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November 6, 2018

Category
Fair Practice

Affected Rules
[Rule G-17](#), [Rule G-18](#)

Request for Comment on Draft Interpretive Guidance on Pennyning and Draft Amendments to Existing Guidance on Best Execution

Overview

The Municipal Securities Rulemaking Board (MSRB) is seeking comment on draft interpretive guidance related to “pennyning” and draft amendments to existing guidance on best execution relating to the posting of bid-wanted on multiple trading platforms.¹

In addition, as part of its ongoing review of its rules, the MSRB also seeks comment as to whether there are other secondary market trading practices that could benefit from additional regulatory guidance or clarity, or whether there are any MSRB requirements related to secondary market trading practices that commenters may feel are no longer necessary and could be removed from and/or amended in MSRB rules.

Comments should be submitted no later than November 6, 2018 and may be submitted in electronic or paper form. [Comments may be submitted electronically by clicking here](#). Comments submitted in paper form should be sent to Ronald W. Smith, Corporate Secretary, Municipal Securities Rulemaking Board, 1300 I Street NW, Suite 1000, Washington, DC 20005. Generally, all comments will be available for public inspection on the MSRB’s website.²

¹ A bid-wanted is the process by which a dealer or investor actively solicits bids on a security from the marketplace.

² Comments generally are posted on the MSRB website without change. For example, personal identifying information such as name, address, telephone number, or email address will not be edited from submissions. Therefore, commenters should only submit information that they wish to make available publicly.



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Questions about this notice should be directed to John Bagley, Chief Market Structure Officer, Leila Barbour, Market Leadership Manager, Saliha Olgun, Associate General Counsel, or Carl Tugberk, Assistant General Counsel, at 202-838-1500.

Background and Request for Comment

Pennying

“Pennying,” sometimes also referred to as “last-look,” occurs when a dealer purchases bonds for its own account, following the dissemination of a bid-wanted (through either an alternative trading system or a broker’s broker) for a customer who is seeking to sell a municipal security. The dealer, after reviewing bid information received, either matches the high bid received in response to the bid-wanted or purchases the bonds at a price that is nominally higher than the high bid.

When viewed in isolation, this practice may *appear* to benefit the customer, as the dealer technically provides the customer a price that is equal to, or nominally better than, the best bid obtained through the bid-wanted process. However, widespread pennyning may have harmful effects for investors, bidding dealers and the market as a whole, as more fully described below.

The MSRB previously expressed concern about pennyning in the context of the use of broker’s brokers. In a 2012 notice to dealers that use the services of broker’s brokers, the MSRB stated that the use of broker’s brokers solely for price discovery purposes (and not with a bona fide intent to trade) harms the bid-wanted and offering processes by reducing bidders, thereby reducing the likelihood that the high bid in a bid-wanted will represent the fair market value of the securities.³ The MSRB noted that potential bidding dealers had informed the MSRB that they were skeptical of many of the bid-wanted they saw because they believed they were being used solely for price discovery purposes (and did not represent a true intent to sell). Additionally, the MSRB noted that such use solely for price discovery purposes causes broker’s brokers to work without reasonable expectation of compensation. Accordingly, the notice concluded that, depending upon the facts and circumstances, the use of bid-wanted solely for price discovery purposes

³ See [MSRB Notice to Dealers That Use the Services of Broker’s Brokers](#) (December 22, 2012).

may be a violation of a dealer's fair-dealing obligations under MSRB Rule G-17, the MSRB's fair dealing rule.⁴

In recent outreach to a broad range of market participants, it has been suggested that pennyning is prevalent in the municipal market and that widespread pennyning does indeed disincentivize participation in the bid-wanted process, discourages bidders from giving their best price in a bid-wanted and may impact the efficiency of the market. Additionally, while the MSRB is not aware of any economic literature analyzing pennyning in the municipal market, one recent study analyzing behavior similar to pennyning in the equity market (*i.e.*, stepping ahead of a publicly-displayed order by an economically insignificant amount to trade with a customer contra order) found that such behavior may discourage public quotations and therefore impair market quality—particularly for illiquid securities.⁵ Since most municipal bonds are relatively illiquid when compared to stocks and even other fixed-income securities, the MSRB is concerned that pennyning in the municipal market also may discourage quotations by market participants and thus harm municipal market liquidity. To address these concerns and given the increasing role of alternative trading systems (ATSs) in the municipal market,⁶ the MSRB now seeks comment on a proposal generally to extend the 2012 guidance on pennyning in the context of broker's brokers to pennyning that occurs following a bid-wanted distributed via an ATS. As described in the draft interpretive guidance, the MSRB would make clear that, depending on the facts and circumstances, the use of bid-wanted (whether distributed via an ATS or broker's broker) solely for price discovery

