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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 11-08; FINRA Requests Comment on Proposed Consolidated FINRA Rules Governing Markups, Commissions and Fees

Dear Ms. Asquith,

The Cornell Securities Law Clinic ("the Clinic") submits this letter supporting in part and opposing in part the proposal contained in Regulatory Notice 11-08 ("the Rule Proposal") regarding the consolidated Financial Industry Regulatory Authority ("FINRA") rules governing markups, commissions and fees. The Clinic is a Cornell Law School curricular program, in which law students provide representation to public investors and provide public education on investment fraud in the "Southern Tier" region of upstate New York. For more information, please see http://securities.lawschool.cornell.edu.

Current NASD Rule 2440, NASD IM-2440-1 and NASD IM-2440-2 govern markups, markdowns and commissions in transactions with customers. FINRA proposes to transfer these rules to the Consolidated FINRA Rulebook with significant changes, including the elimination of the 5% policy and the addition of a requirement for firms to provide commission schedules for equity securities to retail customers. The Rule Proposal, in making changes to the existing rules, also eliminates the "proceeds provision" under NASD Rule IM-2440-1. Additionally, the Rule Proposal includes certain provisions related to commissions charged when a firm misses the market.[1]

[1] The Rule Proposal requires firms to notify and obtain consent from customers when firms miss the market and trade with the customer on a principal basis. The Clinic takes no position on this particular issue.

The Clinic suggests, as set forth below, that: (a) FINRA should replace the 5% policy with a 3% policy based on existing standards of excessiveness in U.S. Securities and Exchange Commission ("SEC") litigated cases and current industry practice; (b) FINRA should not eliminate the "proceeds provision" in NASD IM-2440-1 because the benefits of the rule outweigh the difficulties of enforcement; and (c) FINRA should require firms to provide commission schedules for equity securities transactions to retail customers.

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

The guidance for the industry, described in NASD IM-2440-1, is that a markup in excess of 5% above the prevailing market price for a security is not reasonably related to the market price and therefore the markup is excessive. Although the 5% policy was originally based on a 1943 survey of industry practices, it remained relevant for the industry in light of later litigated cases. *See, e.g., In re Application of First Honolulu Securities, Inc. and Jacobson*, Exchange Act Release No. 32,933, 1993 WL 380039, *4 (1993) (SEC found that applicants' markups above 5% were excessive in light of existing guidance); *In re Midland Securities, Inc. and Ben Degaetano*, Exchange Act Release No. 34,6413, 1960 WL 56304, *2 (1960)(SEC found applicants in violation of the 5% policy by charging mark-ups over market price ranging from 7.1% to 67%).

FINRA argues that average markups, markdowns and commissions charged by firms are significantly lower than the 5% policy. (Rule Proposal at 4) Changing industry practices, however, are no basis to eliminate the guidance altogether, especially because the policy has been useful in litigating cases and guiding firms.

FINRA should replace the 5% policy with a lower percentage markup as guidance to reflect both industry practices and the cases actually litigated by the SEC. A 3% policy replacement would be reasonable because it would include the percent markups that most firms charge in equity transactions. Moreover, a 3% policy would be reflective of SEC litigated cases, in which 3% and lower markups generally have not been found to be excessive. *See, e.g., Press v. Chemical Inv. Servs. Corp.*, 988 F.Supp. 375, 385-86 (S.D.N.Y. 1997)(citing *In re Lehman Bros.*, Exchange Act Release No. 34,37673, 1996 WL 519914, *3-7 (1996))("From 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."), *aff'd*, 166 F.3d 529 (2d Cir. 1999); *In re DBCC v. MMAR Group, Inc., et al.*, 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.").

Like the 5% policy, the 3% policy would serve as a guide to firms indicating the upper limit of acceptable commissions without categorically justifying markups lower than 3% as reasonable. *See S.E.C. v. Zwick*, 2007 WL 831812, *15 (S.D.N.Y. Mar. 16, 2007)("It has been the SEC's position that there is no bright-line floor beneath which any markup is reasonable."), *aff'd*, 317 F. App'x. 34 (2d Cir. 2008).

The Clinic believes that FINRA would lose a valuable opportunity to guide the industry to charge "reasonable" markups required by NASD IM-2440-1 by eliminating the 5% policy outright. A new policy more tailored to industry practices and SEC litigated cases makes the best use of this opportunity to guide firms to charge "reasonable" markups while maintaining the flexibility of the 5% policy.

B. FINRA Should Clarify the "Proceeds Provision"

When a customer sells securities to or through a broker, and uses the proceeds to simultaneously purchase securities from or through a broker, the "proceeds provision" requires brokers to include commission charged on the sale of securities in the commission charged on the purchase of securities. FINRA enacted this provision to avoid double remuneration for what is effectively one transaction. The Rule Proposal seeks to eliminate the "proceeds provision." (Rule Proposal at 6)

Investors are injured by paying double commission on what is essentially one transaction, but the problem is further exacerbated as investors have limited and costly means to seek compensation. The benefit of the proceeds provision as an investor protection is lost if the provision is eliminated in the transfer of NASD IM-2440-1 to the Consolidated FINRA Rulebook merely due to the difficulties of enforcement.

FINRA should clarify the rule to aid enforceability in the interest of investor protection by specifying the time period in question and the relatedness of the transactions. These amendments may accommodate industry practices while taking into account the challenges of enforceability. A clearer "proceeds provision" will reduce problems of notice to firms and enforcement while avoiding the complete elimination of an investor protection against unfair commissions.

C. FINRA Should Require Firms to Provide Commission Schedules to Retail Customers

The Clinic believes that the Rule Proposal provides a valuable opportunity to foster competition and transparency in the industry, which will lower commissions, markups and markdowns. Written notice is an important element of this issue, which allows retail customers to access information easily, to make informed decisions and to mobilize firms as competitors in the market. The Rule Proposal's added provision on privately negotiated commissions allows flexibility for firms as well as easing the costs of compliance.

Conclusion

The Clinic greatly appreciates the opportunity to comment on the Rule Proposal. The Clinic urges FINRA (a) to consider a 3% policy rather than eliminating the 5% policy with no replacement, (b) retain but clarify the proceeds provision, and (c) require member firms to provide commission schedules for equity securities transactions to retail customers.

Respectfully submitted,

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