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September 14, 2020

<u>Via Electronic Submission: pubcom@finra.org</u>

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

RE: COMMENT LETTER ON THE PROPOSED CHANGES TO TRACE REPORTING RELATING TO DELAYED TREASURY SPOT AND PORTFOLIO TRADES (REGULATORY NOTICE 20-24)

Dear Ms. Mitchell,

Bloomberg L.P.[1] is grateful for the opportunity to provide the Financial Industry Regulatory Authority ("FINRA") with our comments regarding the above-referenced proposal ("Proposal").

I. Executive Summary

FINRA has proposed making two changes to the Trade Reporting and Compliance Engine (TRACE) reporting rules to provide greater clarity to market participants with additional information on two types of trades in corporate bonds. The first proposed change compels market participants, when reporting a corporate bond transaction to TRACE operations, to add a modifier that identifies executions where the price of the transaction is based on a spread to the yield of a U.S. Treasury Security where the spread was agreed upon that day prior to the Time of Execution of the transaction. In addition to adding a modifier to the trade report, the reporting firm would also be required to report the time at which the spread was agreed upon (in addition

[1] Bloomberg L.P. ("Bloomberg") is a global business and financial information company headquartered in New York. The principal product offered by Bloomberg is the Bloomberg Terminal® service (formerly known as the Bloomberg Professional® service), which provides financial market information, data, news and analytics to banks, broker-dealers, institutional investors, governmental bodies and other business and financial professionals worldwide.

to the Time of Execution). The second proposed change would require reporting firms to add a modifier to identify transactions that were completed as part of a "portfolio trade."

Bloomberg is highly supportive of the regulatory goals of the proposal to bring greater clarity to TRACE disseminated prices by identifying the types of trades in the TRACE data that may not be reflective of the current market price for the bonds and may be less informative for market participants that rely on TRACE for price discovery or other analyses. While the proposal to add a modifier when the Treasury spot is delayed moves TRACE much closer to achieving this goal, instituting the modifier to indicate a portfolio trade, in its current proposed form, would represent a colossal missed opportunity because the definition is far too narrow.

II. Delayed Treasury Price Proposal

FINRA notes that market participants may trade corporate bonds on the basis of a spread to a benchmark U.S. Treasury Security, which is then converted to a dollar price by "spotting" the benchmark U.S. Treasury Security at a designated time in the future, e.g. the closing price which is traditionally set at 3:00 pm ET when the US Treasury futures markets "close" their day session. Despite the trade being arranged at an earlier time (e.g. 10:00 am), the transaction is reportable only when the corporate bond price is set after the benchmark Treasury yield is "spotted" (at 3:00 pm).

The proposal adds an incredible amount of value, insight and transparency into TRACE data. Currently, when such a delayed transaction is disseminated at 3:00 pm, difference in prices for the same corporate bond could be a result of either a move in the underlying Treasury benchmark or a change in perception of the credit worthiness of the corporate issuer. By identifying these delayed spread trades and disseminating the time that they were arranged, it will become possible for market participants to derive intraday credit spread moves in specific corporate bond issues and issuers. This is particularly important during this unprecedented time impacted by the coronavirus. According to Bloomberg[2], BBB-rated bonds made 51% of investment grade issuance in 2019, and Fitch Ratings[3] estimates that, as of September 2019, over 58% of the corporate bond market is rated BBB, the lowest investment grade rating. With this new information, it becomes possible to discern whether price moves are the result of a market concern that an issuer is expected to become a fallen angel.

The proposal does not come without a cost, however. For most market participants and infrastructure providers, recording the time that the spread was agreed upon, placing it into a myriad of systems, and augmenting reporting to TRACE operations represents a significant

[2] *See* Perez, I. (2020, February 18). Risks Build From Companies After Multi-Year Bond Market Binge. *Bloomberg*. Retrieved from https://www.bloomberg.com/news/articles/2020-02-18/risks-build-from-companies-after-multi-year-bond-market-binge

[3] *See* Forsyth, R. (2019, November 1). The Bond-Market Panic That Wasn't. *Barron's*. Retrieved from https://www.barrons.com/articles/these-corporate-bonds-were-supposed-to-turn-to-junk-theyre-booming-instead-51572620527

change in workflow. Most of the industry plans changes of this magnitude are based on quarterly rollout schedules. Additionally, consumers of the TRACE data will need specifications in advance in order to make changes to systems that will ingest the new updated feed and make practical changes in order to interpret the data and bring additional market insights that the new time stamp affords. We recommend that FINRA provide the industry with plenty of time to accommodate these changes and conduct an outreach of members to determine an appropriate amount of lead time following FINRA's release of FAQ's and TRACE messaging specifications that is needed to code, test, and implement the necessary changes.

III. Portfolio Trades

In the proposal, FINRA seeks to define a portfolio trade as two parties entering into a single trade for a basket of at least 30 corporate bonds of the same issuer at an agreed aggregate price for the entire basket executed on an all-or-none or most-or-none basis.

Bloomberg has significant reservations with this part of the proposal including that there are significant incentives for liquidity seekers to avoid sending baskets that would meet the criteria; the concept of "most-or-none" is neither defined nor a protocol that exists in the market today; and the data FINRA supplied in the regulatory notice demonstrates that the overall approach actually moves FINRA further away from achieving its stated regulatory objective.

