

As the C.C.O. for a member firm which transacts nearly all of its business in the debt markets, I generally am supportive of an update to the FINRA rules concerning markups, commissions and fees. I feel eliminating the "5% policy" language will generate more attention being paid to the real spirit of the rules which appropriately dictate a member must treat each transaction separately and in each case charge fair and reasonable markups (or commissions). In most cases with debt instruments, the security is sold to a client as a "net" yield or price with a markup (or markdown) already built in. Therefore, the net yield or price must also be fair and reasonable as compared to the market context. I feel the market context is an important aspect of how a markup should be calculated. The current FINRA rules state for presumptive purposes, a member's contemporaneous cost should be used when calculating a markup. That seems very logical in the cases of riskless transactions but that logic breaks down when dealers are selling securities from their own inventory that had been purchased with no client orders in hand. When this occurs, it seems most logical to use the current market context to establish an offering price that is fair and reasonable and if that is accomplished, it would likely follow the markup was justified as being fair and reasonable as well.

In my opinion, the problem with the use of "contemporaneous cost" as it is currently defined and dictated in the rules is twofold. First, it is inherently subjective because of using language like "close enough in time that it would reasonably be expected to reflect the current market price....". One person's idea of this may be different than another's. Second and more importantly, the concept seems a little flawed. In the bond market where trades are essentially negotiated offers and sales, circumstances may dictate times in which a dealer, with no client orders in hand, is able to purchase a security on the bid side or in the middle of the bid/ask spread. When this occurs and the security is active enough to hold live "offer side" quotes, it would seem fair to consider those offer side quotes as the correct market context for a new offer of the security by the dealer. Granted, the rules as they are written (and proposed) could allow for this situation to be interpreted as a markup being calculated from the dealer's original cost but for that markup to be considered justified based on the market context. If so, I would prefer some language in the new rule indicating that. Otherwise I feel adding language in the criteria listed IM 2440-2 (b)(4)(i)(ii) and (iii) to allow for additional circumstances such as this would be warranted.

One other aspect of the proposal I would like to address is the comparison of markups of debt transactions and equity transactions. The comments in the proposal's regulatory notice seem to be at least in part based on an SEC statement (referenced in footnote 13 of the notice). The problem I have with that line of thinking is fact the statement itself was from a release in 1987. Here is the applicable excerpt from release 24368:

If a dealer's price to a customer includes an excessive mark-up over the prevailing market price, then, absent proper disclosure, the dealer has violated section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, and section 17(a) of the Securities Act of 1933 ("Securities Act").¹³ The Commission consistently has held that, at the least, undisclosed mark-ups of more than 10% above the prevailing market price are fraudulent in the sale of equity securities.¹⁴ The Commission also consistently has taken the position that mark-ups on debt securities, including municipal securities, generally are expected to be lower than mark-ups on equity securities,¹⁵ and has upheld NASD decisions finding mark-ups as low as 5.1% to violate the rules of the MSRB.¹⁶

This statement uses language discussing undisclosed markups of “more than 10%” above the prevailing market price for equity transactions and markups “as low as 5.1%” for municipals. Clearly those levels are not indicative of today’s market and when you consider where equity trading has come to with clients often being able to purchase online for \$7 or less it hardly seems relatable.

Thank you for your time and I appreciate this opportunity to comment.

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