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**STAFF REPORT ON THE FIRST YEAR OF THE  
FIXED INCOME MARKET STRUCTURE ADVISORY COMMITTEE**

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December 17, 2018

This is a report of the staff of the U.S. Securities and Exchange Commission.

The Commission has expressed no view regarding the analysis, findings, or conclusions contained in this report.

## Introduction

The staff of the U.S. Securities and Exchange Commission prepared this report to provide the public with a summary of the activities of the Fixed Income Market Structure Advisory Committee (“FIMSAC” or the “committee”).

The Commission formed the FIMSAC in November 2017 to provide the Commission with diverse perspectives on the structure and operations of the U.S. fixed income markets, as well as advice and recommendations on matters related to fixed income market structure.<sup>1</sup> The FIMSAC’s initial focus is on providing advice to the Commission on the efficiency and resiliency of the corporate bond and municipal securities markets and to identify opportunities for regulatory improvements. The FIMSAC has a two-year term that expires on November 15, 2019.

The committee is comprised of 23 members: 21 voting members and 2 non-voting members. The two non-voting members are from the Financial Industry Regulatory Authority (“FINRA”) and the Municipal Securities Rulemaking Board (“MSRB”). The membership includes individuals representing a range of perspectives on the fixed income markets including retail and institutional investors, corporate and municipal issuers, trading venues, bank and non-bank affiliated institutional dealers, a retail dealer, a regional municipal securities dealer, a proprietary trading firm, a data provider, academics, and self-regulatory organizations.<sup>2</sup>

The FIMSAC held four public meetings in 2018 that focused on a wide range of issues and, as is described in more detail below, the FIMSAC made five recommendations to the Commission. The FIMSAC’s inaugural meeting, held on January 11, 2018, focused on the state of liquidity in the U.S. corporate bond market.<sup>3</sup> Key themes emerged during the inaugural meeting, including the increasing adoption and utilization of technology to facilitate the entire lifecycle of a bond trade, the role of transparency in fixed income market structure, and the evolving practices of dealer intermediation and investor participation in these markets.

In order to further study these complex themes, the FIMSAC formed three subcommittees focused on the following topics: (1) transparency, (2) exchange-traded funds (“ETFs”) and open-end mutual funds, and (3) electronic trading systems and related technologies.

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<sup>1</sup> The FIMSAC’s charter is available at: <https://www.sec.gov/files/fimsac-charter.pdf>.

<sup>2</sup> A full list of the FIMSAC’s current members is available at: <https://www.sec.gov/spotlight/fixed-income-advisory-committee>.

<sup>3</sup> The agenda for the FIMSAC’s January 11, 2018 meeting that focused on the state of liquidity in the U.S. corporate bond market is available at: <https://www.sec.gov/news/press-release/2018-1>.

## Update on the Work of the Transparency Subcommittee

The Transparency Subcommittee was created to consider the impacts of transparency, both pre-trade and post-trade, on the corporate bond and municipal securities markets. In particular, it was charged with reviewing the current transparency regimes and identifying methods for analyzing whether they are optimally serving the markets. In June 2018, shortly after the FIMSAC recommended the pilot for large size trades (discussed below), the Transparency Subcommittee was replaced with two transparency subcommittees, one focusing on the corporate bond market and one on the municipal securities market.

The Transparency Subcommittee began its work by considering the impact of the current post-trade transparency regime on liquidity for large size trades in the corporate bond and municipal securities markets.<sup>4</sup> This issue received significant attention at the inaugural FIMSAC meeting, as individuals representing a range of perspectives on the corporate bond market expressed concerns that there was a lack of liquidity when seeking to trade in large size.

Over the course of several weeks, the Transparency Subcommittee gathered information regarding the impact of public price transparency on large trades and debated the potential advantages and disadvantages of modifying the current transparency regime. This process included consultation with outside participants from the corporate bond and municipal securities markets. While there was consistent anecdotal evidence expressing concern about liquidity for large size trades, the Transparency Subcommittee determined that there was a lack of reliable information about whether the current transparency regime is impairing liquidity in the market for large trades.

### *Recommendation for a Pilot Program for Block-Size Trades in Corporate Bonds*

The FIMSAC recommended, on April 9, 2018, a one-year pilot program for corporate bonds.<sup>5</sup> The purpose of this pilot program is to produce quantifiable information concerning the impact of the current transparency regime on liquidity for large trades. The FIMSAC's pilot recommendation would make public the precise size of all transactions up to (1) \$10 million in investment grade corporate bonds and (2) \$5 million in high-yield corporate bond transactions.<sup>6</sup> The FIMSAC's pilot recommendation would also delay public dissemination of transaction

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<sup>4</sup> Summary minutes of each subcommittee meeting can be found here: <https://www.sec.gov/spotlight/fixed-income-advisory-committee/fixed-income-market-structure-advisory-committee-subcommittees.htm>. Subcommittee meetings, held via conference call, are not open to the public. These subcommittee meetings may include, by invitation, non-committee members.