⁴ In a recent letter to the SEC Investor Advocate, the MSRB explained that, where a dealer engages in pennyning, the dealer's willingness to improve the highest bid, even nominally, is beneficial to a customer in the short term. However, the MSRB is concerned that pennyning can be harmful to investors over the long term if the practice discourages broad market participation in the bidding process and renders the market less efficient. See [letter to Rick A. Fleming, Investor Advocate, U.S. Securities and Exchange Commission](#) (Oct. 17, 2017).

⁵ One research paper found that the market quality for illiquid stocks declines with a reduction of the tick size (*i.e.*, the minimum price movement), while it improves for liquid stocks. Specifically, for illiquid low-priced stocks, the quality of a publicly displayed limit order book is dramatically worsened when broker-dealers are able to internalize customers' orders to provide price improvement by a fraction of the tick size. See Sabrina Buti et al., *Tick Size Regulation, Intermarket Competition and Sub-Penny Trading* (June 1, 2011) (unpublished working paper), available at https://pdfs.semanticscholar.org/7e73/098e21c6ae192911896aef2f9f99591665df.pdf?_ga=2.18224377.1394747225.1536070826-816104628.1536070826.

⁶ See MSRB, [Transaction Costs for Customer Trades in the Municipal Bond Market: What is Driving the Decline?](#), at 6 (July 2018) (noting that electronic trading systems have progressed since 2000, especially in the inter-dealer municipal securities market, in which alternative trading systems account for nearly 60% of inter-dealer trades).

purposes would be an unfair practice within the meaning of Rule G-17, and that the repeated practice of pennyng would be indicative of having the sole purpose of price discovery.

Request for Comment

The MSRB seeks comment on draft interpretive guidance on pennyng. In considering the draft interpretive guidance, the MSRB invites commenters to consider the following questions. The MSRB particularly welcomes statistical, empirical and other data from commenters that may support their views and/or support or refute the views or assumptions or issues raised in this request for comment.

1. Is pennyng prevalent or uncommon in the municipal securities market?
2. Would bidding dealers bid more often or more aggressively if they were confident that widespread pennyng did not occur in the municipal market or if they were confident that pennyng would not occur in a bid-wanted?
3. Does the draft interpretive guidance raise any new questions or sufficiently answer the question of what is pennyng? Is more guidance necessary to answer this question? If so, what type of guidance would be valuable?
4. Does the draft interpretive guidance represent the appropriate approach to addressing pennyng in the municipal securities market?
5. As an alternative to adopting the draft interpretive guidance, should the MSRB instead pursue rulemaking to prohibit pennyng? Why or why not? Are there other alternatives that may achieve the same or greater benefits sought by the MSRB at lower cost or burden?
6. If the dealer bids in competition (the dealer submits a bid as part of the bid-wanted process) and on a blind basis (without knowledge of the other bid prices), should any guidance or rule make clear that pennyng has not occurred in those situations, even if the dealer's best such bid is the same as or only modestly better than the next best bid?
7. What are the pros and cons of a dealer using a bid-wanted as opposed to a bid-wanted in competition? Why would a dealer with interest in a bond not distribute a bid-wanted in competition as

opposed to distributing a bid-wanted and then purchasing the bond for its account following the end of the bid-collection period?

