sifma
Invested in America

December 28, 2021

Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File Number SR-FINRA-2021-030

To Whom It May Concern,

SIFMA[1] is pleased to respond to the SEC's publication of FINRA's proposal ("the Proposal") to implement requirements in TRACE for modifiers and other information related to portfolio trades and delayed treasury spot trades. SIFMA previously commented[2] on FINRA's RN 20-24[3] on this topic. In general, our views today are similar to the views expressed in our previous comment letter, with the modifications noted below. In summary form, while we support the broad goals of transparency, we have some concerns regarding the nature of the disclosure that is proposed to be required and the balance of the costs versus the benefits of certain aspects of the Proposal. We also are concerned that the number of modifiers on TRACE reports is becoming excessive.

We note that while the Commission has provided a standard length of time for comment on this proposal (21 days), this comment period ran entirely in December and across two important religious observations. Additionally, year-end is a time when many market participants are out of the office or otherwise focused on important year-end activities. We have provided the most complete response possible to this proposal given the circumstances, but we respectfully believe the Commission should have extended the comment period at least a week or two into January so as to allow for a comprehensive consideration of the proposal.

1. **Portfolio Trades**

As we discussed in our previous comment letter, we believe that market participants today are generally able to identify portfolio trades based on information that is disseminated by TRACE. Accordingly, the incremental benefit to transparency of this flag is somewhat limited.

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[1] SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $18.5 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

[2] SIFMA's comments on RN 20-24 are available here ("our 2020 comment letter"): https://www.sifma.org/wp-content/uploads/2020/09/SIFMA_PortfolioSpot_Final.pdf

[3] FINRA RN 20-24 is available here: https://www.finra.org/sites/default/files/2020-07/Regulatory-Notice-20-24.pdf

Issuers vs. CUSIPS - FINRA has revised the Previous Proposal to define portfolio trades based on the number of CUSIPs versus the previous definition that was based on the number of issuers. We support this change. As we commented on the Previous Proposal, defining a portfolio trade based on issuers, while possibly more accurate if the goal is to capture diversified portfolio trades, creates far greater complication for broker-dealers and would almost certainly require a manual process to deal with numerous interpretive issues (e.g., how to treat parents, corporate siblings, SPVs, guarantees, mapping of corporate names, etc.). Accordingly, we support the change to define trades by the number of CUSIPs. This change will allow for automation and ease the burden of implementation.

Number of Securities in a Portfolio Trade – FINRA proposes to change the number of securities that comprise a portfolio trade from 30 to 10. We do not have a consensus view on the number, however, we would point out that as the number of securities in the basket gets lower, our members believe it is less likely that any individual security traded would be off market. We repeat our previous comment that while the portfolio trade modifier will indicate that a trade could be off market, the special price indicator, which is also required, will definitively indicate when a trade is off market. SIFMA members also point out that there may be cases where, e.g., groups of securities may trade simultaneously on an OWIC/BWIC, but not be a portfolio trade because the securities are not traded for a single agreed price. These situations should be taken into account when firms are examined for compliance with this rule.

Meaning of "Single Aggregate Price" – Our members have requested further clarity with respect to the meaning of a "single aggregate price for the entire basket".

FIMSAC has stated that: *A "portfolio trade" involves a single trade between two parties for a basket of bonds at an agreed price for the entire basket. Portfolio trades may be priced based on a uniform spread to a mid-market pricing service or through other all-or-none aggregated pricing methods that do not necessarily reflect the current market price for each individual bond in the basket.*[4]

Further, the SEC has stated that: *For purposes of the proposed amendment, a "portfolio trade" is a trade between only two parties for a basket of corporate bonds at a single aggregate price for the entire basket" and that "…[t]he parties may obtain mid-market prices for each of the 50 component bonds as a framework for the pricing, and, during the negotiation process, ultimately agree on a uniform spread, resulting in an aggregate dollar price for the entire portfolio. In such cases, members must report to TRACE a trade for each individual bond in the basket with an attributed dollar price for each bond. While, in many cases, the reported price for each corporate bond in a portfolio trade is in line with the security's current market price, in other cases—based on, for example, the liquidity profile of a specific bond or other factors—the attributed price reported for an individual security may deviate from its current market price."*[5]

