June 26, 2019

Mr. Marcia E. Asquith

Office of the Corporate Secretary

FINRA

17135 K Street, NW

Washington, D.C. 20006-1506

Re: FINRA Regulatory Notice 19-12, FINRA Request for Comment on a Proposed Pilot Program to Study Recommended Changes to Corporate Bond Block Trade Dissemination

Dear Ms. Asquith:

We appreciate the opportunity to provide feedback and comment regarding FINRA's proposed pilot program on corporate bond block trade dissemination. The proposed pilot would examine a 48-hour dissemination delay for trading Investment Grade corporate bonds above $ 5 million and for trading High Yield corporate bonds above $ 1 million. It also would examine an increase in the current dissemination cap from $ 5 million to $ 10 million for Investment Grade corporate bonds and from $ 1 million to $ 5 million for High Yield corporate bonds. The proposal would separately and independently in the pilot design implement the 48-hour dissemination delay and the potential increase in the dissemination cap in a two-by-two design with three treatment groups (implementing the dissemination delay and change to the dissemination cap individually and jointly) and a control group (using the current dissemination cap and no dissemination delay), applying stratified sampling and random assignment. The four groups would be with and without the dissemination delay and with and without the increase in the dissemination cap.

By way of background, the three authors of this comment letter are currently studying the impact of dissemination caps in the corporate bond market and previously analyzed the impact of dealer trading networks for structured products on trading costs and price discovery.[1] Burton Hollifield also has extensively studied the market design of the municipal bond market and the impact of price opacity.[2] Chester Spatt served as Chief Economist of the Commission (2004-2007) during the adoption and implementation of Regulation NMS and served as a member of the Commission's Equity Market Structure Advisory Committee (EMSAC) from 2015 through

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[1] A. Neklyudov, B. Hollifield and C. Spatt, 2017, "Bid-Ask Spreads, Trading Networks, and the Pricing of Securitizations," *Review of Financial Studies* 30, 3048-3085.

[2] R. Green, B. Hollifield and N. Schurhoff, 2006, "Financial Intermediation and the Costs of Trading in an Opaque Market," *Review of Financial Studies* 20, 275-314 and R. Green, B. Hollifield and N. Schurhoff, 2007, "Dealer Intermediation and Price Behavior in the Aftermarket for New Bonds," *Journal of Financial Economics* 86, 643-682.

2017.[3] Both Hollifield and Spatt also have examined in separate studies a range of regulatory and market design issues involving the equity markets.

We feel that the proposed pilot has been thoughtfully designed to the extent that one wants to study changes in the dissemination cap (which addresses transparency in the size of trading) and the introduction of a substantial dissemination delay (limiting price transparency for larger transactions). The design facilitates the study of the two policy changes independently (separately) as well as in combination.

It is clear from prior studies that price transparency has reduced the transaction costs of trading. In the presence of dissemination caps price reporting still arises, but the reporting of the size of large trades is truncated at the dissemination cap (currently $5 million for investment grade instruments and $ 1 million for high yield ones). A variety of studies have made clear that price reporting (price transparency) has played an important role in the reduction of the trading costs in fixed-income markets[4] and especially, the costs experienced by small investors (larger trades could be an exception to this conclusion).[5] As a result, we are skeptical about creating a substantial dissemination delay for the prices of large transactions.[6] Such a delay would significantly disadvantage small investors and potentially retard much of the improvement in the quality of the fixed-income market since the introduction of price transparency. While a substantial dissemination delay has reflected the goals of dealers and large buy-size market participants, this has not been accompanied by strong empirical evidence from the markets. Indeed, when one of us served as Chief Economist of the Securities and Exchange Commission, he informally requested to dealers criticizing the move to price transparency that they provide studies or evidence to support their critique, but none was forthcoming. In principal, one could argue that the development of an upstairs block market would enhance fixed-income trading, but

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[3] Spatt was one of the founders in the mid-1980s of the *Review of Financial Studies* (which quickly emerged as among the three leading journals in finance) and its second executive editor and served as President of both the Society for Financial Society and the Western Finance Association. Besides the EMSAC, he also has served as a member of both the Model Validation Council of the Federal Reserve System and the Advisory Committee of the Office of Financial Research as well as various non-governmental groups, such as the Systemic Risk Council, the Shadow Financial Regulatory Committee and the Financial Economists Roundtable.

