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WSJ: For Munis, SEC Offers Carrot, Threatens Stick.

Officials with the Securities and Exchange Commission's municipal-enforcement unit are urging local governments and the banks that help them sell bonds to self-report certain violations related to disclosure, indicating that harsher penalties could be sought if the violations are discovered later.

Earlier this month, the SEC launched a program to encourage municipalities and banks to come forward with violations regarding continuing disclosure agreements. The move comes after the SEC brought charges against a school district last year for falsely saying in bond-offering documents that it had complied with previous disclosure obligations.

"Think of it as an opportunity to clear your slate, before we come at issuers and underwriters very hard," Peter Chan, an assistant director with the muni enforcement unit in the SEC's Chicago office, said on Friday.

"We're going to go after the issuers," Mr. Chan said. "We're going to find out who was responsible."

Mr. Chan spoke at a National Association of Bond Lawyers conference in Boston. The enforcement unit's chief, LeeAnn Gaunt, said at the conference on Thursday that the SEC had separately been reviewing the past disclosures of financially stressed municipalities, to help ensure investors were not misled about financial conditions.

The comments come as the SEC turns a more critical eye toward the municipal-bond market, which had been viewed as a relatively safe spot for mom-and-pop investors but has seen large bankruptcies in Detroit and Jefferson County, Ala., in recent years.

Under the self-reporting program, called the Municipalities Continuing Disclosure Cooperation Initative, cities that come forward must establish policies and procedures regarding their disclosure obligations, but would not have to pay a monetary penalty. Underwriters that come forward would be subject to a financial penalty, but it would be capped at $500,000.

"We hear complaints from the financial sector and so forth about lack of predictability," Mr. Chan said. Under the program, "you're getting predictability," and Mr. Chan noted it's unusual that market participants "have a situation where you know exactly the type of settlement terms you're going to get."

Lawyers at the conference, who work with cities and banks to help sell debt, questioned whether the program was necessary, noting that disclosure practices have improved in recent years. Jack McWilliams, a former attorney fellow at the SEC's Office of Municipal Securities, which is separate from the enforcement unit, said the municipal-bond market isn't perfect but that there should be other ways to improve it.

"I find the initiative offensive, I find it bullying," said Mr. McWilliams, who now works at Lewis Longman & Walker PA. "The idea that you have to prostrate yourself…there must be a better way to make the market better."

But Mr. Chan noted that although the bond lawyers at Friday's conference may be providing good advice to their clients, they are “not the whole universe.” Indeed, the U.S. Census Bureau says there are about 90,000 local governments in the U.S.

“There are bad actors,” Mr. Chan said. If there weren’t bad actors, “we wouldn’t even be speaking here today.”