MEMO# 33623

June 25, 2021

FINRA Issues Reminder on Best Execution Requirements and Payment for Order Flow

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TO: Equity Markets Advisory Committee RE: FINRA Issues Reminder on Best Execution Requirements and Payment for Order Flow

FINRA issued a notice last week reminding broker-dealer member firms of SEC and FINRA rules and guidance that state that payment for order flow must not interfere with their duty of best execution.[1] FINRA notes that "payment for order flow" broadly includes different practices such as monetary payments and discounts, as well as transaction fee rebates or other fee reduction or credits provided by exchanges.

FINRA reiterated that Rule 5310 (Best Execution and Interpositioning) requires a broker-dealer to "use reasonable diligence"[2] in ascertaining the best market for a security and transact at the price that is "as favorable as possible under prevailing market conditions."

FINRA also reiterated its prior related guidance[3] that broker-dealers must conduct reviews of execution quality and consider

- price improvement opportunities (i.e., the difference between the execution price and the best quotes prevailing at the time the order is received by the market);
- differences in price dis-improvement (i.e., situations in which a customer receives a worse price at execution than the best quotes prevailing at the time the order is received by the market);
- the likelihood of execution of limit orders;
- the speed and size of execution;
- transaction costs;
- customer needs and expectations; and
- the existence of internalization or payment for order flow arrangements.

Where payment for order flow arrangements exist, FINRA emphasized that price improvement is a heightened consideration and broker-dealers that receive such payments should carefully evaluate the practice on execution quality, including whether reliable, superior prices are readily accessible for customer orders. Further, according to FINRA, broker-dealers cannot negotiate order routing arrangements for customer orders in a way that reduce price improvement opportunities otherwise available to those orders absent payment for order flow. Additionally, FINRA emphasizes that existing disclosure requirements—such as those related to customer confirmation statements under Exchange Act Rule 10b-10 or Rule 606 quarterly reports—do not relieve broker-dealers of the duty of best execution.

FINRA also states that it supports the SEC's recently announced effort to consider whether additional requirements or guidance related to best execution are necessary, and that it may evaluate whether changes to its own best execution rule is necessary or appropriate.

Nhan Nguyen
Assistant General Counsel, Securities Regulation

endnotes

[1] FINRA Regulatory Notice 21-23 (June 23, 2021), available at https://www.finra.org/rules-guidance/notices/21-23.

[2] The factors considered in determining whether a firm has used "reasonable diligence" are (i) the character of the market for the security (e.g., price, volatility, relative liquidity, pressure on available communications) (ii) size and type of transaction; (iii) number of markets checked; (iv) accessibility of the quotation; and (v) the terms and conditions of the order which result in the transaction, as communicated to the member and associated persons.

[3] FINRA Regulatory Notice 15-46 (Nov. 20, 2015), available at https://www.finra.org/rules-guidance/notices/15-46.
