

April 18, 2022

Via E-Mail: rule-comments@sec.gov

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street N.E.
Washington, D.C. 20549

**RE: FILE NO. S7-02-22. AMENDMENTS REGARDING THE DEFINITION OF
“EXCHANGE” AND ALTERNATIVE TRADING SYSTEMS (ATSS) THAT TRADE U.S.
TREASURY AND AGENCY SECURITIES, NATIONAL MARKET SYSTEM (NMS)
STOCKS, AND OTHER SECURITIES.**

Dear Ms. Countryman:

The Bond Dealers of America (“BDA”)¹ submits this letter to the U.S. Securities and Exchange Commission (“Commission” or “SEC”) to comment on the above-captioned Proposing Release (“Proposing Release”)² to amend Regulation ATS under the Securities Exchange Act of 1934 (“Exchange Act”).

The electrification of the U.S. fixed income markets has transformed the way that bonds are traded. Electronic trading has reduced costs for customers, improved liquidity for larger issues, and enhanced price discovery. Approximately 36 percent of the daily dollar volume in high grade corporate bonds is executed electronically.³ For high yield corporates, the figure is around 27 percent, and for municipals our estimate is around 15 percent. Fixed income trading platforms continue to emerge and evolve, and we believe the portion of secondary market transactions executed on platforms will continue to grow.

Currently there exists a disparity in the regulation of fixed income trading platforms. Platforms with similar trading protocols are not regulated consistently. The BDA membership is comprised of both users and operators of electronic trading platforms, as well as other means of trade execution. As such, we are generally supportive of efforts to craft and apply appropriately

¹ The Bond Dealers of America is the Washington, DC-based trade association that exclusively represents securities dealers and banks whose primary focus is the U.S. fixed income markets.

² Exchange Act Release No. 94062 (Jan. 26, 2022), 87 Fed. Reg. 15496 (hereinafter the “Proposing Release”). The Proposing Release includes re-Proposing Releases of certain amendments included in the Commission’s 2020 proposed amendments to Regulation ATS. See Exchange Act Release No. 90019 (Sept. 28, 2020), 85 Fed. Reg. 87106 (Dec. 31, 2020) (“2020 Proposing Release”).

³ January Spotlight: US Corporate Bond Market Structure: 2021 by the Numbers, Kevin McPartland, Coalition Greenwich (Jan. 25, 2022).

tailored regulations to these platforms. However, the BDA believes that there should be a common regulatory framework applicable to like functions and services. The SEC’s Fixed Income Market Structure Advisory Committee (“FIMSAC”) noted, with respect to Rule ATS, that “some platforms are regulated as alternative trading systems (ATSs), some are regulated as broker-dealers, and other significant platforms operating the same or similar models are not regulated at all.”⁴ We agree with the FIMSAC’s suggestion that electronic platforms dedicated to bringing together buyers and sellers of debt securities for the purpose of effectuating transactions should generally be subject to similar regulatory obligations regardless of how they are structured internally or what they call themselves. However, while the Proposing Release is written broadly enough to capture some currently unregulated entities that are engaged in broker-dealer or ATS activities, it would also impose additional regulatory burdens on some that are already regulated without any significant justification, such as a benefit to investors.

The Proposing Release dismisses the anticipated resistance to the burdens created by the new proposed regulations on smaller broker-dealers by merely asserting that their order flow would simply be “absorbed and redistributed” to larger ATSs.⁵ This solution is offered ten times in the release. BDA notes that President Biden signed an Executive Order (“EO”) on July 9, 2021 in which he articulated his Administration’s policy of promoting competition, not consolidation, of American industry. Indeed, the EO creates a new inter-agency White House Competition Council and calls for a “whole-of-government approach” to address excessive concentration, abuses of market power, unfair competition, and the effects of monopoly and monopsony.⁶ The EO specifically identified the SEC as one of the agencies whose rules must seek to resist consolidation and promote competition, “including the market entry of new competitors.”⁷ The BDA is opposed to the disproportionate impact that these new provisions would have on smaller broker-dealers and urges the Commission to review the mandate in the EO and revisit those areas in this Proposing Release where it addresses these challenges by predicting the extermination or consolidation of the smaller trading venues in favor of the larger ones.