8. The draft interpretive guidance provides that, depending on the facts and circumstances, the use of bid-wanted (whether distributed via an ATS or broker's broker) solely for price discovery purposes would be an unfair practice within the meaning of Rule G-17, and that the repeated practice of pennyng would be indicative of having the sole purpose of price discovery.
 - a. Is it appropriate to apply an intent-based standard to determine whether pennyng has occurred?
 - b. Is it more appropriate to pursue a bright-line standard?
 - c. Are there instances in which the use of a bid-wanted solely for price discovery should not be deemed an unfair practice within the meaning of Rule G-17?
9. Should the MSRB define what volume or frequency of pennyng would constitute a "repeated practice"? Is guidance necessary on whether a dealer has engaged in a "repeated practice" of pennyng?
10. Given that Rule G-18, on best execution, is an order-handling rule designed to encourage competition, if widespread pennyng discourages dealers from bidding or bidding aggressively, should the MSRB interpret a repeated practice of pennyng as impairing a dealer's ability to meet its best-execution obligations? For example, if a dealer's policies and procedures permit it to engage in a repeated practice of pennyng, should those policies and procedures be viewed as inconsistent with the dealer's best-execution obligations?
11. Is the process for retail bid-wanted significantly different than the process for institutional bid-wanted (e.g., longer firm times—the length of time for which the bidder must honor the bid provided, use of bid-wanted versus bid-wanted in competition, use of last looks)? Is it significantly different even for similar-size positions? If so, are there reasonable grounds for the difference in process or should they be more alike?
12. Should there be a "safe harbor" under the Rule G-17 interpretation for internalization with a substantial price improvement over the best bid in a bid-wanted? If so, is there an amount that should presumptively be deemed "substantial" price improvement?

13. Is there any data that sheds light on the prevalence or impact of pennyng on the market?
14. Would the draft interpretive guidance, if adopted, create direct, indirect or inadvertent costs or burdens? Is there data or other evidence, including studies or research, that support commenters' cost or burden estimates?

Posting Bid-Wanted on Multiple Trading Platforms

Some market participants have observed to the MSRB that the practice of posting the same bid-wanted simultaneously on multiple trading platforms may have harmful effects to dealers, investors and the market as a whole while not necessarily achieving improved execution for customers. Specifically, such market participants have commented that this practice results in "bidder fatigue," whereby dealers expend significant time determining if they previously bid on duplicative bid-wanted or do not bid at all if they mistakenly believe they have, which could lead to reduced liquidity in the secondary market. Similarly, the MSRB has been informed that the posting of a bid-wanted on multiple trading platforms creates a distorted sense of liquidity and a false impression of the depth of the market since what appears on the surface to be multiple offers to sell bonds are in fact only one offer to sell.

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 customer, the MSRB has stated previously that this is not necessarily required in all cases. The proposed amendments to certain of its frequently-asked questions regarding best execution further clarify this point.

Rule G-18, on best execution, requires dealers, in any transaction for or with a customer or a customer of another dealer, to use reasonable diligence to ascertain the best market for the subject security and to buy or sell in that market so that the resultant price to the customer is as favorable as possible under prevailing market conditions. The rule includes a non-exhaustive list of factors that dealers must consider when exercising the reasonable diligence required, which includes the number of markets checked. Following the adoption of Rule G-18, the MSRB published implementation guidance in the form of answers to frequently-asked questions that addressed a number of issues on the standard and was designed to support compliance with the

rule.⁷ While the guidance explains that there is no requirement to use multiple trading platforms (*e.g.*, ATSs and broker's brokers) to satisfy a dealer's best-execution obligations and highlights the flexibility in the rule to accommodate different approaches, including the use of only one trading platform, the MSRB understands that it has become common for firms to seek to fulfill their best-execution obligations by posting the same bid-wanted simultaneously on multiple trading platforms. The MSRB believes that some dealers may not be fully aware of this prior guidance, or may have questions regarding its intended application, and may believe that it is a necessary component of best execution to posting the same bid-wanted simultaneously on multiple trading platforms.

In light of the foregoing, the MSRB is requesting comment on adopting clarifying changes to this guidance. Specifically, the clarifications would: (1) expressly state that a dealer may not need to post a bid-wanted on each fixed income ATS or broker's broker for a sell order or become a subscriber to every ATS to meet its best-execution obligations; (2) emphasize further the breadth of the term "market" and how an ATS or a broker's broker can be considered multiple markets under Rule G-18; and (3) explain further the facts and circumstances under which checking only one ATS or broker's broker could satisfy the best-execution obligation.⁸ The MSRB notes that the draft amendments are intended to provide 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 trading platforms 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 on multiple trading platforms if the dealer believes that this is necessary or appropriate to achieve best execution (and/or its policies and procedures require this).

