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Municipal Securities  
Dealers

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Interpretive Guidance

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Fair Practice; Market  
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**Affected Rules**  
[Rule G-18](#)

## MSRB Amends Implementation Guidance on MSRB Rule G-18, on Best Execution

### Overview

The Municipal Securities Rulemaking Board (MSRB) is adopting clarifying amendments to implementation guidance on Rule G-18, on best execution (the “Implementation Guidance”).<sup>1</sup> The Implementation Guidance primarily provides answers to frequently-asked questions (FAQs) about Rule G-18.

Since the MSRB’s best execution requirements became effective in 2016, some market participants have communicated to the MSRB that the practice of posting the same bid-wanted for a municipal security simultaneously on multiple trading platforms may have harmful effects on dealers, investors and the market as a whole while not necessarily achieving improved execution for customers. While the posting of bid-wanted simultaneously on multiple trading platforms is not prohibited by MSRB rules and may be considered by dealers under prevailing facts and circumstances to be consistent with their best-execution obligations and beneficial to their customers, the MSRB has stated previously, including in the Implementation Guidance, that such simultaneous posting is not required.

### Amendments to the Implementation Guidance

To respond to stakeholder concerns, the MSRB published a request for comment on draft amendments to the Implementation Guidance (the “Request for Comment”) to further clarify this point by: (1) expressly stating that a dealer does not need to put a bid-wanted out with multiple fixed income alternative trading systems (ATSs) or broker’s brokers, though this may be warranted in some cases, or become a subscriber to every ATS to

<sup>1</sup> [MSRB Notice 2015-23](#) (Nov. 20, 2015). When publishing the Implementation Guidance and announcing the effective date of the rule, the MSRB indicated that it might update the FAQs periodically, and that any updates would include appropriate references to dates of new or modified questions and answers.



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meet its best-execution obligations; (2) emphasizing further the breadth of the term “market” and how a single ATS or a broker’s broker can provide exposure to multiple dealers and therefore multiple markets under Rule G-18; and (3) explaining further the facts and circumstances under which checking only one ATS or broker’s broker could satisfy the best-execution obligations.<sup>2</sup>

The MSRB received nine comment letters in response to the Request for Comment, six of which addressed the draft amendments to the Implementation Guidance.<sup>3</sup> All of the six commenters generally confirmed the rationale for, and the concerns related to, the practice of posting bid-wanted simultaneously on multiple ATSs/with multiple broker’s brokers, as raised by stakeholders and highlighted in the Request for Comment, and also generally supported the need to amend the Implementation Guidance to provide greater clarity on how the practice relates to the number of markets checked factor and compliance with Rule G-18.

First, BDA indicated its belief that some dealers post bid-wanted simultaneously on multiple trading platforms to satisfy their best-execution obligations but recognized that such practice is not a mandated component of compliance with Rule G-18. Accordingly, BDA believes it is important for the MSRB to be very clear that such practice is not required.

BDA further noted, however, that there are good and legitimate reasons for a dealer to post bid-wanted simultaneously on multiple ATSs/with multiple broker’s brokers, such as where a dealer may have concerns regarding what kinds of bids it may receive on or from any given ATS or broker’s broker.

Additionally, RBI, a broker’s broker, indicated that it has seen an increase in the number of items put out for the bid with multiple broker’s brokers since the implementation of, and for the purpose of complying with, Rule G-18. RBI views each bid in response to a bid-wanted to be a market for the bond

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<sup>2</sup> [MSRB Notice 2018-22](#) (Sept. 7, 2018). The Request for Comment also addressed the market practice of pennyng, which is not addressed in this notice.

<sup>3</sup> See Letters from: [Michael Nicholas, Chief Executive Officer, Bond Dealers of America](#) (BDA), dated November 13, 2018; [Edward J. Smith, Chief Compliance Officer, and Christopher C. Ferreri, Chief Operating Officer, Hartfield, Titus & Donnelly, LLC](#) (HTD), dated November 13, 2018; [Joseph A. Hemphill III, CEO, and H. Deane Armstrong, CCO, Regional Brokers, Inc.](#) (RBI), dated November 6, 2018; [Denien Rasmussen, Co-Chief Compliance Officer and Chief Operating Officer, RW Smith & Associates, LLC](#) (RWS), dated November 13, 2018; [Leslie M. Norwood, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association](#) (SIFMA), dated November 13, 2018; and [Thomas S. Vales, Chief Executive Officer, TMC Bonds LLC](#) (TMC), dated November 14, 2018.

and requests that the MSRB define each bid as such. HTD and RWS, also broker's brokers, submitted comment letters which also noted the increase in the number of bid-wanted being posted simultaneously with multiple broker's brokers and ATs coinciding with the implementation of Rule G-18. HTD and RWS believe there is a misunderstanding among market participants of best-execution obligations, which is causing dealers to post what are essentially duplicate bid-wanted solely for the purpose of meeting such obligations. Like RBI, HTD and RWS believe the issue can be addressed by making it clear that every bid is, in fact, a "market" under the rule and that it is not necessary to put bid-wanted out with multiple broker's brokers and ATs.

