

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-76059; File No. SR-FINRA-2015-033)

September 30, 2015

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; 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

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on September 17, 2015, Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to amend 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.

Below is the text of the proposed rule change. Proposed new language is underlined.

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¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

0100. GENERAL STANDARDS

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0150. Application of Rules to Exempted Securities Except Municipal Securities

(a) through (c) No Change.

(d) FINRA Rule 2121 is applicable to transactions in, and business activities relating to, exempted securities that are government securities.

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II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Rule 0150(c) enumerates the FINRA rules and the rules of the National Association of Securities Dealers ("NASD") that apply to transactions in, and business activities relating to, exempted securities, except municipal securities, conducted by members and associated persons.³ Currently, this rule does not include Rule 2121, Supplementary Material .01, or Supplementary Material .02, which govern mark-ups and commissions ("mark-up rule").⁴

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

The basis for not applying certain FINRA and NASD rules, including the mark-up rules, to exempted securities (except municipal securities) is largely historical. Prior to 1993, there were statutory limitations on NASD’s ability to apply sales practice rules, including the mark-up rules, to transactions in exempted securities. 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.⁵ This provision was eliminated as part of the

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 Information Notice, March 12, 2008 (Rulebook Consolidation Process).

⁴ NASD Rule 2440, IM-2440-1, and IM-2440-2 were recently moved to the FINRA rules without any substantive changes, becoming Rule 2121, Supplementary Material .01, and Supplementary Material .02, respectively. See Securities Exchange Act Release No. 72208 (May 21, 2014), 79 FR 30675 (May 28, 2014) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2014-023).

⁵ Prior to 1986, Section 15A(f) provided that “[n]othing in this section shall be construed to apply with respect to any transaction by a broker or dealer in any exempted security.” See 15 U.S.C. § 78o-3 (historical notes).

In 1986, the Government Securities Act of 1986 (“GSA”) was enacted, which established a federal system for the regulation of brokers and dealers who transact business in government securities and certain other exempted securities. See Government Securities Act of 1986, Pub. L. No. 99-571, 100 Stat. 3208 (1986). The GSA, among other things, amended Section 15A(f) to provide that, “[e]xcept as provided in paragraph (2) of this subsection, nothing in this section shall be construed to apply with respect to any transaction by a registered broker or dealer in any exempted security.” See Government Securities Act of 1986, Pub. L. No. 99-571, §102(g)(1), 100 Stat. 3208 (1986). Paragraph (f)(2), which was added by the GSA, provided that a registered securities association could adopt and implement rules with respect to exempted securities to (1) enforce members’ compliance with the relevant provisions of the Act and rules and regulations thereunder, (2) adequately discipline its members, (3) inspect members’ books and records, and (4) prohibit fraudulent, misleading, deceptive and false advertising. Id.

Government Securities Act Amendments of 1993 (“GSAA”).⁶ Following the GSAA, the NASD proposed to apply certain NASD rules to exempted securities other than to municipal securities, although it did not propose to apply the mark-up rule then in effect (NASD Rule 2440 and IM-2440-1) to such securities.⁷ Rather, the NASD stated 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.⁸ The NASD further stated 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).⁹ In 2001, NASD adopted Rule 0116 (now FINRA Rule 0150), which set forth the NASD rules that would apply to transactions in exempted securities, except municipal securities.¹⁰ In 2007, the SEC approved IM-2440-2, which set forth a mark-up policy for transactions in debt securities, except municipal securities.¹¹

⁶ See Government Securities Act Amendments of 1993, Pub. L. No. 103-202, § 106(b)(1), 107 Stat. 2344 (1993).

⁷ See Securities Exchange Act Release No. 37588 (August 20, 1996), 61 FR 44100 (August 27, 1996) (Order Approving File No. SR-NASD-95-39).

⁸ See id. at 44104-44105 nn.3-4.

⁹ See id. at 44113 (noting that Amendment No. 5 to the proposal “clarifies and reminds members that [NASD] rules requiring members to adhere to just and equitable principles of trade apply to conduct that may violate the Fair Prices and Commissions provision and the Mark-Up Policy.”)

NASD Rule 2110 has since been adopted as FINRA Rule 2010. See Securities Exchange Release No. 58643 (September 25, 2008), 73 FR 57174 (October 1, 2008) (Order Approving File No. SR-FINRA-2008-028).

¹⁰ See Securities Exchange Act Release No. 44631 (July 31, 2001), 66 FR 41283 (August 7, 2001) (Order Approving File No. SR-NASD-00-38).

