FACT SHEET

Regulation Best Execution

The Securities and Exchange Commission proposed Regulation Best Execution to, among other things:

- Establish a best execution standard for brokers, dealers, government securities brokers, government securities dealers, and municipal securities dealers (collectively "broker-dealers");
- Require broker-dealers to establish, maintain, and enforce written policies and procedures reasonably designed to comply with the best execution standard;
- Require more robust policies and procedures for broker-dealers that engage in certain conflicted transactions for or with a retail customer;
- Require broker-dealers to review the execution quality of their customer transactions at least quarterly;
- Exempt broker-dealers that qualify as "introducing brokers" from certain requirements if they establish, maintain, and enforce specified policies and procedures; and
- Require broker-dealers to review their best execution policies and procedures at least annually and present a report detailing the results of such review to their boards of directors or equivalent governing bodies.

Why This Matters

The duty of best execution requires a broker-dealer to execute customers' trades at the most favorable terms reasonably available under the circumstances. This duty of best execution derives from common law agency principles and fiduciary obligations and is enforced through the antifraud provisions of the Federal securities laws. While a best execution rule was first established in 1968 by the National Association of Securities Dealers, Inc., the predecessor to the Financial Industry Regulatory Authority, Inc., there has not previously been a rule established by the SEC. Customers benefit from broker-dealers' robust considerations of execution opportunities that may provide customers with the most favorable terms. Accordingly, promoting the best execution of customer orders is of fundamental importance to investors and the markets and is an important aspect of investor protection. The Commission has made statements concerning the duty of best execution over the years, and this action represents the first time it has proposed its own rules addressing best execution.

How The Rules Would Apply

Proposed Rule 1100 under proposed Regulation Best Execution would set forth the best execution standard. Specifically, in any transaction for or with a customer or a customer of another broker-dealer, a broker-dealer (or a natural person who is an associated person of the broker-dealer) would be required to use reasonable diligence to ascertain the best market for the security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions.

Proposed Rule 1100 would exempt a broker-dealer from this standard when: (1) another broker-dealer is executing a customer order against the broker-dealer's quotation; (2) an institutional customer, exercising independent judgment, executes its order against the broker-dealer's quotation; or (3) the broker-dealer receives an unsolicited instruction from a customer to route its order to a particular market for execution and the broker-dealer processes that customer's order promptly and in accordance with the terms of the order.

Proposed Rule 1101 would require broker-dealers to establish, maintain, and enforce written policies and procedures reasonably designed to comply with the best execution standard. Proposed Rule 1101(a) would require these policies and procedures 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.

Broker-dealers that engage in conflicted transactions with respect to retail customer orders would be subject to additional obligations under proposed Rule 1101(b). A conflicted transaction would be any transaction where a broker-dealer: (1) executes an order as principal, including riskless principal; (2) routes an order to or receives an order from an affiliate for execution; or (3) provides or receives payment for order flow. Proposed Rule 1101(b) would require additional policies and procedures for conflicted transactions and would require broker-dealers to document their compliance with the best execution standard for such transactions and any arrangement concerning payment for order flow.

Proposed Rule 1101(c) would require broker-dealers to review at least quarterly the execution quality of their customer transactions; compare it with the execution quality that might have been obtained from other markets; revise accordingly their best execution policies and procedures, including order handling practices; and document the results of the review.

Proposed Rule 1101(d) would provide an exemption to "introducing brokers" from complying with proposed Rules 1101(a), (b), and (c) if they establish, maintain, and enforce policies and procedures that require them to regularly review the execution quality obtained from their executing broker, compare it with the execution quality they might have obtained from other executing brokers, and revise their order handling practices accordingly. Introducing brokers would be required to document the results of the review.

Finally, proposed Rule 1102 would require broker-dealers to review at least annually their best execution policies and procedures, including their order handling practices. Broker-dealers would be required to document such reviews and prepare and present written reports detailing the results of the reviews to their boards of directors or equivalent governing bodies.

The proposal also would amend Exchange Act Rule 17a-4 to require broker-dealers to preserve records made pursuant to proposed Regulation Best Execution.

Additional Information:

The public comment period will remain open until March 31, 2023, or until 60 days after the date of publication of the proposing release in the Federal Register, whichever is later.