

Regional Brokers, Inc. (RBI) appreciates the opportunity to respond to Notice 2018-22 issued by the Municipal Securities Rulemaking Board (MSRB) in which the MSRB is requesting comment on draft interpretation guidance related to “pennying” and draft amendments on existing guidance on best execution relating to the posting of bid-wanted on multiple trading platforms. RBI is a Municipal Securities Broker’s Broker (MSBB).

1. Pennying

“Pennying”, as referred to in this request, is the practice by a firm of stepping slightly though the high bid provided by an MSBB in order to keep the bonds “in house”. RBI does not believe that the practice is prevalent, and understands that its counterparties have legitimate reasons for bidding, and keeping, bonds internally (for example, ensuring that their customers receive prices that reflect Best Execution for their bonds).

RBI would suggest that any guidance furnished by the MSRB in this regard should continue to remind firms that they may engage in this practice only when legitimate reasons apply. Firms should look not only to the mandate of Rule G-17, Fair Dealing, but also to previous guidance from Rule G-43, which forbids the “use of broker’s brokers solely for price discovery purposes”.

One other comment that RBI would make regarding this request notice is that the term “last look” be removed from any association with guidance related to pennyning. “Last looks” are already prohibited on the part of MSBBs by MSRB Rule G-43, and while the MSRB has attempted to use the term differently in this case, RBI believes that the inclusion of the term could cause confusion, having already been prohibited elsewhere in the MSRB rules.

2. Best Execution

Historically, any dealer who quoted a bid or asked side for a bond was said to be making a “market” on that bond. When RBI, as an MSBB, places an item out for the bid, it considers each bid to be a market for the bond.

Since the inception of MSRB Rule G-18, “Best Execution”, RBI has seen an increase in the number of items put out for the bid with multiple MSBBs. Firms engaging in this practice have explained to RBI that the Rule, as strictly read, (and despite early guidance from the MSRB) implies that they should do this in order to demonstrate best execution.

MSRB Rule G-18 (a) states that, using certain factors, “a dealer 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”. One of the factors in determining whether a dealer has used reasonable diligence is listed in part (a) (3) of the Rule, “the number of markets checked”.

“Market”, under Supplementary Material .04, is defined as “a variety of different venues, including but not limited to broker’s brokers, alternative trading systems or platforms...”

The inclusion of broker’s brokers and platforms as “venues” therefore implies that if dealers choose to make use of “markets checked” in order to achieve best execution, they should put the bonds out with multiple broker’s brokers.

RBI would request that in any future guidance, the MSRB define each bid received by an MSBB as a “market”, thereby correcting what RBI believes to be the misunderstanding that items should be placed with multiple MSBBs and ATS’s in order to evidence best execution.

Guidance of this sort by the MSRB would be the simplest way to alleviate the issues, real or not, that have arisen around “depth of market”, “bidder fatigue”, and “actual market volume”.

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