

March 1, 2021

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

In regard to File Number S7-12-20

Dear Ms. Countryman,

The Bond Dealers of America is pleased to comment on Release No. 34-90019, "Regulation Alternate Trading Systems for ATSS that Trade Government Securities, National Market System Stock, and Other Securities; Regulation SCI for ATSS that Trade U.S. Treasury Securities and Agency Securities; and Electronic Corporate Bond and Municipal Securities Markets" (the "Release"). BDA is the only DC-based group exclusively representing the interests of securities dealers and banks focused on the US fixed income markets. Our comments focus just on Section VIII of the Release titled "Concept Release on Electronic Corporate Bond and Municipal Securities Market."

The electronification of the US bond market has brought a transformation in how bonds are traded. Electronic trading has reduced costs for customers, improved liquidity, and enhanced efficient pricing. Approximately 32 percent of the daily dollar volume in high grade corporate bonds is executed electronically.¹ For high yield corporates, the figure is around 23 percent, and for municipals our estimate is around 15 percent. Fixed income trading platforms continue to emerge and evolve, and we believe the portion of secondary market transactions executed on platforms will continue to grow. BDA's member firms are heavy users of electronic trading, and the regulation of trading platforms is of interest to BDA members.

SEC Regulation ATS was adopted in 1998, just as electronic trading in fixed income was emerging. The Internet was in its infancy, and virtually all trades in municipal and corporate debt securities were executed by voice over the telephone. Today, electronic trading is firmly established. Given the changes that have taken place in the fixed income markets and the economy in the last quarter century, it is appropriate for the SEC to revisit Rule ATS with an eye towards revision. BDA is pleased to comment.

Regulating fixed income ATSS

We generally agree with the sentiment of the July 16, 2018 recommendation of the SEC's Fixed Income Market Structure Advisory Committee with respect Rule ATS.² The FIMSAC pointed out the

¹ Kevin McPartland, "E-Trading Hits New Highs in Busy Start to 2021—February Data Spotlight: U.S. Credit Trading," Greenwich Associates, February 2021.

² U.S. Securities and Exchange Commission Fixed Income Market Structure Advisory Committee, "Recommendation for the SEC to Review the Framework for the Oversight of Electronic Trading Platforms for Corporate and Municipal Bonds," July 16, 2018, www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-electronic-trading-platforms-recommendation.pdf.

disparity in the regulation of fixed income trading platforms, stating “some platforms are regulated as alternative trading systems (ATSs), some are regulated as broker-dealers, and other significant platforms operating the same or similar models are not regulated at all.” We agree with the FIMSAC’s suggestion that electronic platforms dedicated to bringing together buyers and sellers of debt securities for the purpose of effecting transactions should generally be regulated the same regardless of how they are structured internally. Regulation should be based on the functions and services trading platforms provide in the market.

In addition, securities dealers are subject to a panoply of rules focused on customer protection. These include regulations governing suitability, best execution, trade reporting, know your customer, markup/markdown regulation and disclosure, anti-money laundering, and fair pricing, among others. This point is important because traditionally—and still predominantly—fixed income trades are between a dealer and a customer; dealers commit capital to provide liquidity to investors. Trading platforms have emerged that support trades between any two parties—dealer and customer, dealer and dealer, or customer and customer.

This raises the question of what investor protections apply when two customers trade directly with each other. BDA supports applying key investor protection rules to trades executed on electronic platforms regardless of the parties to the trade. In a transaction where a dealer’s counterparty is a non-dealer and their identity is known to the dealer, the dealer should bear customer protection responsibility. If two non-dealers are trading directly with each other or if the counterparty to a trade is unknown to a dealer, the trading platform should bear that responsibility.

For example, MSRB Rule G-30(a) mandates that “no broker, dealer or municipal securities dealer shall purchase municipal securities for its own account from a customer, or sell municipal securities for its own account to a customer, except at an aggregate price (including any mark-up or mark-down) that is fair and reasonable.” Similarly, paragraph (b) of the rule provides in relevant part that “[e]ach broker, dealer and municipal securities dealer, when executing a transaction in municipal securities for or on behalf of a customer as agent, shall make a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions.” Rule G-30 is an integral element of the MSRB’s investor protection rules. It ensures that customers do not pay too much when they buy bonds or receive too little when they sell. If no dealer was involved in the trade, no party would be subject to a fair pricing requirement. In this example it is important that the trading platform assume this duty.