The inclusion of Government Securities platforms into the ATS framework makes sense and is supported by the BDA. However, the current proposal to expand the definition of “exchange” and to apply it to venues that may only have conditional trading interest, goes too far. The BDA believes that regulatory proposals need to be better tailored to the characteristics of the securities and the markets that would be subject to the new rules and that there be a significant regulatory or investor benefit for imposing these additional burdens. Here, that would mean that any change should reflect the challenges presented by trading on the specific venues, the form of trading that is taking place there, and the regulatory status of participants on both sides of the trades. There must also be an additional regulatory interest that is not already being

⁴ FIMSAC, Recommendation for the [Commission] to Review the Framework for the Oversight of Electronic Trading Platforms for Corporate and Municipal Bonds (July 16, 2018).

⁵ Proposing Release at 15633.

⁶ Exec. Order No. 14036, 86 Fed. Reg. 36987 (July 14, 2021).

⁷ *Id.* at 36989.

achieved through an existing framework or clear enhancement to investor protection. The BDA thanks the Commission for the opportunity to comment.

I. GOVERNMENT SECURITIES ATSS

A. BDA SUPPORTS RESCINDING THE EXEMPTION FROM REGULATION ATS FOR GOVERNMENT SECURITIES ATSS

BDA supports rescinding the exemption from Regulation ATS for Government Securities platforms. However, Regulation ATS was designed for equity markets and not for electronic trading of over-the-counter fixed income securities. As FIMSAC noted, “significant aspects of the Regulation ATS ruleset...largely reflect the trading practices of the equity markets and not necessarily those of the fixed income markets.”⁸ BDA agrees with FIMSAC and notes that there are practical reasons that electronic fixed income trading platforms have evolved into a different range of protocols and business models than equity platforms. There are several aspects of Reg ATS that are simply not applicable to fixed income markets, and it is BDA’s hope that if certain rules do not apply, that they will not be implemented.

B. BDA OPPOSES REQUIRING GOVERNMENT SECURITY ATSS TO FILE THE EQUITY MARKET FORM ATS-N.

BDA supports the requirement that Government Securities ATSS file a form with the Commission. However, it supports the filing of the ATS-G described in the Commission’s 2020 proposal,⁹ not the ATS-N currently proposed. While there is some information common to both ATSS for government securities and ATS for NMS stocks, the markets are very different and the forms should be tailored to those differences. It is not efficient for an ATS operator in either market sector to have to spend time identifying those questions on the form that pertain to them and the ones that are not applicable to its market. Fixed income and equities markets are very different and the forms ATS used by each one should reflect those different operational and market structures. Ergo, the Commission should re-propose adoption of its previously proposed Form ATS-G for Government Securities ATS.

C. BDA OPPOSES REQUIRING GOVERNMENT SECURITY ATS TO ELECTRONICALLY FILE FORMS THROUGH THE EDGAR SYSTEM.

The Commission has proposed to require ATSS that submit a Form ATS to do so through the Commission’s EDGAR system. The Commission also proposes to require all ATSS to file Form ATS-R through the Commission’s EDGAR system. BDA does not believe that the Government Securities Form ATS should be filed in a publicly available venue such as EDGAR. There are a number of different fixed income platforms that perform dissimilarly across the market sectors and charge for access or trading in different ways. This is commercially

⁸ *Id.*

⁹ Regulation ATS for ATSS that Trade U.S. Government Securities, NMS Stock, and Other Securities; Regulation SCI for ATSS that Trade U.S. Treasury Securities and Agency Securities; and Electronic Corporate Bond and Municipal Securities Markets, Exchange Act Rel. No. 34-90019.

sensitive, proprietary information. Public disclosure of such information could have a negative impact on innovation and competition. As regulated entities, the Commission may request them to produce that information at any time, as may platform participants, but the BDA sees no value in universally providing that data publicly.