When negotiating the pricing terms for a group of securities for simultaneous purchase or sale, SIFMA members frequently calculate pricing at the individual CUSIP level (based on, for example, an internally determined mid price or a mid price suggested by the counterparty, plus a spread determined by the member which may differ across CUSIP or groupings of CUSIP). The member would then communicate such individual prices, along with for convenience an aggregate price for the entire group, to the counterparty. We ask the SEC to confirm that the foregoing would not constitute "a single

[4] Available here: https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-additional-trace-flags-recommendation.pdf

[5] Proposal at 69339.

aggregated price" as it relates to the definition of portfolio trade given that the CUSIPs are priced individually. Further examples of what does and does not constitute a "single aggregated price" would be helpful.

2. Delayed Treasury Spot Trades ("DTST")

The Proposal for flagging of delayed Treasury spot trades is broadly similar to the Previous Proposal. SIFMA's current views are also similar to those expressed in our comment letter on the Previous Proposal. Our remembers are concerned about the balance of cost vs. benefit for the DTST proposal, particularly so if the proposed addition of requirements to report the specific spread are implemented. While the modifier could provide some additional information regarding these types of trades, that benefit needs to be balanced against the meaningfulness of that information, which we believe to be relatively low, the risk that client trading strategies may be revealed, and the costs of implementation, which we believe would be high.

Here we will repeat some of our previous commentary:

> *"The potential benefit of this proposal would be to provide a clearer picture, retrospectively, as to liquidity flows throughout the day. SIFMA members understand how this information could be helpful to market participants and observers and note that FINRA (via FIMSAC) provided data to support the existence of delayed spot trades on TRACE at end-of-day. Members understand that US IG trades which occur early in the day which then report end of day may or may not seem "off market" by end of day, depending on the magnitude of the bond's credit spread movement throughout the day.*
>
> *Despite this acknowledgement, some members have indicated that the technical implementation of this proposal is complex. Specifically, a number of our members disagree that "[t]he variable cost of reporting the new modifier and populating the time field should be minimal for firms as costs currently are incurred for existing TRACE reporting." While building a flag to identify a spot trade is not difficult, members have reported that the ability to automate the flow of the time the trade was spotted could be much more complicated. For example, information about time of spotting may be housed in a trading platform (or other internal system) for which the dealer does not have connectivity through to its TRACE reporting system, and that connectivity would either need to be built or a manual workflow would need to be managed (e.g., based off of a report from a platform). Additionally, some firms will have to build this connectivity across multiple lines of business. Manual workflows are of course not favored.*
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> *Some of our smaller, non-primary dealer members have pointed out that there is a fixed-cost burden presented by this proposal that is more meaningful to these dealers. In other words, smaller dealers that do less of this business would face the same implementation requirements discussed in the preceding paragraph, but they have fewer resources, tend to be more dependent on third-party vendors, and ultimately may have less motivation to bear the cost. The end result could be that they do not create the necessary infrastructure and they revert to a manual process, which as we noted, is generally not favored and adds operational risk. It also could be the case that some of these dealers simply choose to no longer engage in these kinds of trades, possibly further concentrating the activity in larger firms and reducing the number of market participants."*[6]

[6] See our 2020 comment letter at 3.

We repeat these comments here because these views have not changed from the Previous Proposal to today's proposal. Each step in the proposal creates burden and cost – the DTST indicator is least burdensome on a relative basis, the addition of a time stamp is more burdensome, and if the spread requirement were implemented, it would create a materially higher burden. As we discuss further below, clients may trade with dealers in a variety of ways through a variety of venues, which complicates this implementation. These combined burdens need to be balanced against the benefits of the proposal.

