WSJ: Treasury Turns Its Gaze to Municipal-Bond Market.

WASHINGTON—U.S. policy makers, concerned about strained public finances in places like Detroit and Puerto Rico, are moving to keep closer tabs on the ability of states and cities to raise money in the $3.7 trillion municipal-bond market.

The Treasury Department is forming a new unit to broadly monitor the market, with a focus on troubled borrowers, according to a Treasury official. The unit, which will be headed by a veteran public-finance banker at J.P. Morgan Chase & Co., also will track state and local pensions as well as the financing of bridges, roads and other infrastructure projects. Public-pension funding levels have been a problem area for many states and municipalities.

By boosting the department's monitoring of municipal finance, the Treasury hopes in part to better understand the ramifications of municipal-market stresses, the official said. The unit wouldn't have authority to write and enforce rules for the market like the Securities and Exchange Commission.

Efforts to boost oversight of the municipal-bond market have taken on new urgency in the wake of financial problems in places like Puerto Rico, which is beset by challenges including 15% unemployment and roughly $70 billion of outstanding debt.

Puerto Rico's troubles could reverberate well beyond its borders because roughly three-quarters of municipal-bond mutual funds own some debt issued by the commonwealth. It is among the biggest issuers in the municipal-bond market due to its tax benefits and often higher yields. The Federal Reserve's interest-rate-setting committee, meeting in January, said the commonwealth's financing situation "needed to be watched carefully," according to minutes of the meeting.

The SEC, which is the municipal-bond market's primary regulator, also has ramped up its scrutiny of the sector and is conducting a review of past disclosures by financially stressed states and municipalities to determine if they may have misled investors about their financial condition, according to SEC officials.

The Treasury's effort to gain greater insight into the municipal-bond market will be led by Kent Hiteshew, who will join the department in mid-May. Mr. Hiteshew has overseen J.P. Morgan's relationship with its housing-sector clients and municipal borrowers in the Northeast region. A J.P. Morgan spokeswoman declined to comment on Mr. Hiteshew's behalf.

"This office will centralize a lot of the work that is already happening across the building," said Matthew Rutherford, the Treasury's assistant secretary for financial markets. "It can look at various issues that arise in the municipal marketplace and make sure we understand what's driving them."

The municipal-bond market long has been seen by many mom-and-pop investors as a reliable source of tax-exempt income and as a vehicle for retirement savings. But that view has been rattled in recent years by episodes including the largest-ever municipal bankruptcy filing last July by Detroit and Puerto Rico's problems.

Last month, Puerto Rico sold $3.5 billion in new bonds to help pay down existing debt, a move that bought officials time to eliminate persistent budget deficits and jump-start the economy. The bonds have fallen in price in recent days amid reports that the island hired consultants that specialize in restructuring, though island officials haven't said they are working on a debt-restructuring plan. Credit-rating firms downgraded Puerto Rico to junk status this year.The commonwealth has said it plans to honor its obligations.

While the U.S. government has had talks with island officials about how Puerto Rico can improve its financial condition, Treasury officials have said they aren't contemplating a federal bailout. The Treasury official said the department doesn't have the authority to grant federal financial assistance.

Federal officials have sought to boost their oversight of the municipal-bond market in the wake of the financial crisis, when a contraction in state and local income-tax receipts squeezed municipalities andthreatened the ability of some governments to fulfill their financial obligations.

The SEC, which sets disclosure rules for state and local governments that issue bonds, is pushing for additional authority from Congress to crack down on municipalities that don't keep the public apprised of their financial health.

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