

MEMO# 23603

July 1, 2009

FINRA Undertakes Initiatives Related to Municipal Securities Markets

[23603]

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TO: MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 25-09 RE: FINRA UNDERTAKES
INITIATIVES RELATED TO MUNICIPAL SECURITIES MARKETS

On June 30, the Financial Industry Regulatory Authority (FINRA) announced that it has undertaken several measures related to the municipal securities markets, including conducting sweep examinations, issuing a Regulatory Notice to members, and issuing an Investor Alert in conjunction with the Municipal Securities Rulemaking Board (MSRB). [\[1\]](#) FINRA's stated goal in pursuing these initiatives is to conduct a "comprehensive initiative to survey retail sales practices in the municipal securities market, promote investor protection in that market and give retail investors online tools and information that will help them make informed investment decisions when trading in that market."

Sweep Examinations

FINRA announced three sweep investigations, designed to review: retail municipal securities transactions, [\[2\]](#) municipal underwritings and municipal derivative instruments, [\[3\]](#) and retail sale of "gas bonds." [\[4\]](#) The first sweep, covering the period from January 1, 2009 through March 31, 2009, will examine industry sales and supervisory practices generally with respect to sales of municipal bonds to retail investors. [\[5\]](#) The requested information includes sales data, marketing data, pricing data and procedures, disclosure practices, customer complaints, and supervisory procedures and practices.

The second sweep, covering the period from July 1, 2006 through March 30, 2009, will examine potential conflicts, disclosure practices, and marketing by firms underwriting municipal securities involving swaps and derivatives for small municipalities. [6] The requested information includes identifying data regarding all municipal underwritings in which a participating firm also used one or more municipal derivative instruments associated with the underwriting, selection practices, use of recommendations, role of compensation, and due diligence practices. The third sweep, covering the period from January 1, 2008 through December 31, 2008, will narrowly target firms that engaged in retail sales of municipal “gas bonds” that were underwritten and guaranteed by the now-defunct Lehman Brothers and quickly became distressed. The requested information will include pricing processes, marketing materials, customer complaints, and supervisory procedures and practices.

Regulatory Notice

FINRA issued a Regulatory Notice to members engaged in municipal securities business reminding them of their regulatory and compliance obligations for municipal securities activities generally and in light of recent changes to the MSRB’s Electronic Municipal Market Access system (EmMA). [7] These changes include filing continuing disclosures with EmMA, which will become the sole entity designated by the SEC as a nationally recognized municipal securities information repository, annually filing information for certain issuers using the small issuer exemption, and complying with the “access equals delivery” standard for dissemination of official statements. In the Regulatory Notice, FINRA specifically encouraged firms to review and reassess the overall adequacy and effectiveness of their current policies and procedures, including those relating to the disclosure of material information, the suitability of recommendations to retail customers, and the general supervision of their municipal securities activities.

Joint Investor Alert

FINRA and the MSRB jointly issued an Investor Alert that seeks to provide investors with information about municipal bonds by highlighting basic information about the bonds, reviewing common risk factors, and providing a discussion of investment strategies. [8] In light of current market conditions, in the Investor Alert, FINRA and the MSRB explain that municipal defaults, while rare, do occur; information about financial problems affecting a municipal issuer has not always been readily available to investors; ratings with insurance may not reflect the financial condition of the municipal issuer; and, a bond’s market value may change for reasons having nothing to do with the financial condition of the municipal issuer, such as a change in interest rates. FINRA and the MSRB also issued a separate online “Muni Bond Checklist,” to provide a guide to “help investors avoid the most common pitfalls of muni[cipal] bond investing.” [9]

endnotes

[1] See FINRA News Release, FINRA Takes Sweeping Action to Protect Muni Bond Investors, June 30, 2009, available at: <http://www.finra.org/Newsroom/NewsReleases/2009/P119064>.

[2] See FINRA Targeted Examination Request, Re: Retail Municipal Securities Transactions, June 2009, available at: <http://www.finra.org/Industry/Regulation/Guidance/TargetedExaminationLetters/P118892>.

[3] See FINRA Targeted Examination Request, Re: Municipal Underwritings and Municipal Derivative Instruments, May 2009, available at: <http://www.finra.org/Industry/Regulation/Guidance/TargetedExaminationLetters/P119050>.

[4] See FINRA Targeted Examination Request, Re: Retail Sale of "Gas Bonds," June 2009, available at: <http://www.finra.org/Industry/Regulation/Guidance/TargetedExaminationLetters/P119051>.

[5] For purposes of the sweep, FINRA will define "retail municipal transaction" as a transaction of less than 100 municipal bonds (i.e., less than \$100,000 in par value) effected with a customer, including institutional customers.

[6] For purposes of the sweep, FINRA will define "municipal derivative instruments" as including, but not limited to, interest rate swaps, interest rate caps, floors and collars, options on swaps, basis swaps, forward delivery contracts, structured notes, and total return swaps.

[7] See FINRA Regulatory Notice 09-35, Municipal Securities – FINRA Recommends Review of Municipal Securities Activities, June 2009, available at: <http://www.finra.org/Industry/Regulation/Notices/2009/P119053>.

[8] See FINRA Investor Alert, Municipal Bonds – Staying on the Safe Side of the Street in Rough Times, June 30, 2009, available at: <http://www.finra.org/Investors/ProtectYourself/InvestorAlerts/FraudsAndScams/P118923>.

[9] See FINRA Investor Alert, Muni Bond Checklist, available at:
<http://www.finra.org/Investors/ProtectYourself/InvestorAlerts/Bonds/P118925>.

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