Securities Regulation Daily Wrap Up, BROKER-DEALERS—SEC proposes first ever Commission-drafted best execution standard, (Dec. 15, 2022)

Securities Regulation Daily Wrap Up

Click to open document in a browser

By John Filar Atwood

Brokers have been operating under rules established by FINRA in 1968, and by the MSRB in 2016 for municipal securities.

Among the raft of proposals and adoptions undertaken by the SEC this week was a proposed rule, Regulation Best Execution, that would require broker-dealers to establish policies and procedures to ensure that they seek best execution when trading equities, fixed income, options, crypto tokens, or other securities. If adopted, it will be the first SEC-established rule dealing with best execution. The Commission voted 3 to 2 to issue the proposal (Regulation Best Execution, Release No. 34-96496, December 14, 2022).

Brokers have been operating under a best execution rule written by the NASD, the predecessor to FINRA, since 1968. Chair Gary Gensler said that a best execution standard is "too important, too central to the SEC's mandate to protect investors, not to have on the books as Commission rule text." He cited trading in off-exchange dark venues that are less transparent than lit exchanges as one of the reasons he believes best execution is so important.

Gensler also noted that a Commission-level best execution standard would provide for additional enforcement capabilities. Those would include the ability to bring remedial actions and impose sanctions for violations of the new rule, he said.

Regulation Best Execution would require broker-dealers to establish, maintain, and enforce written policies and procedures designed to comply with the proposed best execution standard. The policies and procedures would have to address how broker-dealers will comply with the best execution standard and how they will determine the best market and make routing or execution decisions for customer orders.

Conflicted transactions. Under the proposal, brokers' policies and procedures would have to address additional factors for conflicted transactions with retail customers. Specifically, broker-dealers would have to document their compliance with the best execution standard, including all efforts to enforce their best execution policies and procedures for conflicted transactions and the information relied on for their determinations that the conflicted transactions would comply with the best execution standard.

Broker-dealers would also be required to document any arrangement concerning payment for order flow. If brokers receive payment for order flow from a wholesaler, those brokers would be required to have policies and procedures that reflect enhanced diligence in seeking best execution, and document why the transaction complies with the best execution standard.

Proposed Regulation Best Execution also would require broker-dealers to review the execution quality of customer orders at least quarterly, and to review their best execution policies and procedures at least annually. Brokers would have to document those reviews, and present written reports detailing the results of the reviews to their boards of directors or equivalent governing bodies. Gensler noted that the proposal would narrow the scope of introducing brokers that would be exempt from certain best execution requirements. Under the proposal, broker-dealers that qualify as introducing brokers would be exempt from many of the operative provisions of the proposed rules so long as they establish, maintain, and enforce policies and procedures that require them to regularly review the execution quality obtained from their executing brokers. They then must compare that execution quality with the execution quality they might have obtained from other executing brokers, and revise

© 2025 CCH Incorporated and its affiliates and licensors. All rights reserved.

their order handling practices accordingly. Introducing brokers would be required to document the results of the review.

Commissioner opposition. The proposal drew dissension from Commissioners Hester Peirce and Mark Uyeda. Peirce said that she could have supported a principles-based approach to best execution, but believes the current proposal is unduly prescriptive. The proposal seems less concerned whether customers get best execution than if brokers follow a Commission-imposed checklist that may not achieve best execution, she stated.

Uyeda pointed out that there are already existing best execution regulatory regimes that appear to be working well. He questioned whether a third best execution standard layered on top of the ones already imposed by FINRA and the MSRB is really necessary.

Uyeda also is troubled that in requiring that a broker-dealer obtain and assess "reasonably accessible information" with respect to a wide number of market variables, the proposed rule does not take a position on whether the market data infrastructure core information will satisfy the obligation. He is concerned that brokers may feel compelled to purchase more market data than they need from the exchanges and alternative trading systems because of uncertainty in satisfying their best execution obligations.

MainStory: TopStory BrokerDealers FINRANews GCNNews MunicipalSecuritiesNews

© 2025 CCH Incorporated and its affiliates and licensors.
All rights reserved.