WSJ: Rules to Curb Muni-Bond Advisers.

WASHINGTON—U.S. securities regulators, under pressure from Congress to prevent a repeat of financial debacles in municipalities like Detroit and Jefferson County, Ala., are set to propose a series of rules to rein in advisers that help states and localities raise cash in the $3.7 trillion municipal-bond market.

The Municipal Securities Rulemaking Board, a self-regulator for the muni-bond market, is expected this week to propose the first of a long-delayed set of rules for municipal advisers aimed at better protecting taxpayers from the types of complex transactions that soured during the financial crisis. Many unsophisticated local governments didn't fully understand those transactions, which primarily involved so-called interest-rate swaps to hedge against higher borrowing costs.

The advisers targeted by the rules are firms, sometimes affiliated with banks, hired to work with states and localities to time, market and price municipal-bond deals and related transactions. But most advisers are unaffiliated with banks and were previously unregulated.

Lawmakers and regulators say they pushed to increase oversight of municipal advisers in the wake of tumult in localities like Jefferson County, where officials and Wall Street firms repeatedly used interest-rate swaps as a vehicle for kickbacks and other types of fraud. The 2010 Dodd-Frank financial law requires the advisers to register with the Securities and Exchange Commission and adhere to MSRB rules.

Matt Fabian, managing director at the research firm Municipal Market Advisors, said the rules could help municipalities avoid repeating mistakes that have caused financial turmoil in cities like Detroit, where the structure of swaps contributed to the now-bankrupt city's problems. Under the coming rules, which set broad standards of conduct, a swap adviser would have to better understand and disclose the risks of such transactions to their clients.

Efforts to regulate advisers have taken far longer than lawmakers originally intended, in part because it took the SEC, which oversees the MSRB, until September to complete the definition of a municipal adviser and set up a permanent registration system. The final SEC rule spans 700 pages and goes into effect next week.

The coming MSRB rules are partly aimed at ensuring a level regulatory playing field between advisers affiliated with banks, such as Goldman Sachs Group Inc., GS -0.60% and so-called independent advisers that are unaffiliated with banks or brokerages. Bank- and brokerage-affiliated firms have long had to adhere to a set a conduct and pay-to-play restrictions that didn't apply to independent advisers, which are typically small firms that employ three or four individual advisers.

The MSRB, which operates a separate registration system, says 928 firms are registered as municipal advisers. Of those, 224 are affiliated with banks or brokerages while 704 are "independent" firms.

Thomas Johnsen, a principal at Fieldman, Rolapp & Associates, an independent advisory firm based in Irvine, Calif., said advisers support the coming rules but worry about the affordability of compliance costs, especially for smaller firms.

The first set of MSRB rules seeks to ensure municipalities have competent advisers and establishes standards of conduct. Firms would have to possess expertise to advise on complex swaps transactions, disclose any conflicts of interest and adhere to a “duty of care” to act in the interests of their clients. They also would have to disclose the risks tied to a bond deal or related transaction, such as a swap.

In coming months, the agency also plans to propose supervisory provisions for advisory firms, restrictions on political contributions to local officials who can award bond business and limits on gifts and gratuities advisers can receive from clients. The MSRB also is developing a professional qualification exam similar to the exams brokers must pass.

The MSRB will collect public comments on all the proposals, and the SEC must sign off on them before they can go into effect.

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