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Finra Says It's Examining Trading in New Puerto Rico Bonds.

The Financial Industry Regulatory Authority said it's examining trading in the \$3.5 billion of general-obligations that Puerto Rico sold this month.

The self-governing U.S. territory sold the debt March 11, in the biggest-ever high-yield offering for the \$3.7 trillion municipal market. The issue gave the island, which was cut to junk last month, enough cash to pay bills through June 2015, as officials try to revive a shrinking economy. Hedge funds made up the majority of buyers in the tax-exempt deal, according to David Chafey, chairman of the island's Government Development Bank. The securities mature in July 2035 and priced to yield about 8.73 percent. Sale documents stipulate that "the bonds shall be issued in the minimum denomination of \$100,000 and any integral multiple of \$5,000 in excess thereof," unless one of the three largest rating companies raise Puerto Rico to investment grade. The bonds were free to trade March 11. Since then, they changed hands in at least 75 transactions less than \$100,000, data compiled by Bloomberg show. The bonds' highest price, 100 cents on the dollar, was for a \$25,000 trade at 10:47 a.m. in New York on March 12.

Activity Examined

Asked about whether Finra was looking into the smaller trades, spokesman George Smaragdis said in an e-mail that the independent monitor of the securities business was "aware of the situation and is examining trading activity" in the bonds.

Trades below the minimum amount for investors that don't already own at least \$100,000 of the debt violate the Municipal Securities Rulemaking Board's Rule G-15 subsection F, said Martha Haines, who led the Securities and Exchange Commission's Municipal Securities office from 2001 to 2011.

"These are intended for institutional purchasers, or at least for people that can afford the risk by making it a minimum denomination of \$100,000," said Haines, who teaches municipal finance at the Maurer School of Law at Indiana University in Bloomington. The rule Haines referenced states that brokers and dealers can't execute a trade of a municipal security that's below the minimum denomination of the issue, according to the MSRB's website.

Minimum Denomination

The Securities Industry and Financial Market Association, a New York-based trade group that represents banks and investors, released a notice today warning firms about trading the Puerto Rico bonds in sizes below \$100,000. "We urge firms to take care in cases where customers may request to split trades among accounts in ways that would result in trade sizes smaller than the minimum denomination," according to the notice. The bonds declined today. Their average yield was about 8.73 percent, the highest since they were free to trade. The price touched 92 cents, the cheapest yet.

The finances of the Caribbean commonwealth of 3.6 million people influence the entire municipal market because 70 percent of U.S. mutual funds that focus on local debt hold the securities, according to Morningstar Inc. The island's bonds, like territories such as Guam, are tax-exempt

nationwide.

Barbara Morgan, David Millar and Betsy Nazario, spokesmen for the Government Development Bank, which handles the island's debt sales, didn't immediately respond to an e-mail seeking comment. The Bond Buyer reported March 19 that smaller-denomination sales were being made in violation of the requirement. By Michelle Kaske March 21, 2014

To contact the reporter on this story: Michelle Kaske in New York at mkaske@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net
Mark Tannenbaum, Alan Goldstein

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