

MEMO# 31399

September 21, 2018

MSRB's Request for Comment on Pennying Guidance and Amendments to Best Execution Guidance

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September 21, 2018 TO: Fixed-Income Advisory Committee
Municipal Securities Advisory Committee RE: MSRB's Request for Comment on Pennying Guidance and Amendments to Best Execution Guidance

The Municipal Securities Rulemaking Board (MSRB) recently published a notice (“MSRB Notice”) requesting comments on: (1) draft interpretive guidance related to “pennying” on alternative trading systems (ATSs); and (2) draft amendments to existing guidance on best execution relating to the posting of bid-wanted on multiple trading platforms.^[1] The MSRB Notice also requests comments on other secondary market trading practices that could benefit from additional regulatory guidance, and on any existing MSRB requirements that may no longer be necessary and could be removed or amended. This memorandum summarizes the draft interpretive guidance on pennyning and draft amendments to existing guidance on best execution.

Comments on the MSRB Notice are due by November 6, 2018. We will hold a member call to discuss the MSRB Notice on Wednesday, October 3, at 2:00 pm. If you would like to participate in that call, please contact Monique Curtis at monique.curtis@ici.org to receive dial-in information.

Pennyning

Customers typically rely on broker-dealers to facilitate purchases or sales of municipal securities. The MSRB Notice describes pennyning in the context of a customer that contacts a broker-dealer to sell a municipal security. To facilitate the customer’s sale, the broker-dealer may place bid-wanted^[2] with a broker’s broker or post bid-wanted on an ATS. Following the conclusion of the bid-collection period, the dealer would convey the high bid to the customer, and the customer would decide whether to sell at that price. In some instances, if the customer decides to sell, the dealer, in a practice known as “pennyning,” will purchase the customer’s securities for its own account by either matching the high bid or offering a nominal price improvement to the customer.

According to the MSRB, pennyning may appear to benefit a customer that receives a slightly better price than the highest bid obtained through the bid-wanted process, but widespread

pennyning may harm investors, bidding dealers, and the municipal securities market as a whole. Several dealers have “informed the MSRB that pennyning 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 pennyning.”[\[3\]](#)

The MSRB has issued guidance to curtail pennyning in the past. In 2012, the MSRB published guidance addressing the issue of pennyning in the context of the use of broker’s brokers.[\[4\]](#) The 2012 guidance explained that dealers sometimes placed bid-wanted with broker’s brokers solely for price-discovery purposes and without a bona-fide intent to sell through the broker’s brokers and, shortly thereafter, those same dealers purchased the same securities for their own accounts at prices that exceed the brokers’ brokers’ bids by a very small amount. This reduced the broker’s brokers’ willingness to bid in the bid-wanted process and lowered the likelihood that the high bid in a bid-wanted would represent the fair market value of the securities. The 2012 guidance concluded that, depending on 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 Rule G-17, the MSRB’s fair dealing rule.

The MSRB Notice proposes to extend the 2012 guidance to pennyning that occurs following a bid-wanted distributed via an ATS, which, according to the MSRB, gives rise to the same harms as pennyning in the context a bid-wanted distributed via a broker’s broker. Accordingly, the MSRB Notice provides that, depending on the facts and circumstances, the use of bid-wanted, either in the context of the use of a broker’s broker or an ATS, solely for price-discovery purposes would be an unfair practice within the meaning of Rule G-17.

Best Execution

The MSRB Notice also proposes changes to MSRB guidance[\[5\]](#) published in 2015 following the adoption of Rule G-18, the MSRB’s best execution rule.[\[6\]](#) The MSRB Notice asserts that “it has become common” for firms to post the same bid-wanted simultaneously on multiple trading platforms in an effort to fulfill their best execution obligations. This practice, according to the MSRB Notice, may result in a distorted sense of liquidity and depth in the market, and in dealers expending significant time determining whether they previously have bid on duplicative bid-wanted or not bidding at all if they mistakenly believe they have.

The proposed changes would:

1. Expressly state that dealers may not need to post a bid-wanted on each ATS or broker’s broker or become a subscriber to every ATS to meet their best execution obligations;
2. Emphasize further the breadth of the term “market” and how an ATS or a broker’s broker may be considered multiple markets for purposes of Rule G-18;
3. Explain further the facts and circumstances under which checking only one ATS or broker’s broker could satisfy best execution obligations.

The proposed changes would not, however, amend Rule G-18 itself or prohibit dealers from using multiple trading platforms to achieve best execution.

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endnotes

[1] See [*Request for Comment on Draft Interpretive Guidance on Pennying and Draft Amendments to Existing Guidance on Best Execution*](#), MSRB Notice 2018-22 (September 7, 2018).

[2] A bid-wanted is a process by which dealers or investors solicit bids on securities.

[3] MSRB Notice at 10.

[4] See [*Notice to Dealers that Use the Services of Broker's Brokers*](#), (December 22, 2012).

[5] See [*Implementation Guidance on MSRB Rule G-18, on Best Execution*](#), (November 20, 2015).

[6] Rule G-18 requires dealers to exercise reasonable diligence to identify the best market for buying or selling securities so that the resultant price to the customer is as favorable as possible under prevailing market conditions.