Taking into account our comments above and later in this letter, we agree with FINRA that dealers should only have to submit one report for each trade and that the report is required after the trade is executed. Requiring multiple reports, e.g., one at the time of spot agreement and another upon execution would be burdensome, confusing to market participants, and potentially misleading given that trades may be cancelled prior to execution.

We do have a more technical definitional question on what makes a trade a delayed spot trade. The proposed definition of a delayed spot trade reads, in part, *"…a transaction in a corporate bond, the price of which is based on a spread to the yield of a U.S. Treasury Security and where the spread was agreed upon that day prior to the Time of Execution of the transaction…"* It is not clear what the timeframe or delay is that makes a trade a delayed spot trade. If there is a 5-minute gap between agreement on the spot and the execution, is that a delayed spot trade? Operational issues could cause such a delay. Or is it intended to be a longer period of time, such as an hour or more?

We believe the intent of the FIMSAC was to identify trades where the <u>request of the counterparty</u> was to spot a trade, generally at the end of the day. They stated that "*These delayed spot trades are generally preferred by index funds for the purpose of better aligning their spot price with the daily mark-to-market of the underlying index*" and that "*The recommended flag for delayed spot trades would apply only if the single reported transaction was then delayed for the purpose of a Treasury spot*."[7] Accordingly, the final rule should clarify that a trade becomes a delayed spot trade when the counterparty requests that the spread be spotted at a later time, and does not become a delayed sport trade because of, e.g., operational concerns not related to client requests.

<u>Commission requests for comment on DTST spread and CUSIP information</u>

In Section IV of the Proposal the Commission discusses and requests comment on the submission of specific spread and CUSIP information. Generally, SIFMA does not believe that dealers should be required to submit either data point, as they may be discerned by market participants through other means and the costs outweigh the benefits of this requirement.

We believe that market participants should be able to discern spread information from available information if they are provided with the timestamp for when the spot was agreed. The Treasury market is very liquid and market participants have broad access to pricing information on trading platforms, data providers, and market counterparties. On the other hand, similar to what we discuss above for timestamps, inclusion of spread information in the data submission requirements would greatly increase the burden of this proposal with a much smaller benefit.

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[7] See "Recommendation Regarding Additional TRACE Reporting Indicators for Corporate Bond Trades" (February 10, 2020), available here: https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-additional-trace-flags-recommendation.pdf, at 2

Different broker dealers may have different ways of tracking spread information for DTST. Additionally, there is a difference between data being captured by a given medium or system, and that data being easily extractable into a TRACE reporting system. Further, it may be the case that spread information is captured in an RFQ platform or other vendor system, but that does not mean it is something dealers (or those platforms and ATSs) could easily redirect into a TRACE feed. Additionally, clients may provide trade information to dealers in a variety of ways, as we discuss further in the implementation section of this letter. This information is not subject to any regulatory disclosure requirement at this time, and accordingly, it is not something that dealers have put into systems that are accessible to or connected with automated data feed systems such as their TRACE reporting systems. A requirement for the submission of specific spread information would, for many if not most dealers, require a significant build of systems, from the front end used by traders all of the way through to the system that submits information to TRACE. Validation, compliance, and other policies and processes would need to be developed. Our members believe this would be very time consuming and expensive.

If the information were uniquely valuable and unknowable to the rest of the market, the balance of cost vs. benefit here might be acceptable. However, in this case, we do not see such balance – we believe market participants can derive similar information through other means which are far less costly and burdensome. It does not make sense to require dealers to spend thousands of development hours and millions of dollars to implement a change that provides information that others already can derive. Accordingly, we support FINRA's proposal that does not require specific spread information, and we oppose amendments to the Proposal that would require it.

