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WSJ: Finra Examining Trading in Puerto Rico Bonds.

Move Comes Just a Week After the Island Territory's $3.5 Billion Bond Sale.

The Financial Industry Regulatory Authority is examining trading in Puerto Rico's newly sold $3.5 billion bond issue, according to a spokesman for the Wall-Street-funded self-regulatory group that oversees broker-dealers.

The move comes amid concerns that the new bonds—which carry junk ratings—are being improperly sold to individual investors. The bonds' prospectus says the debt will be issued in minimum denominations of $100,000, unless Puerto Rico's credit rating is upgraded, but some recent activity shows the bonds trading in amounts as low as $5,000. Smaller trade sizes are more typical of individual investors.

Finra's inquiry also comes on the heels of similar scrutiny from the Securities and Exchange Commission over how broker-dealers allocate newly sold corporate bonds to investors. The SEC recently asked some banks for information on how they divvy up the new debt among buyers and how they traded those bonds after the sale.

"It's not shocking that there's a concerted focus on bonds and bond-related issues," said George Friedman, a former senior officer at Finra who left the organization last year. Thought of by investors as being safe and secure, municipal bonds are "going to get Finra's attention" given that Detroit filed for bankruptcy last year and the recent financial troubles in Puerto Rico.

Mr. Friedman said Finra could levy fines if broker-dealers were found to violate securities regulations. A rule from the Municipal Securities Rulemaking Board states that dealers "shall not effect a customer transaction" that is "lower than the minimum denomination of the issue," with certain exceptions.

The smaller Puerto Rico trades were reported earlier this week by The Bond Buyer.

Puerto Rico sold the debt last week to help prop up its budget, giving officials more time to jump-start the economy and deal with persistent budget deficits. Island officials had been laying groundwork for the sale for months, which was made more challenging after Puerto Rico's outstanding debt tumbled amid investor worries about the island's financial health.

Puerto Rico's bonds have traded lower this week after a frenzy of trading pushed the prices as much as 7.5% higher the day after the sale. The bonds on Friday traded at 92.5 cents on the dollar, below the offering price of 93 cents, according to the Municipal Securities Rulemaking Board's EMMA website.

Investors and lawyers said the typical minimum denomination for a municipal bond is $5,000, though it is not surprising that Puerto Rico, with its financial troubles, had a $100,000 minimum.

Since the minimum denomination was in the prospectus, “I don’t think bonds smaller than that should trade in the secondary market,” said Kathy Bramlage, a director at Treasury Partners, a unit of financial-advisory firm HighTower Advisors. “It does make you wonder” how the trades were completed, she said.

Making the trade size contingent on ratings is unusual, and suggests the writer of the documents intentionally meant to prevent trades to small investors, said Kenneth Potts, a portfolio manager at Samson Capital Advisors.

“It strikes me as a potential liability for dealers that traded it” in the smaller sizes, he said. “I think that an individual would have a strong case if they wanted that trade broken.”

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