

# Bond Case Briefs

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## Finra to Probe Broker Conflicts When Exchanges Offer Rebates.

The brokerage industry's self-regulator will spend 2015 looking into whether deals between brokers and exchanges are taking money out of investors' pockets, regulators said in a letter outlining the year's oversight priorities.

The Financial Industry Regulatory Authority will also review whether customers get fair prices on electronic bond-trading platforms and how brokers market financial products that are sensitive to interest-rate changes such as alternative mutual funds, structured retail products and bank-loan mutual funds, it said.

The letter lays out some of this year's biggest concerns for Finra, which is funded by the brokerage industry that it polices. The group, which levied about \$60 million in fines last year, has faced repeated criticism from other regulators and investors that it isn't tough enough on Wall Street misconduct.

In recent brokerage inspections, Finra found that some firms don't have active "best-execution committees" or other supervisors in place to ensure that clients get the best price as securities rules require, according to the letter.

"We certainly expect to see tightening up and much greater focus from firms," Finra Chief Executive Officer Richard Ketchum said in an interview. "There is a high likelihood you'll see enforcement actions as well."

Regulators and lawmakers have said that brokers face a conflict of interest when exchanges offer them rebates and other incentives to draw their business. Brokers have more than 40 exchanges and private trading venues to choose from when filling their clients' orders.

The Securities and Exchange Commission, which oversees Finra, has already been looking into the issue. Senator Carl Levin in a June hearing grilled TD Ameritrade Holding Corp. (AMTD) executives over the firm's practice of selling retail orders to be filled by market makers.

### **Bond Trading**

Finra also said that it will launch a pilot program to probe whether brokers who use electronic bond-trading platforms are getting the best prices for customers. Unlike stock exchanges, bond-trading venues generally don't make prices available to the public. That leaves investors with little means to verify whether they're receiving the best price or paying a significant markup over what a dealer paid.

The venues have grown in popularity as more trading moves to computer platforms. About 16 percent of investment-grade corporate bond trading happens on such systems, according to Greenwich Associates. Regulators such as Finra and the SEC have largely allowed them to develop free from stringent oversight.

“We’re at a significant flex moment with respect to the handling of fixed-income orders,” Ketchum said. “We do think it deserves more attention.”

Last year, the SEC and Finra began a campaign to force more transparency of bond prices and markups on sales to retail customers. Such a move could generate opposition from banks, which derive a significant portion of their income from bond trading and sales. It’s historically been more profitable to trade bonds than stocks because the debt markets are less transparent, making it easier for brokers to take a bigger fee for each exchange.

### **Alternative Funds**

Finra will also examine brokers’ sales of alternative mutual funds, structured retail products and bank-loan mutual funds, Finra said. The regulator will be looking for cases in which brokers may have pushed investors into large, concentrated positions in products that are highly sensitive to interest-rate changes.

Alternative mutual funds are among the fastest-growing segments of the \$15 trillion fund industry. Finra said it has found some brokers aren’t adequately reviewing new alternative mutual funds, which mimic riskier hedge-fund strategies, before selling them.

“It’s important for customers to understand they are dealing with higher fees and a level of complexity,” Ketchum said. “They have to really understand the risk-return involved in the products.”

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By Dave Michaels Jan 6, 2015 12:22 PM PT

To contact the reporter on this story: Dave Michaels in Washington at [dmichaels5@bloomberg.net](mailto:dmichaels5@bloomberg.net)

To contact the editors responsible for this story: Joshua Gallu at [jgallu@bloomberg.net](mailto:jgallu@bloomberg.net) Gregory Mott

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