Preliminary Recommendation Regarding Additional TRACE Reporting Indicators for Corporate Bond Trades

The Technology and Electronic Trading Subcommittee ("Subcommittee") of the Fixed Income Market Structure Advisory Committee ("FIMSAC") was formed to consider the impact of the increased use of electronic trading platforms on the liquidity, efficiency and resiliency of the corporate and municipal bond markets. As a result of such consideration, the Subcommittee has reached a recommendation to improve the price transparency for certain types of fixed income transactions reported to FINRA's Trade Reporting and Compliance Engine ("TRACE").

FINRA Rule 6730 (Transaction Reporting) generally requires that each FINRA member that is a party to a transaction in a TRACE-Eligible Security report the transaction to TRACE within the period of time prescribed in the rule. Among other things, Rule 6730(c) requires that firms report the "price of the transaction" and the "time of execution", while Rule 6730(d) recognizes that there may be occasions when a transaction is not executed at a price that reflects the current market price. In those cases, TRACE rules dictate the firm shall use a "special price" modifier.

The Subcommittee considered two particular types of trades for which the TRACE reported price may not be reflective of the current market price: completed spread trades awaiting a treasury spot and portfolio trades.

**Completed Spread Trades Awaiting a Treasury Spot.**

Most investment grade bonds trade on the basis of a spread to the applicable benchmark government bond yield.1 These trades are then converted to a dollar price by "spotting" the benchmark Treasury security. The spotting process can either occur at the time of the spread trade or it can be done a delayed basis (often at a set time in the afternoon, such as 3 p.m.). These delayed spot trades are generally preferred by index funds for the purpose of better aligning their spot price with the daily mark-to-market of the underlying index. When a trade is spotted on a delayed basis, FINRA Rule 6710(d) provides that the time of execution shall be the time when the parties have agreed all of the terms of the transaction that are sufficient to calculate the dollar price of the trade (i.e., the time of the delayed Treasury spot). Completed spread trades awaiting a treasury spot are therefore reported to TRACE following the completion of the spotting process, even if the parties agreed to the spread much earlier in the day.

As corporate bond spreads and Treasury prices can move throughout a day, the delayed spot process allows for a potential mismatch between the assumed value of the trade when the spread is agreed and the price reported to TRACE following the Treasury spot later in the day. To address this issue, the Subcommittee believes that FINRA should require reporting parties to include a flag or modifier for delayed spot trades, which will alert market participants that the spread-based economics of the trade had been agreed earlier in the day.2 In addition, the Subcommittee is recommending that

---

1 While certain municipal bonds trade on the basis of a spread to Treasury, the Subcommittee does not believe that the delayed spotting process discussed in this recommendation is currently as prevalent in the municipal bond market. If delayed spotting becomes more common in the municipal bond market, the Subcommittee believes that the reporting procedures for such trades should be reviewed at such time.

2 For the avoidance of doubt, the Subcommittee does not believe that the proposed rule amendment should impact the current practice regarding resting orders or indications of interest that have been partially executed. The Subcommittee believes that resting orders or indications of interest that are being worked throughout the day should continue to be reported to TRACE as a single transaction only when such orders or indications have been filled (or partially filled with balance cancelled or expired). The recommended flag for
the reporting party on a delayed spot trade be required to report the time at which the spread was agreed earlier in the day. Even though the trade will still be reported to TRACE following the completion of the spotting process, the inclusion of the time at which the spread was agreed will allow market participants to estimate the agreed spread to Treasury.³

**Portfolio Trades.**

A “portfolio trade” involves a single trade between two parties for a basket of bonds at an agreed price for the entire basket.⁴ Portfolio trades may be priced based on a uniform spread to a mid-market pricing service or through other all-or-none aggregated pricing methods that do not necessarily reflect the current market price for each individual bond in the basket. Notwithstanding that a portfolio trade is executed at a single aggregate price, firms are required to report each bond in the portfolio to TRACE with the attributed price for each line item. Although it is currently possible to estimate which TRACE reports are part of a portfolio trade based on the common time of execution or the characteristics of the various portfolio components, the Subcommittee believes that requiring a TRACE flag or modifier for a bond that is part of a portfolio trade would allow market participants to know with certainty that the price was agreed as part of a portfolio and may therefore not be reflective of the independent market price for the particular bond.

