



Municipal Securities Rulemaking Board

April 18, 2022

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: File No. S7-02-22 - Amendments to Exchange Act Rule 3b-16 Regarding the Definition of “Exchange”; Regulation ATS for ATs That Trade U.S. Government Securities, NMS Stocks, and Other Securities; Regulation SCI for ATs That Trade U.S. Treasury Securities and Agency Securities

Dear Ms. Countryman,

The Board of Directors of the Municipal Securities Rulemaking Board (“MSRB” or “Board”) appreciates the opportunity to provide comments to the Securities and Exchange Commission (“SEC” or “Commission”) in response to a Commission proposal seeking comment on the definition of “Exchange”; Regulation ATS for alternative trading systems (ATs) that trade U.S. Government Securities, NMS stocks and other securities, including municipal securities; and Regulation SCI for ATs that trade U.S. Treasury Securities and Agency Securities (the “Proposal”). The Proposal was published in the Federal Register on March 18, 2022, requesting comment on Exchange Act Release No. 94062 on or before April 18, 2022.¹

As detailed below, the MSRB supports enhancements to the regulatory framework that could improve transparency and would further enhance the Commission’s and the MSRB’s regulatory oversight to ensure a fair and efficient municipal securities market. The MSRB cautions against uniformly applying one regulatory standard across all asset classes and supports prudent regulation that recognizes the unique characteristics of each evolving market, addresses the harms to investors in that market, facilitates capital formation, analyzes costs and benefits of compliance burdens, and develops regulation that strengthens the market and the opportunities it provides.

I. Introduction

The MSRB protects and strengthens the municipal securities market, enabling access to capital, economic growth, and societal progress in tens of thousands of communities across the country. The MSRB is a self-regulatory organization created by Congress with the statutory mandate under Section 15B of the Securities Exchange Act of 1934 (the “Exchange Act”) to

¹ 87 FR 15496 (March 18, 2022).

promulgate rules for the municipal bond market that protect investors, state and local governments and other municipal entities, obligated persons and the public interest.² The MSRB's highest priority is to fulfill its congressional mandate to protect investors, issuers and the public interest by promoting a fair and efficient market and ensuring access to capital for communities across the country. The MSRB fulfills its mission in safeguarding the nearly \$4 trillion municipal securities market by, among other activities, establishing rules for brokers, dealers, municipal securities dealers (collectively, "dealers") and municipal advisors that engage in municipal securities and advisory activities that are designed to prevent fraud and manipulation and promote fair dealing, and a fair and efficient market.

To further promote a fair and efficient market, one that facilitates equal access to information and market transparency, the MSRB provides technology systems that power the municipal securities market and provide market transparency. Over the past decade, the MSRB significantly advanced transparency in the municipal securities market through its Electronic Municipal Market Access (EMMA[®]) website and technology systems. The EMMA website is the official source for municipal securities data and disclosure documents and provides investors, state and local governments and other market participants with free access to key information and tools to effectively use that information.

As a self-regulatory organization, the MSRB is governed by a Board of Directors, consisting of a majority of public members in addition to representatives of regulated entities, with deep expertise in municipal securities markets. Our Board of Directors exercises its accountability and governance responsibilities through oversight of the MSRB's strategic plan, operations and regulatory activities.

II. Background

The MSRB served as a member of the SEC's Fixed Income Market Structure Advisory Committee ("FIMSAC") and appreciated this opportunity to share its expertise and unique perspectives on the municipal securities market. FIMSAC recommended that the SEC review the framework for the oversight of electronic trading platforms for corporate and municipal bonds noting that without a unifying regulatory framework for all fixed income electronic trading platforms, market structures will likely fragment further as regulators adopt new regulations that apply to only one type of platform.³ Specifically, FIMSAC noted its concern with the lack of regulatory

² Pursuant to Section 15B(b)(2)(C) of the Exchange Act, such rules must not be designed to impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. 15 U.S.C. 78o-4(b)(2)(C).

