CITADEL

August 15, 2016

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549–1090

Re: Proposed Rule Change Relating to the Reporting of U.S. Treasury Securities to the Trade Reporting and Compliance Engine (SR-FINRA-2016-027)

Dear Mr. Fields:

Citadel LLC[1] ("Citadel") appreciates the opportunity to provide comments to the Securities and Exchange Commission (the "Commission") on Financial Industry Regulatory Authority ("FINRA") Rule Filing SR-FINRA-2016-027 (the "Rule Proposal"). This proposed rule change would require FINRA members to report secondary market transactions in U.S. Treasuries to the Trade Reporting and Compliance Engine ("TRACE") for regulatory reporting purposes.

Citadel strongly supports increasing the amount of U.S. Treasury market data that is readily available to the official sector, as further detailed in our response to the recent Request for Information on the evolution of U.S. Treasury market structure (the "Treasury RFI").[2] We believe enhanced reporting to the official sector, and the robust audit trail that is created, will improve general monitoring and surveillance capabilities, including those designed to detect prohibited trading practices and potential risks to market stability. In addition, with comprehensive data, regulators and policymakers will be better equipped to identify specific market trends and to evaluate the expected impact of subsequent policy decisions.

Nevertheless, we have two primary concerns with the Rule Proposal. First, we believe the proposed reporting regime should be enhanced to provide additional granularity to the official sector. The Treasury RFI requested input on a number of areas of market structure that may be the focus of subsequent policy decisions, including public reporting, trading venue oversight, and central clearing. It is therefore critical that the official sector reporting regime collects sufficiently granular data to assist regulators and policymakers in assessing the costs and benefits of various policy proposals in these areas. As a financial firm with a FINRA member broker-dealer, we appreciate the focus in the Rule Proposal on limiting operational costs by leveraging existing TRACE infrastructure and data reporting fields. However, we believe the existing TRACE data reporting fields should be supplemented in a few specific areas in order to ensure that regulators

[1] Citadel is a global financial firm built around world-class talent, sound risk management, and innovative market-leading technology. For more than a quarter of a century, Citadel's hedge funds and capital markets platforms have delivered meaningful and measurable results to top-tier investors and clients around the world. Citadel operates in all major asset classes and financial markets, with offices in the world's leading financial centers, including Chicago, New York, San Francisco, Boston, London, Hong Kong, and Shanghai.

[2] Available at: https://www.regulations.gov/document?D=TREAS-DO-2015-0013-0045.

and policymakers have sufficiently granular data to evaluate all of the aspects of market structure addressed in the Treasury RFI.

Second, the operational infrastructure that is built to implement the official sector reporting regime should be scalable to accommodate potential subsequent policy decisions, such as a public reporting requirement, in a cost-effective manner. We are concerned that the proposed requirement for same-day reporting, instead of a more immediate reporting requirement, will result in the design of operational workflows that employ batch reporting rather than transaction-by-transaction reporting. As a result, the operational workflows designed to implement official sector reporting may have to be significantly altered in order to accommodate any subsequent policy decision to require public reporting, thereby unnecessarily increasing implementation costs. Based on industry responses to the Treasury RFI, there is significant support for an eventual transition to public reporting, and therefore the reporting infrastructure should be designed to accommodate this possibility.

We detail both of these concerns below and suggest targeted modifications to the Rule Proposal in order to address them.

I. Further Enhancing the Official Sector Reporting Regime

A central benefit of implementing official sector reporting is that regulators and policymakers will be better equipped to identify specific market trends and to evaluate the expected impact of future policy decisions. As a result, we believe the existing TRACE data reporting fields should be supplemented in a few specific areas in order to ensure that sufficiently granular data is provided to the official sector.

