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Regulators Tone Deaf, Stephens Says.

PHOENIX – Overzealous regulators are a big problem for middle-market broker-dealers, according to Warren Stephens, chief executive officer of Stephens, Inc. and a founding member of the Bond Dealers of America.

Stephens, who since 1986 has headed the Little Rock, Ark.-based firm that his family founded during the Great Depression, described the challenges of the industry in a wide-ranging interview with The Bond Buyer.

Chief among his concerns are the significant new rules and enforcement initiatives from federal regulators in recent years, which Stephens said have demonstrated a lack of understanding of the municipal bond business landscape.

"The challenges are numerous," Stephens said, honing in on the Municipalities Continuing Disclosure Cooperation initiative, which the Securities and Exchange Commission launched in March 2014. The MCDC program allowed underwriters and issuers to receive lenient settlement terms if they self-reported any instances during the previous five years in which issuers falsely claimed in official statements that they were in compliance with their self-imposed continuing disclosure agreements.

As of Feb. 2, the SEC had completed its underwriter settlements, having ordered a total of 72 firms representing 96% of the market share for muni underwriting to pay a total of $18 million for selling municipal bonds using offering documents that falsely stated issuers had filed timely disclosure in compliance with their continuing disclosure obligations.

A key priority for the Bond Dealers of America, which represents middle-market firms like Stephens, has been to point out what it feels is the disproportionate impact of regulation and enforcement on firms much smaller than the major Wall Street fixtures.

Stephens, who said nobody lost any money as a result of the instances his firm self-reported, strongly agrees.

But Stephens also has a more general sense that regulators' efforts have been misguided. "The whole MCDC thing is just a perfect example of that," Stephens said. His firm was fined $400,000, Stephens said, a mere $100,000 less than the maximum $500,000 fine levied against some of the largest investment banks in the world.

The SEC's municipal advisor rule, for example, imposes a fiduciary duty on anyone who gives bond-related advice to a state or local issuer. It also prevents anyone who has given such advice from underwriting a resulting bond issuance.

Many municipal advisors do not have to worry about this because they are non-dealer advisors who do not have an underwriting business, and some issuers have expressed a preference for non-dealer advisors in the wake of the MA rule's adoption. But Stephens said the presence of such advisors is

generally not any help to the deal team.

“I don’t think they add any value,” he said, because an advisor who doesn’t have any experience going out in the market with securities is less likely to understand how best to serve the issuer client.

Stephens further added that he doesn’t put much stock in the idea that issuers need a third party muni advisor at all.

“We consider ourselves an advisor to all our clients,” he said.

He said much recent regulation of the municipal securities arena is pointless.

“It’s hurting the efficiency of the market,” he said. “We’re complying with rules that don’t really matter. It’s not useful. We’re just pushing paper around.”

Stephens said that regulators were generally more receptive to industry input in the past. While the Municipal Securities Rulemaking Board and the SEC have frequently invited market participants to comment or reach out to them as needed, Stephens is not alone in feeling that his concerns have been ignored.

Issuer officials such as Florida’s bond finance director, Ben Watkins, have leveled similar charges.

Stephens is less concerned by the market landscape in the wake of the Detroit bankruptcy and the ongoing Puerto Rico crisis.

The treatment of bondholders in Detroit and elsewhere where investors were forced to take steep haircuts on their securities have caused some bond lawyers and analysts to question basic market assumptions about the security of the general obligation pledge and the willingness of municipalities to use bankruptcy to restructure their debts. Stephens said he is concerned that courts would side with other creditors over bondholders, but said he doesn’t sense any seismic shift in the landscape.

“From our firm’s perspective, nothing has changed in the marketplace,” he said. “I think we’ve always placed a high premium on financially sound issuers. A credit is only as good as the financial’s behind it.”

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