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MSRB to Consider Taking Action on Front Running, Best Execution.

The Municipal Securities Rulemaking Board, at its meeting in Boston next week, will consider whether to create a rule to crackdown on front running as well as request comments on applying best execution practices for municipal bonds.

There is currently no MSRB rule on front running, a type of insider trading that occurs when a dealer uses non-public knowledge to execute advantageous trades either for preferred customers or the firm's own accounts. A dealer might that has a customer who wants to sell a large dollar amount of securities might, for example, to choose to sell off its own holdings of that debt before the big sale hits the market and depresses the price. It could also include trading on other types of inside information, such as unreleased rating agency reports or financial data.

The Financial Industry Regulatory Authority has a rule that prohibits front running, and it is already specifically regulated in all other securities markets. Observers said it will be interesting to see whether the MSRB mimics FINRA's Rule 5270, which a member firm from buying or selling securities or other financial instruments if it has material information that is not publicly available.

The board may also decide to solicit comments on best execution, a concept which could be difficult to define, but could provide an opportunity for the MSRB to use an existing FINRA rule as a guide. The MSRB has been mulling the creation of a best execution rule since last year, when it was recommended by the Securities and Exchange Commission in its report on the municipal market.

Speaking at Securities Industry and Financial Market's 2012 Municipal Bond Summit, MSRB executive director Lynnette Kelly said any such rule, if based on FINRA's rule, would not require dealers to quote the best price to a customer. FINRA's rule requires dealers to have "written policies and procedures in place that address how [they] will determine the best interdealer market for such a security in the absence of pricing information or multiple quotations." It also requires dealers to document their compliance with those policies and procedures.

Malcolm Northam, the former head of fixed income regulation at the Financial Industry Regulatory Authority who now has his own consulting firm, said the discussion is complex because pricing is not the only factor to consider when determining the best execution for a customer. Some customers might be seeking liquidity, he noted, and even if that means they aren't getting the best price they might still be getting the best execution. Northam said it will be interesting to see the board's approach.

Paul Maco, a partner at Bracewell & Giuliani LLP and former SEC muni chief, had similar thoughts.

"This is an interesting concept," Maco said. "How are they going to define that? What does best execution mean in the context of a thinly traded over the counter market?"

The board will also discuss consolidating into a new rule two existing rules and guidance on fair pricing, a controversial topic that is likewise difficult to define. A recent study by the Fairfax, Va.-

based Securities Litigation and Consulting Group, Inc. claimed widespread markup abuse but drew a sharp retort from dealers. Other topics include whether the board should request public comments on enhancing existing post-trade data and collecting pre-trade information, or combine existing registration requirements into one rule.

by: KYLE GLAZIER

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