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Ms. Vanessa Countryman
Acting Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: FINRA's Proposed Rule Change to Establish a Corporate Bond New Issue Reference Data
Service (File No. SR-FINRA-2019-008)

Dear Ms. Countryman:

I appreciate the opportunity to comment on FINRA's proposed rule change to establish a corporate bond new issue reference data service.

Although I am a member of the SEC's Fixed Income Market Structure Advisory Committee ("FIMSAC"), I write today in my name only. My comments represent my opinions only and not necessarily those of any of my FIMSAC colleagues, Interactive Brokers for whom I serve as lead independent director, any of the mutual funds for which I am a director or trustee, or my employer USC. Moreover, none of these entities have reviewed or in any way limited my comments.

I strongly support the establishment of a central depository for bond reference data that anyone can easily and cheaply access. The depository should cover all bonds that can be publicly traded. FINRA's proposed service is a step in the right direction. However, additional steps are necessary to fulfill this vision and obtain the benefits that I describe below.

Unless otherwise noted, my comments below apply both to FINRA's service and to the broader depository that I envision. For brevity, I will refer to both as "Mandated Reference Data Collection and Dissemination," or "MRDCD" for short. Also note that I use the terms "bonds," "issues," and "fixed income securities" synonymously. They all refer to registered debt securities that the public can trade.

Reference Data Collection and Dissemination

Reference data characterize the nature of debt securities. These data include maturity, payment schedule, coupon rate, precedence in the capital structure, and call, put, and conversion options.

These data provide the terms of an issue—they are specified in the indenture agreements that define issued securities.

MRDCD does not require the disclosure of any data that is not already disclosed in required security registration statements and other required filings. Rather, it merely requires that those entities responsible for filing these documents produce machine-readable summaries of their key features. The process is no different than the current requirement that corporate filers use Extensible Markup Language ("XML") to substantially reduce the costs of extracting a predefined set of variable values from their regular corporate financial disclosures.

Presently, unless issuers or their underwriters provide these data in machine-readable format (or other summarized format that is easily transcribed) to the reference data vendors[1], these data must be obtained by reading the mandated disclosures. The process is tedious, prone to transcription errors, and must be repeated for every bond in which the reference data vendor or the end user is interested.

Each vendor of reference data must incur these research costs to produce their products. Since these costs are fixed, the largest vendors have economy-of-scale cost advantages over smaller vendors and over potential new entrants because they can spread the fixed costs over more clients. Practitioners, regulators, legislatures, jurists, and economists have long recognized that industry economies of scale due to large fixed costs often lead to natural monopolies in which the largest vendors have substantial market power. The potential exercise of market power, the potential anti-competitive effects, and the duplication of costs are all issues that should interest the Commission. MRDCD would meaningfully increase competition among reference data providers by substantially reducing their research costs and thus the costs of entry for new competitors.

For end users interested in screening bonds or who need to examine many bonds to produce information about a large group of bonds (for example to compute the value of an index), the process of collecting reference data from mandated disclosures is prohibitively expensive. They instead obtain their reference data—if they can afford them—from reference data vendors.

Practitioners, regulators, issuers, and academics require high-quality reference data for many purposes. They need these data to

- value bonds when deciding whether to buy, sell, or hold them,
- compute accrued interest to settle bond trades,
- characterize the various risks—such as interest rate, duration, credit, and early call— inherent in bonds,

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[1] I do not know whether any reference data vendors have arranged to receive machine-readable reference data from underwriters. If some reference data vendors receive such reports while others do not, the Commission should consider the serious competitive issues associated with such selective distributions. In any event, MRDCD would effectively end this potential problem.

- understand the liquidity risks associated with bond markets and with investment vehicles—such as exchange-traded products—that hold fixed income instruments or whose values depend on indices based on fixed income prices,
- compute indices used for performance evaluation, performance prediction, and risk management,[2]
- compute transaction cost estimates for bonds that have not recently traded, and
- decide how to structure new instruments to issue.

These activities benefit investors, issuers, and the economy by facilitating the efficient operation of our fixed income markets and by promoting the formation of prices that reflect all available information about future returns. These benefits also extend to our equity markets because equity values ultimately depend on the values of corporate liabilities, the most important of which often are corporate debt issues.