As another example, SEC Rule 15c3-5 is intended to address risk management issues for dealers who provide electronic market access to customers. The rule requires dealers’ “financial risk management controls and supervisory procedures be reasonably designed to systematically limit the financial exposure of the broker-dealer that could arise as a result of market access.”³ The rule mandates, for example, that dealers that provide electronic market access to customers, including indirect access to fixed income trading platforms, have procedures in place to prevent “the entry of orders that exceed appropriate pre-set credit or capital thresholds in the aggregate for each customer and the

³ Securities and Exchange Commission Division of Trading and Markets, “Responses to Frequently Asked Questions Concerning Risk Management Controls for Brokers or Dealers with Market Access,” April 15, 2014, www.sec.gov/divisions/marketreg/faq-15c-5-risk-management-controls-bd.htm.

broker-dealer.” If investors trade directly with each other on electronic platforms, how would the functions associated with Rule 15c3-5 be served?

In case the SEC decides to revise Rule ATS, it is important that individual dealer’s systems for providing electronic market access to customers not be treated as ATSs. Individual dealer systems generally do not meet the definitions of exchange or ATS. They are not designed to match buyers and sellers in the same way as true electronic trading platforms. It is appropriate to regulate those systems as broker-dealer activity.

Some regulatory obligations apply to certain ATSs based on volume thresholds. For example, Rule 301(6)(b) of Rule ATS specifies certain IT and data protection standards for ATSs that account for 20 percent of corporate or municipal trading volume. The Fair Access Rule applies when an ATS accounts for an average five percent of corporate or municipal volume in four of the preceding six months. We generally agree with those thresholds and we do not believe that trading platforms responsible for relatively small trading volumes should be subject to heightened standards.

Finally, in addition to the issues raised by FIMSAC that are the topic of the Release, the FIMSAC has also addressed the issue of inconsistencies in reporting fixed income trades. In its “Preliminary Recommendation Regarding Defining ‘Electronic Trading’ for Regulatory Purposes” FIMSAC states “no consistent standard for publicly reporting electronic trading volumes exists across the over 20 trading platforms currently trading corporate and municipal bonds. Multiple inconsistent practices characterize the discretionary disclosure of volumes by the individual venues.” They also reference differences in FINRA and MSRB rules related to trade reporting where FINRA, for example, specifies that TRACE trade reports distinguish between trades executed electronically and those executed by voice; trades conducted electronically have a particular “flag” designation. The MSRB also requires an ATS flag for reports to their Real-time Trade Reporting System, but only for interdealer trades conducted on ATSs, not trades with customers and not trades on non-ATS platforms.

While we agree that more and better data on fixed income trading is welcome and we support a flag on trade reports for trades conducted electronically, we point out the increasing complexity of TRACE trade reporting. Since the system was established, FINRA has added a number of flags intended to distinguish certain trades. This complexity increases the likelihood of unintended noncompliance. We urge regulators to consider that issue generally when adding new fields to FINRA and MSRB trade reporting rules. Addressing FIMSAC’s recommendation would not necessarily require the addition of new flags; the modification of existing flags, coupled with clear guidance as to when the flags should be added, would be a more effective approach.

Conclusion

We generally agree that the time is right to revise Rule ATS as it relates to fixed income trading. The inconsistent regulation currently applied to electronic trading platforms results in confusion and could motivate regulatory arbitrage as new electronic trading entrants choose the company structure that minimizes their regulatory duties. As the FIMSAC said in their 2018 Rule ATS recommendation, “without a unifying regulatory framework for all fixed income electronic trading platforms, market structures will likely fragment further as regulators adopt new regulations that apply to only one type of platform.”

We look forward to working with the SEC, FINRA and the MSRB as the conversation around trading platform regulation advances. Please call if you have any questions.

Sincerely,

A handwritten signature in dark ink, appearing to read "Michael Decker", written in a cursive style.

Michael Decker
Senior Vice President for Public Policy