The Subcommittee considered potential downsides to its recommendation and believes that the only likely potential negative impact would be an increased theoretical risk that a market participant could identify the seller of the portfolio. The Committee believes that this risk is small and outweighed by the increased price transparency for all market participants.

The Subcommittee recognizes that its recommendation will depend heavily on the definition of a “portfolio trade”. After deliberation, the Subcommittee recommends that a “portfolio trade”, for purpose of inclusion of a TRACE flag, shall mean a trade:

a) that is executed between only two parties;
b) involving a basket of securities of at least 30 unique issuers;
c) for a single agreed price for the entire basket⁵; and 
d) that was executed on an all-or-none or most-or-none basis.

³ The Subcommittee considered whether the terms (including the agreed spread and applicable Treasury benchmark) of a spread-based trade that is solely contingent on a delayed Treasury spot should be reported to TRACE within 15 minutes of the parties’ agreement to all of the terms of the transaction other than the price of the Treasury. While this construct would allow market participants to fully understand the spread-based economics of the trade at the point at which they are agreed, the Subcommittee believes that the recommended approach will be simpler and more cost-effective to implement. The recommended approach also avoids the need for reporting parties to enhance the initial TRACE report with the calculated dollar price of the trade when the delayed spot trade is “spotted” later in the day.

⁴ While portfolio trades may involve corporate bonds or municipal securities, the Subcommittee does not believe that portfolio trades involving municipal securities are as common as portfolio trades for corporate bonds. As with delayed spotting, the Subcommittee believes the reporting procedures for portfolio trades involving municipal securities should be reviewed in the future if and when they become more prevalent.

⁵ The Subcommittee considers that the recommended single agreed price requirement for portfolio trade identification will exclude normal multi-dealer list trades that originate as either an electronic OWIC or a BWIC as such protocols result in a competitively negotiated price for each security in the list.
Although the Subcommittee did not believe that a minimum volume threshold was necessary for the definition, it recommends that the rule should be implemented in a way that excludes trades executed by reporting firms on behalf of retail clients.

**Electronic Trades.**

The Subcommittee also believes that market participants would benefit from a complete and accurate picture of the number and volume of trades that are executed electronically in order to track changes in e-trading trends in all fixed income products and to better inform transaction cost analysis. Currently, the only TRACE flag that would generally indicate that a bond trade has been executed electronically is the alternative trading system (“ATS”) flag. However, as the Subcommittee described in its “Recommendation for the SEC to Review the Framework for the Oversight of Electronic Trading Platforms for Corporate and Municipal Bonds” that was approved by FIMSAC on July 16, 2018, some electronic trading platforms are regulated as ATSSs, some are regulated as broker-dealers, and other significant platforms operating the same or similar models are not regulated at all. The varying regulatory treatment afforded electronic trading platforms currently prevents the Subcommittee from recommending that FINRA and MSRB incorporate an “electronic trade” modifier. However, the Subcommittee believes that once there is a unifying regulatory framework for all fixed income electronic trading platforms, FINRA and MSRB should establish an appropriate definition of an “electronic trade” that could form the basis for a comprehensive electronic trading flag.

**Recommendation:**

Based on the foregoing, the Subcommittee recommends that the SEC, in conjunction with FINRA, propose the following rules:

1) **Completed Spread Trades Awaiting a Treasury Spot:**
   a. require that reporting parties include a flag or modifier for delayed spot trades that will alert market participants that the spread-based economics of the trade had been agreed earlier in the day; and
   b. require that the reporting party on a delayed spot trade be required to report the time at which the spread was agreed.

2) **Portfolio Trades:**
   a. require that reporting firms use a TRACE modifier to identify whether a particular trade was executed as part of a portfolio trade; and
   b. for purposes of this recommendation, “portfolio trade” shall mean a trade:
      i. that is executed between only two parties;
      ii. involving a basket of securities of at least 30 unique issuers;
      iii. for a single agreed price for the entire basket; and
      iv. that was executed on an all-or-none or most-or-none basis.

The Subcommittee recognizes that the establishment of new modifiers and rules for reporting spread-based trades will impose costs on FINRA and all reporting firms and that the recommendation should therefore be subject to an appropriate cost-benefit analysis and comment period. The Subcommittee notes that new TRACE fields have been added in recent years for “no-remuneration” indicators and ATS venues without significant cost or disruption to the market.