In response to the commentary of the Commission, FINRA poses some specific requests for comment:

> *RFC #1 - How easy or difficult would it be for market observers to "derive an estimate of the spread" having only the time that the spread was agreed between the counterparties to the delayed Treasury spot trade? How confident are market observers that their estimates are accurate? Would reporting and public dissemination of the actual spread for each specific delayed Treasury spot trade and the benchmark CUSIP used for the spread be preferable?*

As discussed above, we believe that a spread may be discerned with a reasonable level of certainty. The Treasury market is the most liquid financial market in the world. The corporate bond market is subject to real-time transaction reporting and dissemination regulations. Market participants have access to a wealth of transaction information in both markets, from TRACE, from trading platforms, from market color, and from third party data providers. The FIMSAC indicate it believed this to be the case: "*the inclusion of the time at which the spread was agreed will allow market participants to estimate the agreed spread to Treasury*".[8] We believe that the costs of requiring the submission of the spread far exceed the benefits, because the information may already be discerned, and accordingly, we support the manner in which FINRA has presented this aspect of the Proposal.

Regarding Treasury CUSIP information, we believe that market conventions for benchmarking are clear enough that dealers should not be required to submit the benchmark CUSIP. If a market participant is knowledgeable enough to know that a corporate bond is benchmarked against a Treasury, we believe it is reasonable to assume that they know which Treasury it is benchmarked against. Again, the costs outweigh the benefits here given that this information is available through other means. For example, our members have informed us that Bloomberg screens for bonds contain information about

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[8] Id. at 2.

benchmark Treasuries for tradable corporates. Bloomberg is a system that is broadly available to and used by many fixed income market participants. Other vendors and systems may provide similar information (or, could easily do so if they do not do so currently). Accordingly, there is no need for dealers to submit benchmark CUSIP information.

> *RFC #2 - Do FINRA members who engage in delayed Treasury spot trades keep a record of the agreed upon spread and the benchmark CUSIP for a specific trade in any internal systems? Could FINRA members who engage in delayed Treasury spot trades capture the agreed upon spread and the benchmark CUSIP used for the spread on a specific trade in the same location as the time the spread was agreed to that FINRA is proposing to be reported in this proposal? Whatever the case, please describe the burdens that would be associated with reporting the actual spread and the CUSIP number (or other identifier) of the benchmark U.S. Treasury Security.*

> *RFC #3 - The current proposal, if approved by the Commission, would require members to add a new modifier to a delayed Treasury spot trade and to report the time at which the spread for the delayed Treasury spot trade was agreed upon. Affected reporting members would have to make systems changes to report these additional data elements for all delayed Treasury spot trades. What would be the incremental burden of the systems changes necessary to report two additional data elements—the agreed upon spread and the CUSIP or other identifier of the benchmark U.S. Treasury Security—at same time? What would be the costs of adding these two additional data elements in the future, as part of a separate systems upgrade, relative to implementing all four data elements as part of the same upgrade?*

We answer RFC #2 and RFC #3 together. As discussed above, we understand that different broker-dealers have differing practices in this regard. There are a variety of ways in which spread information could be captured at a particular firm. However, the fact that a given piece of information is captured does not imply that it is reasonable, or easy, for that information to be fed into a TRACE feed in an automatable fashion. We note that this information may also be captured at trading platforms and ATSs outside of the broker-dealer. If it is, it is not the case that dealers can simply access it and send it out in their TRACE feed. While it may vary from firm to firm, we believe doing so for the majority of firms would require material changes to systems from the front end all the way to the TRACE reporting service they operate, including across multiple trading desks in larger organizations. We believe this would be a very expensive and time-consuming change to implement.

As mentioned above, given the ability of market participants to otherwise discern this information, we do not believe the costs meet the benefits and we oppose such a requirement. We believe FINRA has accurately targeted the Proposal in this regard.

> *RFC #4 - How confident are market observers that they share the same understanding as the counterparties to a delayed Treasury spot trade of the specific U.S. Treasury Security used as the benchmark? Are there delayed Treasury spot trades where the time to maturity for the corporate bond does not correspond exactly to any U.S. Treasury Security so there is ambiguity as to what U.S. Treasury Security would serve as the benchmark? Is there a clear market convention for benchmarking off-the-run corporate securities for which the maturities fall between two on-the-run Treasury securities (for example, 4-year maturities, 6-year maturities, etc.)?*

As discussed in the answer to question 1 above, we believe that benchmarking market practices are broadly known, accepted, and understood. Additionally, widely used information platforms contain this information. There is no need to require dealers to submit this information.