II. PROPOSED AMENDMENTS TO EXCHANGE ACT RULE 3B-16 CONCERNING THE DEFINITION OF “EXCHANGE” AND REQUIREMENT THAT IT APPLIES TO ORDERS

The Commission has proposed significant changes to the definition of “exchange” in Exchange Act Rule 3b-16.¹⁰ The proposal to include certain “communication protocol systems” within the definition of “exchange” is probably the most notable. In addition, the proposal would change the term “orders” to “trading interest,” which would expand the definition to include non-firm trading interest which goes well beyond the definition of “order.”¹¹ Indeed, a “trading interest” would include an order or “any non-firm indication of a willingness to buy or sell a security that identifies at least the security and either quantity, direction (buy or sell), or price.”¹² BDA opposes these proposed changes and believes that they would have a negative impact on fixed income market structure, the price discovery process in over-the-counter markets, and would not advance any regulatory interest or investor protection goals.

A. BDA OPPOSES THE PROPOSED DEFINITION OF EXCHANGE AS BEING OVERLY BROAD

The Commission has introduced the term “communication protocol system” as a type of entity to be included within the Rule 3b-16 definition of “exchange.” Although the term is used 634 times in the proposing release, not once is it specifically defined.¹³ It is a term that has not been historically used by the Commission, nor has it been part of securities industry jargon. Without a definition it remains vague and potentially overbroad. The BDA believes that significant changes, such as those in this Proposing Release, should be clear and unambiguous to ensure regulated entities and other market participants understand what facts and activities trigger “exchange” activities. Furthermore, such definition must be tailored to the facts and serve a beneficial purpose. Without a clear definition of the boundaries of this term it risks application to far too many entities and with no discernable benefits. This, coupled with the change of the term “order” to “trading interest,” will create numerous problems including, perhaps, the unintended consequence of making compliance more expensive and more difficult as many entities will meet the new definition of exchange.

¹⁰ 17 CFR 240.3b-16.

¹¹ Proposing Release at 15504.

¹² *Id.*

¹³ Footnote 5 of the Proposing Release says that “[a] “Communication Protocol System” would include a system that offers protocols and the use of non-firm trading interest to bring together buyers and sellers of securities.” We respectfully submit that a definition that includes two of the three words of the term in the definition, is no definition at all.

B. BDA OPPOSES THE INCLUSION OF PASSIVE SYSTEMS, CONNECTIVITY PROTOCOLS, COMMUNICATIONS CONDUITS, AND SINGLE-DEALER SYSTEMS IN THE NEW DEFINITION

BDA opposes expanding the definition of exchange to entities that play a passive role, connectivity protocols, communications conduits, and single-dealer systems in the fixed income market. Any system that either provides portals for connectivity or hosts passive platforms that merely allow buyers and sellers to meet, should not satisfy the new definition. Conversely, if a system's operator may interact with the data or activity on the platform, such as aggregating or analyzing it to provide additional services for users, provide the ability to write trade tickets, or have a role in the settlement process, it is not a passive system. The expansion of the definition of exchange to include "communication protocol systems" is overly inclusive and with no demonstrable benefit to the market or market participants.

Examples of systems that should not be included in the definition would be:

Bulletin Boards. Bulletin Boards are passive. They provide a platform that hosts market participants' indications of where they might be willing to do a trade, but the actual trade negotiations, ticket writing, and clearance and settlement of the transactions take place elsewhere. The Bulletin Board does not interact with either the platforms users or the data.

Order management systems, electronic connectivity or infrastructure. These are the conduits through which orders or interests are routed. They are generally a regulated entity's own systems and technology or connect to a regulated entity's systems. Typically, they carry customer's orders or interests to the regulated entity or allow this input to be routed elsewhere. These systems are the pipes through which the information travels and should not be considered exchanges. They are generally used for transmitting trade or order information, not trade execution services. Moreover, the information is already required to be kept as part of the regulated entity's books and records obligations and is accessible, if requested, by regulators.

The real problem here is that the Commission appears to want to regulate all communications. Where the "system" used to start at the venue where the trading would actually occur, the Proposing Release would move the perimeter back to the front end where the customer enters the order. The "system" now starts where the customer's order is captured and travels through to the trading venue. These connectivity options are all passive and should not be regulated.