We are supportive of the two supplemental trade modifiers included in the Rule Proposal that are intended to identify (a) basis trades involving a future, and (b) other packages where at least one of the legs is executed at a pre-determined fixed price (or otherwise off-market). As the official sector continues to review the functioning of the U.S. Treasury market, it is important that the various types of package transactions involving a U.S. Treasury are able to be accurately identified so that linkages between different types of instruments are better understood. Therefore, in addition to the proposed modifiers above, we believe the reported data should more generally identify whether a U.S. Treasury transaction is part of a package and, if so, the number of legs associated with the package and the types of instruments involved (e.g. a future, an interest rate swap, etc.).

In addition, the Rule Proposal should be modified to require market participants to report (i) the trading venue (if any) where the transaction was executed,[3] and (ii) whether the transaction was cleared. Trading venue oversight and central clearing are important areas of focus in the

[3] We note FINRA Rule 6730 requires, for transactions that occurred on an ATS, the MPID of the ATS to be reported. However, this should be expanded to include U.S. Treasury trading venues (both "dealer-to-dealer" and "dealer-to-customer" venues) given the current exemption from ATS registration for venues that solely trade Treasuries.

ongoing review of the regulatory framework applicable to U.S. Treasuries.[4] The official sector, therefore, should have comprehensive data regarding the percentage of trading activity occurring on trading venues (including both "dealer-to-dealer" and "dealer-to-customer" venues) and the percentage of trading activity that is being cleared. As with the two supplemental trade modifiers included in the Rule Proposal, market participants could be given additional time to provide this information by phasing-in these data reporting fields.[5] However, we believe it is critical that the official sector has access to this information for purposes of assessing future policy decisions.

We also urge FINRA to re-assess whether dual-sided reporting is the optimal construct for reporting U.S. Treasury transactions. Similar to how other instruments are currently reported to TRACE, the Rule Proposal requires a transaction between two FINRA member firms to be reported by both parties. However, the volume of transactions in the U.S. Treasury market may warrant a different approach in order to reduce complexity and data discrepancies. As set forth in our response to the Treasury RFI, we suggest using a single-sided reporting hierarchy where each transaction is only reported by one party. Such a streamlined methodology could reduce implementation costs by leveraging trading venues, first, and registered broker-dealers, second. This would also allow the methodology to more easily be applied to other market participants as the official sector reporting regime is expanded to include trading activity between non-FINRA member firms.

II. Ensuring the Operational Infrastructure Is Scalable

A. Batch Reporting Workflows May Not Easily Accommodate a Subsequent Policy Decision to Require Public Reporting

The Rule Proposal would only require same-day reporting of U.S. Treasury transactions, a marked divergence from the more immediate reporting requirements applicable to most other instruments currently reported to the TRACE system.[6] FINRA explains that same-day reporting was selected instead of a more immediate requirement "[b]ecause FINRA is not currently proposing to disseminate any trade-level information to the public".[7] Although it has been made clear to market participants that any policy decision regarding public reporting would only be taken after implementation of an official sector reporting regime,[8] FINRA should seek to implement a reporting regime for U.S. Treasury transactions that can accommodate both official sector reporting and any eventual public reporting in the most cost-effective manner. This will allow subsequent policy decisions to be implemented without sacrificing the synergies that would be

[4] *See* Remarks by Acting Assistant Secretary for Financial Markets Daleep Singh at the SIFMA Fixed Income Market Structure Seminar (May 24, 2016), available at: https://www.treasury.gov/press-center/press-releases/Pages/jl0465.aspx.

[5] See 81 Fed. Reg. 48465 (July 25, 2016) (the "**Rule Proposal**") at 48471.

[6] *See* FINRA Rule 6730.

[7] Rule Proposal at 48467.

[8] *See* Remarks by Acting Assistant Secretary for Financial Markets Daleep Singh at the SIFMA Fixed Income Market Structure Seminar (May 24, 2016), available at: https://www.treasury.gov/press-center/press-releases/Pages/jl0465.aspx.

gained by leveraging the same operational infrastructure for both official sector and public reporting.