³ See FIMSAC, Recommendation for the SEC to Review the Framework for the Oversight of Electronic Trading Platforms for Corporate and Municipal Bonds (July 16, 2018)

harmonization among fixed income electronic trading platforms recognizing that some firms are regulated as alternative trading systems, while some are regulated as broker-dealers or not at all based on differences in trading protocols or business models. In particular, the FIMSAC observed that electronic Request for Quote (“RFQ”) platforms represent a large and growing fraction of electronic corporate and municipal bond trading but are generally regulated only as broker-dealers. FIMSAC concluded that these distinctions in regulatory oversight complicate efforts to improve the efficiency and resiliency of the fixed income electronic trading markets

In addition, FIMSAC recommended harmonization for all fixed income electronic trading platforms noting that, in coordination with FINRA and the MSRB as appropriate, the SEC should clearly define “electronic trading” so that any new regulation or framework comprehensively covers the platforms and trading functionality that the SEC intends to cover without reliance on the current ATS definition.⁴ FIMSAC recognized that without a unifying regulatory framework for all fixed income electronic trading platforms, market structures will likely fragment further as regulators adopt new regulations that apply to only one type of platform.

III. Support for Proposal to Address Regulatory Gaps

The MSRB recognizes the increasingly important role of electronic platforms in the municipal market and generally supports the SEC’s efforts to address gaps in the current regulatory framework for fixed income trading platforms, including extending the regulatory framework to certain other fixed income electronic platforms that are currently exempt from Regulation ATS and SRO membership requirements.

The SEC asked well over two hundred questions that were primarily divided by asset class, with few that specifically sought input from market participants’ experiences with electronic platforms in the municipal market. This letter does not provide comment on each of the SEC’s itemized questions; the MSRB is pleased to share its expertise in response to the questions identified below.

Do you agree with the Commission's description of the municipal debt market?

The MSRB acknowledges that the municipal securities market is viewed as more fragmented than other fixed income markets because of the approximately 50,000 issuers and 1,000,000

(“FIMSAC 2018 Recommendation”). <https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-electronic-trading-platforms-recommendation.pdf>.

⁴ See FIMSAC Recommendation Regarding Defining “Electronic Trading” for Regulatory Purpose, October 5, 2020. <https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-recommendation-definition-of-electronic-trading.pdf>.

individual bonds outstanding.⁵ On average, approximately only one percent of the outstanding bonds trade on any given day and the trading of many securities is characterized by frequent trading shortly after issuance with little to no trading during the remaining life of the bond.

The MSRB agrees that ATSs have become a significant component of liquidity in the municipal securities market, especially for individual investors. ATSs aggregate liquidity for customer purchases and sales from many dealers. ATSs also provide tools to help dealers and investors, including individual investors, to efficiently search and find offerings based upon a variety of pertinent attributes, including state, coupon, maturity, tax status, etc.

Since 2016, dealers reporting trades to the MSRB have been obligated to use a special indicator to identify when trades are executed on or through the services of an ATS. MSRB trade data shows how significant ATSs have become in the inter-dealer market. MSRB trade data for 2021 also shows that ATSs were involved 20% of all trades and 55% of all inter-dealer trades.⁶ For trades of \$100,000 or less, ATSs accounted for 22% of all trades and 58% of all inter-dealer trades. The median trade size in 2021, for all trades reported as occurring on an ATS, was \$25,000. The significant number of trades, especially smaller-sized trades that are associated with ATSs indicates the importance of ATS to individual investors and the entire municipal securities market.

ATSs are vital in the municipal securities market especially in providing liquidity for individual investors. There were more than 1.5 million trades reported to the MSRB as ATS trades in 2021 representing a par amount of \$113 billion with almost 300,000 different securities being traded. An MSRB study showed that dealers are increasingly using liquidity from other dealers, often through ATSs, to meet the liquidity needs of individual investors. In 2021, 55% of the inter-dealer trades reported to the MSRB were flagged as occurring over an ATS. ATS trades also represented 22% of all trades under \$100,000. Nearly 90% of trades that occurred on ATSs were \$100,000 or less and the median trade size for trades executed on an ATS was \$25,000 affirming the importance of ATSs to liquidity for individual investors.

In a recent MSRB Publication titled "[Use of Internal and External Liquidity in the Municipal Market](#)," MSRB research showed that for customer transactions of \$100,000 or less, the use of external liquidity increased significantly from an average of 30% in 2011 to 35% in 2015 and

⁵ MSRB Inter-Dealer Municipal Trading Fact Sheet. <https://www.msrb.org/Market-Topics/-/media/9D7FD21EBF18421295BA5F9FE5428E33.ashx?>

⁶ According to data reported to the MSRB's RTRS system. Trade data excludes variable-rate municipal securities and Commercial Paper.

44% in 2019, before decreasing slightly to 42% in 2020.⁷ The study clearly shows a significant increase in competition among dealers to capture order flow for individual investors.