Pre-Trade Communications or Structured Chat. Outside of certain U.S. government securities and certain corporate bonds, most electronically posted offerings in the fixed income markets *are conditional* – they are *not* executable. This means that, for most of the market, pre-trade communications are a necessary step to permit interested buyers to check on the status of offerings. These communications are typically used to confirm the information in the offering, *to wit*, if the bonds are still there or if they have traded, if the price is still good, and maybe even if a better price could be negotiated. Most of these

communications will not conclude with a trade. If communications result in a trade, that transaction information gets executed by a regulated entity and then reported to whatever trade reporting venue is appropriate or required. There is no policy reason to regulate any of the information connected with pre-trade communications. These conversations are cryptic and full of market jargon. They are very contextual, so to have any utility whatsoever they would need to be matched, an enormously time-consuming task, and often still do not provide much clarity.

The Commission is applying its desire to regulate such equity market communications as, for example, “Indications of Interest” (“IOIs”) to the bond market. Equity market IOIs are generally considered non-binding expressions of a willingness to trade. By contrast, most of the communications in the fixed income market are to find out if there is anything still there to trade, what price it could trade at, and how many would trade there. In the equity market, there is a real intent to do a trade, in fixed income they are trying to gather information that will be considered in order to decide if they want to trade. In bond market communications where no trade results, either the bonds have already traded or the communicated interest is not even at a market level so no trade will occur. The bond market pre-trade communications, therefore, would be at least confusing and at worst misleading.

RFQ’s . If a “request for quote” (also known as a bid wanted or offering wanted) system is passive, it should not be considered a communication protocol system. If it is just providing a connection between the party initiating the inquiry and those parties invited to respond to the request, or putting out dealer inventories, it should fall outside of the scope of the definition of an exchange. By contrast, if a platform is able to interact with the information, aggregate data for purposes of providing additional color to market participants, feedback, or provide any services beyond hosting the interested participants, it is not passive. The Proposing Release describes an RFQ system that may “scrape” or obtain the symbol of trading interest that a participant is seeking from the participant’s order management or execution management system and use that to alert other participants on its system about potential contra-side interest in seeking to initiate a negotiation.”¹⁴ BDA does not consider that platform to be an RFQ system but rather something materially different.

Single-Dealer Systems. These typically are systems through which a broker-dealer will reflect its own and, often, other broker-dealers’ fixed income offerings to its self-directed retail customer base, its financial advisor network, correspondent firms, and institutional clients. In the case of U.S. Treasury bonds, and some corporate bonds, a single-dealer system may reflect both bids and offers. An interest in a bid or offering that is displayed over these systems by any of these market participants generally has to be sent to the dealer’s trading desk to confirm its continued availability before a trade can be executed. Additionally, the trading desk is usually the counterparty to at least one side of the trade. If the bonds that were shown are owned by a different broker-dealer than the one hosting

¹⁴ Proposing Release at 15501.

the system, the single-dealer host would be the counterparty to both sides of the trade. As the Proposing Release itself acknowledges, systems that “allow persons to enter orders for execution against the bids and offers of a single dealer if certain additional conditions are met” are excluded under Rule 3b-16(b), and “[t]hese systems would continue to not fall within the definition of “exchange.””¹⁵

BDA strongly agrees with the Commission on this point. Moreover, the broker-dealers who offer these single-dealer systems are already regulated by both the SEC and FINRA. This means that they are already required to have internal policies and procedures that guide their interactions through these systems, risk management, compliance and surveillance, requirements for keeping certain books and records, and are subject to examination of this activity. Simply put, there is no regulatory “gap” to fill here by bringing them within the ambit of Rule 3b-16, and no regulatory or investor interest served in imposing further regulatory obligations.

C. BDA OPPOSES THE SUBSTITUTION OF “ORDER” WITH “TRADING INTEREST”

The proposed change from “order” to “trading interest” should be beyond the scope of a definition of exchange. Expressions of trading interest are important tools for facilitating timely and competitive price discovery. However, there does not seem to be any articulable regulatory benefit in imposing a regulatory framework onto “trading interests.” The purpose of providing transparency into actual orders is to allow market participants, and any other interested parties, genuine facts relating to the levels at which fixed income transactions occurred. Transparency of trade data provides them the material information that will help to decide whether to buy, sell, or forego any trade action.