Throughout the history of TRACE, FINRA has sought to balance transparency and the potential impact to liquidity. Currently, portfolio trades are disseminated through TRACE as a series of unrelated transactions. This protects liquidity seekers from their trading and investing strategies being reverse engineered. On the other hand, implementing the designation as proposed by FINRA could lead to significant information leakage because it is so specific. FIMSAC committee member Lynn Martin recognized that when she said that the designation would help participants "understand the mechanism as to ***why*** and how the trade was executed."[4]

The designation is problematic because it will alert the market that a change in portfolio strategy has just occurred. For example, a portfolio designation would enable participants to group the transactions together to reverse engineer, or signal, that an institution has extended the duration or soured on a particular issuer. From the liquidity provider perspective, the designation acts as an immediate signal that a liquidity provider just took down a portfolio and could dampen liquidity for trades that meet the stated criteria. Thus, the proposal will most likely not provide the transparency or insight into market structure that FINRA is seeking because liquidity seekers and providers may simply split up their lists into smaller lists that do not meet the criteria, to avoid the designation signaling investment strategy shifts and subsequent potential adverse market impact.

An all-or-none designation included on an order is an execution constraint that is well defined in all markets. However, "most-or-none" is a concept that does not currently exist in any market. And for good reason – from our experience this is a common practice of trade negotiation. How

[4] *See* Transcript of FIMSAC Meeting (February 10, 2020) at page 105, available at https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-021020-transcript.pdf

is "most" different than sending a list that is open for trade negotiation? Why does this need to be defined when it is embedded in the process? Moreover, if there is a regulatory reason why an order needs to stipulate "most" it needs to be defined - what is the threshold on the number of constituents in the basket that constitutes "most"? Is it a percentage or a number based on the threshold of 30 bonds from the same issuer in the portfolio trade?

Regulatory reporting designations from orders are far more difficult to track. This is in part why most reporting regulations focus on executions. It is a far simpler approach from both regulatory and practical system implementation point of view (and FINRA examinations point of view). Consider for example, a definition of a basket that includes 30 executions with bonds from the same issuer between two parties at an aggregate price. This definition acknowledges that a portfolio is a specific form of a basket trade and makes it clear from the transaction that a reportable transaction was executed.

FINRA's regulatory transparency objective is to provide greater clarity in the TRACE data by indicating that prices may be off-market (not reflective of the current market price for the bonds). Perhaps the greatest problem with the portfolio trading modifier is that, in its attempt to bring more clarity to the market structure, the proposal pulls FINRA further away from addressing its stated regulatory transparency objective. To move closer to the transparency objective, TRACE should identify every situation where two or more securities are transacted at an agreed upon price where the price may not reflect the current market price for the bonds. This point was also raised by FIMSAC member and USC Marshall School of Business Professor Larry Harris,[5] but was not addressed by the electronic trading subcommittee or the full committee at large. As a subject matter expert also in equities, Mr. Harris draws parallels to the equity market from time-to-time. Regarding transparency, the Security Information Processors ("SIP") is instructive.

The SIP, in order to indicate which prices are reflective of the current market price for a stock, requires market participants to assign condition codes (reporting modifiers) that indicate transactions with special circumstances that impact price. Like the SIP, TRACE has modifiers (conditions codes) to identify (weighted) average price trades. The SIP, however, has additional condition codes that flag derivatively priced and qualified contingent trades where the price of the transaction is defined by a relationship between the assets rather than the current market price of the asset. FINRA's data shows that, by flagging only "portfolio" trades, 75-85% of these trades will continue to published without the needed price context.

FINRA's stated regulatory objective is to provide greater ***price*** transparency, not ***market structure*** transparency. Therefore, FINRA, similar to the SIP, should consider creating a new or

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[5] *See* FIMSAC Meeting Transcript at page 124. "With respect to portfolio trading, the distinguishing characteristic of a portfolio trade, and the reason that we're concerned about this, is that there is a single price for the portfolio. And underlying that single price, there is some sort of matrix pricing for the individual trades. So the present proposal says that we should implement these new procedures for portfolio trades whenever there are 30 or more transactions or lines, as they have been called, associated with the portfolio. But the truth was that the principle applies to any transaction where there are more than one line, more than one line, with prices being somewhat arbitrarily assigned. And so I think that the 30 ought to be brought down to two. I don't see any additional cost because anybody who is using a system that is working it this way, it goes into that system."

using an established modifier for reported trades when the derived price of the corporate bond may not accurately reflect the current market price for the bond.

We agree with the late Thomas Gira when he explained at the February 10, 2020 FIMSAC meeting that, "…I think anytime we [FINRA] can add contextual information about trades, particularly trades that might be away from the current prevailing market, that's always a good thing for the audit trail."[6] With the changes to provide greater clarity to delayed Treasury prices and Bloomberg's suggested changes to the portfolio trading proposal, FINRA will move closer to fulfilling its regulatory transparency objective.

As we advised in the Delayed Treasury Price part of this Proposal, tracking the trades where prices may not be reflective of the current market price for the bonds because they are priced based upon an aggregate price in order to add a modifier in the TRACE report is not a trivial change to current systems and infrastructure. Market participants will need time to integrate these changes into basket trading software, books and records, and TRACE reporting systems. Most of the industry plans changes of this magnitude are based on quarterly rollout schedules. We recommend that FINRA provide the industry with plenty of time to accommodate these changes and conduct an outreach of members to determine an appropriate amount of lead time following FINRA's release of FAQ's and TRACE messaging specifications that is needed to code, test, and implement the necessary changes.

Very truly yours,

Gregory R Babyak

Gregory Babyak
Global Head of Regulatory Affairs, Bloomberg L.P.

[6] *See* FIMSAC Meeting Transcript at page 117.