Further MSRB analysis shows that the number of dealers that executed a substantial amount of business, categorized as more than 25,000 trades per year, continued to increase in 2018 to 43, or 5% of all dealers, up from 39 dealers in 2017, or 4.5% of all dealers, and 27 dealers in 2006, or 1.9% percent of all dealers. The analysis also shows that for small and large trade sizes investors are less reliant on the top 1,3, 5 and 10 dealers for liquidity in 2018 than in 2006. This again shows more dealers competing for order flow and more depth to the pool of liquidity providers.⁸

In August of 2021 the MSRB released a report titled “[Transaction Costs During the COVID-19 Crisis](#).” The analysis shows spreads in the municipal securities market continued to decline in the last decade. Furthermore, the difference in effective spread between smaller individual-sized customer trades and larger institutional-sized customer trades continued to shrink over the past decade. The reduction was mostly due to the steadily declining effective spread for individual-sized customer trades, as institutional-sized customer trades (par value more than \$1,000,000) had a relatively stable level of effective spread during the period.

The MSRB has observed notable trends of reduced spreads, increased competition and use of electronic trading, increasing use of external liquidity to meet individual investor needs and the growth of mutual funds, Exchange Traded Funds and Separately Managed Accounts. The data indicates that the municipal securities market is becoming increasingly competitive and efficient because of enhanced transparency, advances in electronic trading and the increased use of professional asset managers by individual investors.

Do you agree with the Commission's description of broker's brokers and their role in the municipal bond market? Please provide any details you feel are necessary to fully understanding this point.

The Commission's description is not inconsistent with the MSRB's findings in its 2021 white paper on the impact of electronic trading technology on the municipal securities market by

⁷ External liquidity is defined to mean when a customer purchase (sale) is filled using the offering (bid) of a different and unaffiliated dealer than the client's dealer. The related inter-dealer trade will be for the same quantity as the customer buy or sell and transacted on the same day.

⁸ Dealer Participation and Concentration in the Municipal Securities Market.
<https://msrb.org/Market-Topics/~~/media/9EF010CA1A2B4261859CF70A490C63FC.ashx?>

analyzing inter-dealer trading activity on ATSS and broker's broker platforms.⁹ As noted, the business model of broker's brokers has evolved from the historically pure voice brokerage (via the usage of a telephone) to a hybrid usage of telephone negotiation and, increasingly, electronic systems and broker's brokers perform similar functions to those provided by the modern-day ATSS, such as aggregating liquidity and acting as agent or riskless principal in the purchase or sale of securities for dealers, institutions and other sophisticated market participants.¹⁰

In 2021, broker's brokers accounted for almost 3% of the par amount reported to the MSRB and slightly more than 2% of the trades with an average trade size of approximately \$362,000.

Should the Commission change the five percent fair access threshold for NMS stocks, equity securities that are not NMS stocks, corporate bonds, or municipal securities?

The SEC's Proposal identifies thresholds for when an ATS in municipal securities would trigger other SEC rules under Regulation ATS, the Fair Access Rule and the Capacity, Integrity and Security Rule.¹¹ Currently the SEC's thresholds for these two rules are based on a percentage of overall volume. The MSRB believes that any threshold that is based solely on the par amount traded for all types of municipal bonds is potentially flawed and could underestimate the importance of the ATS to the overall market and especially to individual investors. While trades for individual investors may account for the vast majority of the trades on an ATS, those trades

⁹ See "Characteristics of Municipal Securities Trading on Alternative Trading Systems and Broker's Broker Platforms" (2021), Municipal Securities Rulemaking Board, available at <https://msrb.org/Market-Topics/-/media/27E4F111D18246C6B9DA849082230CD0.ashx?>

¹⁰ Citing Securities Industry and Financial Markets Association's paper "The Role of Municipal Securities Broker's Brokers in the Municipal Markets," 2017.

¹¹ The Fair Access Rule, Rule 301(b)(5) of Regulation ATS, requires an ATS that meets the applicable threshold, to establish reasonable standards for access to the ATS and apply those standards to all prospective and current subscribers in a fair and non-discriminatory manner. The Capacity, Integrity and Security Rule, Rule 301(b)(6) of Regulation ATS, requires an ATS that meets the applicable threshold, to, among other things, establish reasonable current and future capacity estimates; conduct periodic capacity stress tests of critical systems to determine such system's ability to process transactions in an accurate, timely, and efficient manner; and develop and implement reasonable procedures to review and keep current its system development and testing methodology with respect to those systems that support order entry, order routing, order execution, transaction reporting, and trade comparison.

account for a significantly smaller portion of the par amount. For example, in 2012, 20% of trades reported to the MSRB were flagged as occurring over an ATS, this only represented 5% of the overall par volume in the municipal securities market.