Because the vast majority of the fixed income market does not and cannot have executable quotes, and are typically one-sided offering-only markets, potential parties to transactions interact through expressing an interest in bonds being offered. If trading interest does not result in a transaction, the “trading interest” itself really provides no valuable information to anyone. In fact, a trading interest may not necessarily even encompass an actual intent to trade, just to inquire and maybe even just to “price” another bond. There are many reasons that a trade does not happen, and most of them are specific to those whose negotiation failed and would not be relevant to other parties. By contrast, an “order” is an intention and expressed willingness to trade, and that is the reason that the firm intent to trade at a particular price is the relevant threshold for this Rule. The term “trading interest” is simply too broad.

III. FAIR ACCESS RULE AND REGULATION SYSTEMS COMPLIANCE AND INTEGRITY (“REG SCI”)

The Commission has concluded in the Proposing Release, without any analysis, that the Fair Access Rule would apply to fixed income ATSS. The rationale for its application seems to be that the Fair Access Rule applies to ATSS, ergo fixed income ATSS must establish minimum requirements for the written standards required for ATSS to comply with it pursuant to the Fair

¹⁵ Proposing Release at n. 72.

Access Rule. In addition, the Proposing Release would require firms to aggregate the transaction volume for a security or security category of ATSS that are operated by a common broker-dealer or operated by affiliated broker-dealers in order to create a threshold for the application of Reg SCI. Again, the rationale for this is merely that fixed income ATSS need to comply with Reg SCI, if their volumes exceed the thresholds, because they are ATSS – there is no factual basis that would support the need for Reg SCI, nor evidence offered that the application of Reg SCI would make the fixed income markets any better. The Fair Access Rule and Reg SCI are strictly equity market concepts and ***should not apply to fixed income ATSS***. The BDA opposes the inclusion of both of these in any new rule adoption, and it is imperative that before any version of this proposed rule is finalized, that it be more appropriately tailored to the realities and functionality of the fixed income markets.

A. BDA OPPOSES THE APPLICATION OF THE FAIR ACCESS RULE

Regulation ATS established a regulatory framework for “alternative trading systems.” One provision of Reg ATS is Rule 301(b)(5), the “Fair Access Rule.”¹⁶ The Fair Access Rule requires an ATS, that has more than a specific threshold of trading volume in a security or category of securities during a certain period of time, to comply with a number of heightened requirements. They must also establish written standards for granting access to trading on the ATS and they must not unreasonably prohibit or limit access by applying those access standards in an unfair or discriminatory manner.¹⁷

The fixed income market is very different that the equity market upon which Reg ATS and the Fair Access Rule are founded. Nowhere in the Proposing Release did the Commission provide evidence or even an allegation that any fixed income platform ***has ever*** provided disparate treatment to different subscribers or behaved in any manner that was unfair or unreasonably discriminatory. The application of the Fair Access Rule here is being gratuitously proposed merely because the Commission is proposing to newly require a market to be compliant with Reg ATS and, therefore, the Fair Access Rule, 301(b)(5) -- it is simply part of that regulatory framework. There has been no analysis, no evidence or even a credible allegation of any facts that would support the application of such a rule to bond markets.

The Commission has granted exemptions for entities where no conduct that would implicate the standards of the Fair Access Rule were in evidence.¹⁸ Liquidnet, for example, successfully argued that it did not discriminate. In fact, the Commission found that Liquidnet’s business model was not premised “on the ability to deny access to certain subscribers or potential subscribers in a manner that could be construed as unfair or discriminatory under Regulation ATS. Liquidnet caters to institutional investors, typically mutual funds and pension funds, that seek to trade large volumes with other similarly-minded institutions while minimizing the market impact of such trades. Liquidnet subscribers expect that potential counterparties will negotiate in

¹⁶ 17 CFR 242.301(b)(5).

