading investors about two major pension funds. That year, the agency also fined four former San Diego officials for misleading investors about the city's fiscal problems. The SEC said it had never before secured penalties from city officials in a municipal bond fraud case.

Last year, the SEC launched an inquiry into internal audits by the D.C. Office of the Chief Financial Officer that were not released to bondholders. And this year alone, the agency has brokered settlements with Illinois and three localities, an unusual pace for these kinds of cases, muni bond experts said.

"There's more in the pipeline," said SEC Commissioner Elisse B. Walter, who led the effort to produce a lengthy report last year detailing the agency's concerns about the way that market operates. "You're seeing the marketplace sitting up and taking notice."

The scrutiny comes at a time of turbulence in the muni bond market because of bankruptcies in a handful of major cities, such as Detroit, and a rash of bond-selling triggered by uncertainties about the end of the Federal Reserve's stimulus policy.

The SEC's cases have focused on lapses in disclosure.

Localities that issue bonds agree to continuously disclose their finances and certain material events, defined as those that a reasonable investor would consider significant.

In its report last year, the SEC concluded that the muni bond market is so opaque that investors who purchase these bonds can't make fully informed decisions about what they're buying. The enforcement cases aim to remedy that phenomenon.

One of the more notable ones this year involved Pennsylvania’s capital city, which the SEC accused of making fraudulent statements about its financial condition. Harrisburg had failed for years to file the disclosures for investors, so the SEC held the city liable for what it said in its State of the City address and other online documents.

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