

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-76639; File No. SR-FINRA-2015-033)

DECEMBER 14, 2015

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change to Amend FINRA Rule 0150 to Apply FINRA Rule 2121 and its Supplementary Material .01 and .02 to Transactions in Exempted Securities That Are Government Securities

I. Introduction

On September 17, 2015, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “Exchange Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to FINRA Rule 0150, Application of Rules to Exempted Securities Except Municipal Securities, so that FINRA Rule 2121 and its Supplementary Material .01 and .02, which govern mark-ups and commissions, will apply to transactions in exempted securities that are government securities. The proposed amendment was published for comment in the Federal Register on October 6, 2015.³ On November 19, 2015, FINRA granted the Commission an extension of time, until January 4, 2016 to act on the proposal.⁴ No comments were received in response to the proposal. This order approves the rule change as proposed.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Notice of Filing of a Proposed Rule Change to Amend FINRA Rule 0150 to Apply FINRA Rule 2121 and its Supplementary Material .01 and .02 to Transactions in Exempted Securities That Are Government Securities; Exchange Act Release No. 76059 (September 30, 2015), 80 FR 60416 (October 6, 2015) (“Notice”).

⁴ See Letter from Andrew Madar, Associate General Counsel, FINRA Regulatory Policy and Oversight, to Katherine England, Assistant Director, Division of Trading and Markets, Securities and Exchange Commission, dated November 19, 2015.

II. Description of the Proposed Rule Change

A. Background

As stated in the Notice, FINRA is proposing to amend FINRA Rule 0150, which governs the application of FINRA rules and the rules of the National Association of Securities Dealers (“NASD”)⁵ that apply to transactions in, and business activities relating to, exempted securities, except municipal securities, conducted by members and associated persons.⁶ Current FINRA Rule 0150(c) specifically enumerates these provisions and does not include reference to FINRA Rule 2121, Supplementary Material .01, and Supplementary Material .02, which govern mark-ups and commissions (“mark-up rule”).⁷ The proposed amendment would incorporate the mark-up rule into FINRA Rule 0150 and extend its application to transactions in, and business activities relating to, exempted securities that are government securities, as defined in Section 3(a)(42) of the Exchange Act.⁸

In the Notice, FINRA described the historical reasons for not applying certain NASD rules, including the mark-up rule, to exempted securities (except municipal securities). Prior to 1993, there were statutory limitations on the NASD’s ability to apply sales practice rules,

⁵ The current FINRA rulebook consists of: (1) FINRA Rules; (2) NASD Rules; and (3) rules incorporated from NYSE (“Incorporated NYSE Rules”) (together, the NASD Rules and Incorporated NYSE Rules are referred to as the “Transitional Rulebook”). While the NASD Rules generally apply to all FINRA members, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE (“Dual Members”). The FINRA Rules apply to all FINRA members, unless such rules have a more limited application by their terms. For more information about the rulebook consolidation process, see FINRA Information Notice, March 12, 2008 (Rulebook Consolidation Process), available at <https://www.finra.org/sites/default/files/NoticeDocument/p038121.pdf>.

⁶ The terms exempted securities, municipal securities, and government securities as used in this order are defined in Sections 3(a)(12), 3(a)(29), and 3(a)(42) of the Act, respectively.

⁷ NASD Rule 2440, IM–2440–1, and IM–2440–2 were recently moved to the FINRA rules without any substantive changes, becoming FINRA Rule 2121, Supplementary Material .01, and Supplementary Material .02, respectively. See Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Adopt FINRA Rule 2121 (Fair Prices and Commissions), Supplementary Material .01 (Mark-Up Policy) and Supplementary Material .02 (Additional Mark-Up Policy For Transactions in Debt Securities, Except Municipal Securities) in the Consolidated FINRA Rulebook; Exchange Act Release No. 72208 (May 21, 2014), 79 FR 30675 (May 28, 2014).

⁸ This includes U.S. Treasury securities, as defined in FINRA Rule 6710(p). See Notice at 60417, note 12.

including the mark-up rules, to transactions in exempted securities. The Government Securities Act Amendments of 1993 (“GSAA”)⁹ eliminated the limitations on the authority of registered securities associations over transactions by a registered broker or dealer in an exempted security.¹⁰ Following the GSAA, NASD proposed to apply certain NASD rules to exempted securities other than to municipal securities but did not propose to apply the mark-up rule then in effect to such securities.¹¹ FINRA stated in the Notice that the NASD believed at the time that actions for conduct generally encompassed by the NASD mark-up rule in the government securities market could be brought under NASD Rule 2110 (Standards of Commercial Honor and Principles of Trade).¹²

B. Purpose

FINRA believes that the proposal to extend FINRA Rule 0150 to apply the mark-up rule to transactions in government securities is consistent with both the GSAA and with the prior application by NASD of certain of its rules, following the GSAA, to exempted securities other than municipal securities.¹³

FINRA also believes that there would be regulatory benefits from amending FINRA Rule 0150 to apply the mark-up rule to transactions in government securities. In the Notice, FINRA notes that it must use the general provisions of FINRA Rule 2010 if FINRA staff wants to bring

⁹ Government Securities Act Amendments of 1993, Pub. L. No. 103-202, § 106(b)(1), 107 Stat. 2344 (1993).