¹⁷ *Id.*

¹⁸ See Order Granting Exemption to Liquidnet, Inc. from Certain Provisions of Regulation ATS under the Securities Exchange Act of 1934, Exchange Act Rel. No. 34-52514 (September 27, 2005).

good faith and will not use information about trading interest learned on the Liquidnet system to trade ahead of that interest outside the system.”¹⁹

Bonds that are available for sale are generally held by broker-dealers in their inventory or by large institutional investors such as pension funds and mutual funds and can only be reached through a transaction with a regulated entity that is already subject to myriad rules focused on customer protection and fair dealing. There are regulations governing suitability, best execution, trade reporting, know your customer, markup/markdown regulation and disclosure, anti-money laundering, and fair pricing, to name a few. This point is important because traditionally—and still predominantly—fixed income trades are between a broker-dealer and a customer. Broker-dealers commit capital to provide liquidity to investors.

Broker-dealers and institutions transact in the fixed income market in the same manner that sufficed to permit Liquidnet to qualify for an exemption from the Fair Access Rule. BDA respectfully submits that absent some kind of evidence that fixed income ATS discriminate among subscribers or operate in anything but good faith that they too should be exempt from the Fair Access Rule.

B. BDA OPPOSES THE APPLICATION OF REG SCI TO FIXED INCOME ATS

Reg SCI was adopted in 2014.²⁰ It was designed to protect equities trading venues that trade NMS securities where technological linkage among the venues exposed them to a risk of one venue with system issues impacting the trading on others. Reg SCI requires these platforms to take corrective action when systems issues occur, provide the SEC with notification and reports on systems problems and changes, inform members and participants about systems issues, conduct business continuity and disaster recovery testing, conduct annual reviews of their automated systems, and make and keep certain books and records. It is the weakest link theory. However, fixed income market ATSs *do not have* linked systems. One fixed income ATS with a technological problem *would not impact* the trading at any others. Moreover, Reg ATS *already* requires ATSs with certain volume thresholds to maintain appropriate capacity, integrity, and security of their automated systems.

Reg SCI was not made applicable to the fixed income markets when it was adopted because there was far less reliance on electronic trading and automation at the time. However, the BDA does not believe that Reg SCI is appropriate for fixed income ATSs even now that there is more electronic trading. As the BDA has maintained throughout this comment, it strongly believes that the application of any regulatory framework be tailored to the characteristics of the security and the manner in which it trades. In addition, there should be a demonstrable and articulated benefit to expanding its application in any manner. Here, Reg SCI would *not* improve the resiliency of fixed income ATSs or protect market participants who trade on them. Rather, it would only raise their operating costs. Such additional costs will affect all market participants, but will disproportionately hit middle-market and smaller firms, and by definition, be a barrier to competition. They would be burdened with additional regulations

¹⁹ *Id.* at 3.

²⁰ Regulation Systems Compliance and Integrity, Exchange Act Rel. No. 34-73639, 79 FR 72251 (Dec. 5, 2014).

without any tangible advantage to investors or articulable regulatory benefit. The BDA submits that imposing Reg SCI onto the bond markets is a solution looking for a problem that the fixed income ATSS simply do not have.

Additionally, the Commission's own economic analysis has concluded that the cost of complying with Reg SCI, a requirement that would be triggered by having a trading volume of 5% or more on the platform, is higher than the revenues that many platforms generated by trading that volume. If the Commission insists on its application, the volume trigger should be much higher.

IV. CONCLUSION

The inconsistent regulation currently applied to electronic trading platforms is confusing and leaves open the door to regulatory arbitrage as new electronic trading entrants logically choose a format and structure that minimizes their regulatory burdens. As the FIMSAC said in their 2018 Rule ATS recommendation, "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."²¹ The BDA supports efforts to homogenize the regulatory treatment of like platforms, functions, and services, and encourages an approach that is specifically tailored to the products and markets that it will impact, and does not result in needless challenges for smaller and mid-sized regulated entities to compete in the fixed income markets.

We look forward to working with the SEC, FINRA and the MSRB as the conversation around trading platform regulation advances.

Sincerely,

A handwritten signature in blue ink, appearing to read "Michael Nicholas".

Michael Nicholas
Chief Executive Officer
Bond Dealers of America

²¹ FIMSAC, *supra* note 4.