FINANCIAL SERVICES INSTITUTE
VOICE OF INDEPENDENT BROKER-DEALERS AND INDEPENDENT FINANCIAL ADVISORS
www.financialservices.org

VIA ELECTRONIC MAIL

March 28, 2011

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

RE: Regulatory Notice 11-08 – Markups, Commissions, and Fees

Dear Ms. Asquith:

On February 10, 2011, the Financial Industry Regulatory Authority (FINRA) published Regulatory Notice 11-08 (RN 11-08) requesting comment on proposed FINRA Rules governing markups, commissions, and fees (Proposed Amendments).[1] Among other changes and revisions, the Proposed Amendments would eliminate the "5% policy" and the "proceeds provision" in NASD Rule IM-2440-1. FINRA also proposes to require firms to provide retail customers a commission schedule for equity securities transactions.

The Financial Services Institute (FSI)[2] welcomes this opportunity to comment on the Proposed Amendments. In general, we support the Proposed Amendments and believe that they are timely given the consolidation of the NASD and NYSE Rulebooks. In addition, we note that the "5% Policy" has not been revised in nearly seven decades despite advances in market efficiency. However, we have serious concern related to the lack of specific guidance in the Proposed Amendments related to caps on markups, markdowns, or commissions. We also have concerns related to the new requirements to publish standard commission schedules, and charges & fees for services performed. These concerns are addressed in more detail below.

Background on FSI Members

FSI represents independent broker-dealers (IBD) and the independent financial advisors that affiliate with them. The IBD community has been an important and active part of the lives of American investors for more than 30 years. The IBD business model focuses on comprehensive financial planning services and unbiased investment advice. IBD firms also share a number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives. Due to their unique business model, IBDs and their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to

[1] See FINRA Regulatory Notice 11-08, available at http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p122918.pdf.

[2] The Financial Services Institute is an advocacy organization for the financial services industry – the only one of its kind – FSI is the voice of independent broker-dealers and independent financial advisors in Washington, D.C. Established in January 2004, FSI's mission is to create a healthier regulatory environment for their members through aggressive and effective advocacy, education and public awareness. FSI represents more than 125 independent broker-dealers and more than 16,000 independent financial advisors, reaching more than 15 million households. FSI is headquartered in Atlanta, GA with an office in Washington, D.C.

achieve their financial goals and objectives.

In the U.S., approximately 201,000 financial advisors – or 64% percent of all practicing registered representatives – operate as self-employed independent contractors, rather than employees, of their affiliated broker-dealer firm.[3] These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisors are typically "main street America" – it is, in fact, almost part of the "charter" of the independent channel. The core market of advisors affiliated with IBDs is clients who have tens and hundreds of thousands as opposed to millions of dollars to invest. Independent financial advisors are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence.[4] Independent financial advisors get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisors have a strong incentive to make the achievement of their clients' investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisors. Member firms formed FSI to improve their compliance efforts and promote the IBD business model. FSI is committed to preserving the valuable role that IBDs and independent advisors play in helping Americans plan for and achieve their financial goals. FSI's mission is to ensure our members operate in a regulatory environment that is fair and balanced. FSI's advocacy efforts on behalf of our members include industry surveys, research, and outreach to legislators, regulators, and policymakers. FSI also provides our members with an appropriate forum to share best practices in an effort to improve their compliance, operations, and marketing efforts.

Comments on the Proposed Rule

As stated above, FSI generally supports the Proposed Amendments and believe that they are timely given the consolidation of the NASD and NYSE Rulebook, and appropriate them as the "5% Policy" has not been revised in nearly seven decades. However, we have serious concern related to the lack of specific guidance in the Proposed Amendments related to caps on markups, markdowns, or commissions. We also have concerns related to the new requirements to publish standard commission schedules, and charges/fees for services performed. These concerns are addressed in more detail below.

- **Lack of Specific Guidance on Caps** – Proposed FINRA Rule 2121 would eliminate the existing 5% Policy set forth in IM-2440-1. Instead of imposing a hard cap or providing new guidance, FINRA proposes that firms apply the relevant factors currently set forth in IM-2440-1 to evaluate their markups, markdowns, and commissions resulting from a transaction.

  RN 11-08 notes that 5% Policy is significantly higher than the average markup, markdown or commission currently charged by most firms in equity transactions. FINRA cites a 2007 study titled, "The Law and Finance of Broker-Dealer Mark-Ups,"[5] wherein the author indicates that based on a sample of more than 161,000 equity

[3] Cerulli Associates at http://www.cerulli.com/.
[4] These "centers of influence" may include lawyers, accountants, human resources managers, or other trusted advisors.
[5] FINRA Regulatory Notice 11-08, 4, citing Ferrell, A., The Law and Finance of Broker-Dealer Mark-Ups (2007)

transactions with customers, the mean markup was 2.2 percent and the average or median markup was 2 percent.[6] The author also indicates that the mean markdown was 1.9 percent and the median markdown was 1.3 percent.[7]

FINRA indicates that it will provide industry guidance related to markups, markdowns, and commissions, but will do so in a future Regulatory Notice. Specifically, endnote 14 of RN 11-08 provides the following:

> "In lieu of stating in proposed FINRA Rule 2121 that a markup, markdown or commission of less than a specified amount or percentage, such as 3 percent or 3.5 percent, may not be excessive, FINRA expects to provide guidance in a *Regulatory Notice* that markups, markdowns and commissions above certain specified percentages will be subject to additional regulatory scrutiny, requiring members to provide additional justification to establish that such markups, markdowns, and commissions are not excessive."

