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[Best Execution's Role Unclear.]

WASHINGTON — Many municipal market professionals are concerned that the Municipal Securities Rulemaking Board's proposed best execution rule would not be functionally different from the fair pricing obligations that the MSRB and Financial Industry Regulatory Authority already impose on dealers.

The MSRB announced earlier this month that it will very soon seek Securities and Exchange Commission approval of the proposed best-ex rule, a well-known concept that already exists in the corporate market.

The proposed Rule G-18 would require dealers to use "reasonable diligence" when handling orders and executing municipal security trades for retail investors to "obtain a price that is as favorable as possible under prevailing market conditions." While market participants have expressed general support for many of the MSRB's concepts, many claim the proposed rule is not that different from existing fair pricing obligations and that it would create new burdensome compliance procedures for no good reason.

Elizabeth Baird, a partner in Bingham McCutchen's Washington office, said she does not view a best execution rule in the muni market as being distinct from rules requiring fair pricing and prohibiting unfair markups. The MSRB's Rule G-30 on prices and commissions requires that dealers conduct principal transactions at a price that is "fair and reasonable" and that they also make a "reasonable effort" to obtain a fair price for customers in agency transactions.

Baird said it is unclear what conduct would lead to a violation of the best ex rule, if and when the SEC gives it the go-ahead. The best execution proposal is basically an equities market concept ported over to the bond market so that regulators could appear to be reforming it, Baird said.

"They're doing it to appease somebody," she said. "Little by little, they're making it harder to operate in the municipal bond market."

The SEC's 2012 comprehensive report on the municipal market recommended that the MSRB adopt a best execution rule, and the MSRB has said in written materials that the rule would strengthen and support existing obligations.

Most dealers believe they already abide by the MSRB's best execution concept, sources said, but have concerns about how FINRA examiners will assess their compliance. The MSRB proposal includes a list of factors similar to those listed under the FINRA corporate best ex rule that could be used to determine if a dealer used "reasonable diligence," including what information the firm reviewed before the transaction and the terms and conditions of the customer's inquiry of the dealer.

Nathan Howard, an attorney who is counsel to the National Association of Independent Public Finance Advisors, said his group has argued that the rule would establish a "substantive pricing standard" because if best execution is applicable in a primary issuance then dealers will have to provide the “best price” to issuers while merely offering a “fair price” to investors. The MSRB said in its proposal that the rule would not be a substantive pricing standard, but rather an “order-handling and transaction-execution standard.”

“If the MSRB is correct, and the rule doesn’t create a substantive pricing standard, then I would agree, it is not necessary since it will not have a substantive impact on pricing,” Howard said. “However, this would seem contrary to the ‘provide the customer the most favorable price possible’ comment contained within the initial release.”

David Cohen, managing director and associate general counsel at the Securities Industry and Financial Markets Association, said the proposal creates a higher standard than the current obligations in terms of what it will require from dealers’ policies and procedures. SIFMA previously floated its own execution standard to the MSRB, calling it “execution with diligence.”

“The current execution standard is ‘fair and reasonable,’ which SIFMA believes is the proper standard in light of the structure of the municipal market,” Cohen said. SIFMA members believe that ‘best execution’ is an equity market concept that is inapplicable to the over-the counter markets such as municipal securities.”

The SEC would have to approve the MSRB proposal before it could become a rule, and could choose to require changes before doing so.

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