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MSRB Files Best-Ex Rule With SEC for Approval.

The Municipal Securities Rulemaking Board has asked the Securities and Exchange Commission to approve its proposal to require municipal securities dealers to seek the most favorable price possible when executing transactions for most investors.

The board wants the proposed changes to its Rule G-18 on execution of transactions, which are similar to those the MSRB issued in February, to take effect one year after the SEC approves them.

The best execution standard generally would require dealers to use “reasonable diligence” to determine the best market for a security and then buy or sell the security in that market so the resulting price to the customer “is as favorable as possible under prevailing market conditions,” the MSRB said.

To meet their due diligence obligations, dealers would have to take into account a list of factors, including the character of the market for the security, the size and type of transaction, the number of markets checked, the information reviewed to determine the current market for the subject security or similar securities, the accessibility of quotations, and the terms and conditions of the customer’s inquiry or order.

One MSRB factor does not appear in the Financial Industry Regulatory Authority best-ex rule for corporate bonds — information reviewed to determine the current market for the subject security or similar securities. This factor will help guide the use of reasonable diligence when dealers cannot find quotations for a bond, the MSRB told the SEC in the filing.

The board’s action follows recent complaints by some market participants that a best execution rule is not needed because it is very similar to the board’s Rule G-30 on fair prices and commissions.

But the MSRB told the SEC, “While G-30 contains substantive pricing standards, under which dealers must (among other things) use reasonable diligence in determining a security’s fair market value, a best execution standard is an order-handling and transaction-execution standard, under which the goal of the dealer’s reasonable diligence would be to ascertain among the variety of venues where the municipal security may be executed, the best market for the security.”

As proposed in February, broker-dealers would be exempt from the best execution standard in transactions with sophisticated municipal market professionals. SMMPs are institutional investors or individuals with assets of at least \$50 million.

But one market participant said the MSRB would make dealers get a whole new certificate of affirmation from SMMPs that significantly differs from the one dealers get for SMMPs under FINRA’s Rule 2111 on suitability. The rule changes proposed in February would have allowed dealers to use the same SMMP certificate that they use to comply with the FINRA rule. Obtaining new certificates will be burdensome, the source said.

The MSRB’s revised Rule G-18 would differ from the FINRA rule in another major way, as it does not

require dealers to show why it was reasonable to use a broker's broker. The MSRB said it wanted to develop a rule that did not favor any particular market venue over any other.

The MSRB said it received 10 comment letters on its proposed standard and that "many commenters supported the development of an explicit best-execution standard for the municipal securities market."

The National Association of Independent Public Finance Advisors raised concerns that the rule could create a different "substantive pricing standard" for issuers than for investors. But MSRB said the rule proposal is an "order-handling and transaction execution standard" that would not impact dealer behavior in new issuances.

Some dealers remain skeptical of the use of an equities market concept in the muni market. The Securities Industry and Financial Markets Association and others were concerned about the cost of compliance.

The MSRB told the SEC that it "welcomes SIFMA's offer to provide the MSRB reliable empirical data." The board also noted that SIFMA proposed "a highly similar order-handling rule" and said, "It has not been shown that the costs of proposed Rule G-18 would be significantly greater than the costs of SIFMA's proposal."

Jessica Giroux, senior counsel and senior vice president for federal regulatory policy at Bond Dealers of America, said, "We are pleased that transactions with SMMPs remain exempted from the proposal and that rule language and supplementary material tailor best-execution obligations to the unique characteristics of the municipal securities market. Further, it seems as if the supplementary material addresses some of the concerns we continue to discuss with our membership including the promotion of reasonable diligence versus a substantive pricing standard as well as allowances in instances where there are limited pricing information."

But Giroux added, "We still need to more closely analyze the proposal and plan to submit comments to the SEC."

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