WSJ: Detroit Bankruptcy Plan Called Unfair to Bondholders.

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The Securities Industry and Financial Markets Association, the bond market's main trade group, warned Michigan's governor that Detroit's bankruptcy plan unfairly punishes bondholders whose debt is supposed to be guaranteed under state law.

In a letter Thursday, the bond-market trade group told Gov. Rick Snyder and state Treasurer Andy Dillon that the bankruptcy "could have potentially significant, negative municipal securities market implications," including raising borrowing costs for municipalities across the state. The letter was signed by Sifma General Counsel Ira Hammerman.

Detroit filed for the largest municipal bankruptcy in history Thursday with estimated liabilities of about $18 billion, overtaking Jefferson County, Ala., which filed in November 2011 with about $4 billion in debt.

Sifma is taking issue with Detroit's emergency manager Kevyn Orr's proposed treatment of some of the city's "unlimited tax general obligation bonds," which would be repaid at pennies on the dollar under a restructuring plan Mr. Orr presented in June.

Such treatment "ignores the appropriate priority that should be given to these bonds," Sifma said. The Michigan Constitution also states that some of Detroit's bonds are guaranteed, it said.

General-obligation bonds are viewed as one of the safest types of muni investments because they are backed by a government's "full faith and credit" pledge to raise taxes as necessary to repay the bonds. That backing as well as their tax-exempt status have made those types of municipal bonds popular, particularly among individual investors.

The group warned that bondholders might sell other Michigan municipal debt and be reluctant to buy debt from Michigan cities and towns, "causing the cost of financing infrastructure projects to rise."

"We understand Detroit has serious financial issues," but hurting bondholders will only provide a temporary salve, the letter said.

Sifma added that other states have considered alternatives to help their distressed localities, including enacting laws that protect local government debt, "to ensure that the markets' perception of what investors are due matches the outcome."

Sifma's outcry follows similar complaints recently from some Detroit creditors. Bond insurer Ambac Assurance Corp., which backs the principal and interest payments of some of the city's bonds, said last week that the city's proposed treatment of general-obligation bonds "is harmful to Detroit and the interest of taxpayers in Michigan." It added a "successful revitalization" of Detroit will depend on access to "cost-effective financing," and "such access will be needlessly imperiled as a result of the emergency manager’s approach.”

In a report last month, Nuveen Asset Management, which owns some of the city’s debt, said Mr. Orr’s proposed actions could be replicated in one or more of Michigan’s other distressed cities or towns, also hurting bondholders .

The firm estimated that nearly 10% of Michigan’s population lives in a community that is under the control of an emergency manager or is under some stage of state oversight due to its fiscal problems.