⁷ See [MSRB Notice 2015-23](#) (Nov. 20, 2015); [Implementation Guidance on MSRB Rule G-18, on Best Execution](#) (Nov. 20, 2015).

⁸ FAQ III.4 currently explains the facts and circumstances under which checking only one ATS could satisfy the best-execution obligation. The draft amendments therein would add conforming references to broker's brokers to more comprehensively address markets that expose customer orders to multiple offerings or bids.

Request for Comment

The MSRB seeks comment on the draft amendments to the implementation guidance on best execution. In considering the draft amendments, the MSRB invites commenters to consider the following questions. The MSRB particularly welcomes statistical, empirical and other data from commenters that may support their views and/or support or refute the views or assumptions or issues raised in this request for comment.

1. Is the practice of posting the same bid-wanted simultaneously on multiple trading platforms prevalent in the municipal securities market?
2. Does the posting of the same bid-wanted simultaneously on multiple trading platforms provide dealers with greater access to liquidity?
3. Are there reasons for a dealer to post the same bid-wanted simultaneously on multiple trading platforms other than for the purpose of complying with Rule G-18?
4. Does the posting of the same bid-wanted simultaneously on multiple trading platforms impact dealers' willingness to respond to bid-wanted, and do dealers alter their bidding strategies when responding to bid-wanted that are posted simultaneously on multiple trading platforms?
5. Does the practice of posting the same bid-wanted simultaneously on multiple trading platforms otherwise have an effect on market liquidity? If the foregoing effects are observed, should the MSRB take any action, such as engaging in rulemaking, to prevent any perceived or observed market harms?
6. Does the practice of posting simultaneously on multiple trading platforms occur on the offering side of the market? If so, please comment on its prevalence and impact in response to the above questions as it relates to that side of the market.
7. Would the draft amendments, if adopted, create direct, indirect or inadvertent costs or burdens? Is there data or other evidence, including studies or research, that support commenters' cost or burden estimates?

September 7, 2018

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Text of Draft Notice on Pennyning

Interpretive Notice on Pennyning

This notice is intended to extend prior MSRB interpretive guidance on pennyning in the context of broker's brokers, which provided that, depending upon the facts and circumstances, the use of bid-wanted solely for price discovery purposes may be a violation of a dealer's fair-dealing obligations under MSRB Rule G-17, to pennyning that occurs following a bid-wanted distributed via an ATS, even where the dealer may not be acting in the capacity of a broker's broker. It further provides that the repeated practice of pennyning would be indicative of having the sole purpose of price discovery.

Introduction

When a customer considers selling a bond, the customer typically will contact his or her dealer. Often, the dealer will place a bid-wanted with a broker's broker or post a bid-wanted on an alternative trading system (ATS). Typically following the conclusion of the bid-collection period, the ATS or broker's broker will convey the high bid to the dealer. The dealer then will convey the high bid (less the compensation to the dealer) to the customer, and the customer will decide whether to sell at that price. If the customer determines to sell at that price, in some instances, the dealer will purchase the bonds from the customer for its own proprietary account, rather than act as an intermediary between the customer and the highest bidder and sell that security to the highest bidder. If the dealer determines to buy the bonds for its own account or "internalize," the dealer may match the high bid or offer the customer a nominal price improvement in comparison to the high bid.¹ This practice is known as "pennyning" and is sometimes also referred to as "last look."

The MSRB notes that while pennyning—one form of internalization—may have harmful effects on the market, there are other forms of internalization that may not have these same effects or may even be beneficial to the market. For example, a dealer may determine to internalize and significantly improve upon the best bid in a bid-wanted because the best bid received would not result in a fair and reasonable price to the dealer's customer. In other instances, the dealer itself may provide the best bid in a bid-wanted in competition (blind). As described further below, the harm sought to be addressed by the MSRB arises not with the practice of all internalization, but with one specific type of internalization that causes harm to the market. Accordingly, the guidance below is tailored to address pennyning in the municipal market and does not necessarily apply to all instances of internalization.

