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Client Alert

Current Issues Relevant to Our Clients

October 5, 2015

SEC Seeks Comment on FINRA Proposal To Apply Mark-up Rule To Government Securities

The Financial Industry Regulatory Authority, Inc. ("FINRA") recently filed a proposed rule change with the Securities and Exchange Commission (the "SEC") to apply FINRA rules on bond mark-ups and commissions to transactions in exempted securities that are government securities. Government securities include securities which are direct obligations of, or obligations guaranteed as to principal or interest by, the United States and certain agency securities. The full text of the proposed rule amendment can be found here.

Background and Discussion

FINRA Rule 0150 sets forth the FINRA and NASD rules that apply to transactions in exempted securities, such as government securities. The enumerated rules in Rule 0150 currently do not include FINRA Rule 2121. FINRA Rule 2121 was adopted in 2014 to consolidate existing NASD rules and guidance on mark-ups, mark-downs and commissions. FINRA Rule 2121 generally requires that securities be sold to or purchased from customers at fair and reasonable prices and be subject to fair and reasonable commissions where a firm is acting as agent. For more information about FINRA Rule 2121, please see our February 5, 2013 Client Alert available here. For information about the similar Municipal Securities Rulemaking Board (the "MSRB") rule governing mark-ups and commissions on municipal securities, see our May 15, 2014 Client Alert available here.

Because Rule 0150 does not apply Rule 2121 to exempted securities, FINRA has generally brought cases alleging excessive mark-ups, mark-downs or commissions related to trades in such securities under the more general FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade). FINRA believes that, as a practical matter, the standards for mark-ups, mark-downs or commissions under Rules 2010 and 2121 are the same. The proposed rule change would modify Rule 0150 to apply Rule 2121 and its Supplementary Material .01 and .02 to transactions in exempted securities that are government securities. The intention of the proposed rule change is to more clearly signal to members that conduct relating to mark-ups and commissions in the market for government securities directly implicates the mark-up rule and to provide members with specific criteria by which they should assess debt mark-ups and mark-downs. FINRA believes that amending Rule 0150 to apply Rule 2121 to government securities would have little impact upon members.

Other Mark-up Proposals

The current FINRA proposal follows other recent efforts by both FINRA and the MSRB relating to mark-ups, mark-downs, commissions and pricing of debt securities. FINRA and the MSRB have recently published proposals regarding disclosure of certain pricing information on fixed income trade confirmations. For information on these proposals, see our November 19, 2014 and September 28, 2015 Client Alerts available here and here. The latest MSRB proposal would require firms to disclose municipal bond mark-ups and mark-downs on retail customer trade confirmations. It is expected that FINRA will issue a similar revised proposal for debt securities that are not municipal securities in the near future.

What Now?

You can submit comments to the SEC by submitting a hard copy, by using the SEC's internet comment form available under SR-FINRA-2015-033 at this link or by sending an email to rule-comments@sec.gov with File Number SR-FINRA-2015-033 in the subject line. Comments must be received within 21 days from the date of publication of the filing in the Federal Register.

The proposed rule change will likely not have a significant impact on members as the substantive requirements of Rule 2121 already largely apply to trades in government securities through Rule 2010, however, firms should consider reviewing their existing policies and procedures for compliance with applicable rules and guidance related to pricing of fixed income securities.

For More Information

To discuss any topic covered in this Client Alert, please contact a member of the Investment Management Group or visit us online at chapman.com.

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