We are concerned that the same-day reporting requirement in the Rule Proposal will result in the design of operational workflows that employ batch reporting rather than transaction-by-transaction reporting, something that appears to be acknowledged by FINRA.[9] Batch reporting workflows may have to be significantly altered in order to accommodate the transaction-by-transaction reporting that would be part of any subsequent policy decision to require public reporting. Therefore, we suggest modifying the Rule Proposal to also require transaction-by-transaction reporting to the official sector, with reporting to occur within a certain number of minutes or hours following execution. Based on the Rule Proposal, it appears market participants may be given up to a year to build the operational infrastructure necessary to support official sector reporting.[10] The Rule Proposal should seek to ensure that market participants are using this time to put in place infrastructure that is scalable and able to accommodate subsequent policy decisions in the most cost-effective manner.

B. The Treasury RFI Responses Indicate Significant Support for an Eventual Transition to Public Reporting

A review of the industry responses to the Treasury RFI demonstrates why FINRA should take into account the possibility that public reporting may later be required for certain U.S. Treasury transactions. A diverse group of 13 commenters supported increased post-trade transparency, including buyside firms,[11] agency brokers,[12] broker-dealers,[13] trading venues,[14] clearing venues,[15] electronic market makers,[16] and academics.[17] Meanwhile, 12 commenters urged varying degrees of caution regarding the implementation of a public reporting regime, with the majority of such responses submitted by primary dealers and dealer-owned trading venues.[18]

Despite this apparent divide between certain types of market participants, a closer analysis of the Treasury RFI responses indicates there may be more agreement than it first appears. One of the main concerns identified by those commenters urging caution is the potential for adverse

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[9] Rule Proposal at 48472 ("FINRA notes that much of the benefits of batch-reporting can be achieved by providing an end-of-day reporting timeframe.").

[10] Rule Proposal at 48469.

[11] *See* Letters from the Managed Funds Association and Citadel LLC.

[12] *See* Letter from Convergex.

[13] *See* Letter from Ronin Capital, LLC.

[14] *See* Letters from Direct Match and Nasdaq, Inc.

[15] *See* Letter from DTCC.

[16] *See* Letters from Virtu Financial, KCG Holdings, FIA PTG, and the Modern Markets Initiative.

[17] *See* Letters from Joel Hasbrouck and Eric Budish.

[18] *See* Letters from Citigroup Global Markets Inc., Credit Suisse, RBS Securities Inc., SIFMA/ABA, TD Securities (USA) LLC, Tradeweb Markets LLC, and Wells Fargo. Other responses include Guggenheim Partners Investment Management, ICAP, the Investment Company Institute, Prudential, and SIFMA AMG.

effects on liquidity if public reporting is required. However, this concern tended to be articulated in the context of large block size transactions and the less liquid off-the-run Treasuries.[19] Few commenters appeared to express concerns about the impact on liquidity for standard size transactions in on-the-run Treasuries if these were required to be publicly reported.[20]

This focus on the treatment of block size transactions and off-the-run Treasuries is echoed in many of the responses from commenters in favor of public reporting.[21] These commenters also provided suggestions for appropriately tailoring the public reporting regime, such as by capping the reported size at a specific threshold and providing public reporting delays for less liquid instruments. In addition, the lack of concern expressed by commenters regarding liquidity conditions for standard size transactions in on-the-run Treasuries is consistent with documented experience with public reporting in other markets. For example, research has shown that post-trade transparency has actually improved liquidity for both corporate bonds and swaps, taking into account the tailored treatment for block trades.[22]

The other main argument advanced by those commenters urging caution is that the U.S. Treasury market already provides investors with sufficient transparency.[23] In making this argument, commenters tended to focus on the pre-trade transparency provided to investors by virtue of having access to streaming dealer quotes, both bilaterally and on trading venues. However, many of these same commenters appeared to acknowledge that investors may find additional information helpful for purposes of analyzing trading activity across the market.[24] This

[19] *See, e.g.*, Letters from Credit Suisse, Guggenheim Partners Investment Management, the Investment Company Institute, Prudential, SIFMA/ABA, SIFMA AMG, Tradeweb Markets LLC, and Wells Fargo.

