

June 29, 2018

Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20006-1506
Attention: The Honorable Jay Clayton, Chairman

FINRA
1735 K Street, NW
Washington, D.C. 20549-1090
Attention: Mr. Robert Cook, President & CEO

Re: SEC Fixed Income Market Structure Advisory Committee's Recommendation regarding a Pilot
for Block-Size Trades in Corporate Bonds

Dear Sirs:

We are writing to express JP Morgan Chase & Co.'s ("JPMC") support for the recent recommendation of the Securities Exchange Commission's ("SEC") Fixed Income Market Structure Advisory Committee ("FIMSAC") to create a pilot program to study the implications on market liquidity of a change in the disclosure regime for block-size trades in corporate bonds.¹ As JPMC and its subsidiaries are large issuers of corporate debt as well as a diversified financial services provider with independent subsidiaries participating in the corporate bond market, JPMC offers a multifaceted perspective. J.P. Morgan Securities LLC ("JPMS") is the largest broker dealer for underwriting and secondary trading of corporate bonds.² J.P. Morgan Asset Management ("JPMAM") is a large asset manager with substantial assets under management invested in corporate bonds.

We believe the recommended pilot could be an effective means to evaluate the impact of transparency on market liquidity. While we support the concept, we recommend several modifications to better allow for the study of impacts to the entire market. As discussed in more detail below, we believe a change to FIMSAC's recommended dissemination cap for non-investment grade corporate bonds would allow for a more effective pilot for this sector. In addition, we believe that it is important to establish the metrics by which success will be measured prior to initiating the pilot.

¹ Preliminary Recommendation for a Pilot Program to Study the Market Implications of Changing the Reporting Regime for Block-Size Trades in Corporate Bonds" adopted by the FIMSAC, as amended, on April 9, 2018 (hereinafter "FIMSAC Recommendation"), available at <https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-block-trade-recommendation.pdf>.

² Coalition 2H 2017 Competitor Analysis (based on revenue).

As we currently understand it, the FIMSAC pilot recommendation applies to all TRACE-eligible corporate bonds and would:

- Raise the dissemination cap³ to \$10mm or more for trades in investment grade corporate bonds (currently \$5mm or more).
- Raise the dissemination cap to \$5mm or more for trades in non-investment grade corporate bonds (currently \$1mm or more).
- Modify the dissemination timeframes such that trades above their respective dissemination cap will continue to be required to be reported as soon as practicable, but no later than 15 minutes after the time of execution, but they will be publicly disseminated 48 hours after execution time, or later depending on the time of receipt of the trade report.
- Modify the timeframe for public dissemination of actual trade sizes for all capped transactions from 6 months to 3 months after the end of the calendar quarter in which they are reported.
- Have a one year observation period, with an early termination mechanism linked to market quality indicators.⁴

Background – Changes to the Corporate Bond Market

The corporate bond market has experienced an evolution in market structure over the past decade, along with a variety of new regulations and changing risk appetites on the part of investors and dealers. Concurrently, there has been a notable change in market liquidity that deserves attention. Broker dealers have decreased their balance sheets for corporate bonds by more than 62% since January 2013.⁵ Electronification of corporate bond market trading has continued to develop with 20%⁶ of the overall market trading electronically, but this trend is for primarily smaller trades.

There has also been a change in market participants. A decline in proprietary trading since the financial crisis has led to a greater concentration of buy and hold investors, including insurance companies and large asset managers. Additionally, the growth in fixed income ETFs has encouraged the trading of fixed income exposure through the equity markets (i.e., using an ETF, a market participant can trade a basket

³ Dissemination cap refers to the trade size at or above which the actual size is not publicly disclosed for a period of time. E.g., An investment grade trade of \$10mm executed today would result in immediate public disclosure that a trade of \$5mm+ was executed. The actual trade size would then be publicly disclosed following a significant delay (currently 6 months).

⁴ FIMSAC Recommendation at 1-3.

⁵ FRBNY data as of July 2017.

