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Bond Industry Struggles Under Regulatory Burden, Experts Say.

AUSTIN — The municipal bond industry is struggling to cope with heavy regulation while trying to broaden its appeal to the investment community, experts told The Bond Buyer's Texas Public Finance Conference.

The Securities Industry and Financial Markets Association's Leslie Norwood described the current regulatory environment as "death by a thousand cuts."

The most recent struggle came from the Securities and Exchange Commission's Municipalities Continuing Disclosure Cooperation initiative, or MCDC, which allowed issuers to report violations of disclosure events that they might have failed to report over the last five years. The SEC offered lenient settlement terms in exchange for the voluntary reporting, but not blanket amnesty.

To find any information that the SEC might consider a violation, issuers, their financial advisors and attorneys had to pore over records for the past five years, a time-consuming and costly process, said Norwood, SIFMA's managing director, associate general counsel and co-head of municipal securities.

"Was there any consideration of the cost to the industry searching the same deal over and over?" Norwood asked fellow panel member David Woodcock, regional director of the SEC. "We have an estimate of the costs and they are staggering."

Woodcock said the MCDC effort was one of several firsts for the SEC in 2014, which were designed to "encourage people to take seriously these continuing disclosures."

Woodcock said the SEC is currently examining the disclosures before deciding which ones to pursue, comparing it to "triage" in a hospital emergency room.

"Ultimately, what we're talking about are violations," Woodcock said.

Kit Addleman, a partner with the firm of Haynes and Boone, said that an issuer who stated that it had never failed to disclose any material events would effectively be opening more than five years of record to scrutiny.

"The settlements that were offered in MCDC were not all that different than those offered pre-MCDC," Addleman said. "There was a lot of incentive to participate or cooperate and the cost was enormous."

Norwood questioned how "voluntary" the MCDC disclosure was in the fall of 2014.

"Did you really think it was voluntary when the SEC said we're going to come down on you like a ton of bricks?" Norwood said.

Penelope Blackwell, deputy regional chief counsel for the south region of the Financial Industry Regulatory Authority, disagreed with the notion that pre- and post-MCDC enforcement measures were the same.

“The settlement you’ve seen in the past for non-reporting are not going to be the settlements you’ll see going forward,” Blackwell said.

Another issue that also needs more clarity, the experts said, is the municipal advisor rule that went into effect in 2014. The MA rule, which took effect July 1, puts into practice the Dodd-Frank Act’s requirement that firms providing advice to muni issuers have a fiduciary duty to put their clients’ interests first ahead of their own.

Since the MA rule’s requirement that municipal advisors register with the SEC and the MSRB, some advisors remain confused about what the registration entails, according to

Lawrence Sandor, deputy general counsel of the Municipal Securities Rulemaking Board. He said that since the rule went into effect, there have been 550 registrations with the SEC and 780 with the MSRB.

“Obviously, That’s going to have to be reconciled,” Sandor said.

In another panel discussion on the future of the muni market, Thomas Doe, president and founder of Municipal Market Analytics, said the trend of increasing regulation is in conflict with the need to bring more liquidity to the market.

The only way to invest in the muni bond market is to own bonds, Doe said. In equities, investors can bet against various companies or sectors by short-selling and using arbitrage, Doe said.

“It’s a long-only market,” Doe said. “There is not a hedge for muni debt.”

One way to think of the muni market in the current world is as a parallel to “crowd funding” that is popular with start-ups and new proposals.

“We really are the original version of crowd funding,” Doe said. “That’s certainly a positive way to think about raising money for infrastructure.”

THE BOND BUYER

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FEB 10, 2015

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