

April 18, 2022

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE, Washington DC 20549

Via E-Mail: rule-comments@sec.gov

Re: File No. S7-02-22; Amendments to Exchange Act Rule 3b-16 Regarding the Definition of “Exchange”; Regulation ATS for ATSS That Trade U.S. Government Securities, NMS Stocks, and Other Securities; Regulation SCI for ATSS That Trade U.S. Treasury Securities and Agency Securities

Dear Ms. Countryman:

MarketAxess Holdings Inc. (“MarketAxess”)¹ is grateful for the opportunity to provide the Securities and Exchange Commission (“SEC” or “Commission”) with our comments regarding the above-referenced proposed rule change (“Proposal”).

I. Summary of Comments

As we noted in our prior letter in response to the Commission’s 2021 Concept Release on the Electronic Corporate Bond and Municipal Securities Market, MarketAxess is supportive of the Commission’s review of the regulatory oversight of fixed income electronic trading platforms². We believe that there should be a common regulatory framework for all multilateral fixed income electronic trading platforms so that platforms offering similar services are regulated consistently, regardless of whether they rely on firm orders or non-firm trading interest.

While we do have significant reservations about the Proposal, we wish to note our support for it in two key areas. First, we appreciate that the Proposal would achieve the Fixed Income Market Structure Advisory Committee’s goal of harmonizing the regulatory framework for fixed income electronic trading platforms that operate different trading protocols and business models. By moving away from a definition of an ATS that largely reflected the trading practices of the order-driven equity markets, we believe that the Proposal, if adopted, will prevent the further fragmentation of the regulatory framework for fixed income electronic trading platforms.

¹ MarketAxess operates the leading, institutional electronic trading platform for corporate bonds. Through its registered broker-dealer, MarketAxess Corporation, and its global affiliates, more than 1,900 firms traded a record \$6.8 trillion of U.S. investment-grade bonds, U.S. high yield bonds, emerging market debt, Eurobonds, Treasuries and other fixed income securities on the MarketAxess platform in 2021. MarketAxess’ Open Trading™ marketplace is regarded as the premier all-to-all trading solution in the global credit markets, creating a unique liquidity pool for the broad range of credit market participants.

² Letter from Scott Pintoff, to Vanessa Countryman, Secretary, SEC, at Page 1 (Mar. 1, 2021) (the “Prior Comment Letter”).

Second, the Proposal recognizes, and accepts, the variety of trading protocols that are currently utilized in the fixed income electronic trading markets, including request-for-quote (“RFQ”), streaming quotes, order books and matching sessions. The Proposal does not impose prescriptive requirements that mandate, or favor, any specific trading protocol or intermediation model. This continued flexibility is essential for allowing market participants to continue to benefit from broad-based competition among venues, investments in new and innovative trading protocols, greater trading efficiency, and lower transaction costs. Further, we commend the Commission for not imposing additional equity market trading practices on the fixed income markets.

Our concerns with the Proposal relate to (1) the unreasonably low market share threshold for applying Regulation SCI to ATSs for U.S. Treasury securities or Agency securities, (2) the failure of the Proposal to address the knock-on effects of CPSs operating as an ATS in relation to Rule 15c3-5, (3) the overly broad expansion of the definition of “exchange “ in Exchange Act Rule 3b-16 and the lack of a clear definition of Communication Protocol Systems (“CPS”) and (4) the limited transition periods for adherence to the new rule set. Our reservations with respect to these issues are discussed below.

II. The Commission should increase the Market Share Threshold for the Application of Regulation SCI to Government Securities ATSs to at least 15%.

As we stated in our Prior Comment Letter, we believe that the capacity, integrity and security requirements of Rule 301(b)(6) should apply, at a minimum, to all fixed income electronic trading platforms, including Government Securities ATSs, as a condition of operation.³ However, we do not support a 5% market share threshold for the application of Regulation SCI to Government Securities ATSs. Regulation SCI was designed to address concerns with those entities that are most essential to the functioning of U.S. securities markets. In addition, Regulation SCI was introduced following the Commission’s introduction of Regulation NMS, which required all automated markets to interconnect to ensure compliance with the “trade through” requirements of Regulation NMS. Such mandated interconnectedness does not exist in the Treasury markets at nearly the same levels as in the U.S. equity markets. As a result, Government Securities ATSs do not present the same risk-based considerations as equity ATSs as there is lower likelihood that they could negatively impact the market in the event of a systems issue.