⁶ Bloomberg: “Electronic Bond Trading Gains Ground”, Matthew Leising and Molly Smith, February 15, 2018.

of bonds in the equity markets; the majority of ETF trading does not trigger transactions in the underlying securities).⁷

The Importance of the Pilot in Understanding Changes to Liquidity

With all of this change as a backdrop, there has been a significant amount of research about the impact of TRACE reporting on liquidity in the corporate bond market. Since 2002, the SEC has phased in the requirements for immediate public disclosure of trade information for all corporate bonds (TRACE) subject to limited masking of the actual trade sizes for large trades (over \$5mm investment grade and over \$1mm non-investment grade). It has been impossible to isolate the impact of this transparency requirement at the same time that many other changes are occurring in the market, and the research has been inconclusive in terms of impacts. Spreads have tightened⁸, which would suggest better liquidity, but the average trade size for the 1,000 most active issuers has dropped almost 35% between 2007 and 2013, and the portion of block trades greater than \$5mm has declined over this same period by almost 15%.⁹

The recommended pilot would provide a data-driven approach to consider regulatory changes and calibrate a well-tailored transparency regime. Transparency is important to the price discovery process, but the risk of mis-calibration is significant, with the potential to undermine the overall functioning of the market. The pilot would provide an opportunity to ensure that market functioning and liquidity are supported and not impaired through transparency requirements. While we believe that transparency is important for the corporate bond market as well as for other markets, we agree with the FIMSAC that transparency for transparency's sake must not be the goal and that appropriate transparency should support enhanced market liquidity, functionality and integrity.

We further agree that the area of corporate bond liquidity that is most in need of evaluation is transparency for block trades. Providers of liquidity accept heightened risk when transacting in block trades, and these trades are immediately disclosed to the market with masked trade sizes.

We believe as a result of this immediate disclosure, broker dealers now prefer smaller trade sizes on average, particularly for less liquid and lower rated bonds. This changes the risk/reward for the broker dealers and is reflected in their pricing. Similarly, we observe that asset managers at times can experience challenges in transacting large trade sizes. We believe that it is important to study whether increases in the delay of public disclosure for block trades, as well as in the dissemination caps, would support larger trade sizes and tighter pricing, which would make the market more effective and be beneficial to market participants.

⁷ Shelly Antoniewicz and Mike McNamee, "More Unfounded Speculation on Bond ETFs and Financial Stability," April 12, 2015, available at https://www.ici.org/viewpoints/view_15_ft_etfs.

⁸ Staff of the Federal Reserve Board, "Staff Q2 2017 Report on Corporate Bond Market Liquidity," available at <https://www.federalreserve.gov/foia/files/bond-market-liquidity-report-2017Q2.pdf>.

⁹ Bruce Mizrach, "Analysis of Corporate Bond Liquidity," available at https://www.finra.org/sites/default/files/OCE_researchnote_liquidity_2015_12.pdf.

Program Design

For the pilot to be successful, the dissemination cap must enable observation of the impact of delayed reporting on liquidity in all sectors of the market. We understand that FIMSAC broadly agreed to a pilot that would move the block trade cap from \$5mm to \$10mm for investment grade bonds. However, the FIMSAC considered and later rejected a pilot that would have moved the dissemination cap for non-investment grade bonds to \$3mm. Instead, the committee recommended a dissemination cap of \$5mm, with the intent to provide a balance between market transparency and increased block trade liquidity.

While we agree it is important to balance market transparency and liquidity, we suggest further consideration of the portion of the market that will be most affected by the pilot – i.e., block trades. Accordingly, JPMS analyzed FINRA TRACE data, focusing on the average block trades for each market segment. The results suggest that a \$5mm dissemination cap may not be appropriate for the non-investment grade market. Consider the following:

Investment Grade:

- The average block trade size in the investment grade corporate market is \$11.6mm.¹⁰
- A \$10mm dissemination cap is 16% below the average block trade size.
- This will provide large block underwriters or buyers with 48 hours to hedge their risk, which may result in more competitive pricing for block trades.

¹⁰ FINRA data calculated based on 2013-YE 2017 block trades for investment grade corporate bonds.

Non-Investment Grade:

- The average block trade for non-investment grade corporate bonds is \$3.7mm.¹¹
- A \$5mm dissemination cap is above the average block trade.
- Under the proposed \$5mm dissemination cap, 59.2% of trade volume would be exposed to immediate full transparency,¹² and therefore we would not be able to observe the impact of delayed public disclosure on these bonds.¹³

We believe the \$3mm dissemination cap would allow for a more appropriate study across the entire market.¹⁴ This would be similar to the treatment for investment grade credit: a 16% premium over the average block size of \$3.7mm would point to a non-investment grade threshold of \$3.2mm. While a \$3mm non-investment grade threshold would delay transparency for a relatively larger share of the market than investment grade bonds, we believe this is appropriate given the different trading conditions for non-investment grade bonds which heighten market and liquidity risk. As the FIMSAC reported, a \$10mm dissemination cap would delay transparency for 1.2% of investment grade trades or 32.6% of the investment grade trade volume, while a \$3mm dissemination cap would delay 5.8% of trades or 56.4% of the non-investment grade trade volume.¹⁵

Proposed Measurement Criteria

We note that the FIMSAC has proposed the following measurement criteria for this exercise:

- A. Average daily trading volume of capped and uncapped trades during the pilot period and compared to the year prior to the pilot, using 1) the prior cap size; 2) the pilot cap size; and 3) capped and uncapped trades.
- B. Average daily number of trades of capped and uncapped trades during the pilot period and compared to the year prior to the pilot, using 1) the prior cap size; 2) the pilot cap size; and 3) capped and uncapped trades.
- C. Average trade size of capped and uncapped trades during the pilot period and compared to the year prior to the pilot, using 1) the prior cap size; 2) the pilot cap size; and 3) capped and uncapped trades.

