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WSJ: In Muni-Bond Market, Some Investors Fly First Class.

Municipalities Are Allowed to Treat Large Investors Differently.

On a Friday in late March, representatives of about two dozen investment firms gathered at the New York offices of Barclays PLC to hear Puerto Rico government officials explain why the island's bonds—recently downgraded to near "junk"—were still a good investment.

The officials told the firms, major holders of Puerto Rico debt, that a controversial pension-overhaul proposal favored by investors would pass the island's legislature. Some investors also got private meetings with island officials that day, and at least one firm at the event sold Puerto Rico bonds. Slides from the meeting were posted online by the following Monday.

Puerto Rico didn't break any laws or regulations in holding the meeting, attorneys say. The event highlighted differences in the rules governing how companies and municipal-securities issuers interact with investors.

Securities laws generally require firms to disclose what they say to investors if the information is both material and nonpublic. These regulations don't apply to municipalities, in part because of concerns about the federal government interfering in state and local affairs.

This exception can give large money managers with access to public officials an edge in the $3.7 trillion municipal-bond market, according to industry executives and investors.

Puerto Rico's bonds are down 16.42% this year as the island's economic outlook has deteriorated. The bonds are on track for their worst year since 2008 when they fell 12.5%, according to the S&P Municipal Bond Puerto Rico Index.

Investors and others have informed regulators including the Securities and Exchange Commission and the Municipal Securities Rulemaking Board about the Puerto Rico meeting, but regulators haven't said what they have done in response.

Lynnette Kelly, executive director of the MSRB, said the board is concerned about debt issuers disclosing material information to investors selectively.

"The municipal market should…ensure that all investors have equal access to information and that the market operates fairly," she said.

Unpublicized meetings involving powerful institutions create a "two-tiered market," said Malcolm Northam, a consultant in the financial-services business who is a former official at the Financial Industry Regulatory Authority, the Wall Street-funded self-regulator.

"That's not how markets are supposed to work," Mr. Northam said.

Since the financial crisis, the SEC has ramped up its enforcement of fraud in the municipal-bond market amid concerns about issuers' disclosure practices. The SEC launched a new unit in 2010 to focus on the market and public pensions.

Since then, the agency has filed fraud charges against Harrisburg, Pa., accusing the state capital of making misleading statements about its finances, and against Miami and its former budget director, alleging the city misled investors about its financial health. Harrisburg agreed to settle the charges and didn't pay a financial penalty. Miami has said it would fight the allegations.

The SEC also last year pushed for Congress to give it more authority to oversee municipal bonds. The MSRB, which oversees securities firms, banks and municipal advisers, encourages issuers to post information on its disclosure website.

Investors who attended the Puerto Rico meeting said officials didn't disclose any new information.

Even so, the gathering offered attendees some advantages, including a chance to talk with people in charge of the island's finances and an opportunity to ask follow-up questions. In May, Puerto Rico held another private gathering for some investors on the sidelines of a more-public conference in San Juan.

Other municipalities have hosted investor gatherings in more transparent fashion. Massachusetts says it allows individual investors to attend its annual investor conference.

Puerto Rico's exclusive meeting drew ire from professional fund managers who didn't make the list.

"Why should any one investor have more access to an issuer than another?" said Adam Mackey, managing director of municipal fixed income at PNC Capital Advisors. He wasn't invited.

The meeting came at a crucial time for Puerto Rico, which had struggled through a prolonged recession. Many investors hadn't met officials from the administration of Gov. Alejandro Garcia Padilla, who was elected the previous November. Puerto Rico bonds are widely held, in part because the interest—unlike on most other municipal bonds—is exempt from federal, state and local income taxes, regardless of where the investor lives.

Officials from the Government Development Bank, Puerto Rico's financial adviser, declined to comment about the exclusive nature of the March meeting.

Ron Pearson, a financial planner in Virginia Beach, Va., who has a client with $1.2 million of Puerto Rico bonds, said he didn't know about the meeting but noticed that his client's Puerto Rico bonds lost 6% of their value in March.

His client continues to hold the Puerto Rico bonds.

"My client is not happy to see his portfolio drop," said Mr. Pearson, a former Navy pilot.

One firm that sold Puerto Rico bonds the day of the March meeting was Nuveen Asset Management. John Miller, co-head of fixed income, said his firm didn't sell the bonds because of what Nuveen heard in the meeting.

He said Nuveen already was looking to trim its exposure to longer-term Puerto Rico debt in a handful of its funds, adding that those funds sold a similar amount of Puerto Rico bonds in the prior week. He also said Nuveen bought shorter-dated Puerto Rico bonds during the same time frame.

"What happened for a long time is that the SEC didn't pay attention to the municipal market because there were so few bankruptcies and so few problems, and there were so many on the corporate side," said Andrea Bacon, a public-finance lawyer at Chapman and Cutler LLP.

Many observers said they believe the agency should be looking at the issue of private meetings.

"It certainly would be an issue I would be concerned about if I were still at the SEC," said Martha Haines, former chief of the SEC's office of municipal securities.