



P.O. Box 2600
Valley Forge, PA 19482-2600

January 2, 2019

Submitted electronically

Securities and Exchange Commission
Fixed Income Market Structure Advisory Committee
Attn: Mr. Brent J. Fields, Secretary
100 F Street NE
Washington DC 20459

Re: **Preliminary Recommendation for a Pilot Program to Study the Market Implications of Changing the Reporting Regime for Block-Size Trades in Corporate Bonds (“Reporting Changes”); SEC File No. 265-30.**

Dear Mr. Fields:

Vanguard¹ appreciates the opportunity to provide our comments to the Fixed Income Market Structure Advisory Committee (“FIMSAC”) on the proposed Reporting Changes. As of September 30, 2018, Vanguard manages approximately \$1.44 trillion in fixed income assets globally and approximately \$1.36 trillion in US fixed income assets. We welcome the FIMSAC’s contemplation of increased dissemination size caps as a positive evolution.

However, we believe that the delayed dissemination of trade data proposed in the Reporting Changes is fundamentally flawed by sacrificing transparency of a material portion of the fixed income market without first demonstrating a meaningful benefit to the overall market by doing so or setting a clear process for measuring success.

I. The Delayed Dissemination of Trade Data Sacrifices Transparency Without Compelling Justification

The proposed dissemination time frames in Reporting Changes seek to trade off transparency in a purported effort to improve market liquidity. However, we are not convinced that such a tradeoff has been justified and encourage the SEC – as well as the Financial Industry Regulatory Authority (“FINRA”) – to consider the implications for delayed trade dissemination beyond the ease of facilitating block trades. We believe that regulators should balance post trade transparency and liquidity concerns relative to the impacts to the overall fixed income market ecosystem rather than a narrow focus on any particular type of trade.

¹ Vanguard is an SEC-registered investment adviser with aggregate assets under management of approximately \$5.8 trillion as of September 30, 2018.

As proposed, the Reporting Changes would delay the reporting of a third of the recorded market volume based on historical Trade Reporting and Compliance Engine operated by FINRA (“TRACE”) data.² We share other commenters’ concerns that this could have a meaningful negative impact on daily price discovery and execution costs while advantaging a segment of market participants over others.

A. The Delayed Dissemination of Trade Data Harms Price Discovery Without A Clear Liquidity Benefit

We believe that delaying pricing information for a third of the market volume will have a meaningful impact on price discovery. For example, diminishing intraday trade transparency creates pricing challenges for market makers who create/redeem exchange traded funds. This translates into higher costs for participants in this market segment. Additionally, the post trade transparency created by TRACE has been linked to reductions in trade execution costs in the past decade.³

As regulators look to assess post trade transparency relative to liquidity, we caution against oversimplification of liquidity metrics as purely based on trading volume. Liquidity is dynamic. It has a price that changes with market conditions. Volume alone is not an appropriate measure of success for fixed income markets. Low turnover of the corporate bond market—which can be expressed as trading volume as a percentage of market value—is driven by the buy and hold nature of bond investing; the distribution of an issuer’s borrowing across many different bond issues; and the fact that many bonds are substitutes for one another based on common characteristics, such as issuer, sector, credit quality, and maturity. These distinguishing characteristics should not be overlooked in assessing the impact, in particular on price discovery, of modifying fixed income post-trade reporting.

We urge regulators contemplating these Reporting Changes to first take advantage of the trade data currently collected by TRACE and start with a data-driven assessment examining where liquidity and post trade transparency result in meaningful conflict for market participants.⁴

B. The Delayed Dissemination of Trade Data Picks Winners and Losers

Delayed reporting creates information asymmetry and by consequence designates winners and losers in the market. By bifurcating the market into those with access to information and those without, the Reporting Changes may even create additional barriers to entry for newer or smaller market participants, and further entrench those with the largest market positions.

²The total investment-grade volume notional traded from October 2017 to September 2018 was \$4.94 billion. Of those, \$1.66 billion (~34%) were trades above \$10 million notional. Data collected from actual FINRA volume and Bloomberg TFLO (estimated volumes). High-yield data reflects a similar pattern.

³For example there is academic research that sought to quantify TRACE’s impact to transaction costs and concluded that these costs were reduced by 50% for bonds eligible for TRACE transactions. *See* Market Transparency, Liquidity Externalities, and Institutional Trading Costs in Corporate Bonds, Hendrik (Hank) Bessembinder, William F. Maxwell, and Kumar Venkataraman, *Journal of Financial Economics*, (November 2005).

⁴Recently, the Office of Financial Research included an analysis of corporate bond market liquidity in their 2018 annual report to Congress. Within the corporate bond market, while block-trades are defined in the report as greater than \$5 million, only “mega-block trades” (over \$25 million or more or over \$10 million for investment-grade and high-yield markets, respectively) generally showed a decline as a share of trading volume since 2008. *See* Office of Financial Research, Annual Report to Congress 2018 (November 15, 2018) available at <https://www.financialresearch.gov/annual-reports/2018-annual-report/>.

Transparency serves as a foundational building block to foster technological changes and innovation in the fixed income markets. As fixed income markets evolve from principal based market making and to agency and electronic market structures, information is increasingly substituted for capital in creating liquidity.

II. The Reporting Changes' Design Fails to Set a Clear Standard for Success

The design of the Reporting Changes lack standard characteristics of a pilot, e.g. inclusion of a control group or a clear process for measuring success. We believe this will result in data that is open to misinterpretation. As described above, volume alone is not an appropriate measure of success for fixed income markets. A pilot should be measurable, holistic, and consider the market efficiency and effectiveness for all market participants, rather than simply create a new market practice. Additionally, as previously stated, we also believe the proposed thresholds for delayed transparency are far too low. This pilot design could lead to gaming and data distortions that would impair the credibility of the results.

* * * * *

We have long advocated that regulators support policies and practices that create efficient and robust financial markets for all market participants. For the reasons set forth above, we continue to believe that transparent markets should be valued at a premium and that any proposals to decrease price discovery should be tied to a thoughtful data-driven approach.

We appreciate the opportunity to comment on the Reporting Changes. If you have any questions about Vanguard's comments or would like any additional information, please contact Jillien Flores at [REDACTED] or Christyn Rossman at [REDACTED]

Sincerely,

/s/ Gregory Davis

Gregory Davis
Chief Investment Officer
Vanguard

cc: The Honorable Jay Clayton, Chairman
The Honorable Kara M. Stein, Commissioner
The Honorable Robert J. Jackson Jr., Commissioner
The Honorable Hester M. Peirce, Commissioner
The Honorable Elad L. Roisman, Commissioner
Brett Redfearn, Director, Division of Trading and Markets
Robert W. Cook, President and Chief Executive Officer, FINRA