Like the other commenters, SIFMA noted that it has become common practice for some dealers to post the same bid-wanted simultaneously with multiple broker's brokers and ATs for compliance with Rule G-18. SIFMA indicated that this practice may impact other dealers' willingness to respond to bid-wanted or otherwise alter their bidding strategies, which may have a negative impact on the market. Although SIFMA noted that it is clear that posting bonds a dealer owns or posting a bid-wanted on multiple trading platforms is not a violation of MSRB rules, it recommended minor revisions to the draft amendments to make it clear that multiple postings are not necessary.

Finally, TMC opined that the Implementation Guidance on this aspect of the rule is vague, which, in TMC's view, has encouraged the practice, as well as the issues caused by the duplication of bid-wanted.

After careful consideration of these comments, the MSRB is amending the Implementation Guidance in substantially the same form as proposed in the draft amendments with minor revisions to provide even more clarity as requested by commenters. The MSRB notes that the amendments are intended to provide further clarification of Rule G-18 and the Implementation Guidance specifically related to the number-of-markets-checked factor. They are not, however, intended to amend the rule itself or otherwise change its requirements by, for example, prohibiting dealers from using multiple ATs and/or broker's brokers to achieve best execution.

Importantly, while the MSRB believes that the steps necessary to achieve best execution depend upon the prevailing facts and circumstances, it does not intend to discourage dealers from posting bid-wanted simultaneously using multiple ATs and/or broker's brokers if the dealer believes that this is necessary or appropriate to achieve best execution.

Questions concerning this notice may be directed to John Bagley, Chief Market Structure Officer, or Lanny A. Schwartz, Chief Regulatory Officer, at 202-838-1500.

February 7, 2019

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## Text of Amendments\*

### Background

MSRB Rule G-18, establishing the first best-execution rule for transactions in municipal securities, ~~will be effective 120 days from the date of the publication of this implementation guidance, which is~~became effective March 21, 2016. The best-execution rule requires brokers, dealers and municipal securities dealers (dealers) to use reasonable diligence to ascertain the best market for the subject security and buy or sell in that market so that the resultant price to the customer is as favorable as possible under prevailing market conditions. Related amendments to MSRB Rule G-48, on transactions with sophisticated municipal market professionals (SMMPs), and to MSRB Rule D-15, on the definition of an SMMP, exempt transactions with SMMPs from the best-execution rule. This implementation guidance provides answers to frequently asked questions about the best-execution rule and the SMMP exemption.

### Use of This Document

The MSRB is providing in this document general implementation guidance on certain aspects of new Rule G-18 and amended Rules G-48 and D-15 (rules) in a question-and-answer format. This guidance is designed to support compliance with the best-execution rule and the SMMP exemption.<sup>1</sup> The answers are not considered rules and have neither been approved nor disapproved by the Securities and Exchange Commission (SEC).

The MSRB may update these questions and answers periodically, and any updates will include appropriate references to dates of new or modified questions and answers.

I - II No changes.

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\* Underlining indicates new language; strikethrough denotes deletions.

<sup>1</sup> The MSRB believes the guidance in this Notice is consistent in all material respects with guidance on best execution obligations on transactions in corporate fixed income securities published by the Financial Industry Regulatory Authority (FINRA) on November 20, 2016, except where the rule or context otherwise specifically requires. The two instances where material differences exist with the FINRA guidance are with respect to (1) the review of policies and procedures and execution quality by dealers, and (2) the timeliness of executions consistent with reasonable diligence. See note 12 and accompanying text; VI.1 infra; Section 1 (The Duty of Best Execution) and Section 2 (Regular and Rigorous Review for Best Execution) of FINRA Notice to Members 15-46 (November 2015). The MSRB and FINRA will continue to work together with the goal of ensuring that their guidance on best-execution obligations remains consistent in all material respects, unless differentiation is necessary due to differences in the markets for municipal or corporate fixed income securities or their respective rules.

