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Dealer Groups Unsure About Best Ex Rule Proposal.

WASHINGTON — Dealer groups are unsure whether the Municipal Securities Rulemaking Board's proposed best execution rule is tailored enough for the municipal market, but are pleased it would exempt sophisticated professionals.

Draft Rule G-18, which the MSRB released Wednesday, would require broker-dealers to "use reasonable diligence in seeking to obtain for their customer transactions in municipal securities the most favorable terms available under prevailing market conditions."

Based on the Financial Industry Regulatory Authority's Rule 5310 for equities and corporate debt, the rule goes a step beyond the current Rule G-18 on execution of transactions, which requires dealers to "make a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions."

The proposal also seeks to alter the MSRB's proposed Rule G-48 on sophisticated municipal market professionals to make clear that the best execution obligations would not apply to sophisticated municipal market participants, which need less protection.

"That's something right off the bat we were happy to see," said Bond Dealers of America senior vice president of government relations Susan Collet. BDA among others suggested an SMMP exemption be included in any best execution proposal.

Although the SEC recommended in its 2012 comprehensive report on the municipal market that the MSRB adopt a best execution rule, dealers have said attempting to impose a "trade-by-trade" pricing mandate on them would be unreasonable in a market as illiquid and opaque as the muni market. The muni space does not have a single location where all pricing information is quickly available.

Collet said BDA is not yet sure whether the MSRB's efforts to create a rule with aspects more unique to the muni market are sufficient. The MSRB proposal notes the rule must be tailored for the muni market, so a dealer could demonstrate it met its obligations for specific munis by reviewing information to determine the current market for them or similar munis. That wording is not included in the FINRA rule.

Another muni-specific aspect of the proposed rule is its treatment of broker's brokers. Unlike the FINRA rule, draft Rule G-18 would not require dealers to show why it was reasonable to use a broker's broker.

The Securities Industry and Financial Markets Association last year floated an "execution with diligence" proposal that would have required dealers to use "reasonable diligence" to get a "fair and reasonable" price for customers. Randy Snook, SIFMA's executive vice president of business policies and practices, thanked the MSRB for considering that proposal but said SIFMA shares BDA's uncertainty about the rule's suitability for the muni market.

"Developing a higher standard is in the best interest of investors and the municipal market, and is

something SIFMA has been focused on for the past year," Snook said. "SIFMA appreciates the MSRB's consideration of our 'execution with diligence' proposal. We also appreciate that the MSRB, in its proposal, noted that a failure to have actually obtained the most favorable price will not necessarily mean that the dealer failed to use reasonable diligence. We are reviewing the MSRB's best-execution proposal, particularly with regard to the extent it reflects the unique characteristics of the municipal securities market as FINRA 5310 is, at its core, an equity market rule. SIFMA is committed to working with the MSRB on this issue and will provide more substantive comments after a full review with our members."

The MSRB said it was shooting for a principles-based rule that will protect investors without imposing a strict pricing standard on dealers. The board is seeking public comments on several questions related to the rule proposal. Among these are whether the same goal could be better achieved through alternative regulatory measures, whether a best execution standard is a worthwhile goal, what effect the rule might have on the efficiency of transactions, and what additional costs the rule might impose on dealers.

If a best-execution standard was adopted, dealers would need to establish or revise compliance policies and written supervisory procedures, as well as implement additional monitoring and surveillance. Dealers who are not subject to the FINRA rule would probably be the most affected and bear the highest costs, the MSRB said in the notice on its proposal.

The MSRB asked that public comments on the proposal be submitted by March 21. The rule would have to be filed with, and approved by, the SEC before it could take effect.

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