August 6, 2013

Elizabeth Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Comment Letter on Proposed Regulation SCI (File No. S7-01-13)

TMC Bonds LLC ("TMC") appreciates the opportunity to comment on the Commission's proposal on Systems Compliance and Integrity ("SCI") and particularly on its potential impact on the retail ATS market. TMC is a consortium-backed ATS with significant market share in the inter-dealer municipal market, as well as smaller but growing presences in various taxable fixed income markets. The major theme of this letter is that the retail ATS' have significant market share only in the retail/odd lot market, function in a market in which execution times are orders of magnitude higher than in the equity market, and are not inter-connected in any way. As a result, it does not seem appropriate that the Commission adopt a regulatory structure for the retail fixed income ATS market that is designed for a market that has massively higher volumes and faster execution times.

1. Different Trading Velocities Results in Greatly Different Systems Risk

In Release No. 34-69077, page 15-16 the SEC states that trading centers are "extremely fast and interconnected systems." The SEC, citing such rules as Regulation NMS and others, recognizes that it has mandated and encouraged automation. The retail fixed income market does not fit the description, however, as most ATS's operate on a Request for Quote ("RFQ") model or have "confirm" pricing models, in which market makers have the opportunity to approve or deny a trade. Thus, ATS execution times are measured in seconds and minutes (some ATS' allow trade executions to occur at least several minutes after the order is received). Furthermore, the retail fixed income market is fragmented; there is no meaningful connectivity among the fixed income ATS participants. Historically, any ATS outage has simply resulted in transactions volume moving to other platforms, and, in the case of broader outages (such as major storms or blackouts), volume in the markets is such that participants can conduct business on a voice basis, as they still do to a large extent in any event.

Given that low latency trading does not exist for the retail municipal or corporate bond markets, there is virtually no systemic risk if one (or more) fixed income ATS' has an outage. Market participants use inventory management systems that prevent them from selling securities that they do not own, some ATS' allow one or both parties to a trade to affirm or deny a trade subsequent to receipt of an order, and volumes in the market are extremely low, compared with the equities or rates markets. Additionally, compliance with SEC 15c3-5, also a regulation recently adopted from the equity market, has mitigated risks with respect to systems malfunctions.

2. Compliance Costs

Retail fixed income ATS' operate on a vastly different scale than do those in the institutional equity markets. More volume trades in one minute in the equity market than trades in the municipal securities market in an entire year. As a result, we submit that using a single regulatory scheme for SCI purposes is inappropriate. Arguably, the costs of compliance for a retail fixed income ATS, that has as few as 2300 municipal bonds trades/day (roughly 5% of the number of daily municipal bond trades), with an average par amount per trade of about $50,000, would be several orders of magnitude higher (either on a per trade or a per dollar amount basis) than for an exchange in the equity market. Given the cost of compliance for SCI firms in the "one size fits all" environment, costs would overwhelm revenues if a retail fixed income ATS had an SCI designation. Many responders to the notice suggested that complying with the rule could cost firms from $1 million up to $10 million. Given that virtually all of the retail fixed income ATS's qualify as FINRA "small firms", the cost of compliance would be astronomical

3. Significant Volume Measurement

There are different ATS models in the retail fixed income space that would impact trade count/volume for SCI purposes. Some ATS' act as counter-party to trades. Thus, when a buyer and seller are matched, four trades are generated, ATS Buy from the seller, seller Sale to the ATS, buyer Buy from the ATS, and ATS Sale to the Buyer. The ATS has two trades to report, while each market participant reports one trade. The other model is such that the ATS is not counter-party to the trade, the ATS does not report any trades, and only two trades are recorded as the buyer and seller write tickets against each other. The language states for "five percent or more of the average daily volume as calculated by the SRO to which such transactions are reported" may not consider ATS's that are not counter-parties to trades. Even though the variant models allow ATS' to intermediate, if one model falls under new regulations, while the other does not, new rules could result in all ATS' changing their model to disclosed counter-party, which would result in no retail fixed income ATS falling under the regulations. In this case, the retail fixed income participant would lose the ability to transact anonymously, which is much of the value provided by the platforms.

Also, the number-of-trade versus volume distinction highlights the low impact of systemic risk presented by fixed income ATS's. As the proposed regulation points out, to meet the proposed volume definition, an ATS would need to have either (approximately) 2300 trades per day or have daily volume exceeding $580 million over a rolling period of time. The SEC also suggests that 3 firms may meet this definition in the municipal market; however, this is likely true based on trade count only. With an average par amount per trade of 50 bonds, the par amount of these trades on the retail ATS' is low and thus presents far less risk to the market. TMC believes that par amount traded would be a better measure of systemic risk. In fact, a failure in the institutional market, in which the ATS' essentially do not participate, would likely pose far greater risk to system integrity. The reality is that the large dealers trade a far greater par amount on a daily basis than the average ATS, the regulation as proposed would be focusing on a few entities based on ATS designation, not on their potential impact on the market.

4. SCI Events Unlikely in Retail ATS Markets

Most fixed income ATS's have developed extensive front-end systems for market participants to access the ATS marketplace. The integrated software results in a much greater diversity of interfaces and methodologies for users to connect to the ATS'. Firms can login via a browser, connect via an API, send comma delimited files, and even receive emails for updates. The ATS' supporting equities are much more purely trading focused. Thus, the occurrence of an SCI Event is much less likely in the fragmented fixed income market and would have a much narrower impact, as only one or a few participants could be affected. While the current language leaves it to the discretion of the ATS to define "significant harm or loss to market participants", it is hard to argue that an entity with a nominal 2000 trades per day (more or less), with an issue impacting one user, would be a major disruption for the market.

5. Co-ordinated Testing

Rule 1000(b)(9)(ii), suggesting that "SCI entit(ies) coordinate testing on an industry- or sector-wide basis with other SCI entities", would be difficult in the retail fixed income markets, as ATS' are not connected to each other and algorithmic trading is virtually non-existent. With different protocols and trade acceptance times, synchronized trading does not exist in the market and cannot be emulated in testing.

TMC greatly appreciates the opportunity to have its voice heard on the SEC's SCI proposal and would be available for any further conversation. We believe that a process whereby a moderate expansion of existing 15c3-5 or a risk adjusted SCI would be a more measured response for regulation of electronic fixed income trading. As the both the risks and scale for fixed income electronic trading are significantly different than those of the equity market, the compliance and integrity monitoring for each should differ as well.

Sincerely,

Thomas S. Vales
Chief Executive Officer