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Muni Bond Dangers You Should Look Out For.

Muni bond defaults are rare.

To the tune of less than one-tenth of one percent.

But you're probably careful when you walk under scaffolding even though the risk of a construction worker falling on top of your head is slight too.

There are a number of things you and the Securities and Exchange Commission and muni bond issuers can do to protect yourself against the possibility of losing significant amounts of money on the municipal bonds you buy and hold.

The safeguards you can take, and dangers surfaced at an SEC roundtable on muni bond disclosures Thursday.

Municipal bond prospectuses can be too lengthy, ponderous and yes, boring, to read in full.

Like with any lengthy financial document, such as an SEC filing, there are nuggets you can find quickly by doing key word searches.

SEC Commissioner Robert Jackson suggested looking up "repayment," which will tell you where the city, state or other local government is getting to repay the money you are lending it through a muni bond purchase and "unfunded liabilities,"—other demands on the governmental unit on the pot of money it is using to pay bondholders.

The biggest danger a retail investor who owns munis can avoid is to sell them immediately when bad news comes out because things inevitably get better, advised Jim Spiotto, managing partner of Chapman Strategic Partners.

One of the reasons problems with a muni bond issuer quickly improve, said Spiotto, is just as doctors bury their mistakes, finance officers finance theirs.

Spiotto's firm is an outgrowth of Chapman and Cutler one of the top law firms in the municipal bond arena for over half of a century.

Speaking to the potential for a wave of new muni bonds hitting the market if Congress passes a major infrastructure bill, Spiotto acknowledged when anyone (including local governments) does anything fast, it is important short cuts aren't taken.

"When muni bond issuers make multiple issues in a short period of time, they will have to make sure tax revenues to support the bonds are sustainable and affordable," the consultant said.

At the same time, Spiotto said infrastructure improvements could ease the financial stress on muni bond issuers because they stimulate local economies.

The expert said if a muni bond issuer tells one investor about changes in their financial condition to tell all.

“Disclosure allows all to understand the situation including those who would constructively help if they knew the accurate situation,” said Spiotto.

He added issuers who expand disclosures can be better market credibility and better credit ratings.

When it comes to developments have put an issuer under financial distress, Spiotto said investor panic can be reduced or eliminated by full and prompt disclosure of the evolving situation.

Retail investors need better and faster information from muni bond government creators to help make better buy and hold decisions, SEC Chair Jay Clayton told the gathering.

“Without it, it is challenging to evaluate the condition of issuers,” said Clayton.

He complained some issuers don’t release their financial statements until significantly after the end of their fiscal years.

He noted mom and pop investors hold about $2.66 trillion in muni bonds directly or indirectly, two-thirds of the entire value of the market.

With the heavy reliance of retail investors on muni bonds and of society as a whole since they account for two-thirds of the infrastructure in the country, Clayton said there should be a close regulatory focus on the municipal bond market.

He said the SEC and the Municipal Securities Rulemaking Board are studying ideas to improve the speed and completeness of muni bond disclosures.

Timeliness needs to be improved, asserted SEC Investor Advocate Rick Fleming.

“Financials are stale by the time they are disclosed, that has been an investor issue for a long time,” said Fleming.

Democratic SEC Commissioner Kara Stein added her voice to the calls for better information for muni bond issuers to investors: “More work needs to be done on disclosures.”

She added there are no shortage of issues that need to be looked at for their potential impact on muni bonds including public pension shortages and interest rate changes.

Republican Hester Peirce said she is all in favor of clear English in muni bond disclosures because while retail investors might not read them, third parties that distill the highlights and feed them to individual investors do.

She explained the disclosures can be important in muni bond pricing.

In terms of what information the SEC should mandate from the issuers, Peirce said: “I don’t want to give people a sense there is a lower bar for materiality than there is.”

Fidelity Research Analyst Amy Johonnett protested disclosure is inconsistent everywhere in municipal securities.

With the calls for more disclosures, there are worries they could further strain the budgets of already financially strapped local governments, said SEC Office of Municipal Securities Attorney-

Advisor Adam Windell.

During the session, S&P Global Ratings Managing Director Robin Prunty called the 2019 economic forecast for state and local governments “troubling.”

“There will be a much more strained budget climate,” she said.

She added, though, economists are not predicting a recession and many state and local governments are in good financial shape.

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by Ted Knutson

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Ted Knutson is one of the most experienced financial regulatory reporters in Washington. For years, he has covered the SEC, CFTC, the bank regulators and the key Congressional committees.