Bond Case Briefs

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Edward Jones to Pay $20 Million to Settle SEC Municipal Bond Charges.

The Securities and Exchange Commission, moving against abusive practices in the municipal-bond industry, penalized a major brokerage firm for overcharging customers.

Edward Jones will pay $20 million to settle charges that the St. Louis-based firm and Stina R. Wishman, the former head of its municipal underwriting desk, improperly sold new bonds to customers at prices higher than those negotiated with bonds' issuers, the SEC said. The agency said the firm's practice cost customers at least $4.6 million.

It is the SEC's first pricing-related case against an underwriter selling new municipal securities.

Edward Jones and Ms. Wishman settled without admitting or denying the SEC's findings. An Edward Jones spokesman said the firm will fully compensate the 13,000 current and former clients who were overcharged between 2009 and 2013. The firm said it cooperated fully with the SEC investigation and has taken steps to enhance its municipal-bond business.

A lawyer representing Ms. Wishman couldn't immediately be reached for comment.

Some analysts said the case opens a new front for the SEC's enforcement efforts in the sale of bonds backed by state and local government-related entities, showing a changing focus from problems related to disclosure to those related to pricing. SEC commissioners Luis Aguilar, Daniel Gallagher, Kara Stein and Michael Piwowar said in a statement the case illustrates the need for better rules on transparency in bond pricing.

"The Commission's recent enforcement action against [Edward Jones] involving the offer and sale of municipal bonds to retail investors highlights the need for clear rules requiring the disclosure of mark-ups and mark-downs," they wrote, urging the Financial Industry Regulatory Authority and the Municipal Securities Rulemaking Board to complete rules mandating increased price transparency. "If not, we believe the Commission should propose rules to address this important issue," they wrote.

Chairwoman Mary Jo White said in June 2014 that the SEC would work with Finra and the MSRB on rules for increased pricing transparency, saying the importance of such disclosure was greater in the current low interest-rate environment, where brokers' compensation can measurably impact investors' returns.

"This information should help customers assess the reasonableness of their dealer's compensation and should deter overcharging," she said.

Small investors make up around 70% of the $3.7 trillion municipal bond market, either individually or through mutual funds. But researchers have found that significant markups persist on municipal bonds sold to retail investors, long after similar practices in other markets have largely been swept aside by changing technology, competition and enforcement efforts.

Elaine Greenberg, partner in the securities litigation, investigations and enforcement practice at Orrick, Herrington & Sutcliffe LLP, said the case sends a message to municipal-market participants that the SEC is on the hunt for violations of securities law or MSRB regulations in both the primary and secondary markets.

"They're really looking at all aspects of the market, whether it's disclosure, market structure or pricing," she said. Ms. Greenberg previously served as head of the SEC's specialized unit on municipal securities and public pensions.

The SEC said that Edward Jones took new bonds into inventory, then wrongly sold them to customers at higher prices.

In some cases, the firm didn't offer the bonds to its customers until secondary trading began, then sold them at inflated prices. The SEC also charged the firm with failing to adequately supervise some secondary-market trades.

The settlement includes about $5.2 million in payments to current and former customers who were overcharged, the SEC said. Ms. Wishman agreed to pay $15,000 and will be barred from working in the securities industry for at least two years. Edward Jones now discloses the percentage and dollar amount of markups on all fixed-income trade confirmations to retail customers, the SEC said.

A marketwide study by Securities Litigation and Consulting Group found that investors paid $10.6 billion in markups across $2.5 trillion worth of municipal bond trades between 2005 and 2013, more than half of which were excessive. Fees have been dropping, yet remain above those charged in other, more transparent markets such as stocks, according to S&P Dow Jones Indices LLC, part of McGraw Hill Financial.

"It's a very visible and painful warning that will put a fire under other firms that aren't fully compliant with SEC rules," said Matt Fabian, partner at Concord, Mass.-based research firm Municipal Market Analytics. "It's important that customers have faith in the prices on municipal bonds offered for sale."

The SEC called the municipal-bond market "illiquid and opaque" in a 2012 report and called for greater protections for investors.

The report said transaction costs and markups are typically higher for individual investors than for institutions, unlike in U.S. equity markets, and some studies have shown that "the opacity of the market contributes to the relatively higher prices paid by retail investors."

The SEC's efforts since have included settlements with underwriting firms for making false statements or omissions in bond documents, brokerages for improperly selling junk-rated Puerto Rico bonds to individual investors, and states for failing to disclose the risk of unfunded pension obligations on the repayment of municipal bonds. The agency has even sought to ban local officials from the market for their involvement in alleged fraud.

Andrew Ceresney, director of the SEC's Enforcement Division, said Thursday's move demonstrates the SEC's commitment to maintaining the integrity of the market, which he called critical to financing U.S. infrastructure such as bridges and schools.

"It also further illustrates our continued focus on the municipal market and ensuring that participants in this market follow all legal requirements," he said.

THE WALL STREET JOURNAL

By AARON KURILOFF

Updated Aug. 13, 2015 8:43 p.m. ET

—Chelsey Dulaney
contributed to this article.

Write to Aaron Kuriloff at AARON.KURILOFF@wsj.com