There are multiple trading platforms for U.S Treasuries that have meaningful market share and a substantial amount of U.S. Treasuries trading, perhaps as much of 40% of volumes, continues to take place via voice trading. These Government Securities ATSs do not have interconnected technology and there is no mandated national market system by which problems at one platform could spread rapidly and create widespread damage, as in the equity market. Not only are Government Securities ATSs not as interconnected as in the equity market, but many such ATSs employ a variety of trading protocols that are intrinsically less risky for price formation than equity order books. For example, all of the Agency security trading conducted on MarketAxess’ platform is done via RFQ protocols and we have also recently launched U.S. Treasury trading via RFQ. RFQ is effectively a low speed, high-touch, one-to-many order delivery mechanism that does not present the same systematic risk as low latency matching engines. Applying Regulation SCI to all Government Securities ATSs with a 5% market share, without

³ The Commission chose not to apply the requirements of Rule 301(b)(6) to the trading of government securities on ATSs. See Proposal, Page 90. This will result in no capacity, integrity and security requirements being applied to Government Securities ATSs with a market share below the Regulation SCI threshold.

regard to their manner of operation, could potentially limit competition, and discourage innovation, in these markets.

The initial and ongoing costs to comply with Regulation SCI are significant. The Commission itself estimates that the initial cost of complying with Regulation SCI will be between \$1.1 to \$3.2 million per ATS and the ongoing costs will be \$1.15 million to \$2.5 million per year.⁴ The imposition of this level of costs is unreasonable given the revenue opportunity for ATSs associated with a 5% market share of either U.S. Treasury or Agency security trading. For example, we estimate that MarketAxess' revenues associated with a 5% market share for Agency securities trading would be less than the \$2.5 million per year in expense that the Commission estimates could be required just to comply with Regulation SCI. This cost-benefit analysis could force Government Securities ATSs to take steps to stay under the threshold or cease providing services for some fixed income product areas.

In addition, a Government Security ATS that captures only 5% of market volumes is not critical to the overall market. In the event of a system disruption, trading could transition to multiple other platforms or methods of trading. The Regulation SCI application threshold should therefore be increased to a more material level such that it captures only those Government ATSs that have the potential to significantly impact the market should an SCI event occur. We believe this threshold should be at least 15% for the application of Regulation SCI, which is still less than the current threshold for applying the lesser requirements of Rule 301(b)(6) to ATSs that trade corporate or municipal debt.

We also believe that the expansive concept of CPSs under the Proposal requires the Commission to adjust how it calculates market share for purposes of Regulation SCI. While RFQ functionality is presumably a CPS, we do not believe that RFQ functionality should be considered when calculating market share for purposes of Regulation SCI. RFQ is a system function that is equivalent to order routing functionality in the equities market, which is currently not included when calculating Regulation SCI market share on equity ATSs. As discussed above, disclosed RFQ involves connecting clients directly to dealers on a fully disclosed basis for the purposes of requesting, and receiving, execution, just as ATSs and exchanges in the equity markets route orders to other dealers, ATSs or exchanges. For purposes of calculating market share under Regulation SCI, we believe that the Commission should apply the same treatment to disclosed RFQ functionality as it currently applies to order routing functionality in the equity markets.

III. The Commission must address the knock-on effects of Rule 15c3-5 on Newly Designated ATSs Operating on a Disclosed Basis.

If the Proposal is adopted, the Commission expects a significant number of CPSs will be forced to operate for the first time as newly designated ATSs, including CPSs that offer fully disclosed, non-automated, trading protocols, such as RFQ. These newly designated ATSs will also be required to comply with Rule 15c3-5, which requires brokers or dealers providing direct market access to customers or other persons to implement risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of this business activity. However, as we noted in our Prior Comment Letter, we do not believe the market access controls that are imposed on ATSs by Rule 15c3-5 can be properly applied by trading platforms operating on a disclosed basis, particularly the credit limit controls.

⁴ See Proposal, Page 480, Table VIII.9.

We believe it is clear from the text of Rule 15c3-5(c)(1) that the Commission did not contemplate that ATSs might someday operate on a disclosed basis, as will happen en masse if the Proposal is adopted.⁵ Instead, the Rule specifies that the required controls must be “designed to systematically limit the financial exposure of *the broker or dealer* that could arise as a result of market access”. In order to implement the financial risk management controls required by Rule 15c3-5(c)(1), CPSs operating on a disclosed basis would have to interpose their perspective on appropriate credit limits between a dealer and its clients despite the fact that it is not a party to the trade and will have no financial exposure to the customer. We believe the Commission should review how Rule 15c3-5 will work in conjunction with the Proposal and, at a minimum, clarify that CPSs operating as ATSs have flexibility in applying the financial risk management controls for disclosed trading protocols, including disclosed RFQ.⁶ Otherwise, the imposition of market access controls will likely have an adverse impact on dealer interactions with their clients.

