



April 7, 2015

By **Electronic Mail to pubcom@finra.org**

Maria E Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 200006-1506

Re: FINRA Regulatory Notice 2015 - 03 / Proposal to Require Alternative Trading Systems to Submit Quotation Information Relating to Fixed Income Securities to FINRA for Regulatory Purposes

Dear Ms. Asquith:

The Securities Industry and Financial Markets Association (“SIFMA”)¹ appreciates the opportunity to respond to the request for comment by the Financial Industry Regulatory Authority (“FINRA”) on the Proposal to Require Each Alternative Trading System (“ATS”) to Submit Quotation Information Relating to Fixed Income Securities to FINRA for Regulatory Purposes (the “Proposal”). SIFMA understands FINRA’s desire to have this additional information, however, given the evolving market structure; we encourage regulators to better understand the existing and evolving forms of execution and communication between and among dealers and investors prior to utilizing this information. In particular, we urge caution in utilizing any collected quotation information for regulatory or surveillance purposes in light of the inherent limitations of the data being collected. We further encourage FINRA to share more information on any planned regulatory uses of the data including any planned surveillance construct and to do so by publication of a request for comment. We have several observations and suggestions below for your consideration as you contemplate the appropriate framework for collection and regulatory use of this type of data. We have also identified certain operational issues and clarifications needed with regard to the transmission of data by an ATS.

¹ SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA’s mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, please visit www.sifma.org.

Need For Uniformity and Coordination In Approach Among Regulatory Efforts

We are aware that the Securities and Exchange Commission (the “SEC”) requested and subsequently collected a sample of pre-trade data from several ATSs in the last year. We are also aware that the Municipal Securities Regulatory Board (the “MSRB”) contemplated collection of such data in the concept release dated July 13, 2013². Given the interest expressed from several regulators, we are concerned that disparate and uncoordinated efforts from regulators will result in overlapping, redundant and fragmented approaches. We repeat our call for more uniform and coordinated efforts by regulators related to fixed income market structure to support an efficient and cost effective market structure and avoid unintended and avoidable negative and costly outcomes. Failure to coordinate among regulators in advance and provide for uniformity where reasonable, conflicts with the goal of producing the best outcome for investors by unnecessarily increasing the compliance, technology and operational cost structures of broker dealers (ATSs included).

Legal and Contractual Limitation of ATS Subscription Contracts

Several ATSs are examining their subscription agreements and any clauses related to the disclosure of subscriber entity information and quotation data. It is not clear at this point whether a FINRA rule would obviate or supersede any contractual privacy clauses or provisions that expressly prohibit or limit the ability of an ATS to share information. We suggest that FINRA examine this issue and provide legal clarity to the extent possible. Should a rule result in the need to amend contracts, the timeline to implementation would need to be extended accordingly.

Dissemination

The Proposal does not propose public dissemination and SIFMA does not support the pursuit of public dissemination of quotations prices by regulators. Our members are greatly concerned that public dissemination could discourage active market making and could have a chilling effect on the current market innovation and on liquidity generally.

Scope of the Proposal - Entities and Products Captured

We perceive that the Proposal’s intent is to capture, for regulatory purposes, those prices seen by “many” as opposed to prices seen by a “few”. In that respect, request for quote (RFQ) data is not included in the scope. It makes some sense for FINRA to attempt to segregate a subset of quotation data that is available to market participants in a broader manner. FINRA should, however, recognize that a significant percentage of retail customer liquidations is executed via a RFQ bid wanted price discovery process and thus a meaningful segment of data may be excluded in your analysis. FINRA characterizes the scope of the Proposal as including prices that are seen by a “subset” of subscribers and this characterization may need clearer boundaries to understand who is and isn’t in scope given

² <http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2013/2013-14.aspx>

the unique and varied execution models in the market. At a minimum, an ATS in its infancy may have a limited subscriber base and thus prices may be seen by a limited number of potential counterparties, or the platform may be explicitly designed for a limited number of subscribers to interact on a given price or security. Quotes produced in these circumstances may thus be less homogenous with other collected data. It is also not clear whether the Proposal is intended to capture only those quotations “seen” by subscribers versus those “intended to be available” to subscribers. An ATS may only display quotations at the “top of the book” (i.e. best bid and best offer) rather than the “full book” of quotations. In these instances, a price that is not top of the book could be canceled without ever being viewed by subscribers. FINRA may choose to collect those prices as well but needs to recognize that the depth of market may not have been transparent to subscribers. We suggest FINRA clarify the intended scope and work with the universe of ATSs to define the Proposal accordingly.