We understand the conventions for intermediate maturities to be as follows:

- 4-6yr corp final maturity = benchmarked to current ust 5yr
- 7-15yr corp final maturity = benchmarked to current ust 10yr
- 16-23yr corp final maturity = benchmarked to current ust 20yr
- 24yr+ corp final maturity = benchmark to one off the run 30yr (OLB)

> *RFC #5 - Do you believe it would be appropriate for FINRA to disseminate its assumption of the U.S. Treasury Security used as the benchmark for a delayed Treasury spot trade, even if FINRA does not require it to be reported by members? Why or why not?*

As discussed in the answer to RFC #1 above, we believe this information is broadly known and do not believe FINRA needs to do this to solve an information gap in the market. However, if FINRA chose to do this we do not see harm if it were implemented correctly (e.g., assuming FINRA appropriately reflected market practice for benchmarking).

3. Implementation Considerations

FINRA proposes a staged implementation. First, the flags would be required for portfolio trades and DTST within 15 months from Commission approval. At a later date, FINRA would require the time of spot information for DTST. FINRA also notes that in some cases, trades may require flags for both DTST and portfolio trades, and this would be accomplished with an as of now unknown third flag.

For the trade type modifiers alone, we believe 15 months may be inadequate. We believe an 18-24 month period would be more appropriate given competing regulatory implementations. For the DTST modifier in particular, the implementation is complex due to the trade flow preferences of dealers' institutional clients. For example, certain clients trades are done strictly over voice or chat where the spot is agreed upon and the trading desk inputs the trades. In other instances, the counterparty might discuss and agree to a trade with a dealer, and later use an ECN to transmit the trade information to the dealer, and rely on the ECN for parts of the process. Some clients might send over this information immediately, while others may send it at a later time. Other customers may trade with a dealer throughout the day and request to spot all of their trades at a designated time. The preferences of these clients may be driven by their strategies and their IT set-ups. The end result is that in order to capture the time when the spread was agreed upon, it will require the involvement of several IT work flows at a dealer. This is combined with factors discussed above, regarding the integration of the capture of spread time into TRACE reporting systems.

Regarding the unknown third modifier that would be applied to DTST that are also portfolio trades, our members have expressed some concerns. First, members have asked why we would need a third modifier given that the other two modifiers would be available (and it was noted in the Proposal that these modifiers would not replace other modifiers such as special price). This would just seem to increase implementation cost and risk of errors, but provide no actual benefit since it would not provide any new information. Second, there is no information about when or how this modifier would be used, so FINRA should disclose more information about and rationale for this to allow for informed commentary on their proposal. It is not clear why this third indicator is necessary.

We have concerns that a staged implementation would be more costly than a single, more comprehensive implementation. Similar to car repair, sometimes a significant proportion of cost can be incurred merely by opening up a system for repair or change. In this case, going into the same systems twice to make changes is likely to be more expensive than a single and larger change effort. We believe the Commission should consider a single implementation that runs on a longer timeframe. We believe a single implementation encompassing DTST and portfolio flags along with the time of spot information for DTST would be preferable. This would require a longer implementation window that just for the trade type modifiers, along the lines of 36 months.

We also believe that FINRA should consider the overall level of modifiers and indicators on TRACE reports. While we understand how these modifiers may provide useful supervisory information, there are many of them, added on over the years, and they are not all unique (e.g., the special price indicator and these two indicators we have discussed today). FINRA should consider if and how the current regime provides the most effective information to users of the TRACE data.

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SIFMA supports enhancements to transparency that weigh benefits to market participants against the impact on liquidity and costs of compliance. We hope that these comments are informative, and would be pleased to discuss our views in more detail. Please contact me at ckillian@sifma.org if you would like to discuss any of these issues further.

Sincerely,

Chris B Killian

Chris Killian
Managing Director
Securitization and Credit