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Muni Disclosure: Time to Bring In SEC?

After decades of what investors see as inadequate disclosure from cities, towns and states, it's time to consider a fundamental change in the \$4 trillion municipal bond market: direct federal oversight.

That's the argument from a pair of market veterans who admit it's a provocative position for a market that is famously distinctive in its power of self-regulation.

Issuers and their bond counsel, unsurprisingly, are dead set against the proposal.

In a pair of articles posted on University of Chicago Booth School of Business academic journal Promarket, public finance attorney David Dubrow, a partner at ArentFox Schiff, and former director of the Office of State and Local Finance at the U.S. Treasury Kent Hiteshew lay out their case for why it's time for the Securities and Exchange Commission to step in and directly oversee issuer disclosure or, at the least, expand its anti-fraud powers over underwriters to include specific disclosure requirements.

The first piece, published Oct. 22, is titled "[Decades of Regulatory Exemptions Have Been to the Detriment of the Municipal Bond Market](#)," and outlines the history of issuer exemption and the later adoption of indirect regulation through underwriters.

The second piece, published Oct. 23, is titled "[The Case for Modernizing Municipal Bond Disclosure Transparency](#)," and outlines an argument for increased oversight, either through Congress or the SEC, and offers guidelines to enhance consistency and transparency and bring muni disclosure "into the modern era."

"We understand some of the things we said will be controversial," Hiteshew said. "But we have, in the span of several years, the largest defaults ever in Detroit, Jefferson County [Alabama] and Puerto Rico, and we've had no discussion of whether improved disclosure may be appropriate," he said. "We thought it would be a good time to have that conversation."

They sent the articles to the SEC and Municipal Securities Rulemaking Board.

The debate over disclosure by government entities issuing municipal bonds stretches back decades. While the muni market has been partially exempt from Securities and Exchange Commission oversight since the commission's creation in 1933, there have been tweaks along the way to increase oversight.

Most of the changes came in the wake of high-profile troubled municipal events, Dubrow and Hiteshew noted in their article.

It was New York City's near default in 1974 that created the Municipal Securities Rulemaking Board as a self-regulatory body. The Washington Public Power Supply System's bankruptcy and default on \$2.2 billion of bonds in 1983 prompted the SEC to use its anti-fraud powers for indirect regulation through the creation of Rule 15c2-12 requiring underwriters to impose disclosure requirements, which was amended in 1994 to include continuing disclosure.

In addition to the defaults, "the municipal market has changed a lot," Dubrow said. One-third of the market now consists of private activity bonds issued for borrowers who often act more like private entities than traditional muni issuers, said Dubrow, who works on restructurings, workouts and bankruptcies.

"That's a big deal in the sense that the disclosure and requirements in the municipal market are different than when these private entities go to market in the corporate market, and so there's certain advantages to using the muni market, but the disclosure requirements really shouldn't be different," he said.

Increasing oversight could either come through Congress repealing the Tower Act, which restricts direct SEC and MSRB authority, so the two bodies could directly regulate issuer offering statements, or by expanding the SEC and MSRB anti-fraud regulatory authority over broker-dealers to include specified disclosure requirements within Rule 15c2-12.

Dubrow and Hiteshew prefer the statutory route. "That's very straightforward and they'd be passing a law that would require issuers to do these things," Dubrow said.

Congress could direct the SEC to differentiate between different issuers, they proposed. "For example, conduit borrowers should be treated more akin to the corporate-like issuers they truly represent and subjected to more rigorous standards consistent with their much higher default experience. In addition, small, infrequent governmental issuers might be afforded more abbreviated standards than larger, regular governmental issuers."

The pair outline eight guidelines for enhancing transparency in offering documents, including readability, robust risk sections, and timely audits.

From the perspective of the local governments and states who issue bonds, and the bond counsel who represent them, direct regulation is an unnecessary overreach of federal power.

Repeal of the Tower Amendment "is a nonstarter for us," said Jason Akers at Foley & Judell, LLP, president of the National Association of Bond Lawyers, in an email.

"We recognize the need for disclosure practices to evolve with changes in the market, but we don't need to burn the existing system to the ground to foster greater transparency," Akers said. "It would be more productive to have inclusive industry discussions about if and how we move toward some of these guidelines, rather than asking Congress or regulators to force it upon such a sizeable and diverse market," he said. "Market practices are constantly evolving and improving, and industry efforts within the existing regulatory paradigm have led to some of the most positive developments in municipal disclosure over the years."

Issuers themselves are well aware of the importance and market benefits of solid disclosure and work hard at meeting best practices, said Emily Brock, federal liaison for the Government Finance Officers Association.

The GFOA's best practices ranges "from primary through continuing and to voluntary disclosure practices and are practiced by issuers throughout the United States," Brock said. "The articles fail to acknowledge the voluntary work issuers have already done and will continue to do to move the needle forward on municipal disclosure."

As someone who has been tracking the disclosure debate since the 1980s, Rich Ciccarone, president emeritus of Merritt Research Services, said while some disclosure areas, like accessibility and comparability, have improved, others, like timeliness, remain a big problem. States like Illinois and

California have still not filed their 2023 audits, he noted.

“That creates a serious vulnerability in the integrity of the municipal bond market,” said Ciccarone, who penned an article for the Wall Street Journal in 1987 titled “Municipal bondholders need more information.”

“The history of self-regulatory improvements have met a lot of our expectations and created a very substantial framework to complete the job,” he said. “But I would say right now that I think a measured response from the regulatory arena is in order.”

By Caitlin Devitt

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