### III. REASONABLE DILIGENCE FACTORS – NUMBER OF MARKETS CHECKED

#### III.1: General

**Q: When effecting a customer transaction in municipal securities, how many dealers and/or markets does a dealer need to check, and how much diligence does a dealer need to conduct in order to have confidence that all appropriate dealers and/or markets are included?**

**A:** The duty of best execution requires a dealer to use reasonable diligence. It does not require a dealer to access every available market, especially given the differences in pricing information and execution functionality offered, and there is no set number of dealers making an offer or collecting bids on behalf of a customer order, or other markets, to check that categorically qualifies as reasonable diligence for compliance with the best-execution obligation. Accordingly, a dealer does not need to post a bid-wanted simultaneously on multiple fixed income alternative trading systems (ATs) and/or with multiple broker's brokers, though this may be warranted in some cases, or become a subscriber to every ATs. However, in general, dealers should check more than one market or expose customer orders to multiple offerings or bids, and show external offerings and bids to retail customers, which may be accomplished by the use of ATs or broker's brokers that expose orders to multiple dealers, each of which constitutes a "market," as that term is broadly defined in paragraph .04 of the Supplementary Material.<sup>10</sup> For example, a dealer's policies and procedures could require that, after receiving offers or bids, the dealer must evaluate the offer or bid price versus relevant market information to determine whether any additional markets, including, but not limited to, other dealers, should be checked to perform reasonable diligence. Each dealer should consider including in its written policies and procedures how and when its trading desk exposes retail customer orders to multiple offerings or bids and shows external offerings and bids to retail customers (directly or through financial advisors). Some dealers may employ "filters," which generally refer to automated tools that allow the dealer to limit its trading, with, for example, specific parties or parties with specified attributes with which it does not want to interact. If a dealer uses filters on counterparties or filters on specific securities intended to limit accessing bids or offers in those securities, they may be used only for a legitimate purpose consistent with obtaining the most favorable executions for non-SMMP customers, and should be reviewed on a periodic basis and adjusted as needed. The dealer, accordingly, should have policies and procedures in place that govern when and how to: reasonably use filters without negatively impacting the quality of execution of non-SMMP customer transactions; periodically reevaluate their use; and determine whether to lift them upon request.<sup>11</sup>

Given that the rule is designed, in part, to promote fair competition among dealers, generally, a dealer's policies and procedures should facilitate competition for its customer order flow, including by eliminating practices that discourage other dealers from offering (bidding on) securities to (from) its clients. However,

<sup>10</sup> See III.5 *infra*.

<sup>11</sup> The scope of a dealer's policies and procedures on the use of filters, as well as the periodic review and adjustment of their use, should be appropriate to the nature of the dealer's municipal securities business and, therefore, may be different than the policies and procedures used by other dealers.

exposing customer order flow to other dealers, alone, is not sufficient to satisfy reasonable diligence, and dealers must also consider the non-exhaustive list of factors identified in Rule G-18(a).

(November 20, 2015)

(Updated February 7, 2019)

### **III.2: Use of Broker's Brokers and ATSs**

#### **Q: Under what circumstances must a dealer use a broker's broker or ~~alternative trading systems (an ATS)~~ to demonstrate reasonable diligence in ascertaining the best market?**

**A:** There is no categorical requirement in MSRB Rule G-18 for dealers to use a broker's broker or an ATS, and the rule is designed specifically not to favor any particular type of venue over another for dealers to meet their best-execution obligations. Paragraph .04 of the Supplementary Material construes the term "market" broadly for purposes of Rule G-18, including the rule's core provision, section (a), requiring the exercise of reasonable diligence in ascertaining the "best market" for the security. Paragraph .04 of the Supplementary Material states: "This expansive interpretation is meant both to inform dealers as to the breadth of the scope of venues that must be considered in the furtherance of their best-execution obligations and to promote fair competition among dealers (including broker's brokers), alternative trading systems and platforms, and any other venue that may emerge, by not mandating that certain trading venues have less relevance than others in the course of determining a dealer's best-execution obligations." A principal purpose of this broad and even-handed language is to tailor the definition of the critical term "market" to the characteristics of the municipal securities market and provide flexibility for future developments in both market structure and applied technology. For example, the language expressly recognizes a characteristic of the municipal securities market (*i.e.*, the role of dealer inventories in providing liquidity) by providing that the executing dealer itself, acting in a principal capacity, may be the best market for the security. Additionally, while an ATS or a broker's broker, individually, can be considered a market, each can also be a mechanism to expose customer orders to multiple dealers and, therefore, multiple markets.

