VIA EMAIL

October 16, 2020

Jennifer Piorko Mitchell
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006-1506
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Re: FINRA Regulatory Notice 20-29 - Requests for Comment on the Practice of Pennying in the Corporate Bond Market

Dear Ms. Mitchell:

ICE Bonds Securities Corporation (CRD# 123635)("**ICE Bonds**")[1] appreciates the opportunity to respond to FINRA Notice 20-29 (the "**Request**") issued by the Financial Industry National Regulatory Authority ("**FINRA**") to request comment on the practice of internalizing customer trades in the corporate bond market, a practice commonly known in the industry as "pennying."

ICE Bonds supports balanced regulation to ensure a healthy trading environment for fixed income products that ultimately benefits both issuers and investors. ICE Bonds further supports the SEC's Fixed Income Market Structure Advisory Committee ("**FIMSAC**") recommendation that the SEC make a statement disapproving of the practice of pennying and encourage FINRA to publish clear guidance on what constitutes abusive pennying and then seek to dissuade the practice through examinations and enforcement. ICE Bonds believes that broad participation and behavioral flexibility are increasingly important during times of market stress, such as the markets have experienced in 2020. ICE Bonds' comments on the Request are provided from such a perspective.

In considering changes to the regulatory regime for the practice of pennying, we encourage FINRA to proceed with the intent of broadening, rather than narrowing, the range of participants that seek to access the fixed income markets. ICE Bonds believes that the publication of clear guidance that differentiates anti-competitive pennying from meaningful price improvement will lend itself to broadening the level of participation in the fixed income markets.

[1] ICE Bonds is the operator of three (3) alternative trading systems (ICE BondPoint, ICE Credit Trade and ICE TMC) for the trading of fixed income products and a broker-dealer registered with the US Securities and Exchange Commission, pursuant to Section 15 of the Securities Exchange Act of 1934, is a member of FINRA, the Municipal Securities Rulemaking Board and is registered with the National Futures Association as an introducing broker pursuant to the provisions of the Commodity Exchange Act.

The Request sets forth a number of questions regarding the definition of pennying in the corporate bond markets, to which we provide specific responses below. In general, however, ICE Bonds agrees with the definitions of pennying and last look practices that were put forth by the FIMSAC in June 2019, as well as the distinction between the two practices.[2] We further encourage FINRA to consider refinements to these concepts to account for other factors that may be important to a broker-dealer's decision to internalize a customer order beyond the amount of price improvement. Such refinements could include making clear that occasional internalization by a broker-dealer, even without "material" price improvement, may not necessarily be defined as "pennying" when other factors such as trade size, bond maturity, certainty of execution, counterparty risk or even overall costs of clearance and settlement are part of the decision process.

Importantly, it is our view that the *frequency* of internationalization without meaningful price improvement is a key factor in evaluating whether a regular practice of internalization amounts to abusive pennying or is justified in light of other factors. For example, the Request describes FINRA's analysis of data where auctions resulted in internal executions. Within that data, FINRA observed that 28 percent of executions were based on internal bid prices that did not improve the best external bid and an additional 16 percent with less than five basis points of price improvement. These are interesting data points, however, we recommend that FINRA not consider the lack of price improvement in isolation, but instead consider additional factors such as the ones noted in the paragraph above, when examining patterns of broker-dealer activity that may indicate pennying.

Response to Question 3: *If pennying is defined as a pattern or practice of internalization with no or slight price improvement after viewing prices obtained through an RFQ, what amount of price improvement should be considered meaningful and what level of regularity would constitute a pattern or practice?*

a. Should price improvement be considered on a percentage or total dollar basis, or some combination of the measures? Does the answer depend on the size of the transaction? For example, should price improvement of 25 basis points on a $100,000 transaction, or $250, be considered more meaningful than price improvement of 25 basis points on a $10,000 transaction, or $25?