Most importantly, reducing the costs of investment research will lead to more informative prices and lower liquidity costs as more market participants make better-informed decisions about what to buy, sell, and hold. The Commission has long recognized the benefits of reducing information acquisition costs, especially as they relate to fundamental information about the financing and performance of corporations. Our entire disclosure regime is predicated on near-universal agreement that information about issues and issuers should be easy to obtain by all. When new information technologies permitted electronic dissemination of these disclosures, the Commission created EDGAR to facilitate distribution. And when the Commission recognized the benefit of marking up these disclosures so that machines could easily read them, the Commission required that many of these disclosures be so marked.

MRDCD is the next logical step in this progression. The value of the reference data and the low costs to the industry of requiring that they should be delivered in some machine-readable form provide an extraordinarily strong foundation for the Commission to mandate MRDCD.

The actual form of the MRDCD is not important. The data can be collected from XML-marked documents, web-based input forms, or through APIs. However, once collected, they should be available for complete or partial dissemination at a low cost to all intermediate and end-users. The data must be archived for easy download by users interested in a subset of the data or the entire history.

The cost to issuers of providing these data is small since issuers must keep track of the terms of their outstanding issues. Most issuers—perhaps all—undoubtedly already have the terms of their issues entered into machine-readable databases.

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[2] Analysts commonly compute and use value-weighted price indices where the value weights are based on the issuance amount.

Who Should Create the New Service?

The SEC should collect and disseminate bond reference through EDGAR or a similar system because these data are no different in principle from the other XML-formatted disclosures that the SEC already collects and disseminates through EDGAR. The SEC manages EDGAR for the public good as a free utility provided at the public expense. The benefit-to-cost ratio of this project is overwhelming. Few, if any, other projects that the government undertakes have such a strong cost-benefit foundation.

FIMSAC recommended that FINRA create this new service because FINRA has related expertise and related data systems in its TRACE program. This logic is sensible if FINRA is indeed the lowest cost provider. However, the SEC's long experience with EDGAR suggests that it also may be the lowest cost provider. I strongly recommend that the Commission consider carefully whether it or FINRA is the lowest cost provider of MRDCD before approving the FINRA proposal.

Competition

Some reference data vendors sell reference data products that provide these data along with other data such as ratings and indications of whether an issuer is currently in default, in an agreement to merge, or negotiating such an agreement. These other data provide additional value to their customers.

MRDCD does not, and should not, require the production of such additional information, much of which is subjective. The value-added of MRDCD comes exclusively from the reduction in data collection costs to reference data users, whether those users are reference data vendors or end users. Accordingly, since end-users value these other types of information, reference data vendors will continue to compete to supply them.

MRDCD thus does not displace reference data vendors. It simply lowers their research costs, which will promote competition by decreasing entry costs for new entrants. The lower research costs and the potential for additional competition both should lower the costs of their products to end users.

The fact that existing data vendors currently collect and sell reference data should not dissuade the Commission from either directly or indirectly requiring issuers or their underwriters to provide the data in a machine-readable form that anyone can access. The mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. By substantially decreasing the cost of reference data, the SEC furthers its mission in all three areas.

Investors are best protected when they have the information necessary to make good investment decisions. MRDCD would decrease the costs of obtaining information essential to valuing bonds.

Efficient capital markets are ones in which practitioner costs are low. MRDCD decreases the costs of operating our capital markets by making the collection of reference data substantially more efficient than it presently is. The cost savings come both from having the data marked-up by the those who know it best (issuers or their underwriters) and also from reducing the duplication of effort by current vendors who all must read filings by hand to collect the same reference data.

MRDCD promotes capital formation by lowering the costs of valuing bonds so that prices more accurately reflect all available information. In our market-based economy, informative prices ensure that capital is allocated to the best uses and not wasted on poor projects.

Mandating filings in machine-readable form is a power that only the SEC (or FINRA acting under its supervision) has. Private data vendors do not have this power over issuers or their underwriters, and if any of them did, they would not willingly share the information so obtained with their competitors. No free-market process exists that ensures that the private sector will produce the efficiencies that MRDCD can provide, or that such efficiencies would be available to all reference data vendors. The SEC thus would act in the public interest if it were to promote MRDCD to reduce the costs of reference data to end users and the high entry costs that burden the competition among reference data vendors.

The FINRA Proposal

I support the FINRA proposal only if the SEC determines that FINRA is the lowest cost provider or if the SEC decides that it will not undertake the collection and dissemination of machine-readable reference data itself.

