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George K. Baum Overcharged School District, Regulator Says.

Municipal-bond underwriter George K. Baum & Co. agreed to pay a \$100,000 fine over allegations it charged a school district four times the typical fee to sell debt, in part to help cover the cost of bond elections, a regulator of securities dealers said.

The firm in 2011 charged an unnamed district \$416,173, or \$43 per \$1,000 of bonds issued, according to the Financial Industry Regulatory Authority, or Finra. The fee was “was inappropriate given the underwriting work it performed,” Finra said. Baum had told the school district a typical fee would be \$7 to \$9 per \$1,000 of bonds.

State and federal officials have raised questions about the high underwriting fees by dealers that provide services to help borrowers get voters to authorize bonds. California Attorney General Kamela Harris said last month that promising underwriters they will be hired to sell debt if the provide election services is illegal.

The Municipal Securities Rulemaking Board, which oversees the \$3.7 trillion tax-exempt bond market, bans most contributions from underwriters to elected officials who oversee awarding of bond work. In 2013 it began requiring dealers to disclose contributions or services donated to passing bond issues. At the time Lynnette Kelley, executive director, said the revelations would “shine light on potential connections between dealers’ financial contributions and the awarding of bond business.”

Underwriters Overcharging

A study by the Haas Institute for a Fair and Inclusive Study last year that U.S. state and local governments found that smaller school districts in California and various kinds of special districts nationwide are sometimes paying \$20 per \$1,000 or more in underwriting fees. The Haas Institute is a policy center at the University of California at Berkeley.

“We found many cases of overcharging by underwriters and other types of municipal bond service providers,” said Marc Joffe, the author of the study.

George K. Baum self-reported the violations under the U.S. Securities and Exchange Commission’s continuing disclosure initiative, which involves municipal securities underwriters voluntarily revealing violations of disclosure obligations in bond documents. Baum settled without admitting or denying the findings. Jonathan Baum, the firm’s chairman and chief executive, declined to comment.

Higher Fees

According to Finra, Baum, in justifying its fee, told district officials it had originally thought it would be selling a larger bond issue and that it had provided services to help the district pass bond elections. Finra said those factors had “no reasonable relationship to the actual underwriting by the firm.”

In addition to the fine, Finra said in its February disciplinary report that the firm would give up \$170,000 in fees and interest.

A study released in August by Todd Ely of the University of Colorado in Denver and Thad Calabrese of New York University reported that underwriters that contributed earned fees 12.75 percent higher, on average, than those that didn't, based on 118 contributions and 192 issues between 2007 and 2012. The report also found potentially more expensive debt structures for bonds underwritten by the firms that made contributions.

"It's one thing to worry about the appearance of impropriety," said Ely. "It's another thing when when you have to pay more because there is a higher cost to pay the firm that helped with the election."

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by Darrell Preston

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