

Client Alert

Current Issues Relevant to Our Clients

December 1, 2015

New MSRB Best Execution Rule Effective March 21, 2016; FINRA and MSRB Provide Best Execution Guidance

In December 2014, the Securities and Exchange Commission approved a new Municipal Securities Rulemaking Board (“MSRB”) best execution rule for transactions in municipal securities and related amendments applicable to “sophisticated municipal market professionals” (“SMMPs”). The MSRB subsequently announced that it would provide additional guidance on implementation of the new best execution rule and delay effectiveness of the rule until 120 days after publication of that guidance. The MSRB recently published the implementation guidance, which provides answers to frequently asked questions about the new best execution rule and the SMMP exemption. On the same day the MSRB guidance was published, the Financial Industry Regulatory Authority, Inc. (“FINRA”) also issued guidance on best execution obligations for equity securities, options and non-municipal fixed income securities. New MSRB Rule G-18 (Best Execution) and amendments related to SMMPs in MSRB Rules G-48 (Transactions with Sophisticated Municipal Market Professionals) and D-15 (Sophisticated Municipal Market Professional) will be effective on March 21, 2016. The MSRB Q&A guidance on the new and amended rules is available [here](#). For information about the best execution and SMMP rules, please see our December 12, 2014 Client Alert available [here](#). The FINRA guidance is available [here](#). For additional information on the FINRA best execution rule, please see our March 8, 2012 Client Alert available [here](#).

The Basic Best Execution Obligation

Both existing FINRA Rule 5310 (Best Execution and Interpositioning) and new MSRB Rule G-18 require that in any transaction for or with a customer or a customer of another broker-dealer, a firm must 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. The MSRB modeled its new rule on the FINRA rule, but the rules differ in certain respects to reflect differences between municipal securities and corporate equity and fixed income securities. The MSRB also amended Rules G-48 and D-15 to provide that a dealer’s best execution obligation for municipal securities does not apply to transactions with SMMPs and to require additional customer affirmations in order to qualify as an SMMP.

Both the FINRA and MSRB rules set forth similar, non-exhaustive lists of factors that will be considered in determining whether a firm has used “reasonable diligence.” These factors include (a) the character of the market for the security; (b) the size and type of transaction; (c) the number of markets checked; (d) accessibility of the quotation; and (e) the terms and conditions of the order which result in the transaction, as communicated to the broker-dealer. MSRB Rule G-18 also

provides that an additional factor that will be considered for municipal securities is the information reviewed to determine the current market for the subject security or similar securities.

Guidance

The MSRB guidance states that steps by a dealer that meet the reasonable diligence standard under FINRA Rule 5310 generally will be considered to meet the standard under MSRB Rule G-18 in circumstances that are substantially the same. However, the MSRB guidance also states that dealers should consider whether any additional or different steps may need to be taken to address provisions in MSRB Rule G-18 that are tailored specifically for transactions in municipal securities.

Each regulator stated that it believes its current guidance is consistent in all material respects with guidance on best execution obligations on transactions in fixed income securities published by the other regulator, except where the rule or context otherwise specifically requires. The regulators stated that the two instances where material differences exist between the FINRA and the MSRB guidance are with respect to (1) the FINRA requirement to conduct “regular and rigorous review of execution quality” vs. the MSRB requirement to review policies and procedures and execution quality by dealers, and (2) the

timeliness of executions consistent with reasonable diligence. FINRA and the MSRB stated their intention to 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.

Both regulatory notices provide significant guidance on a wide range of topics under each rule. Firms should review the guidance and consider their systems and procedures to ensure they are designed to incorporate and reflect the best execution principles and the guidance provided in the FINRA and MSRB notices.

For More Information

To discuss any topic covered in this Client Alert, please contact a member of the Investment Management Group or visit us online at chapman.com.

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