¹¹ FINRA data calculated based on 2013-YE 2017 block trades for non-investment grade and 144A.

¹² FIMSAC recommendation at 5.

¹³ If the threshold were set at \$5mm, there is an open question concerning whether the average block trade size for non-investment grade corporate bonds would increase commensurate with this new threshold. We do not believe this dynamic would occur as broker dealers' views of what constitutes a large trade size for a given name are not likely to change as a result of this pilot.

¹⁴ Should the SEC decide that a \$5mm threshold is more appropriate for non-investment grade bonds, we would continue to support the pilot. We believe the proposed 48 hour delay is more important than the revised thresholds.

¹⁵ FIMSAC Recommendation at 4-5.

- D. Number of capped and uncapped trades during the pilot period and compared to the year prior to the pilot, using 1) the prior cap size; 2) the pilot cap size; and 3) capped and uncapped trades.
- E. Proportion of volume in block trades during the pilot period and compared to the year prior to the pilot, using 1) the prior cap size; 2) the pilot cap size; and 3) capped and uncapped trades.
- F. Price impact of block trades during the pilot period and compared to the year prior to the pilot, using 1) the prior cap size; 2) the pilot cap size; and 3) capped and uncapped trades.
- G. Transaction cost analysis using bid offer spreads, price impact studies and price dispersion studies. Analysis for capped compared to uncapped trades.
- H. Changes in dealer capital / inventory.
- I. Dealer behavior— proportion of matching trades compared to committing capital.
- J. All of the above to be compared in normal and stressful conditions.

We believe that A-E above are well defined, objective data points and therefore would be interesting and beneficial to capture and evaluate. We also suggest considering these measurement criteria separately for CUSIPS with large and small outstanding values to compare impact across issue sizes. With regard to F-G, these are more subjective metrics, with no single well-defined calculation methodology. At a minimum, should the SEC determine that it would like to use F-G as measurement criteria, the calculation methodology should be better defined before the pilot begins. In addition, we note that H and I could be misleading as these metrics may be influenced by factors unrelated to this pilot (e.g., changes in Volcker Rule, Leverage Ratio or other regulations or overall market movements).

Measuring Pilot Success

Prior to commencing this pilot, we believe that it is important to establish metrics for measuring market liquidity that can be used to determine “success.” This will ensure that at the end of the one year pilot, there is a mechanism to determine whether a rule change is appropriate. While the metrics outlined above will be interesting to observe, a ratio defined as follows would also provide an important insight into the “success” of this pilot.

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We recommend that for each of the investment grade and non- investment grade markets, the following should be measured prior to the start of the pilot and then again at the end of the pilot:

Percentage of volume traded:

- A. Below the current cap
- B. Between the current and pilot cap
- C. Above the pilot cap

We believe that an increase in C that exceeds any decrease in B would be a strong indicator that the pilot has been successful and should therefore lead to consideration of a rule change for TRACE reporting.

Pilot Timing

Finally, timing for the pilot in the short run is critical to allow for the study of impacts of transparency on market liquidity while markets are strong. While the impacts on market liquidity of transparency have been mixed, this has all occurred in bull markets. As markets undoubtedly will change over the coming months/years, it is very important to review this issue during a generally healthy market environment and address any issues to ensure maximum liquidity during times of market stress.

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The recommended pilot provides an important opportunity to better study the relationship between transparency and liquidity objectives to promote healthy and resilient markets. We encourage the SEC and the Financial Industry Regulatory Authority to support such a pilot through an expeditious FINRA proposal. We would be pleased to provide further input into the structure of the pilot, and to participate in FIMSAC or sub-committee meetings.

Sincerely,

/s/ Sandra E O'Connor

Sandra E. O'Connor
Chief Regulatory Affairs Officer
JPMorgan Chase & Co.

Cc: The Honorable Kara M. Stein, Commissioner
The Honorable Michael S. Piwowar, Commissioner
The Honorable Robert J. Jackson Jr., Commissioner
The Honorable Hester M. Peirce, Commissioner
Brett Redfearn, Director, Division of Trading and Markets