Scope

The FINRA proposal is a step in the right direction, but it is incomplete. The proposed FINRA service will collect reference data only for new issues and not also existing issues.

Reference data should be collected for all public issues. The additional cost is small because most issuers—perhaps all—already these data in machine-readable form. And those that do not cannot have much data to enter.

While the proposed service eventually will collect data for nearly all outstanding issues except perpetual issues (because older, uncovered issues eventually mature and are no longer tradable), the value to end-users of reference data for existing instruments is too large to overlook. The SEC or FINRA should mandate a schedule for fully disclosing machine-readable reference data for all public issues to reduce the costs to end uses of obtaining these data and to reduce the fixed costs of entry from potential reference data vendors.

The list of data fields that FINRA proposes to collect is longer than that proposed by FIMSAC. The longer list should be collected. The list proposed by FIMSAC includes only the data necessary to settle bond trades. The longer list includes additional variables necessary to value most bonds. The inclusion of the additional variables makes the service overwhelmingly more valuable to the economy than would the service be if it collected only the FIMSAC list:[3] The value of lowing investor costs of valuing bonds is substantially more important than simply making it easier to settle their trades.

The fields on the FINRA list are sufficient to value most bonds. The valuation of some bonds will require additional information that FINRA could have required—for example, information about any additional call and put options beyond the first ones. I believe that FINRA chose the fields wisely. The additional benefit of including more fields that rarely would be populated probably would not be worth the additional cost and potential confusion.[4]

Cost

FINRA proposes to offer its new service on a "commercially reasonable basis" at a proposed cost of $250 per month to any person or organization for internal purposes only, and for $6,000 per month where the data is retransmitted or repackaged for delivery dissemination outside the organization. The proposal also indicates that "the proposed fees would price the corporate bond new issue reference data service as a utility, using cost plus margin pricing."

The "commercially reasonable basis" is the wrong basis for pricing these data. I take "commercially reasonable" to reflect both the costs of operating the service and the market for the service.[5] But FINRA is a not-for-profit public utility. At worst, it should collect fees only to cover its costs. At best, it should consider freely offering the service as a public good.[6] If it is legally or practically unable to do so, the SEC should provide the service, or the SEC should

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[3] The column title of the right-most column of Exhibit 3 to FINRA's proposal is confusing. As written, "Currently Mandatory, Voluntary or New Field", does not make it clear that all fields would be required. The title should say "Currently Mandatory or Voluntary, or New Field." Splitting the column into two to show which fields are currently mandatory or voluntary, and which fields are new would be better (with a note or reference indicating that all fields would be mandatory).

[4] The limited number of fields also may have a secondary benefit of discouraging issuers from issuing overly complex bonds.

[5] "Commercially reasonable" may have a well-defined legal meaning of which I am not aware. A quick internet search on "legal definition of commercially reasonable" reveals that the term does not have a precise legal definition. "Reasonable" generally means what a reasonable person would do in the individual circumstance. This definition is of little help here without understanding the objective of the proposed action.

[6] The objective of MRDCD should be to provide low-cost reference data to all who need it because the external benefits to the economy are so great. (External benefits are benefits that accrue to people who do not purchase the data, for example, the overwhelming majority of Americans who do not trade bonds but who benefit from well-functioning capital markets.) The SEC and FINRA thus should consider how to price the data at lowest cost, perhaps through subsidization. In principle, the SEC and FINRA both should be equally interested in promoting this objective. In practice, budgetary issues and the press of other priorities may cause their interests to diverge. Accordingly, the SEC must carefully consider data pricing issues.

contract with FINRA to provide the service. In any event, as a not-for-profit, FINRA should not collect a margin on its costs.[7]

These reference data should be free. They are no different in character or importance than other corporate disclosures now collected and disseminated through EDGAR. The overwhelming benefit to the markets and economy of reducing the costs of obtaining these data argue favorably for the small cost or subsidy the government would need to fund to make them free.

Who collects and disseminates the data is not important as long as they are available to the public for free or at a truly low cost. $250/month is prohibitively expensive for individual investors, many of whom we know pay close attention to other data reported in EDGAR. While some may argue that individual investors are not as important in the bond markets as they are in the equity markets, I note that the costs of reference data alone are enough to exclude most individual investors from the bond markets. The lack of demand from individual investors thus may reflect current costs and not investor interest.