[20] *But see* Letter from Citigroup Global Markets Inc. ("Therefore, in [On-the-Run] securities, we would expect the main impact to be lower levels of depth and resilience and therefore lower liquidity"). This argument appears to be based on observations from the USD interest rate swaps market. We note the data used to support these observations suffers from several flaws, including (a) only covering a limited number of trading venues, (b) excluding trades executed by voice (which is the predominant method of execution on the trading venues referenced), and (c) excluding work-ups and other liquidity available to market participants off-screen through voice brokers when evaluating market depth.

[21] *See, e.g.*, Letters from Citadel, Convergex, FIA PTG, KCG Holdings, the Managed Funds Association, and Virtu Financial.

[22] *See, e.g.*, Goldstein, M. A., Hotchkiss, E. S., Sirri, E. R. Transparency and liquidity: A controlled experiment on corporate bonds. Review of Financial Studies 20 (2), 235-273 (2007); Edwards, A. K., Harris, L. E., Piwowar, M. S. Corporate bond market transparency and transaction costs. The Journal of Finance 62 (3), 1421-1451 (2007); Bessembinder, H., Maxwell, W., Venkataraman, K. Market transparency, liquidity externalities, and institutional trading costs in corporate bonds. Journal of Financial Economics 82 (2), 251-288 (2006); Loon, Y. C., Zhong, Z. K. Does Dodd-Frank affect OTC transaction costs and liquidity? Evidence from real-time CDS trade reports. Journal of Financial Economics, 119 (3), 645–672 (2016).

[23] *See, e.g.*, Letters from Citigroup Global Markets Inc., ICAP, Prudential, RBS Securities Inc., SIFMA/ABA, Tradeweb Markets LLC, and Wells Fargo.

[24] *See, e.g.*, Letters from ICAP ("A good deal of trading activity occurs internally within larger dealer and banking organizations, and that activity can have significant informational value"); Prudential ("We believe that transaction cost data for larger trades would be helpful"); RBS Securities Inc. ("There may be some benefit to the public of more coherent daily price and volume data than is currently available to the public"); and Tradeweb Markets LLC ("Such continued decentralization may adversely impact liquidity and less information may be available to market participants, clouding the state of the market").

ability to more accurately assess execution quality post-trade was an important benefit identified by those commenters in favor of public reporting.[25] Public reporting can provide additional transparency beyond streaming dealer quotes, which are largely indicative (as opposed to firm prices) and are typically quoted with a minimum spread on trading venues, thereby enabling investors to demand more accountability from their liquidity providers and spurring increased price competition.[26]

Based on these industry responses to the Treasury RFI, FINRA should seek to ensure that the reporting infrastructure is designed to be scalable and can accommodate the possibility that public reporting may later be required for certain U.S. Treasury transactions.

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We appreciate the opportunity to provide comments to the Commission on reporting requirements for U.S. Treasuries. Please feel free to call the undersigned at [redacted] with any questions regarding these comments.

Respectfully,

/s/ Adam C. Cooper

Senior Managing Director and Chief Legal Officer

[25] *See, e.g.*, Letters from Citadel, Convergex, Direct Match, Eric Budish, FIA PTG, KCG Holdings, the Modern Markets Initiative, and Virtu Financial.

[26] For example, see the Letter from Direct Match ("Compounding the difference between observable and accessible quotes is that the minimum spread is artificially wide. This has the effect of further obscuring where the true market in fact lies within the minimum increment. Dealer to customer trading often takes place within this increment, providing superficial price improvement. Since the true bid-offer spread itself is within this artificially wide increment, it is not possible for the customers to measure their execution quality against the actual prevailing market.").