Discussion

In guidance on broker's brokers issued in 2012,² the MSRB addressed the issue of pennyning in the context of Rule G-17, on conduct of municipal securities and municipal advisory activities. There, the MSRB explained that broker's brokers had informed the MSRB that many dealers place bid-wanted and

¹ In other cases, the dealer may bid the highest bid (or match the highest bid) in the bid-wanted, but only after all other bidders have submitted their bids, in which case the dealer's bid will be informed by the bids of the other bidders. In contrast, where the dealer bids on a "blind" basis, the dealer's bid is not informed by the bids of other bidders.

² [MSRB Notice to Dealers That Use the Services of Broker's Brokers](#) (December 22, 2012).

offerings with broker's brokers with no intention of selling the securities through the broker's brokers and that, shortly thereafter, the same securities are purchased by those dealers for their own accounts at prices that exceed the high bid by only a very small amount. Others had informed the MSRB that they were skeptical of many of the bid-wanted they saw because they believed that the bid-wanted are being used for price discovery by the dealers. Accordingly, in many cases, they do not bid. The MSRB further noted that this use of broker's brokers solely for price discovery (and not with a bona fide intent to trade) harms the bid-wanted and offering process by reducing bidders, thereby reducing the likelihood that the high bid in a bid-wanted will represent the fair market value of the securities. Accordingly, depending upon the facts and circumstances, the use of bid-wanted solely for price discovery purposes may be an unfair practice within the meaning of Rule G-17.

The MSRB believes that many of the same harms described in that guidance also occur when pennyng is engaged in by a dealer who posts the bid-wanted on an ATS.³ Several dealers informed the MSRB that pennyng was a significant issue of concern in the municipal securities market and that they often do not participate in bid-wanted with other dealers that they believe engage in pennyng. They indicated that there is little incentive for bidding dealers to spend the time and effort required to conduct the necessary due diligence to bid on bonds when their high bid is repeatedly matched or nominally improved upon by the dealer and internalized. These dealers also indicated that they do not put their "best foot forward" on ATSs where they feel pennyng is prevalent. For example, they may provide lower bids, bid less often, or prioritize their time by bidding only on bid-wanted they feel they may have a higher chance of transacting. Some buy-side representatives expressed similar sentiments, also noting that they do not actively participate in bid-wanted from certain platforms on which they believe that pennyng may be widespread.

In the aggregate, the MSRB believes that—regardless of the trading platform or venue a dealer may use to distribute a bid-wanted—widespread pennyng results in significant harms to the market. It artificially inflates the depth of market for a particular bond, results in bidder fatigue, discourages competition and creates a false sense of liquidity, as what appears on the surface to be an offer to sell bonds is in fact only price discovery activity. Further, it may harm the selling customer as fewer bidders bid on their bonds and the likelihood that the final price to the customer will represent the fair market value of the securities and be as favorable as possible under prevailing market conditions is reduced. Widespread pennyng also may hamper market efficiency as dealers bid on bonds that, in reality, they have little or no chance of purchasing. Accordingly, depending on the facts and circumstances, the use of bid-wanted—whether distributed via an ATS or broker's broker—solely for price discovery purposes would be an unfair practice within the meaning of Rule G-17. Further, the repeated practice of pennyng would be indicative of having the sole purpose of price discovery.

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³ The MSRB notes that, to the extent an ATS is also a broker's broker, the 2012 guidance regarding pennyng already applies to pennyng that occurs following a bid-wanted distributed via the broker's broker.

TEXT OF DRAFT AMENDMENTS TO IMPLEMENTATION GUIDANCE ON MSRB RULE G-18, ON BEST EXECUTION*

Questions and Answers Concerning Best Execution and the Exemption for Transactions with Sophisticated Municipal Market Professionals: Rules G-18, G-48 and D-15

I - II No changes.

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 may not need to post a bid-wanted simultaneously on each fixed income alternative trading system (ATS) and/or broker's broker for a sell order, or become a subscriber to every ATS to meet its best-execution obligations. 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 ATSs or broker's brokers that expose orders to multiple dealers, each of which may constitute a "market," as that term is broadly defined in paragraph .04 of the Supplementary Material.¹⁰ 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

* Underlining indicates new language; strikethrough denotes deletions.

¹⁰ See III.5 *infra*.

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.¹¹

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, 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).

III.2: Use of Broker's Brokers and ATs

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

¹¹ 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.

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.¹² This review could include, for example, reviewing EMMA[®] 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.

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?

¹² 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.

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 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.

III.5 - VIII No changes.