If the Commission decides that FINRA should provide this service, the Commission should ensure that FINRA offers a substantially lower price to individuals than that proposed. When considering the arguments offered here, FINRA may decide to revise its proposed pricing, as I believe it should as a public utility. Alternatively, the SEC could subsidize the service, as it effectively already does with its EDGAR contractors. Finally, SEC could approve FINRA's proposal only if FINRA were to substantially lower the price to individual investors.

If necessary, the $6,000/month fee to be charged to reference data vendors could be substantially increased. $72,000/year is a trivial cost to most vendors and undoubtedly substantially lower than they presently incur to collect these data. That said, the data also should be free to reference data vendors. Free data would lower the costs of their reference data services to end users by lowering vendor research costs and through enhancement of competition among reference data vendors.

In all events, the reference data should be available to researchers engaged in regulatory, public policy, practitioner-oriented, and academic research at low cost. Historically these researchers have contributed substantially to our understanding of markets and of how to regulate them.[8] If

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[7] Perhaps the margin is meant to reflect overhead of the FINRA organization. But that should be an allocated cost. Normally the word margin refers to profit, which would be inappropriate for a not-for-profit organization. Note further that the FINRA proposal provides no foundation for the proposed fees. If the fees are truly supposed to be on a cost basis, the costs should be disclosed.

[8] For example, the question of whether to publicly disseminate TRACE and EMMA trade prices was quite controversial when first proposed. The decision depended in large part on the expected transaction cost savings that would result if these data were publicly available in real time. Two studies conducted by staff researchers and visiting academics working at the SEC established that the transaction costs savings would be about a billion dollars per year for each system. These studies required reference data that were prohibitively expensive outside of the SEC. Subsequent research confirmed that those savings were realized.

fees are attached to these data, they should vary by the timeliness of the data. Historic data—for example, a month or older—should be substantially cheaper than real-time data.

Conclusion

Access to accurate reference data is essential to the efficient operation of our fixed income capital markets and to the production of informative prices. The value of these data cannot be overstated because they characterize the issues that trade. Knowing them is essential to valuing bonds as the reference data determine the payments investors receive from holding bonds. For most bonds, reference data are more important for those interested in identifying bond values than is knowing the financial performance of issuers because most issuers do not default. Valuing a fixed income instrument without knowing its promised payment schedule and any associated options is impossible.

Presently reference data are collected by hand at substantial cost from public filings. The data would be much less costly to collect if issuers or their underwriters submitted them to a central database in machine-readable form.

The SEC should provide for the public provision of machine-readable reference data as a further and long-overdue extension of the SEC's long-standing corporate disclosure programs. Like the products of its other disclosure programs, the data should be free to the public.

The lowest cost provider should provide the service. That would be either SEC or FINRA as only they can compel issuers or their underwriters to provide the data in machine-readable form. The SEC should decide which entity would best provide the data to the public. If FINRA is the lowest cost collector and disseminator of the data, it can do so for the SEC under contract if necessary or desirable.

Since the data are already publicly disclosed in registration filings, no incremental costs are associated with the requirement to disclose the data. Instead, the only costs would be associated with the requirement to disclose them in machine-readable form. These costs are small because the data do not include many fields and the field values are well known to the issuers and their underwriters. They are the lowest cost coders of machine-readable data because, as the creators of these data, they know them better than any other entities in our economy.

The FINRA proposal applies only to new issues. Reference data for existing outstanding issuers are equally valuable. The SEC should establish a program to make these data available to the public for free or minimal cost in machine-readable form. The SEC could either require issuers to report data for all outstanding issues in machine-readable form on some reasonable schedule or simply buy them from one or more reference data vendors who have already extracted them from the public filings.

If I can be of further assistance to the Commission on this issue, please do not hesitate to contact me.

Sincerely,

Larry Harris
Fred V. Keenan Chair in Finance
USC Marshall School of Business

cc:
       The Honorable Jay Clayton, Chairman
       The Honorable Robert J. Jackson, Jr., Commissioner
       The Honorable Hester M. Peirce, Commissioner
       The Honorable Elad L. Roisman, Commissioner

       Mr. Brett Redfearn, Director, Division of Trading and Markets
       Mr. S.P. Kothari, Chief Economist and Director, Division of Economic and Risk Analysis

       Mr. Robert Cook, President, and CEO, FINRA