In addition, the short-term municipal bond market, which is predominantly trading in Variable Rate Demand Obligations and Commercial Paper, has a very different market structure from the long-term municipal bond market. The short-term and long-term markets are distinct with respect to investors and average trade size, with a minimal number of trades in the short-term market occurring on ATSs. For that reason, the SEC may want to consider a threshold test that considers volume in the short-term and long-term markets separately as well as combined.

In 2021, the municipal bond short-term market accounted for 27% of the par amount traded but only about 2% of the number of trades reported. The average trade size in the short-term market was \$3.7 million. Yet, short term trading only accounted for 0.3% of the par amount traded on ATSs and 0.2% of the number of trades reported as ATS trades. The SEC may want to consider an additional test for volumes on the short-term market and long-term market separately as well as combined.

Should the Commission allow or require ATSs to use sources of market data other than published data provided by the SRO to which trades are reported? If yes, which data sources?

The MSRB agrees with the SEC's approach to clarify that the data used by an ATS in determining whether the ATS is subject to the Fair Access Rule for municipal securities is the average daily dollar volume in municipal securities provided by the MSRB. The MSRB does not believe ATSs should use market data other than that published by the SRO to which trades are reported.

The MSRB serves as the steward of transaction reports in municipal securities given the established transaction reporting regime for municipal securities. The MSRB's EMMA website is the official source for municipal securities transaction data and provides investors and other market participants market transparency. The MSRB's investment in cloud computing and data analytics will enhance the quality, accessibility, security and value of its market data for investors and all market participants. Our goal is to provide high quality market data that enable comprehensive analysis of, and insight into the municipal securities market; develop innovative data products and services that provide value for all market participants; and increase the opportunities for data to strengthen market efficiency and fairness.

To that end, the MSRB strongly recommends that the SEC require ATSs that facilitate trading in municipal securities to provide the MSRB the same data that is provided to the SEC and other SROs pursuant to Exchange Act Rule 301(b)(2). Consistent with Exchange Act Section 15B, it is unlawful for any municipal securities dealer to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any municipal security unless such municipal securities dealer

is registered with the MSRB. Accordingly, any electronic platform subject to Regulation ATS that facilitates transactions in municipal securities would be required to register with the MSRB and would be subject to MSRB's rules. The failure of an ATS to provide the MSRB the information provided under Rule 301(b)(2) could impede the MSRB's regulatory authority.

IV. Conclusion

The MSRB appreciates the opportunity to provide comment to the Commission on the Proposal and consistent with its mandate to promote a fair and efficient municipal securities market. The MSRB looks forward to reading the comments from municipal market participants and, consistent with FIMSAC's recommendation, working collaboratively with the SEC and Financial Industry Regulatory Authority ("FINRA") on this initiative to review the regulatory framework for oversight of the fixed income electronic trading platforms.¹² If we can provide additional information, please do not hesitate to contact me or Gail Marshall, Chief Regulatory Officer or John Bagley, Chief Market Structure Officer at 202-838-1500.

Sincerely,



Mark Kim
Chief Executive Officer

cc: David Sanchez, Director, Office of Municipal Securities

¹² Specifically, the FIMSAC recommended that the SEC, FINRA, and MSRB form a joint working group to conduct a review of the regulatory framework for oversight of electronic trading platforms used in the corporate and municipal bond markets: (i) to ensure that the regulatory framework best promotes the growth of fair and effective fixed income electronic trading markets; (ii) to ensure that no regulatory gaps or inconsistencies in the application of such regulation exist that increase the potential for investor harm, systemic risk or unfair competition; (iii) to ensure that no regulatory gaps or inconsistencies in the application of such regulation exist that increase the potential for investor harm, systemic risk or unfair competition; (iii) to consider whether Regulation ATS (and any other applicable rules) should be amended to account for differences in protocols and market structures commonly used to trade fixed income as compared to equities; (iv) to ensure that regulation is not unfairly promoting or impeding specific trading protocols and business models over others; and (v) to consider whether any existing regulation impacting the fixed income electronic trading markets is unnecessary from a cost-benefit perspective. See FIMSAC 2018 Recommendation.