IV. The Commission should exclude bilateral systems from the definition of “exchange” and clearly define “communication protocol systems.”

Sophisticated institutional investors in the credit markets have long relied on RFQ as their electronic trading functionality of choice because they have found that liquidity on demand results in the best pricing for illiquid securities. Although electronic RFQ volumes represent the largest percentage of corporate and municipal bond electronic volumes, RFQ platforms have been excluded from Regulation ATS based on the widely-held view that Rule 3b-16(a) did not extend to systems that relied on price requests, rather than firm orders. The Proposal updates the concept of an exchange under Rule 3b-16(a) to include trading functionality that is driven by price requests or non-firm trading interests, such as institutional RFQ platforms, stream axes and conditional order systems. MarketAxess supports the inclusion of each of these electronic systems in the concept of an ATS provided that such system is a trading venue that brings together multiple buyers and sellers for the purpose of agreeing to the terms of a trade.⁷ Such systems, whether relying on the use of orders or quotes, meet the common understanding of a trading system (and, by extension, an ATS).

Bilateral negotiation protocols, on the other hand, which never allow more than one buyer and one seller to interact on a particular trade negotiation, should not be considered to be ATSs. Regardless of whether such bilateral systems use defined communication protocols, buyers and sellers are not in price competition with each other. Bilateral trading functionality essentially elevates, and makes more efficient, the process of two parties communicating via e-mail or instant message. We do not believe that the imposition of communication protocols is significant enough to turn a one-to-one communication, such as a chat feature, into a trading system that performs an exchange market function. MarketAxess also believes that excluding bilateral systems is consistent with the Proposal’s

⁵ The adopting rule release for Rule 15c3-5 explains that the broker-dealer will be required to set appropriate credit thresholds for *each customer* for which it provides market access, including broker-dealer customers, and appropriate capital thresholds for proprietary trading by the broker-dealer itself. See Release No. 34-63241, Risk Management Controls for Brokers or Dealers with Market Access, Pages 38-39.

⁶ The ATS cannot simply rely on the the credit risk controls set by the broker-dealers responding to the RFQ because Rule 15c3-5(d) requires the credit risk control to be under the “direct and exclusive” control of the broker-dealer subject to the Rule.

⁷ In response to Question 6, MarketAxess believes the Commission should not remove the reference to “multiple” in Rule 3b-16(a)(1).

treatment of single dealer system under Rule 3b-16(b). Last, we believe that the inclusion of bilateral communication protocol systems as ATs would result in a radical increase in TRACE reported ATs volumes beyond the level that most market participants would consider represents fully electronic trading volumes. We believe this would send misleading signals to fixed income market participants on the true volume and market share of many-to-many electronic trading venues operating in fixed income markets.

Despite the significance given to “communication protocol” systems in the Proposal, the Commission did not provide a clear definition of the term. Given the Commission’s statement that it “would take an expansive view of what would constitute “communication protocols””, we believe it is appropriate to clearly define the term and any associated exemptions rather than rely on a non-exhaustive list of examples. MarketAxess believes that clearly defining the perimeter of communication protocol systems at the onset may help to avoid a running debate in the future.

V. The Transition Periods in the Proposal should be extended by twelve to eighteen months.

The Proposal would require Newly Designated ATs to file an initial operation report on Form ATS no later than 30 calendar days after the effective date of any final rule.⁸ In addition, a Covered Newly Designated ATs would be required to file an initial Form ATS-N not later than 90 calendar days after the effective date of the final rule.⁹ MarketAxess believes these timeframes are too tight. Although CPSs that seek to operate as ATs will already be operating when the Proposal, if adopted, becomes effective, these systems have not previously operated as ATs. Accordingly, each CPS will be required to design, build and implement the technology and procedures underlying the risk management controls required by Rule 15c3-5 that are applicable to ATs. These risk management controls and related supervisory procedures will need to be described for each CPS in Form ATS or Form ATS-N and may not exist, or even have been designed, on the effective date of any final rule. The technology build to implement the controls may take twelve to eighteen months depending on the complexity of the build, the Commission’s response to our comment above regarding addressing the knock-on effects of Rule 15c3-5 on CPSs and the queue for technology resources at each firm and their third-party technology vendors.

If you have any questions concerning this letter or our responses to the questions, please feel free to contact us. We would welcome the opportunity to discuss these issues further with the Commission.

Yours sincerely,



Scott Pintoff
General Counsel, MarketAxess

cc: The Honorable Gary Gensler, Chair
The Honorable Allison Herren Lee, Commissioner
The Honorable Hester M. Peirce, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner

⁸ See proposed changes to Rule 301(b)(2)(i).

⁹ See proposed changes to Rule 304(a)(1)(iv).