¹¹ See Securities Exchange Act Release No. 55638 (April 16, 2007), 72 FR 20150 (April 23, 2007) (Order Approving File No. SR-NASD-2003-141). As noted above, NASD Rule 2440, IM-2440-1, and IM-2440-2 were recently moved to the FINRA rulebook

FINRA is now proposing to amend Rule 0150 so that Rule 2121, along with Supplementary Material .01 and .02, would apply 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.¹² FINRA believes that amending Rule 0150 to apply the mark-up rule to transactions in government securities is consistent with the GSAA. FINRA also believes that amending Rule 0150 in this manner is consistent with NASD's application of certain of its rules, following the GSAA, to exempted securities except for municipal securities.¹³

FINRA also notes the regulatory benefits of applying the mark-up rule to government securities. Under current rules, if FINRA staff wishes to bring 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, FINRA must bring the case under Rule 2010. Amending Rule 0150 to apply the mark-up rule to transactions and business activities relating to government securities would provide a specific cause of action under which conduct involving such securities could be regulated, in addition to the more general provisions of Rule 2010. As such, this proposed rule change 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, in addition to Rule 2010. FINRA also notes that the mark-up rule provides

without any substantive changes, becoming FINRA Rule 2121, Supplementary Material .01, and Supplementary Material .02, respectively. See supra note 4.

¹² This includes U.S. Treasury securities, as defined in FINRA Rule 6710(p). As defined in Rule 6710(p), a U.S. Treasury Security means a "security issued by the U.S. Department of the Treasury to fund the operations of the federal government or to retire such outstanding securities."

¹³ See Securities Exchange Act Release No. 37588 (August 20, 1996), 61 FR 44100 (August 27, 1996) (Order Approving File No. SR-NASD-95-39).

specific criteria by which members should assess debt mark-ups and mark-downs.¹⁴ Amending Rule 0150 to apply these standards to transactions in government securities would provide both members and FINRA staff with clearer standards by which to measure the propriety of mark-ups, mark-downs and commissions in such transactions.

As a practical matter, FINRA believes that amending Rule 0150 to apply to government securities would have little impact upon members. Rule 2010 already governs transactions in government securities, which would include instances of improper or excessive mark-ups, mark-downs or commissions. Although this proposal would apply the more specific provisions of the mark-up rule to transactions involving government securities, these provisions are already applicable to corporate debt securities. Member firms that currently engage in transactions in corporate debt will therefore already be familiar with the application of the mark-up rule, and FINRA believes that most firms apply substantially similar standards to transactions in all fixed income securities.

FINRA also does not believe that this proposal will impact the reporting or surveillance of transactions in government securities. FINRA currently requires 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 actively surveils the markets in such securities. For those government securities that are not TRACE-eligible, such as U.S. Treasury securities, any review of transactions in such securities pursuant to the mark-up rule would occur as it does today, *e.g.*, through a manual process that is part of FINRA’s regular examination cycle.

¹⁴ See Rule 2121, Supplementary Material .02 (Additional Mark-Up Policy For Transactions in Debt Securities, Except Municipal Securities).

FINRA notes that, following the end of the comment period for this proposal, it will consult with the U.S. Department of the Treasury with respect to the application of the mark-up rule to transactions in government securities that are U.S. Treasury securities.¹⁵

If the Commission approves the proposed rule change, the proposed rule change will be effective upon Commission approval.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁶ which requires, among other things, that FINRA rules must 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, and Section 15A(b)(9) of the Act,¹⁷ which requires that FINRA rules not impose any burden on competition that is not necessary or appropriate. FINRA believes that amending Rule 0150 so that the mark-up rule will apply to government securities is consistent with the Act, because government securities can be subject to instances of excessive mark-ups, and investors in government securities will therefore benefit from the specific application of the mark-up rule to that market. FINRA also believes that this proposal is consistent with both the GSAA and with NASD's subsequent application of certain of its rules to exempted securities except for municipal securities. FINRA also believes that the proposed rule change is consistent with the Act as it will

¹⁵ FINRA also notes that, pursuant to Section 19(b)(5) of the Act, the SEC "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, except where the Commission determines that an emergency exists requiring expeditious or summary action and publishes its reasons therefor." See 15 U.S.C. 78s(b)(5).

¹⁶ 15 U.S.C. 78o-3(b)(6).

¹⁷ 15 U.S.C. 78o-3(b)(9).

provide FINRA with specific authority over instances of excessive mark-ups, mark-downs or commissions relating to government securities that may be pursued, in addition to the more general provisions of Rule 2010.

B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. FINRA notes that the proposed rule change is designed to assist FINRA in meeting its regulatory obligations by extending the rule governing mark-ups and commissions to government securities. FINRA believes that the proposed rule change will have minimal impact on members, as FINRA currently requires members to report transactions in many government securities, and members that charge an excessive mark-up, markdown or commission in transactions in exempted securities are already subject to the provisions of Rule 2010.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were solicited in Regulatory Notice 13-07 but none were received.¹⁸

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

¹⁸ In 2013, FINRA published Regulatory Notice 13-07, which sought comment on a proposed rule change that would have amended several aspects of the mark-up rule, including amending Rule 0150 to apply the mark-up rule to certain government securities. Although FINRA received eight comment letters in connection with this Regulatory Notice, none of those comment letters addressed the proposed rule change that is the subject of this rule filing. A copy of the Regulatory Notice is included as Exhibit 2.

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2015-033 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Robert W. Errett, Deputy Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2015-033. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those

that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2015-033 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁹

Robert W. Errett
Deputy Secretary

¹⁹ 17 CFR 200.30-3(a)(12).