September 15, 2020

Submitted electronically to: pubcom@finra.org

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 20-24 - Proposed Changes to TRACE Reporting Relating to Delayed Treasury Spot and Portfolio Trades

Dear Mrs. Mitchell,

SIFMA[1] is pleased to respond to FINRA's Regulatory Notice (RN)[2] regarding TRACE flags for portfolio trades and delayed treasury spot trades. These proposals, if they became rules, would implement recommendations of the SEC's Fixed Income Market Structure Advisory Committee (FIMSAC), and we write this letter to express our high-level comments on the proposals. As a general matter, SIFMA supports the enhancement of TRACE to provide transparency to market participants, when such transparency is appropriately balanced with the impacts on liquidity and reasonableness of compliance burdens that any particular proposal creates. In this letter we set out some initial views, questions, and requests for further details of SIFMA members on the proposals in the RN. As you will see, while we believe there are positive aspects to the proposals, some of our members have expressed concerns about the utility of them. We hope that FINRA takes our comments into account, and is able to return to the market with more information and clarification to help build a broader base of support for the proposals in the RN. We look forward to a continued dialog on this RN.

1. Portfolio Trading Flag

The RN explains that the proposed portfolio trading flag would allow market participants to *"better identify trade prices that may not reflect the market price if the bond was priced individually."*[3] Our members see two aspects of this proposal: (1) the identification of portfolio trades vs. other kinds of trades and (2) the identification of potentially off-market trades.

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[1] SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $18.5 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).
[2] Available here: https://www.finra.org/sites/default/files/2020-07/Regulatory-Notice-20-24.pdf
[3] Proposal at 12.

We agree that this proposal would make it easier to identify the type of transaction – that a trade was a portfolio trade – since they would be tagged as such. However, some of our members have noted that it is fairly easy, generally speaking, to identify portfolio trades today without the usage of a specific modifier, so the proposal would provide somewhat limited new information to market participants in this regard. Other members noted that this may be beneficial to smaller market participants, as well as market observers and researchers, who may not have systems in place to actively screen for these types of transactions.

The other aspect of the proposal relates to identification of potentially off-market trades and we agree that the modifier may flag a trade that was traded off-market. Generally, the portfolio trading flag would alert users of the data to take care to consider whether or not the flagged trades are off-market. The key word used above is 'may' – indeed the price in a portfolio trade may or may not be off market. The proposed indicator is not definitive. Some of our members have questioned the appropriateness of a flag that does not provide definitive information regarding the price that is reported and have expressed concern that a false impression of being off-market could be created by the flag. Other members noted that it should not be assumed that a portfolio flag would designate that a bond trade was off-market, but rather provide context that the trade price may have been determined in a different manner than a single bond trade.

TRACE already incorporates a special price modifier that is required when trades are executed off market for various reasons (e.g.: NERIs (FAQ 3.4.12), bonds trading flat (FAQ 3.1.40), where prices are very high or very low (FAQ 3.4.26)), and provides an unequivocal signal to data users. Today dealers are expected to review each line item in a portfolio trade to determine if it is off market, and if so, set the special price indicator to 'yes'. A potential benefit of this proposal could be to reduce the compliance burden for dealers if the portfolio trade indicator would supplant the need for the dealer to also do a line by line review of a large trade for the purposes of the special price indicator. Related to this, FINRA should confirm that the modifier would be taken into account in fair pricing reviews and dealers would not face undue burden to explain why a price on a portfolio trade was off-market, given the nature of these transactions.

An additional concern that some of our members have raised is that this proposal would start to shift TRACE away from being a price transparency tool (e.g., size, quantity, time of execution) into a tool that provides trading strategy details (e.g., how a trade was executed). Some members who are active in this market expressed concerns regarding the potential impact on liquidity and potential disclosure of member or client trading strategies, while other members active in the market did not believe this was a material concern with the appropriate definition of a portfolio trade, given those active in the market are already aware of their occurrence. As FINRA knows, both dealers and their clients view trading strategy information as proprietary and sensitive, and the potential for exposure of such information could cause participants to alter how they trade and potentially have impacts on market liquidity. We would appreciate FINRA addressing this concern in subsequent publications, and consideration of whether there are ways to mitigate it.

We have a few more granular comments on the proposal

- Issuers vs. CUSIPS
    - SIFMA members understand that the reason for including a certain number of unique issuers as a criteria for use of the portfolio trade flag is intended to scope in diversified portfolio trades. Members have raised a concern that while this is understandable, it

would be complicated to implement. On the other hand, a definition of a portfolio trade based on a certain number of CUSIPs would be much easier to implement.

    - For example, it could be the case that a company issues debt at the parent level and also issues debt out of a differently-named affiliate or subsidiary with a parent guarantee. Should they be treated as the same issuer? Or perhaps an issuer is involved in a merger with another company but the merged company still has bonds in the market referenced in its 'old' name. Should those two names be considered the same issuer? There could be other edge cases that arise from time to time would require further definition. In any case, traders and compliance personnel would have to examine a potentially large list of bonds and determine how many distinct issuers there were (subject to potential complications like those above) and this would have to be done within the short submission time requirements that exist in TRACE. This would introduce the risk of errors and omissions in TRACE reporting and penalties for dealers. It does not appear that this process would be easily automatable. We expect it would also increase demands on FINRA staff to field questions and provide guidance.
    - On the other hand, a requirement based on a CUSIP count, while not as precise at identifying diversified portfolio trades, would be over-inclusive (if anything), and would be far easier to implement given that it is a simple and automatable counting exercise.