As described above, the level of price improvement that a broker-dealer provides is intertwined with other factors. Taking a bright-line approach to a specific level of price improvement should account for factors such as transaction size and bond maturity, among others. For example, a transaction at the short end of the curve could consider price improvement as a measure of dollar

[2] See FIMSAC Recommendation Regarding the Practice of Pennying in the Corporate and Municipal Bond Market, available at: https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-pennying-recommendations.pdf (stating that pennying "occurs when the dealer, after reviewing the auction information received back in a bid-wanted (BWIC) or offer wanted (OWIC), either matches the best price or executes the bond at a price that is slightly better than the best price").

amount. Conversely, a transaction at the longer end of the curve could be evaluated by expressing price improvement in terms of basis points.

a. *Should the same amount of price improvement be considered more or less meaningful depending on the competitiveness of an auction? For example, would price improvement of 25 basis points be more meaningful after an auction with seven responses than an auction with one or two responses?*

In our experience, the same amount of price improvement should not necessarily be considered in this way. It is possible that the same high bid would exist with seven responses compared to just two responses. Other factors that could be considered more meaningful include, the amount outstanding on an issue, composition of a portfolio, and perceived liquidity of the bond. Factors such as these, and others, should be considered when determining whether price improvement is meaningful.

b. *How do transaction costs affect current measures of price improvement? Should such transaction costs be considered when comparing internal and external bid prices?*

As previously stated, price improvement must not be taken in isolation as indicative of (anti-competitive) pennying, as the overall cost of a given transaction in some circumstances may justify the internalization of a transaction; notwithstanding the fact that there may not have been any significant price improvement when comparing internal and external bid prices.

c. *Do firms apply the same mark-ups and mark-downs to external and internal bid prices to arrive at a final reported price? Are there reasons why firms do or would apply different mark-ups and mark-downs to internal and external bids?*

In our experience, firms apply different mark-ups and mark-downs to external and internal bid prices to arrive at a final reported price. For example, certain firms may mark-down external bids to customers to account for an internal desk fee. However, other firms may not mark-down internal bids to customers because they expect to profit when they sell the bonds purchased through an RFQ.

d. *What level of regularity would signify a systematic business practice? How should regularity of occurrence be considered alongside the amount of price improvement? Should a less regular pattern with lower price improvement be considered similar to a more regular pattern with higher (but still slight) price improvement?*

ICE Bonds believes that it would be unduly complex and difficult to enforce a set of standards that use only the regularity of an occurrence in determining when pennying is deemed to be anti-competitive. We recommend that FINRA consider both the regularity of the occurrence *along with the amount of price improvement* as the appropriate threshold as to whether pennying

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constitutes a systematic business practice. As noted above, not all internalization is anti-competitive and the totality of the circumstances surrounding each transaction should be considered when determining whether there were other factors (e.g. certainty of execution, counterparty risk, cost of settlement, among others) that led to the internalization, irrespective of whether or not price improvement was provided to the client.

Response to Question 4: *What are the market quality and economic consequences of pennying? Does or will pennying harm overall auction competitiveness over time, for example by causing fewer firms to provide bids in response to auctions, or by causing responding firms to bid less aggressively? How can the impact of pennying be measured?*

ICE Bonds supports regulatory action to prohibit anti-competitive pennying behavior that is harmful to the fixed income market. If market participants believe that their response to auctions are being used by other firms for the purpose of price discovery and not execution, those market participants may hesitate to respond with aggressive pricing or may decline to participate in the auction at all. The reduction of the number of market participants ultimately hurts end investors, as they either end up with inferior pricing or they are left with whatever price their own broker-dealer can provide to them through internalization. Further, the risk that market participants will no longer provide competitive pricing may lead to a concentration of trading activity to only a few market players, further diminishing the competitive landscape.

ICE Bonds also believes that pennying has a disparate impact on certain firms, perhaps negatively impacting smaller firms more so than larger firms. However, with respect to FINRA's request for comment as to whether "there [are] ways for initiating firms to make it known to potential auction responders that the initiating firms do not engage in pennying?", we believe it is not possible for the marketplace to "police" itself in any meaningful way that would change the behavior that is the subject of this Request. More specifically, many of these auctions occur on alternative trading systems ("**ATS**") where the broker-dealer operator of the ATS acts in a riskless principal capacity and the counterparty is unknown to the other side of the trade. ICE Bonds believes it would be difficult to manage a process of advance "name give-up" in the context of pennying. Further, any such name give-up would ultimately lead to counterparty blocking requests, which would in turn create a whole different problem impacting market participation. ICE Bonds continues to support the FIMSAC recommendation that the SEC make a statement disapproving of the practice of (anti-competitive) pennying and encourages FINRA to publish clear guidance on what constitutes pennying and then seek to dissuade the practice through examinations and enforcement.