¹⁰ Specifically Section 15A(f) of the Act imposed limitations on the authority of registered securities associations over transactions by a registered broker or dealer in an exempted security. This provision was eliminated as part of the GSAA. For more information on the background of Section 15A(f), see Notice at 60417, note 5.

¹¹ NASD Rule 2440 and IM-2440-1. See Notice at 60417. The NASD stated at the time that it intended to review the specific application of these rules to the government securities market and that it was developing an interpretation of the mark-up rule with respect to exempted securities and other debt securities.

¹² See Notice at 60417, note 9. FINRA also described in the Notice how NASD adopted NASD Rule 0116 (now FINRA Rule 0150) in 2001, setting forth the NASD rules that would apply to transactions in exempted securities, except municipal securities and how the SEC approved IM-2440-2, which set forth a mark-up policy for transactions in debt securities, except municipal securities. See id., notes 10-11.

¹³ See id. at 60417.

a case alleging excessive mark-ups, mark-downs, or commissions in transactions in exempted securities other than municipal securities, such as agency debt securities or U.S. Treasury securities.¹⁴ FINRA believes that the proposed amendment would provide it an additional “specific cause of action under which conduct involving government securities could be regulated” and “would clearly signal to members that conduct relating to mark-ups and commissions in the market for government securities directly implicates the mark-up rule.”¹⁵ FINRA also noted that the mark-up rule provides “specific criteria by which members should assess debt mark-ups and mark-downs.” FINRA believes that amending Rule 0150 to apply these standards to transactions in government securities would provide both members and its staff with “clearer standards by which to measure the propriety of mark-ups, mark-downs, and commissions” in transactions involving government securities.¹⁶

FINRA also believes that the proposed amendment would only have a minimal impact on its members because FINRA Rule 2010 already applies to these transactions.¹⁷ In addition, FINRA noted in the Notice that while the proposal would extend the more specific requirements of the mark-up rule to transactions in government securities, the provisions are already applicable to corporate debt securities.¹⁸ Therefore, FINRA members that currently engage in transactions in corporate debt will be familiar with its application.¹⁹

¹⁴ See id. at 60418.

¹⁵ Id.

¹⁶ Id.

¹⁷ Id.

¹⁸ Id.

¹⁹ Id. FINRA also noted that it believes most firms apply substantially similar standards to all transactions in fixed income securities. Furthermore, FINRA does not believe that the proposed amendments would impact the reporting or surveillance of transactions in government securities because it already requires its members to report transactions in many government securities (i.e., agency debentures and agency asset backed securities) to its Trade Reporting and Compliance Engine (“TRACE”) and it actively surveils the markets in such securities. FINRA also noted that for government securities that are not TRACE-eligible,

III. Discussion and Commission Findings

After carefully considering the proposed rule, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.²⁰ In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Act, which requires, among other things, that FINRA's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.²¹ The Commission notes that no comments were received in response to the proposal.²²

As discussed above, the proposed rule change would expand the applicability of the mark-up rule to exempted securities that are government securities. The Commission notes that government securities can be subject to excessive mark-ups and agrees that making more explicit FINRA's authority over excessive and improper mark-ups, mark-downs, or commissions relating to government securities will benefit investors in government securities. While the Commission acknowledges that FINRA Rule 2010 already applies to transactions in government securities and instances of improper or excessive mark-ups, mark-downs, and commissions, the Commission believes that expanding FINRA Rule 0150 to include the mark-up rule will give FINRA an important enforcement tool with which to pursue instances of excessive mark-ups, mark-downs, and commissions. The Commission also agrees with FINRA's belief that applying

such as U.S. Treasury securities, any review of transactions pursuant to the mark-up rule would not change. See Notice at 60418.

²⁰ In approving the proposed rule change, the Commission has also considered the rule change's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

²¹ 15 U.S.C. 78o-3(b)(6).

²² In 2013, FINRA sought comment on proposed rule changes that, among other things, would have amended Rule 0150 to apply the mark-up rule to certain government securities. No comments were received on that aspect of the proposal. See Notice at 60419, note 18 for more information.

the mark-up rule to these securities will provide members with additional clarity when conducting transactions in government securities.

Pursuant to Section 19(b)(5) of the Act,²³ the Commission consulted with and considered the views of the Department of the Treasury (“Treasury”) in determining to approve the proposed rule change.²⁴ Treasury did not object to FINRA’s proposal that the mark-up rule be applied to government securities.²⁵

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²⁶ that the proposed rule change (SR-FINRA-2015-033), be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁷

Robert W. Errett
Deputy Secretary

²³ 15 U.S.C. 78s(b)(5).

²⁴ Section 19(b)(5) of the Act states generally that the Commission shall consult with and consider the views of the Secretary of the Treasury prior to approving a proposed rule filed by a registered securities association that primarily concerns conduct related to transactions in government securities. See also Notice at 60418, note 15.

²⁵ Telephone conversation between Treasury staff and Lourdes Gonzalez, Assistant Chief Counsel; Alicia Goldin, Senior Special Counsel; and Stephen Benham, Special Counsel, Division of Trading and Markets, Commission, on November 16, 2015.

²⁶ 15 U.S.C. 78s(b)(2).

²⁷ 17 CFR 200.30-3(a)(12).