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SEC Moves Forward on Municipal Finance Abuses

By finalizing its definition of 'municipal advisor,' the SEC has taken an important step forward in implementing a crucial yet often overlooked element of the Dodd-Frank Act. Abuses in the municipal finance market cost taxpayers and investors tens of billions of dollars every year. Egregious Wall Street practices involving the sale of derivatives to public entities played an important contributing role in the three largest municipal bankruptcy filings ever – by Orange County, California; Jefferson County, Alabama; and, most recently, the city of Detroit.

The Dodd Frank act addresses these abuses by giving those who provide financial advice to public entities a fiduciary duty to put the interests of taxpayers first. For too many years, dealers and advisors in the municipal market have felt free to give self-serving advice designed to generate more profits for them at the expense of their clients. Properly implemented, this requirement should curtail the abuse and provide enormous benefits for taxpayers and investors.

The rule the SEC passed today defines which entities will be considered 'municipal advisors' and held to this fiduciary duty. A full assessment of the quality of the final rule must wait for the availability of the complete text, particularly the sections concerning coverage of underwriters and swap dealers. However, we are glad this long-overdue rule has been finalized. Its completion paves the way for the Municipal Securities Rulemaking Board to proceed with the next stage of implementing new municipal protections – defining the scope of the fiduciary duty and the penalties for violation.