<sup>5</sup> See FIMSAC Recommendation for a Pilot Program for Block Size Trades in the Corporate Bond Market (Apr. 9, 2018), available at: <https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-block-trade-recommendation.pdf>.

<sup>6</sup> Today, FINRA public transparency rules result in any trade above \$5 million in investment grade corporate bonds be reflected as \$5MM+. Similarly, FINRA public transparency rules result in any trade above \$1 million in high-yield corporate bonds be reflected as \$1MM+.

reports for trade sizes above \$10 million in investment grade corporate bonds and \$5 million in high-yield corporate bond transactions for 48 hours.

The subcommittee determined not to recommend a similar pilot for the municipal securities market, as reflected in a memorandum to the FIMSAC.<sup>7</sup> In reaching this conclusion, the subcommittee consulted several municipal securities market participants from the buy-side and sell-side, many of which were not FIMSAC members, about the current state of liquidity in the municipal securities market. Most of these market participants believed that the current state of liquidity generally was satisfactory, although there was some concern about liquidity during periods of market stress.<sup>8</sup> Despite this concern, most market participants consulted did not believe that changes in public transparency of large trades would motivate dealers to take on additional risk during periods of market stress.<sup>9</sup>

#### *Corporate Bond Transparency Subcommittee*

The Corporate Bond Transparency Subcommittee's mandate is identical to that of the original Transparency Subcommittee, with the exception that it would focus solely on the corporate bond market. The subcommittee determined to consider the current state of pre-trade transparency and hosted a panel at the July 16, 2018 FIMSAC meeting on that topic.<sup>10</sup> The panel included individuals representing a range of perspectives, including retail and institutional investors, a retail and institutional dealer, and technology service providers.<sup>11</sup>

Following the July 16, 2018 FIMSAC meeting, the subcommittee explored further the topic of pre-trade transparency in both the retail and institutional corporate bond markets and invited market participants to further discuss this issue. In the institutional market, the subcommittee determined that a variety of technology solutions have emerged that are providing pre-trade transparency to institutional market participants. And in the retail market, the subcommittee determined that generally pricing for small size trades is competitive and that retail investors have options for viewing and accessing those prices, especially if they choose to transact through certain types of intermediaries. The subcommittee also considered the new FINRA and MSRB markup disclosure requirements on customer confirmations that provide transparency of dealer compensation for certain retail customer trades. A consensus developed among subcommittee members that there was no imminent need for a recommendation on pre-trade transparency, although the subcommittee would continue to monitor the topic.

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<sup>7</sup> See Transparency Subcommittee, Consideration of Block Masking and Trade Dissemination Times in the Municipal Bond Market, available at: <https://www.sec.gov/spotlight/fixed-income-advisory-committee/transparency-subcommittee-consideration-of-block-masking-fimsa-040918.pdf>.

<sup>8</sup> See *id.*

<sup>9</sup> See *id.*

<sup>10</sup> See July 16, 2018 FIMSAC Agenda, available at: <https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-agenda-071618.htm>.

<sup>11</sup> See *id.*

### *Municipal Securities Transparency Subcommittee*

The Municipal Securities Transparency Subcommittee's mandate is identical to that of the original Transparency Subcommittee, with the exception that it would focus solely on the municipal securities market. Shortly after its formation, the subcommittee determined to consider the current state of pre-trade transparency in the municipal securities market and hosted a panel on the topic at the July 16, 2018 FIMSAC meeting. The panel included representatives from a range of market participants, including a large dealer, an institutional investor, a retail investment adviser, a data service provider, and a discount brokerage firm. Following the July 16, 2018 FIMSAC meeting, the subcommittee determined to continue studying pre-trade transparency in the municipal securities market, and at the October 29, 2018 FIMSAC meeting, the subcommittee hosted a presentation of a recently published paper authored by staff at the MSRB analyzing quotations in municipal securities.