We support further data gathering efforts from FINRA to evaluate patterns of behavior, such as the analysis it conducted in response to FIMSAC's 2019 recommendation on this issue that is described in the Request. To effectively collect a broad set of data that provides the most accurate picture of practices in this area, FINRA should make this an exam priority as it does for reviewing best execution or markup/markdown pricing practices. We also support the requirement that firms be required to disclose to customers information regarding their auction practices, which should include the provision of an internalization report that would inform

clients as to the number/percentage of transactions during a given period of time that were put out for competitive bid and then ultimately internalized. We believe this level of transparency along with the publication of a firm's auction practices would foster transparency that would benefit the end client and promote a level playing field.

Responses to Question 5: *During FIMSAC discussion of the Recommendation, there was some support for a requirement that dealers "bid blind" in response to auctions their firm initiates. Under this kind of requirement, dealers would need to bid on auctions initiated by their firm on a blind, competitive basis during the auction period, the same as any other firm, without the opportunity to review other firms' auction responses before entering the firm's own order.*

a. *Would a blind bidding requirement be an appropriate regulatory approach? If so, would a blind bidding approach need to allow for "last look" and an opportunity for meaningful price improvement? If not, should blind bidding still be considered as a best practice guide for firms?*

The proliferation and use of multiple venues to run auctions has introduced valuable competition into the fixed income marketplace and improved the execution quality received by both retail and institutional clients alike. However, the availability of multiple marketplaces has also led to a lack of transparency and a diminished ability to detect certain market practices that may be deemed anti-competitive or unfair, including pennying practices. We believe that market participants may engage in "venue arbitrage", whereby they initiate an auction on one venue with the intent of using the results of that auction for market discovery purposes and then initiate a new auction on a different venue, using the newly gained market color to participate in the new auction. We believe blind bidding would curtail this practice.

Further, ICE Bonds supports blind bidding to ensure that all bidders (both external and the auction initiator) bid as strongly as possible resulting in a more competitive auction process. ICE Bonds further believes that the initiating firm should be required to participate in the auction on a competitive basis if there is any possibility of internalization. Absent a competitive bid by an initiating firm, internalization should not be permitted. Finally, we believe that blind bidding improves market efficiency and competition because market participants know that all bidders are subject to the same auction terms.

ICE Bonds continues to support the "last look" practice to the extent that an initiating firm participates in the auction and where there are clear parameters for the practice based on transaction size and bond maturity.

b. *Are there any drawbacks to a blind bidding approach? Would a blind bidding approach impose any costs on customers?*

ICE Bonds believes that blind bidding would encourage all bidders (both external and the auction initiator) to put their best price (i.e. a *bona fide* price) in the auction with the intention of winning the auction, as opposed to putting a bid level on the bonds that is less than its best bid.

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c. *Are there any reasons why firms could or should not bid blindly into an auction they initiate on behalf of a customer? In other words, are there any reasons for initiating firms to first review external auction responses before providing their own bid?*

ICE Bonds does not see any reason why an auction initiator should not be required to participate in the auction if there is any possibility of internalization following the auction. The practice of last look in this context would continue to provide the auction initiator with the ability to internalize the trade, if in the client's best interest.

* * * * *

We hope these comments are constructive to FINRA as it considers further regulatory action regarding the practice of (anti-competitive) pennying. In considering any change, we encourage FINRA to provide clear guidance on the type of pennying that constitutes "anti-competitive" and should therefore be discouraged. We believe such guidance will lead to more market participation, as participants can take comfort in knowing that any prices they provide in an auction will not be used for the purpose of price discovery.

Sincerely,

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