SIFMA believes it is appropriate to include corporate and agency debt in the Proposal but exclude securitized products. The securitized products space is still maturing through the post trade reporting process to enhance transparency and is best addressed at a later date, if at all.

It is important to recognize that several electronic platforms have registered or are registering as ATSs but may not be required to register based on the parameters of Reg ATS. While it may be appropriate to focus on ATS venues in this Proposal, FINRA should recognize that ATS registration does not imply that the ATS employs a given model or execution methodology. In fact, many ATSs have registered as such by choice alone rather than to fulfill a regulatory obligation. As discussed further below, we urge caution to FINRA as it considers the appropriate regulatory use of collected data given the inherent limitations of both the quotation data and the current market structure. Should FINRA inadvertently provide a disincentive for participation on ATS platforms as result of disproportionate regulatory burdens for both the ATS and its subscribers, the result may be an exodus from voluntary ATS registration and a preference for certain execution models over others. The advent of more “live and actionable” quotes as well as more “streaming subject quotes” has been a very positive market development and is somewhat experimental in nature. We would not want to discourage this type of ATS activity. SIFMA does not believe that regulatory collection itself will necessarily have such unintended consequences but we do think that misinformed regulatory use of the data could pose such risks.

Finally, it is important to note that the fixed income markets are multidimensional and that ATSs are only one source of market liquidity. There are many portals through which price discovery and execution may take place and to which any given market participant may or may not have access. As a result, the data sought by the Proposal will represent an incomplete picture of the market at best.

The Limitations of Unexecuted Quotation Information

The variety of platforms, executions models and pricing methodologies in today's market limits the value of individual prices in isolation. Quotation data is much more valuable if put in context to the way it was generated, other prices in that security and or similar securities, and the number of parties able to access the price. Market dynamics allow for parties to seek out other parties with some level of common interest and come to an agreement by way of a consummated transaction. An executed transaction submitted to TRACE represents that common agreement over a specific price of a security. Unexecuted prices are by nature only a one-sided opinion and point of reference and therefore not necessarily reflective of the market price. They may however inform you on the potential boundaries surrounding the market price – representing only a piece in the price discovery process. The informational value will however depend on how far the unexecuted quote is from the market price and the number of other reference points in a given timeframe. In fact, the information may be materially misleading. For example, “uncompetitive bids or offers” (where a dealer's price reflects a lack of certainty as to the market price and/or lack of interest in a security but a willingness to express an outer pricing boundary) may have little or no informational value to regulatory surveillance and to ascertaining a market price. The price boundaries and market price may also differ significantly based on the size of the transaction contemplated. The market is attempting to bring larger size transactions for electronic execution but the preponderance of electronically executed transactions is still below \$1 million. Further, prices on ATSs are not always firm, and those supplying prices may fail to execute. Depending on the counterparty in question, the frequency at which they fail to execute can be significant. Moreover, certain dealers may be unable to access such quotes as further described below. Subject prices should be given significantly less weight given the limited reliability of such prices. We caution FINRA to look at any such collected data through a lense or filter that recognizes the innate limitations of what such data reflects and acknowledges reasonable differentiation in pricing.

The Limitation Presented By Market Fragmentation

New ATS platforms are emerging to meet the unique needs of specific market segments (both product and customer). SIFMA believes this increased competition and experimentation with execution models is an important part of the evolution of market structure and we expect that certain models will come to dominate given segments over time. In the near term, however, this new competition is likely to create further fragmentation. It is not economical, practical, desirable, or beneficial for customers, dealers, or institutional investors to participate in or to integrate every platform. Additionally, some platforms are limited to dealers only.