As the availability of electronic systems that facilitate trading in municipal securities increases, dealers need to determine whether these systems might provide benefits to their customer order flow, particularly retail order flow, and help ensure they are meeting their obligations under Rule G-18(a) with respect to ascertaining the best market for their customer transactions. Similarly, pre-trade transparency, such as through electronic trading platforms, is also increasing in the municipal securities market, and dealers need to periodically analyze and determine whether incorporating pricing information available from these systems should be incorporated into their best-execution policies and procedures.

The MSRB recognizes that different markets provide different levels of price information and execution functionality, and that a dealer's analysis of the available pricing information offered by different systems may take these differences into account. Some systems, including auto-execution systems, both display prices and provide execution functionality, while other systems display prices but provide no execution functionality. Still other systems, such as request-for-quotation systems, may provide indications of interest but not display prices or provide execution functionality. As such, it is the dealers' responsibility to

evaluate various markets (e.g., ATSS, inter-dealer brokers, other dealers) and to establish and periodically review reasonably designed written policies and procedures addressing when and how certain markets should be checked to satisfy the requirements of the rule. Pursuant to paragraph .08(a) of the Supplementary Material, “[i]n conducting its periodic reviews, a dealer must assess whether its policies and procedures are reasonably designed to achieve best execution, taking into account the quality of the executions the dealer is obtaining under its current policies and procedures, changes in market structure, new entrants, the availability of additional pre-trade and post-trade data, and the availability of new technologies, and to make promptly any necessary modification(s) to such policies and procedures as may be appropriate in light of such reviews.” As an aspect of this periodic review, dealers should review the execution quality provided by the various markets they choose to use (including the internalization of order flow), and, to the extent information is reasonably available, the execution quality of new markets or markets they do not use to determine whether to use them.<sup>12</sup> This review could include, for example, reviewing EMMA<sup>®</sup> data for previous executions in the subject security or similar securities.

Additionally, Rule G-18(a) provides a non-exhaustive list of factors that will be considered in determining whether a dealer has used reasonable diligence, with no single factor being determinative, including: (1) the character of the market for the security (e.g., price, volatility and relative liquidity); (2) the size and type of transaction; (3) the number of markets checked; (4) the information reviewed to determine the current market for the subject security or similar securities; (5) the accessibility of quotations; and (6) the terms and conditions of the customer’s inquiry or order, including any bids or offers, that result in the transaction, as communicated to the dealer. Accordingly, a dealer’s policies and procedures for best execution should address how these factors will affect the dealer’s municipal securities transactions with customers under various conditions.

(November 20, 2015)

(Updated February 7, 2019)

**III.3** No changes.

#### ***III.4: One ATS/Broker’s Broker***

**Q: Can a dealer comply with MSRB Rule G-18 by exposing customer orders to an ATS or broker’s broker municipal trading platform that captures offers/bids from multiple markets?**

**A:** The market for municipal securities has evolved significantly in recent years. Some dealers have reduced their inventory positions in response to market and regulatory influences and the use of electronic trading systems, including ATSS, continues to grow. In addition, transaction prices for most municipal securities are now widely available to market participants and investors. Although the amount of pre-trade pricing

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<sup>12</sup> In adopting Rule G-18, and paragraph .08 of the Supplementary Material specifically, the MSRB did not include provisions that are contained in FINRA Rule 5310 pertaining to “regular and rigorous review of execution quality,” to tailor the rule to the characteristics of the municipal securities market. Accordingly, the implementation guidance provided herein on dealers’ review of execution quality differs from guidance on regular and rigorous review that has been published by FINRA.

information (*e.g.*, bids and offers) available also has increased, it is still relatively limited as compared to equity securities and generally not readily accessible by the investing public. While new technology and communications in the municipal securities market have advanced, the market remains decentralized, with much trading still occurring primarily through individual dealers.

In light of this evolution of the municipal securities market, the MSRB encourages the use of broker's brokers, ATSS and other markets that typically provide exposure to ~~multiple offers/bids from multiple dealers, each of which could constitute a separate market~~, and it recognizes there may be facts and circumstances under which it may be sufficient for a dealer to check only one such market and satisfy the best-execution obligation. However, utilizing one ATS, one broker's broker or other similar market will not qualify categorically as reasonable diligence in compliance with Rule G-18. To the extent a dealer checks only one ATS, broker's broker or other similar market when executing customer orders, the dealer's policies and procedures should establish what facts and circumstances may allow for the checking of only one such market (*e.g.*, competitiveness of the ATS[,]; the number of dealers, offerings or bids an order is generally exposed to through the ATS or broker's broker; accessibility of quotations) and what steps would be required to be taken in those situations.

(November 20, 2015)

(Updated February 7, 2019)

**III.5 - VIII** No changes.