



Best Execution: The Investor's Perspective

Overview

Bond dealers, typically referred to as brokers, that execute municipal bond transactions on behalf of investors have specific obligations to their customers that include providing relevant information, making suitable recommendations, offering a fair price and providing their customers with best execution on their transactions. A broker's best-execution obligations are paramount to ensure investor protection. This document provides an overview of what investors can expect of their brokers as part of a broker's compliance with its best-execution obligation to customers.

Reasonable Diligence Standard

The term "best execution" generally refers to the process by which brokers handle customer orders and execute customer transactions. It requires brokers to use reasonable diligence to determine the best market for a customer's security and to buy or sell the security in that market so that the resulting price to the customer is as favorable as possible under prevailing market conditions. Best execution is designed to help ensure investors receive fair and reasonable prices for their transactions and better execution quality, while promoting fair competition among brokers and improving market efficiency.

A broker's order-handling obligation should not be confused with MSRB rules that require brokers to trade with customers at fair and reasonable prices and to exercise diligence in establishing the market value of municipal securities and the reasonableness of their compensation. However, the requirement to use reasonable diligence in the order-handling and transaction-execution

process is likely to increase the odds of customers receiving a transaction price that is fair and reasonable.

The Municipal Securities Market and Order Handling

For added context in understanding a broker's best-execution obligation to its customer, investors should be aware that the structure of the municipal securities market has unique characteristics that differentiate it and the way transactions are effected when compared to other securities markets. For example:

- There are no centralized exchanges.
- There are approximately one million unique municipal securities.
- There are more than 50,000 different municipal issuers with debt outstanding.
- There are only about 40,000 daily trades in the municipal market.
- The vast majority, or about 99 percent, of municipal securities do not trade on a given day. Nearly two-thirds of municipal securities trade fewer than 10 times in a given year.

Access other resources for investors in the [MSRB Education Center](#).



[Subscribe to investor education and EMMA email updates from the MSRB.](#)

Scope of the Requirement

The best-execution rule is not an absolute “best-price” standard. It does not require brokers to actually obtain the most favorable price possible in each transaction, though they may frequently do so through their use of reasonable diligence.

While the MSRB’s best-execution rule is new for the municipal securities market, the requirement is generally harmonized with the Financial Industry Regulatory Authority’s (FINRA) corresponding rule for best execution in the stock and corporate bond markets. Therefore, many brokers have been complying for some time with a substantially similar obligation to investors when executing stock and corporate bond transactions, and the MSRB rule extends that protection to investors in municipal bonds.

The best-execution obligation applies to transactions executed by a broker for or with a customer (*i.e.*, both principal and agency transactions). A principal transaction is a securities transaction in which a broker effects the transaction for its own account, and an agency transaction is a transaction in which a broker acts only as an agent for the customer, bringing together a buyer and a seller, for which the broker makes a commission on the sale.

Brokers are exempt from the best-execution obligation for transactions with sophisticated municipal market professionals (SMMP) and for transactions with any customer in municipal fund securities (*e.g.*, 529 college savings plans). To be considered an SMMP, a customer generally must be an institution or have significant assets.

- Municipal issuers vary in size and capital needs. For example, issuers such as the State of California and City of New York have billions of dollars in municipal bonds outstanding and regularly issue new bonds, while an issuers such as the town of Culpepper, Virginia may have less than \$30 million in outstanding municipal bonds and may go years between new issuances.

Due to these characteristics, among others, and the general nature of the municipal securities market, buying or selling a

municipal security can take significantly longer to finalize when compared to stocks, for which transactions can occur nearly instantaneously. Because individual bonds are often not readily available, many municipal bond sales and purchases are still negotiated over the phone with multiple market participants being involved in the process. Consequently, the handling of customer orders or inquiries and the reasonableness of a broker’s diligence in doing so is very dependent on the facts and circumstances related to a customer order or inquiry.



[Subscribe to investor education and EMMA email updates from the MSRB.](#)

Call or email the
MSRB to file a
complaint:
202-838-1330
complaints@msrb.org

In its best-execution rule, the MSRB has provided a non-exhaustive list of factors that will be considered, with no single factor being determinative, to evaluate whether a broker has used reasonable diligence. The factors are:

1. Character of the market for the security (e.g., price, volatility, and relative liquidity);
2. Size and type of transaction;
3. Number of markets checked;
4. Information reviewed to determine the current market for the subject security or similar securities;
5. Accessibility of quotations; and
6. Terms and conditions of the customer's inquiry or order, including any bids or offers, that result in the transaction, as communicated to the broker.

Investors should be mindful of these factors and ask their financial professional questions about the procedures the broker has in place to meet the best-execution obligation.

Best Execution and Fair Pricing

As noted, the best-execution rule does not require dealers to obtain the "best price" for their customers. However, the best-execution rule and the MSRB's fair pricing rule work together to help ensure that the price to a customer and the broker's compensation on a customer transaction are at least fair and reasonable.

To help investors evaluate the fairness and reasonableness of their price and the fairness and reasonableness of their broker's compensation, the MSRB has adopted a requirement for brokers to disclose their compensation on certain

retail customer confirmations. Additionally, brokers must disclose to their retail customers the time of trade and a link to the MSRB's Electronic Municipal Market Access (EMMA[®]) website. On EMMA, an investor can view their trade price and compare it to other close-in-time trades in the same security. Investors may use this information to put their trade price in perspective and get a better sense of whether they got a good price.

Compliance

Brokers typically can meet the best-execution obligation to use reasonable diligence in ascertaining the best market for a security by following sound policies and procedures and periodically reviewing and improving them. Specifically, brokers are required to conduct, at a minimum, annual reviews of their policies and procedures for determining the best available market and promptly make any necessary modifications in light of those reviews.

Brokers can document their compliance with the best-execution obligation in a number of ways. They are, for example, required to have written policies and procedures, and they should consider documenting their periodic reviews of those policies and procedures. Additionally, brokers are required to document their compliance with their policies and procedures with respect to securities with limited quotations or pricing information, and they may choose to do so for their compliance with all of their policies and procedures more generally. Brokerage firms however, vary in size and business model, and may document their adherence to their policies and procedures differently.



Subscribe to investor education and EMMA email updates from the MSRB.

The MSRB establishes rules for brokers that execute municipal bond transactions and for other market participants that engage in municipal securities and municipal advisory activities. FINRA, the Securities and Exchange Commission and bank regulators (for banks that engage in municipal securities activities by executing municipal bond transactions on behalf of customers), examine firms for compliance with MSRB rules, including the new best-execution rule, and take enforcement action when necessary. Although the MSRB does not have examination or enforcement

authority, it regularly coordinates with the other regulators and supports them in their examination and enforcement efforts. Investors should contact the MSRB if they have questions about the MSRB's best-execution rule and its interpretation.

To assist brokers, investors and any other market participants in additional understanding of how best-execution concepts apply to municipal securities transactions, and how brokers can comply, see the [MSRB implementation guidance](#) available on the MSRB website.



[Subscribe to investor education and EMMA email updates from the MSRB.](#)