We are concerned with FINRA's plan to issue subsequent guidance in a future Regulatory Notice concerning the specific amounts or percentages that may be viewed as fair and reasonable. Instead, we urge FINRA to expressly provide this guidance in the Proposed Amendments. FINRA should take advantage of the rulemaking process to solicit industry input and provide clarity and guidance to the on this issue. Accordingly, we urge FINRA to expressly provide the caps in the Proposed Amendments, rather than issue a separate Regulatory Notice on the topic in the future.

Alternatively, if FINRA is reluctant to provide a cap in the Proposed Amendments, we urge FINRA to issue the Regulatory Notice at the time this final rule is approved by the SEC. If FINRA follows this approach, it will provide the industry with an opportunity to review and establish supervisory procedures that accomplish the intent of the Proposed Amendments and provide comfort that firms comply with the new rules.

- **Posting Commission Rates** – In proposed FINRA Rule 2121(e), FINRA proposes an additional requirement regarding transaction-based remuneration. The Proposed Amendments require a member to establish and make available to retail customers the schedule(s) of standard commission charges for transactions in equity securities with retail customers. A member would be allowed to establish and publish multiple schedules of standard commission charges, as long as it discloses in, or with the schedule(s), how the commissions are stratified among all retail customers.

  Most IBDs act as introducing broker-dealers for a national clearing firm. These IBDs set a maximum commission schedule with their respective clearing firm. The financial advisors of the IBDs have the ability to lower the commissions they charge to their customers as they deem appropriate or as agreed to with the client. The maximum commission schedules are extremely complicated documents, written in legalese, by securities experts and securities lawyers. While we support enhanced customers

[6] *Id.*
[7] *Id.*

disclosure about commissions charged, we have serious concerns about a retail customer's ability to comprehend the commission schedules and do not anticipate that they will find value in these disclosures. Additionally, with the ability for the financial advisor to adjust the commission schedule on a client-by-client basis, we do not see how a "one size fits all" document would be workable for meaningful commission schedule disclosure.

Retail customers are currently aware of commissions they pay as they are specifically listed on confirmations received for each individual securities transaction. Clients with concerns about the commission charges have the ability to express these concerns to their financial advisor, the broker-dealer, or can seek less expensive pricing through another broker-dealer. As such, we do not believe that making available the maximum commission schedule of a broker-dealer will enhance investor protection.

- **Effective Disclosure v. Additional Disclosure** - All broker-dealers currently comply with disclosure requirements under SEC Rule 17a-(3) at the time of account opening, thirty (30) days within certain events, and every thirty-six (36) months thereafter. Firms also send annual privacy notices and provide notice of revenue sharing programs to customers. Dual registrant firms comply with various disclosure requirements required by the states, and SEC, related to Form ADV. Moreover, FINRA is currently contemplating a concept proposal that would require member firms, at or prior to commencing a business relationship with a retail customer, to provide a written statement to the customer describing the types of accounts and services it provides, as well as conflicts associated with such services, and any limitations on the duties the firm otherwise owes to retail customers.[8] Compounding these existing and contemplated disclosures with the delivery of the commission and charges & fee schedules is excessive and does not benefit the retail customer in any meaningful way.

  We believe that effective disclosure can be provided through concise high-level client notifications, while allowing a client to request additional information when desired. We believe that effective disclosure does not require new or additional disclosure.[9] Accordingly, we urge FINRA to reevaluate the need for new and additional disclosure that will be meaningless to the majority of retail customers. We ask that FINRA remove the delivery requirements related to the commissions and charges/fees performed schedules contemplated in the Proposed Amendments. In its place, we request that FINRA study the issue to determine what disclosures retail customer truly want and need. Simply adding new disclosure requirements on existing requirements does not provide for effective disclosure.

[8] See FINRA Regulatory Notice 10-54, available at http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p122361.pdf.

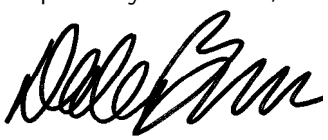
[9] Please see FSI's Comment Letter related to Regulatory Notice 10-54, and our discussion about effective disclosure. FSI's comment letter can be accessed here: http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/noticecomments/p122722.pdf

Conclusion

We are committed to constructive engagement in the regulatory process and, therefore, welcome the opportunity to work with you to on the Proposed Amendemnts to consolidated FINRA Rules governing markups, commissions and fees.

Thank you for your consideration of our comments. Should you have any questions, please contact me at 770 980-8487.

Respectfully submitted,



Dale E. Brown, CAE
President & CEO