- The number of securities traded
    - Our members have also discussed at some length the numerical trigger of 30 names. Some members believe that a lower number (of CUSIPs, as discussed above) would be more appropriate, such as 10, whereas others are comfortable with the proposed 30 or an even higher number.

In sum, we believe it would be useful for FINRA to further discuss with the industry in subsequent publications and meetings a deeper insight into some of the rationale that underlies the proposal and provide perspectives on the questions we raise above, such as the usage of issuers vs. CUSIPs and the appropriate number of them. As noted, while some members see potential benefits to the proposal, some significant questions and concerns have also been raised.

2. Delayed Treasury Spot Trades

Similar to the discussion above, our members both see benefits to this proposal but also have material questions including the overall benefit vs. cost balancing. In this proposal FINRA would require firms to append a new modifier when reporting a corporate bond trade priced based on a spread to a yield of a Treasury security, where the spread was set prior to the time of execution of the trade, and would also require dealers to report the time at which the spread was agreed in addition to the time of execution.

The proposal states: *"A modifier identifying delayed Treasury spot trades may add valuable information to disseminated TRACE data by indicating that the reported price may not be at the current market. The new disseminated field providing the time at which the spread was agreed upon could benefit the market by providing participants with this information, which market participants may use to reasonably evaluate the transaction price compared to other prices reported to TRACE at or near the same time."*[4]

[4] Proposal at 12.

The potential benefit of this proposal would be to provide a clearer picture, retrospectively, as to liquidity flows throughout the day. SIFMA members understand how this information could be helpful to market participants and observers and note that FINRA (via FIMSAC) provided data to support the existence of delayed spot trades on TRACE at end-of-day. Members understand that US IG trades which occur early in the day which then report end of day may or may not seem "off market" by end of day, depending on the magnitude of the bond's credit spread movement throughout the day.

Despite this acknowledgement, some members have indicated that the technical implementation of this proposal is complex. Specifically, a number of our members disagree that *"[t]he variable cost of reporting the new modifier and populating the time field should be minimal for firms as costs currently are incurred for existing TRACE reporting."*[5] While building a flag to identify a spot trade is not difficult, members have reported that the ability to automate the flow of the time the trade was spotted could be much more complicated. For example, information about time of spotting may be housed in a trading platform (or other internal system) for which the dealer does not have connectivity through to its TRACE reporting system, and that connectivity would either need to be built or a manual workflow would need to be managed (e.g., based off of a report from a platform). Additionally, some firms will have to build this connectivity across multiple lines of business. Manual workflows are of course not favored.

Some of our smaller, non-primary dealer members have pointed out that there is a fixed-cost burden presented by this proposal that is more meaningful to these dealers. In other words, smaller dealers that do less of this business would face the same implementation requirements discussed in the preceding paragraph, but they have fewer resources, tend to be more dependent on third-party vendors, and ultimately may have less motivation to bear the cost. The end result could be that they do not create the necessary infrastructure and they revert to a manual process, which as we noted, is generally not favored and adds operational risk. It also could be the case that some of these dealers simply choose to no longer engage in these kinds of trades, possibly further concentrating the activity in larger firms and reducing the number of market participants. The factors discussed in this and the above paragraph cause some of our members to believe it would be preferable to only report the spot flag and not the time.

In any case, in light of the points raised above, we believe that a significant amount of lead time would be needed before the implementation date - on the order of 18 months or more.

We would also like to address some of FINRA's specific requests for comment:

- *"Should FINRA consider requiring firms to report the spread, either at the time that the spread is agreed upon or later in the day when the dollar price is known?"* and *"If the spread should be reported at the time it is agreed upon, should the dollar price also be reported later in the day when known?"*
    - SIFMA members have pointed out that FINRA should have enough information from trade reports from dealers to derive an estimate of the spread without requiring dealers to submit this data.
    - In any case, we believe that dealers should not have to submit two reports (or amend a previous report) for the same trade. This would significantly increase the burden of implementation on dealers, introduce risk of errors, and possibly confuse users of the

[5] Proposal at 12.

data. Accordingly, if spread were required to be reported (which we don't believe is necessary), it should be at the time of execution of the trade.

- *"FINRA understands that the most common pricing benchmark used for delayed Treasury spot trades is the on-the-run U.S. Treasury Security with the maturity that corresponds to the maturity of the corporate bond being priced (e.g., the most recently issued 10-year U.S. Treasury Security typically is used as the benchmark for pricing a 10- year corporate bond issue). FINRA requests comment on whether this understanding is accurate."*
    - Our members share this understanding.

To summarize, we would encourage FINRA to consider these comments regarding spot trades, and carefully consider balancing the costs vs. the benefits of this proposal. We believe a significant lead time for implementation would be required if this proposal were to be implemented.

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We hope these comments are constructive and helpful to FINRA as it considers how to move forward with the proposals in the RN. As mentioned, SIFMA supports enhancements to transparency that weigh benefits to market participants against the impact on liquidity and costs of compliance. We hope that FINRA provides further details in line with some of the questions and comments discussed above, and would be pleased to discuss our views in more detail. Please contact me at ckillian@sifma.org if you would like to discuss any of these issues further.

Sincerely,

Chris Killian
Managing Director
Securitization and Credit