Some ATSs operate a relatively open platform with full anonymity. An ATS may step into the trade in a riskless principal capacity to maintain counterparty anonymity and to facilitate trading amongst firms that may not have a trading relationship or commensurate trading limits to settle trades. Some ATSs simply provide the technology to allow parties to communicate in a centralized forum and are never involved in the operational settlement.

Accordingly, a dealer may also wish or need to limit the subscribers that can view and act on its prices for a host of reasons, including the lack of counterparty trading limits. Dealers also use components of an ATS platform as a sales and marketing tool to reach institutional customers. When doing so, a dealer will limit subscriber access to its customers for proprietary reasons and deny access to its direct competitors. There are a host of permutations to the way platforms allow subscribers to personalize access to meet their individual needs. It is thus important for FINRA to understand the nature and use of the platforms to better understand the pricing data they generate.

The bond market can by nature be liquidity challenged and price discovery challenged. Fixed income securities are most often purchased to be held to maturity and thus some CUSIPS do not trade for long periods of time. There tends to be more liquidity in very large size deals and in the most recently issued deals as those securities come to rest with longer term investors. A significant percentage of transactions is thus often dominated by a concentrated number of CUSIPS. Firms are increasingly utilizing more sophisticated order routing technology, trade data aggregators, pricing data vendors and the like to assimilate a host of data to aid the price discovery process. Firms must also make assumptions about market depth with the knowledge that some orders are posted on multiple platforms and thus need to be discounted when aggregated due to repetition.

The inherent market structure can result in a natural lack of quotation data but the current market structure also results in quotation data that is not available to all market participants simultaneously. We caution FINRA to not extrapolate a simple “should have known” regulatory analysis when doing markup or best execution surveillance with any collected quotation data. FINRA’s application of best execution requirements should recognize these inherent market structure challenges and the inherent weaknesses in the data FINRA is proposing to collect. The rule application should be positioned to require reasonable diligence in efforts to ascertain the best market price at a given point in time, factoring in among other things, the accessibility of such prices. Best execution requirements should not be used as a blunt tool to inordinately and unrealistically drive changes in market structure.

Operational Issues Related to the Data Request

Identity of the Party

We expect that ATSS track their subscribers by legal entity and do not in many cases collect or match names with an MPID. We believe FINRA should append that information after the data is collected if necessary rather than require systems changes at individual ATSS.

Party’s Capacity

We are not aware of any ATS that systematically knows the capacity in which the party is acting (with respect to an end customer or otherwise).

Price, Yield or Spread to Benchmark

It is not clear that every platform displays the price of the relevant benchmark with each spread quotation. In some instances, a benchmark may be referenced with the parties to agree on the spot price at the time of execution. We know that some subscribers include the specific benchmark price reference and update the quotation automatically with changes in the benchmark (resulting in hundreds of quotation changes despite constant spreads).

Modification or cancelation indicators

We expect that some ATSs may not distinguish between a modified and a cancelled order. FINRA should modify their requirements to be subject to a “to the extent available” caveat. We also suggest that FINRA clarify that the “duration” data request is to reflect the time from the quotation’s submission to the ATS to the time of modification or cancellation. Subsequent quotations that result from a modification should presumably be tracked from one modification to the next modification or cancellation.

Conclusion

SIFMA appreciates this opportunity to comment on the Proposal. We encourage FINRA to continue to engage with market participants to better understand the changing market structure and the varied forms of execution emerging in the marketplace. We believe it is essential that FINRA provide further information and seek feedback on any surveillance construct using quotation information once the data has been sufficiently studied. Please let us know if we can be of assistance in that regard. If you have any questions or require further information, please contact Sean Davy at (212) 313-1118 or sdavy@sifma.org.

Very truly yours,

A handwritten signature in black ink that reads "Sean Davy". The signature is written in a cursive, flowing style with a long horizontal tail extending to the right.

Sean Davy
Managing Director