[4] See, for example, H. Bessembinder and W. Maxwell, 2008, "Transparency and the Corporate Bond Market," *Journal of Economic Perspectives* 22, 217-234; P. Asquith, T. Covert and P. Pathak, 2013, "The Effects of Mandatory Transparency in Financial Market Design: Evidence from the Corporate Bond Market, NBER Working Paper No. 19417; and F. Trebbi and K. Xiao, 2019, *Management Science* 65, 1949-1968.

[5] See P. Schultz, 2012, "The Market for New Issues of Municipal Bonds: The Roles of Transparency and Limited Access to Retail Investors," *Journal of Financial Economics* 106, 492-512.

[6] Our skeptical perspective about including a dissemination delay focus in the pilot is reinforced because pilot studies are costly to market participants and so should be undertaken only if meaningful improvements in public policy are likely to emerge. A portion of the cost is associated with the complexity of the pilot design, which itself can reduce the quality of the information inferred from the pilot studies.

indeed in the equity arena the emphasis on competition across platforms has resulted in tighter spreads—despite the demise of the upstairs block market for equity.[7]

As part of our research program, we have been using corporate bond data recently to study the impact of the current dissemination caps in our market environment of price transparency. In the spirit of regression discontinuity methods, our empirical analysis focuses upon actual trade size slightly above and below the reporting cap. The current level of the dissemination caps does not appear to have much impact on price discovery and the predictability of returns or on customer mark-ups and realized spreads. Our preliminary evidence suggests that volume transparency isn't very important in the presence of price transparency. In effect, the market infers what it needs to know about volume.

FINRA's regulatory proposal suggests that an increase in the dissemination cap could offset the reduction in transparency from the substantial delay in dissemination. We disagree with this perspective based upon our preliminary finding around the cap. We don't find much evidence that the cap was particularly important in the presence of a robust price reporting regime. In effect, we view volume information as second order compared to the basic price reporting (the actual volume above the cap does not add much information in the presence of price information). While increasing the dissemination cap causes volume to be revealed for a broader range of values--that would not seem so important, especially relative to the costs associated with delays in price dissemination to the marketplace.

For the purpose of the pilot study it could make sense to consider the possibility of a lower dissemination cap;[8] then volume information would be more limited—but without the adverse consequences to the marketplace of not disseminating prices. This could be a natural alternative for protecting dealers compared to a dissemination delay. While the recent focus in our empirical work on caps suggests that there is not a lot of action around the cap, that is arguably a finding around the current level of the dissemination cap, but opacity of the volume may be helpful when the range of potential volumes is broader.

In summary, we feel that FINRA's proposed randomized pilot is well designed, but we question the need for undertaking a pilot to address dissemination delays in light of the widely documented value of price transparency for the bond markets. Preliminary empirical findings based upon the current dissemination caps suggest that these do not have much impact on price discovery or customer costs near the current caps. Nevertheless, we would be supportive of a randomized pilot examining somewhat tighter caps.

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[7] See, Section 2.20 in J. Angel, L. Harris and C. Spatt, 2015, "Equity Trading in the 21st Century: An Update," *Quarterly Journal of Finance* 5, 1-39.

[8] This is also advocated in comment letters on this proposal by Larry Harris and Haoxiang Zhu.

Sincerely,

Chester Spatt

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Golub Distinguished Visiting Professor of Finance, Sloan School of Management, MIT;

and former Chief Economist, U.S. Securities and Exchange Commission (2004—2007);

Burton Hollifield

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and

Artem Neklyudov

Assistant Professor of Finance, University of Lausanne and Swiss Finance Institute

Cc: Mr. Robert Cook, President and CEO, FINRA

Mr. Robert Colby, Chief Legal Officer, FINRA

Mr. Jonathan Sokobin, Chief Economist, FINRA

Hon. Jay Clayton, Chairman, SEC

Hon. Hester M. Peirce, Commissioner, SEC

Hon. Robert J. Jackson, Jr., Commissioner, SEC

Hon. Elad L. Roisman, Commissioner, SEC

Brett Redfearn, Director of the Division of Trading and Markets, SEC

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