In addition to pre-trade transparency, the subcommittee has focused its efforts on four areas: (1) the transparency-related recommendations in the Commission's 2012 *Report on the Municipal Securities Market*<sup>12</sup> that have not yet been implemented ("2012 Report's Transparency Recommendations"); (2) use of structured disclosure (e.g., XBRL) in the municipal securities market; (3) retail investor participation in primary offerings; and (4) liquidity for retail investors when selling municipal securities. After several subcommittee conference calls, the subcommittee members have decided to continue exploring the 2012 Report's Transparency Recommendations. The subcommittee members are also considering potential recommendations to enhance liquidity in the secondary market for retail investors and promote greater retail participation in the primary offering process for municipal securities, each of which could be presented to the FIMSAC as soon as its next public meeting. The subcommittee has determined not pursue the potential use of structured disclosure in the municipal securities market at this time due to concerns regarding the challenges of adopting a uniform standard such as XBRL.

### **Update on the Work of the ETFs and Bond Funds Subcommittee**

The ETFs and Bond Funds Subcommittee was created to consider the impacts of the growth of registered funds, including both ETFs and open-end mutual funds, as investors in the corporate and municipal bond markets. In particular, it was charged with assessing the consequences of the increased presence of fixed income mutual funds and ETFs in these markets, including their current and possible future impacts on the liquidity and pricing of the underlying bonds under a variety of scenarios, as well as investor understanding of these products.

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<sup>12</sup> See Securities and Exchange Commission, Report on the Municipal Securities Market (Jul. 31, 2012) available at: <https://www.sec.gov/news/studies/2012/munireport073112.pdf>

Over the course of the year, the subcommittee focused its attention on four topics: (1) investor education related to ETFs, (2) consistent naming conventions to classify and label exchange-traded products (“ETPs”), (3) standardized information concerning ETFs, and (4) the operation of bond funds and ETFs in periods of market stress.

The subcommittee met several times, including with industry participants,<sup>13</sup> and hosted two panels at the April 9, 2018 FIMSAC meeting that included academics, regulators, and other industry participants. One panel addressed liquidity considerations for bond ETFs and another panel discussed the state of retail investor disclosure and education. After its consideration of these topics, the subcommittee presented the two following recommendations to the FIMSAC on October 29, 2018. The subcommittee is also considering the presentation of a white paper focused the operation of bond funds and ETFs during periods of market stress to the FIMSAC at its January 28, 2019 meeting.

#### *Recommendation for an Exchange-Traded Products Classification Scheme*

This FIMSAC recommendation, made in a comment letter addressing the Commission’s proposed new Rule 6c-11,<sup>14</sup> stated a need for a consistent naming convention to classify and label various types of ETPs appropriately.<sup>15</sup> Specifically, the FIMSAC recommended a naming convention that, based on specific criteria, would categorize ETPs as ETFs, exchange-traded notes, exchange-traded commodities, or exchange-traded instruments. In its letter, the committee also generally supported the Commission’s proposed rulemaking and the disclosure of information regarding intraday indicative values, premiums and discounts, and bid-ask spreads.

#### *Recommendations for Investor Education and Data on ETFs*

The FIMSAC recommended that the Commission encourage the formation of an industry-wide group to promote investor education, addressing the education of financial advisors, communication with retail investors, and standardization of information concerning ETFs.<sup>16</sup> The FIMSAC also recommended the creation of a centralized and widely accessible database hosting the standardized information.

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<sup>13</sup> Summary minutes of each subcommittee meeting can be found here: <https://www.sec.gov/spotlight/fixed-income-advisory-committee/fixed-income-market-structure-advisory-committee-subcommittees.htm>.

<sup>14</sup> See Proposed Rule: Exchange Traded Funds, Release Nos. 33-10515, IC-33140; File No. S7-15-18, available at: <https://www.sec.gov/rules/proposed/2018/33-10515.pdf>.

<sup>15</sup> See FIMSAC Recommendation for an Exchange-Traded Product Classification Scheme (Oct. 29, 2018), available at: <https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-etp-naming-convention-recommendation.pdf>.

<sup>16</sup> See FIMSAC Recommendations for Education and Data on ETFs (Oct. 29, 2018), available at: <https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-etf-investor-education-and-data-recommendation.pdf>.

## Update on the Work of the Technology and Electronic Trading Subcommittee

The Technology and Electronic-Trading Subcommittee was formed to consider the impact of the growth of electronic trading platforms and the increased use of other electronic systems on the liquidity, efficiency and resiliency of the corporate and municipal bond markets. Throughout 2018, the subcommittee held a number of meetings and invited outside market participants to discuss a range of topics that impact electronic trading. These discussions led the subcommittee to present two recommendations to the FIMSAC, both of which the FIMSAC approved.

In addition, the subcommittee is also engaged in discussions about “last look” practices in bid-wanted auctions<sup>17</sup> occurring on electronic trading platforms. Specifically, the subcommittee has been considering the circumstances under which a dealer that requested bids on behalf of a retail customer would ultimately not execute against the winning bid but instead choose to internalize the customer order. The subcommittee has discussed whether this practice discourages liquidity providers from aggressively responding to requests for bids. In the coming months, the subcommittee intends to further explore this issue and consider developing a recommendation that would be designed to promote competitive electronic trading markets for retail customer orders.

