Bond Dealers of America

1909 K Street NW, Ste 510
Washington, DC 20006
202.204.7900
www.bdamerica.org

January 30, 2023

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street NW
Washington DC 20006

Comments on Regulatory Notice 22-26

Dear Ms. Mitchell,

The Bond Dealers of America ("BDA") is happy to provide comments on Regulatory Notice 22-26, "FINRA Requests Comment on Proposed Changes to TRACE Reporting Relating to Delayed Treasury Spot Trades" (the "Notice"). BDA is the only DC-based group exclusively representing the interests of securities dealers and banks focused on the US fixed income markets.

The Notice proposes to require dealers to make two trade reports to the TRACE system for delayed Treasury spot trades ("DTSTs"), corporate bond trades where a spread to Treasuries is agreed to by both parties to the trade early in the day but where the dollar price is established and actual execution takes place later in the day at an agreed upon time. The Notice would require dealers to report DTSTs once when the spread to Treasuries is established and again when the dollar price is established based on Treasury levels at the time. BDA strongly supports a transparent bond market and reasonable regulatory actions to enhance transparency. However, BDA opposes the proposal in the Notice because it would create a cumbersome and expensive mechanism for trade reporting and because FINRA has not appropriately scoped the full effects of the proposal, relying instead on estimates of the volume of trades that would be affected. Instead, we urge FINRA to revisit the proposal first offered in 2020 to address the issue of DTSTs, requiring a flag on the trade report indicating that it is a DTST and also indicating the time that the spread to Treasuries was established, consistent with the 2020 recommendation of the SEC's Fixed Income Market Structure Advisory Committee ("FIMSAC").

How trades get reported

FINRA Rule 6730 requires all broker-dealers to report certain securities trades to the TRACE system within 15 minutes of the time of execution. "Time of execution" is defined in Rule 6700 as "the time when the Parties to a Transaction agree to all of the terms of the transaction that are sufficient to calculate the dollar price of the trade."

Most of BDA's 60 broker-dealers members use a third-party order management system ("OMS") to manage activity around securities trades. One function provided by virtually all OMS vendors is trade reporting. While FINRA provides two ways for firms to enter trades into TRACE, automated and manual, a large majority of trades are reported on an automated basis using the FIX reporting protocol.[1] Traders

[1] FINRA, Regulatory Notice 22-17, "FINRA Requests Comment on a Proposal to Shorten the Trade Reporting Timeframe for Transactions in Certain TRACE-Eligible Securities From 15 Minutes to One Minute," August 2, 2022.

enter the terms of a trade in an OMS, and when all the terms are fully known, the OMS reports the trade to TRACE. Virtually all DTST trades are conducted through electronic trading platforms. Generally, the trading platforms support DTST trades by sending the trade terms to relevant parties' OMS systems when the dollar price is established, which then send the trades to TRACE.

BDA has talked with several OMS vendors about how the proposal in the Notice would be implemented if adopted. They currently are not able to report trades in the manner prescribed in the Notice. The problem OMS vendors face is that the architecture of their systems are such that the trade reporting function only applies to completed trade records. There is no ability to report "partial trades," like the early day spread-to-Treasuries report that would be mandated by the Notice. Indeed, reporting partial trade parameters is such an operational departure from current trade reporting that it would require an entirely new systems protocol. OMS systems may not even track trades in this manner and generally do not track data fields like spread to Treasuries. In order to implement the proposal in the Notice, OMSs would need to make substantial changes to their systems architecture to make incomplete trades reportable. While we did not get a complete picture of just how expensive and time consuming those changes would be, OMS vendors indicated that this change would be more substantial and expensive than any change to TRACE reporting to date. And while OMS vendors themselves would incur the direct cost of implementing those changes, the costs would ultimately be borne by OMS vendors' customers, the broker-dealers responsible for complying with TRACE reporting rules. Reporting partial trades, as the Notice proposes, also raises challenges because the reporting elements—spread to Treasuries and reference security—are different from the data elements in a trade report under current rules.

The 2020 FIMSAC recommendation with respect to DTSTs—to maintain trade reports when all trade parameters are known—would also require OMSs to adopt systems changes. However, those changes would not involve a substantial change to system architectures. OMS vendors have adopted similar changes to TRACE reporting rules such as adding flags to trade reports with acceptable disruption and expense.

Scope of proposal

As FINRA recognizes in the Notice, there is currently no way to know what volume of corporate bond trades are executed as DTSTs. So as part of its economic analysis of the proposal in the Notice, FINRA assumes that trades reported to take place between 3:00 and 3:15 pm which exceed the average of reported trade volume during other 15-minute periods in the day are DTSTs. As FINRA recognizes, "these data are likely to either overcount the number of delayed Treasury spot trades because some of the trades executed in the time interval are not delayed Treasury spot trades, or undercount because they exclude delayed Treasury spot trades executed at other times during the day." While FINRA believes "this methodology will provide a reasonable baseline for the analysis," we do not believe this estimate is accurate enough to base a significant Rule change as in the Notice. The economic analysis in the Notice is primarily qualitative.

Instead of this unsubstantiated estimate of DTST trade volume, we urge FINRA to adopt the 2020 FIMSAC recommendation and begin to collect data on trades flagged and reported as DTST trades. This would give FINRA an accurate picture of the size of the DTST market and the transparency benefits that would accrue to the market if the proposal in the Notice is adopted. Knowing the volume of DTSTs would provide for a more accurate and constructive analysis of the proposal in the future and would help ensure that the industry does not make a substantial investment in systems changes without commensurate market benefits.

The proposal also raises significant compliance risks for firms. Rather than ensuring that one TRACE trade report is accurate and on time, firms would need to ensure that two trade reports are in compliance, one at the time the Treasury spread is established and one when the dollar price is established. This would be especially true if FINRA adopts their proposal to shorten the TRACE reporting time from 15 minutes to one minute. Indeed, the one-minute reporting proposal would create such a compliance challenge that expecting firms to implement both amendments at once is unreasonable. We urge FINRA to be mindful of stacking trade reporting rule changes on top of each other. If FINRA adopts both one-minute trade reporting and dual reporting for DTST trades as proposed in the Notice, we ask that the proposals be adopted separately with a long period of time between the effective dates of both amendments in order to ensure firms are fully prepared to comply with both.

We are concerned that the additional costs and risks of complying with Rule 6730 could cause some firms, especially smaller broker-dealers, from participating in the DTST market altogether. In addition, we point out that the additional information that would be made available to the market under the Notice—earlier reporting of spread information—would not benefit all market participants equally. Better resourced and more sophisticated dealers and investors better able to process the additional data would clearly benefit more than less sophisticated market participants such as retail investors.

The 2020 FIMSAC recommendation—to continue reporting DTSTs when all trade parameters, including dollar price, are established—would provide nearly all the benefit to market participants as the proposal in the Notice. Adapting to the FIMSAC-recommended change would be substantially less expensive and disruptive than adapting to the proposal in the Notice, and adopting the FIMSAC-recommended change would provide FINRA with useful data on the size of the DTST market. These data would help inform future FINRA consideration of the treatment of DTSTs.

We urge FINRA to abandon the proposal conveyed in the Notice and to repropose the 2020 FIMSAC recommendation with respect to DTSTs. We would welcome the opportunity to work with FINRA on this change. Please call or write if you have any questions.

Best regards,

Michael Decker
Senior Vice President