

April 2, 2013

VIA ELECTRONIC MAIL

Marcia E. Asquith  
Office of the Corporate Secretary  
Financial Industry Regulatory Authority  
1735 K. Street, NW  
Washington, DC 20006-1506

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

Dear Ms. Asquith:

On behalf of the Bond Dealers of America (BDA), I am pleased to submit this letter in response to the Financial Industry Regulatory Authority's (FINRA) solicitation of comments in connection with Regulatory Notice 13-07 (Notice), a proposed rule (Proposed Rule) governing markups, commissions and fees. BDA is the only DC based group representing the interests of middle-market securities dealers and banks focused on the U.S. fixed income markets. We welcome this opportunity to state our position.

The BDA is pleased to have this opportunity to comment on the Proposed Rule as we did in response to FINRA's initial proposal, Regulatory Notice 11-08, regarding proposed FINRA Rules 2121 (Fair Prices and Markups, Markdowns and Commissions) and 2122 (Markups and Markdowns for Transactions in Debt Securities, Except Municipal Securities) governing markups, markdowns and commissions (the proposed markup rules), and proposed FINRA Rule 2123 (Charges and Fees for Services Performed) governing fees. We are encouraged by some of the changes FINRA has made in the revised proposal, but remain concerned with aspects of the Proposed Rule and we reiterate several of our concerns in our comment letter in 2011.

### **Definition of Prevailing Market Price**

The BDA has two concerns about the definition of prevailing market price in the Proposed Rule. First, the term "contemporaneous" should be more clearly defined. What constitutes a "contemporaneous" cost under the Proposed Rule does not provide clarity concerning how much time must elapse for the cost to cease being "contemporaneous." As we noted before, this is a standard that is difficult for dealers to apply in such a unique and, at times, volatile market. In reality, the actual rule of what constitutes "contemporaneous" is left to the divergent views of the FINRA examiners who frequently define "close enough in time" in very different

ways. This ultimately changes how dealers behave in ways that are not in the best interests of the investors. Dealers become less willing to engage in trades or buy debt securities for their own inventory on a principal basis – especially very illiquid securities – because of the regulatory uncertainty involved in defending any one particular transaction.

The BDA's second concern is that the use of "contemporaneous cost" as such a definitive measure of "prevailing market price" does not take into consideration that the price a dealer pays in a purchase of a relatively large block of securities may not be indicative of the "prevailing market price." If, for example, the market price for a security is 92% of par, a dealer may purchase a large block of those securities for 90% of par. In that instance, the purchasing dealer is taking on considerable liquidity risk in the security and the seller of the securities would probably have not realized a 92% price if it sold the entire block of securities into the market at once. We believe that it is inappropriate to use the 90% price as the prevailing market price because the 2% point difference reflects a liquidity risk that the dealer was absorbing that the customer does not absorb since it is purchasing just a portion of those securities. Furthermore, when dealing with relatively illiquid securities, the same is true but even more so. When a dealer purchases a large block of relatively illiquid securities, the cost it pays for those securities includes a liquidity risk that is not borne by the customer in the same way when the dealer sells to the customer a portion of that block. When securities become illiquid, the willingness of dealers to purchase these blocks becomes even more important in order to create a market in those securities. This entails separating out when dealers pay a price that is below the market price because dealers are absorbing risks that are not passed onto the customer. Therefore, we believe that in these instances, (1) the dealers should be permitted to show countervailing evidence of the prevailing market price and (2) the fact that the dealer purchased a block of securities should be a factor in determining the appropriateness of using the dealer's contemporaneous cost as a measure of the prevailing market price.

### **Maintain Qualified Institutional Buyer (QIB) Exception from Definition of Customer**

The BDA appreciates that FINRA has exempted QIB and any such delegated agent of the QIB from the definition of "customer" for purposes of this rule and for Rule 2121 for purchasing or selling non-investment grade debt securities. We believe it is important to recognize the sophistication of QIBs and that the securities laws consistently treat QIBs as possessing the capacity and sophistication of being able to make their own investment decisions. Further, a QIB may even exceed the sophistication of a dealer. For this reason, we do not think that the Proposed Rule is appropriate in requiring a QIB to affirmatively indicate that it is exercising independent judgment in order to fall under the definition. We believe if a QIB, or their agent, meets the definition, then that should suffice. Therefore, we would ask that FINRA remove the requirement that a QIB or their agent must affirmatively indicate they are acting as such.

## **Revised Rule Continues to Lack Objective Enforcement Standards for Determining if Markups and Markdowns are Fair and Reasonable**

We reiterate our concern that the Proposed Rule does not outline definitive enforcement standards for determining if markups and markdowns are fair and reasonable. Considering the many differences between the equities and debt markets, we would suggest that FINRA draft a rule which examiners and dealers alike can read with an eye toward objectivity in creating and enforcing standards which can easily be pointed to when determining if a markup or markdown is fair and reasonable.

We appreciate that FINRA has expanded upon the relevant factors that might be considered in overcoming the presumption that a markup, markdown or commission is unfair or unreasonable. However, we would like to caution that the debt market is subject to any number of potentially unique and unforeseeable situations and the rule should incorporate flexibility that would allow a firm to defend a markup based on situations outside of the relevant factors.

## **Spreads for Distressed Bonds are Higher than for Non-Distressed Bonds**

BDA appreciates that FINRA recognizes that fixed income securities include significantly complex and volatile securities and that, in the revised proposal, they are making allowances for inclusion of this information as a factor in determining the amount or percentage of a markup, markdown or commission. However, we would like to reiterate a point in our previous letter, that if firms continue to view FINRA examiners as unwilling to consider the volatility of a security or the market, this will result in a reduction of the number of firms providing bids and offers in such securities, with the unfortunate consequence that retail customers will bear the burden of increased fees and charges and market illiquidity, a result we believe FINRA aims to avoid.

## **Schedule of Fees Should be Modified to Eliminate Reduction in Charges 30-Day Advanced Notification**

BDA agrees with FINRA in its revised proposal that retail customers should have advance notice of increases in fees that a dealer may be charging for its services or notice of new fee structures that customers may want to review in order to compare them with those of other dealers in order to decide if they wish to continue doing business with the firm. However, if a dealer is reducing its charges and fees across all classes or types of customers, we believe that dealers should be able to implement those reductions without the required 30 days notice. Therefore, we believe the revised rule should be amended to allow dealers to implement reductions in any charges and fees imposed on retail customers, as long as such reductions are posted to the member's website and updates sent to all retail customers at least once each calendar year, as with other fee schedules.

Thank you again for the opportunity to submit these comments.

Sincerely,

A handwritten signature in blue ink that reads "M. Nicholas". The signature is fluid and cursive, with the first name "Michael" and last name "Nicholas" clearly legible.

Michael Nicholas  
Chief Executive Officer  
Bond Dealers of America