



Cornell University
Cornell Law School

William A. Jacobson, Esq.
Associate Clinical Professor
Director, Securities Law Clinic
G57 Myron Taylor Hall
Ithaca, New York 14853
t. 607.254.8270
f. 607.255.3269
waj24@cornell.edu

March 28, 2013

Via Email (pubcom@finra.org)

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

**RE: Regulatory Notice 13-07; FINRA Requests Comment on Proposed FINRA
Rules Governing Markups, Commissions and Fees**

Dear Ms. Asquith:

The Cornell Securities Law Clinic ("Clinic") submits this comment letter opposing the proposal contained in Regulatory Notice 13-07 ("Rule Proposal") regarding the Consolidated Financial Industry Regulatory Authority ("FINRA") rules governing markups, commissions and fees. The Clinic is a Cornell Law School curricular offering, in which law students provide representation to public investors and public education as to investment fraud in the "Southern Tier" region of upstate New York. For more information, please see <http://securities.lawschool.cornell.edu>.

Current NASD Rules 2430, 2440, NASD IM-2440-1 and NASD IM-2440-2 govern markups, markdowns, commissions and fees in transactions with customers. In 2011, FINRA initially proposed to transfer these rules to the Consolidated FINRA Rulebook with significant changes.¹ In its previous comment letter, the Clinic urged FINRA to consider a 3% policy rather than eliminating the 5% policy without replacement, to retain but clarify the "proceeds provision," and to require member firms to provide commission schedules for equity securities to retail customers.²

¹ FINRA Regulatory Notice 11-08 [hereinafter "Initial Rule Proposal"].

² See the Clinic's March 28, 2011 comment letter, *available at* <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/noticerecommendations/p123412.pdf>.

Since the Rule Proposal eliminates the proceeds provision without replacing the outdated 5% policy with a more stringent guideline, it would result in a net harmful impact on retail customers. The Clinic opposes the Rule Proposal for three reasons set forth below.

1. FINRA Should Retain and Clarify the “Proceeds Provision.”

When a customer sells one security and buys a second security using the proceeds of the first trade to pay for the second, the proceeds provision requires that both trades be counted as to whether the markups were excessive.

The Rule Proposal seeks to eliminate the provision because “it includes a standard that is not susceptible to consistent and fair application.” (Rule Proposal at 9.) FINRA suggests that continued monitoring of accounts would be a more practical approach to policing possible churning or other fraudulent trading.

Clarification of the provision can eliminate the risk of inconsistent or unfair application. As FINRA noted, under the current provision, it is not always clear “when two transactions occurring close in time are related” or “how close in time transactions must be” to constitute proceeds transactions. (*Id.* at 13, n.15.) However, such uncertainty is a reason for further clarification of the rule, not a reason for eliminating the provision without an alternative, comparable means of policing.

FINRA should clarify the proceeds provision in light of the underlying purpose to limit the total remuneration for simultaneous trades that are effectively one transaction. Such clarification should aid enforceability in the interest of investor protection by specifying the time period in question and the relatedness of the transactions.

2. FINRA Should Replace the 5% Policy with a 3% Policy.

If FINRA decides to eliminate the proceeds provision, the Clinic urges FINRA to adopt a 3% or lower policy to replace the 5% policy to avoid at least a net harmful impact on retail investors.

As FINRA expressly acknowledged in the Rule Proposal, five percent is “*significantly* higher than the average markup, markdown or commission currently charged by most member firms in customer transactions.” (*Id.* at 6. (emphasis added)) Accordingly, the beneficial impact of the rebuttable presumption of excessiveness for markups, markdowns, or commissions over five percent is marginal, at best. It is even more so given the case laws decided since the 1943 survey of industry practices, upon which the 5% policy is based.

A 3% or lower policy will be a reasonable replacement for the 5% policy. The 5% policy has no practical significance; a 3% or lower policy reflects many SEC and NASD cases. *See, e.g.,* Press v. Chemical Inv. Servs. Corp., 988 F. Supp. 375, 386 (S.D.N.Y. 1997) (“[F]rom the Court’s review, ‘excessiveness’ appears not even to become a consideration in debt-security

cases until markups reach the three to three and one-half percent range.”) (citing *In re Lehman Bros. Inc.*, Exchange Act Release No. 34-37673, 1996 WL 519914, *3–7 (Sept. 12, 1996), *aff’d*, 166 F.3d 529 (2d Cir. 1999); Dep’t of Enforcement v. David Lerner Assocs., Inc., 2012 WL 1906579, *6 (N.A.S.D.R.) (referring to the municipal bond pricing and industry practices in which “markups greater than 3% would be subject to regulatory scrutiny”); Dep’t of Enforcement v. Gonchar, 2006 WL 4390126, *13 (N.A.S.D.R.) (finding that markups above 3% are excessive in convertible bonds); *In re DBCC v. MMAR Group, Inc.*, 1996 WL 1114532, *9 (N.A.S.D.R.) (“Generally, in litigated cases, the [SEC] has not found mark-ups or mark-downs of less than 4% to be excessive . . .”).


3. FINRA Should Require Firms to Provide Commission Schedules to Customers.

The Initial Rule Proposal had suggested a new requirement of providing commission schedules for equity securities transactions to retail customers. (Initial Rule Proposal at 7.) Unlike FINRA’s view that posting commission schedules would set a floor, the Clinic believes that such requirement would provide a valuable opportunity to foster competition and transparency in the industry.

* * *

The Clinic greatly appreciates the opportunity to comment on the Rule Proposal. It urges FINRA (a) to consider reinstating the proceeds provision, (b) to replace the 5% policy with a 3% policy, and (c) to require member firms to provide commission schedules to retail customers.

Respectfully submitted,



William A. Jacobson, Esq.
Associate Clinical Professor of Law
Director, Securities Law Clinic



Minsuk Han
Cornell Law School ‘14