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Bloomington Firm Faces SEC Penalties Over Municipal Debt Practices.

A Bloomington investment banking firm and its owner will pay $200,000 in fines for not telling its municipal bond clients about business practices that ultimately reduced the proceeds from their offerings.

The Securities and Exchange Commission on Wednesday announced settled charges against First Midstate Inc., based in downtown Bloomington, and its owner Paul Brown.

The SEC says First Midstate falsely told clients that it had an extensive customer list that would allow it to sell bonds to investors at competitive interest rates. In reality, First Midstate had a limited customer base, and it sold many of the offerings it underwrote to other broker-dealers, not to investors, the SEC said. The purchasing broker-dealer then marked up the bonds and resold them to investors at higher prices—and corresponding lower yields, according to the SEC.

The SEC points to 101 offerings, totaling $198 million, that were sold off to a single broker-dealer between 2014 and 2018. Had First Midstate sold those bonds directly to investors at those more competitive prices, about $1.4 million could have flowed back to issuers as an increase in bond proceeds, the SEC said. Instead, that $1.4 million became profit for the broker-dealers.

In one example from the SEC order, the commission said Brown and Midstate facilitated a $9.47 million bond issue with a First Midstate fee of $283,153 (2.99% of the PAR value of the issue). Brown then resold the bonds to a broker within 22 minutes. That dealer made another $66,638 in fees after marking up the interest on the bonds and selling them. The SEC said the bond issuer did not know the second fee was likely given First Midstate's business practices.

First Midstate did not disclose to customers that its practice was to sell many of the bonds it underwrote to broker-dealers during the public offering, if it did not receive orders from investors, the SEC said. The firm did not disclose that this practice presented a risk to competitive pricing for their bond.

The SEC also noted that since all but one of Brown and Midstate's clients in the investigation were too small to have a separate bond advisor, the firm had an additional obligation to educate the municipalities on the complete terms of transactions.

In the settled charges announced Wednesday, First Midstate and Brown do not admit or deny the SEC's findings. But they have agreed to the order finding that they willfully violated the fair dealing and advertising provisions of federal securities law. In addition to the $200,000 in civil penalties, First Midstate is also required to hire an independent compliance consultant.

The SEC announcement and order do not identify the impacted clients; First Midstate's municipal clients are primarily Illinois school districts, SEC records show. Municipalities often raise capital by issuing bonds, or debt, that are indirectly sold to the public through an underwriter.

A message left with First Midstate was not immediately returned Wednesday.

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By RYAN DENHAM | DEC 23, 2020