

MULTIPLE-MARKETS



SEC Fixed Income Market Structure Committee
Brent J. Fields, Federal Advisory Committee Management Officer
Securities and Exchange Commission
100 F Street, NE, Washington, DC 20549-1090

Dear Members of the Fixed Income Market Structure Committee:

I congratulate you on the task that you are beginning and hope that you are able to bring more transparency to the fixed income markets. This is a very complex issue especially for municipal bonds which trade infrequently.

In 2013 I wrote about some of these issues and especially encouraged a review of how financial systems in other countries approach trading in odd lot fixed income ([Reuters Muniland blog, April 11, 2013](#));

As it is set up now, retail-directed bond trading either goes through an ATS where prices are pooled, or the investor must choose a specific bond and call a number a dealers to request a price. They then need to establish an account to purchase the security. Efforts aimed at improving pre-trade transparency might give the retail investor some reference data to make price comparisons, but ([page ix](#)) they would require the investor to visit EMMA or rely on their broker to have comparative prices. Having pre-trade data in a different location from an execution venue will likely prove a hurdle for direct investors and make comparison shopping more difficult. The best solution for retail investors is to have pooled trading where real time pricing and investor protections are a part of the structure.

The best way to approach odd-lot trading for retail investors is for the SEC to mandate that dealers who submit pricing to ATS must route the same pricing and liquidity to exchanges. For example, the New York Stock Exchange (NYSE) has been [authorized since 2007](#) to conduct bond trading. This requirement would echo [Reg NMS](#) requirements in the equity market and help start the process of a unified market structure for fixed income.

But dealers choose to route minimal activity to the NYSE Bonds Platform. The enhanced transparency of the exchange model reduces the dealers bid/ask spread. In an exchange model, the market is flatter than OTC markets and more dealers than the dominant “Big 5” dealers could participate. It’s easy to see in an exchange model how smaller, regional dealers could become dominant market makers for securities from their region.

America is miles behind other nations in adopting this approach for bond trading. The Australian government recently adopted a new law to make retail trading in its Commonwealth Government Securities on the Australian Securities Exchange more simple:

Consultation Paper 181 *Retail trading in Commonwealth Government Securities*(**CP 181**), released in July 2012, indicated ASIC’s likely approach to extending the competition market integrity rules to facilitate the trading of CGS depository interests. Our approach is broadly consistent with earlier consultation in CP 181, meaning that for CGS we have extended the scope of market integrity rules relating to:

- extreme price movements
- best execution
- pre- and post-trade transparency
- regulatory data for market surveillance
- market operator obligations in a multi-market environment, and
- market participant obligations

The Shanghai Stock Exchange has a ~\$200 billion annual turnover of bonds, which accounts for 60% of the total turnover of securities traded on the SSE.

NYSE’s European arm NYSE-Euronext has a bond-trading platform that conforms to EU regulations.

US efforts have focused on improving issuer disclosure and devising a method of providing pre-trade prices to the general public. Dealers have tiered pricing that depends on who their counterparties are and the execution venue, and this presents some barriers to opening the architecture of fixed income markets. Their pricing engines are structured to provide the best pricing to their largest institutional clients, and their worst to widows and orphans. The only way to break this market inefficiency is to require that bids and offers posted on ATS must also be routed to exchanges and be executable rather than indicative.

We must look to other nations for our example. We must have a US fixed income “Big Bang” to remake fixed income market structure. Interest rates will eventually rise and retail investors will need a fair and transparent pathway to buy securities when others no longer want them.

Additionally in light of the upcoming implementation of amendments to MSRB G-15 in May, 2018 I wanted to highlight the varied markup disclosure requirements among various market participants. This is an area that bears monitoring and analysis in my view.

Seller	Buyer	Mark-up disclosure required?
Dealer	Non-institutional customer	Yes, if dealer executes offsetting principal transaction on same day
Dealer	Non-institutional customer	No, if from “prior inventory”.
Dealer’s offsetting principal trade is executed with a dealer affiliate and does not occur at arm’s length	Non-institutional customer	Maybe, dealer is required to “look through” to the time and terms of the affiliate’s trade with a third party to determine whether mark-up disclosure is triggered under Rule G-15
Dealer’s offsetting principal trade is executed with a dealer affiliate at “arm’s length*.	Non-institutional customer	Yes if within same trading day. Dealer treats transaction as any other offsetting transaction (<i>i.e.</i> , the dealer would not “look through” to the time and terms of the arms-length transaction).
Dealer	Non-institutional customer	Disclosure is not required for transactions that are list offering price transactions, as defined in paragraph (d)(vii)(A) of Rule G-14 (Primary offerings)
Dealer	RIA	No, under G-15 registered investment advisers are institutional customers therefore mark-up disclosure is not required

*The term “arms-length transaction” is defined in Rule G-15(a)(vi)(I) to mean a transaction that was conducted through a competitive process in which non-affiliate firms could also participate, and where the affiliate relationship did not influence the price paid or proceeds received by the dealer.

Source: [MSRB Interpretive Guidance Rule G-15 Confirmation, Clearance, Settlement and Other Uniform Practice Requirements with Respect to Transactions with Customers](#)

I appreciate an opportunity to provide comments to the Committee and wish you all the very best in your important efforts.

Very truly yours,

Cate Long

[REDACTED]

[REDACTED]

January 9, 2017