### *Recommendation to Review the Oversight Framework for Electronic Trading Platforms*

At the July 16, 2018 meeting, the FIMSAC recommended that the SEC, FINRA and MSRB form a joint working group to conduct a review of the regulatory framework for the oversight of corporate bond and municipal security electronic trading platforms.<sup>18</sup> The FIMSAC recognized that bond trading platforms operate a range of business models and trading protocols, and was concerned that these differences have resulted in a disparate regulatory framework that could complicate efforts to improve the efficiency and resiliency of fixed income electronic trading. The FIMSAC recommended that the review of the regulatory framework should be done in a manner to ensure that, among other things, the regulatory framework promotes the growth of fair and effective electronic markets, protects investors, and does not unfairly promote or impede specific trading protocols or business models.

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<sup>17</sup> A common method for customers to sell bonds is through a bid-wanted auction. The MSRB describes a bid-wanted as the process by which a dealer or investor actively solicits bids on a security from the marketplace. See MSRB Notice 2018-22, available at: <http://www.msrb.org/~media/Files/Regulatory-Notices/RFCs/2018-22.ashx??n=1>.

<sup>18</sup> See FIMSAC Recommendation to Review the Oversight Framework of Electronic Trading Platforms (Jul. 16, 2018), available at: <https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-electronic-trading-platforms-recommendation.pdf>.

## *Recommendation to Establish a New Issue Reference Data Service for Corporate Bonds*

At the October 29, 2018 meeting, the FIMSAC recommended the creation of a centralized and widely accessible database containing specific data elements for newly issued corporate bonds that would make the valuation, trading, settlement and trade reporting of new issue corporate bonds more efficient.<sup>19</sup> The FIMSAC believed that the corporate bond market would benefit from a single source of new issue reference data that is similar to the New Issue Information Dissemination Service developed and operated by Depository Trust & Clearing Corporation for the municipal securities market. In particular, the recommendation calls for FINRA to require managing underwriters of all TRACE-eligible corporate bond new issues to send to FINRA select data elements. The recommendation further calls for FINRA to make this reference data available in a real-time, electronic format on an impartial basis at commercially reasonable fees.

### **Future Areas of Interest for FIMSAC**

The FIMSAC subcommittees are currently studying several topics. For example, the Municipal Securities Transparency Subcommittee continues to review pre-trade transparency, retail liquidity provision, and retail participation in the primary offering process for municipal securities. The ETFs and Bond Funds Subcommittee continues to work on a white paper focused the operation of bond funds and ETFs during periods of market stress, and is considering presenting it to the FIMSAC at its January 28, 2019 meeting. And the Technology and Electronic Trading Subcommittee continues to review last look practices in bid-wanted auctions on electronic trading platforms.

Finally, the FIMSAC is in the process of identifying additional topics for consideration in 2019. For example, at the October 29, 2018 meeting, the FIMSAC hosted a panel dedicated to role of credit ratings in the corporate bond market. In addition, several FIMSAC members expressed interest in exploring new topics. Many of those proposed new topics touched on the broad subjects of transparency, technology and electronic trading, and ETFs and bond funds that are the focus of existing subcommittees, while other proposed topics may result in the creation of new subcommittees. For example, members expressed an interest in studying the roles of derived data and bond index providers, transparency of bid-wanted quotes, the transition from LIBOR to SOFR, the structured note market, the possibility of single entity municipal bank issuers, bond market clearance and settlement, and public dissemination of transaction prices that would be exclusive of customer markups and markdowns.

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<sup>19</sup> See FIMSAC Recommendation to Establish a New Issue Reference Data Service for Corporate Bonds (Oct. 29, 2018), available at: <https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-corporate-bond-new-issue-reference-data-recommendation.pdf>.

## **Conclusion**

This report summarizes the activities of the FIMSAC since it was formed on November 15, 2017. The FIMSAC continues to pursue a variety of initiatives concerning the market structure for corporate bonds and municipal securities. Information regarding the FIMSAC's work is available on the SEC's website at <https://www.sec.gov/spotlight/fixed-income-advisory-committee>. The FIMSAC will also hold quarterly public meetings in 2019 at the SEC's headquarters in Washington, DC, and these meetings will be webcast to the public on the SEC's website. While subject to change, the FIMSAC's quarterly meetings for 2019 currently are scheduled for January 28, May 6, July 29, and November 4.