TMC Bonds | TMCBONDS.COM FIXED INCOME MARKETPLACE

December 11, 2015

Electronic Mail

Attn. Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Request for Comment on Pricing Disclosure in the Fixed Income Markets 15-36

Dear Ms. Asquith:

TMC Bonds, L.L.C. ("TMC") welcomes the opportunity to respond to FINRA's Request for Comment #15-36. For efficiency, we have filed this response with the MSRB as well, as TMC seeks similar guidance in both markets.

TMC is an electronic exchange for trading fixed income securities and a registered Alternative Trading System ("ATS") with the Securities and Exchange Commission. Started in May 2000, TMC has become a leader in facilitating electronic trading for both taxable and tax-exempts bonds over its open and anonymous platform. As counter-party to each side of a trade, TMC reports approximately 4,500 municipal trades daily to the MSRB as riskless principal. TMC also has a significant and growing presence in the taxable market. In October, TMC accounted for approximately 16% of the corporate transaction volume for transactions with trade size under 250 bonds. As with municipals, TMC is the counter-party to the trade and reports its riskless principal trades to TRACE.

While the MSRB has filed a similar request for comment in Regulatory Notice 2015-16, we would like to emphasize support for FINRA and the MSRB to have a fully harmonized ruling. The cost of compliance for one proposal is already significant, and the possibility of adding multiple scenarios for different products greatly increases the programming complexity and cost. While there are differences in form for each market, we believe that the base methodology from either proposal does not present any issues that would negate uniform reporting.

Technology challenges aside, we are greatly concerned that the current Draft Rule has inconsistent goals and deviates from the Securities and Exchange Commission's 2012 Report recommendation to "consider requiring municipal bond dealers to disclose to customers, on confirmations for riskless principal transactions, the amount of any markup or markdown" by virtue of using an arbitrary time parameter as a means to identify riskless trades. While we believe the MSRB's shorter time frame is more meaningful than FINRA's "same-day" requirement to capture an estimated mark-up, its weakness is that it does not truly capture the spirit of disclosing "riskless-principal" mark-ups but instead discloses all matched trades executed within the set time. A time-based methodology, unless measured in much smaller increments, is including the baby with the bath water, as the true at-risk trades will be included with the riskless trades. This conflation of mixing the accurate with the misleading becomes more problematic as the time parameter is widened, as suggested in the FINRA proposal. Any trade committed without an order in-hand is an "at-risk" trade.

The time parameter obfuscates the potential risk that a trader takes and prices into a trading decision and blurs its meaning when a positioned bond is moved quickly out of inventory.

The time dilemma highlights the difficulty of trying to capture an idea that is difficult to define. If one is truly interested in disclosing any principal trade mark-up, then the only meaningful calculation is from the prevailing market price. As in most instances for illiquid bonds (using TMC's municipal experience as a barometer), 85% of the transacted bonds have no market depth, meaning it would be the owner of the security estimating the prevailing market price. Likewise, for disclosing any riskless principal trade mark-up, then the dealers contemporaneous cost would be appropriate.

Therefore, we believe that the only appropriate mark-up available for disclosure would be for true riskless principal trades, in which a matched trade is executed contemporaneously. We would support the regulators explicitly defining a riskless-trade and modeling language similar to FINRA's NTM-99-65 for equities, which defines a riskless-principal transaction as "a transaction in which a member, after having received an order to buy (sell) a security, purchases (sells) the security as principal and satisfies the original order by selling (buying) as principal at the same price (the offsetting "riskless" leg). Generally, a riskless principal transaction involves two orders, the execution of one being dependent upon the receipt or execution of the other; hence, there is no "risk" in the interdependent transactions when completed." We would also seek further transparency on current market data where a shorter time window can be used than the "same-day" recommendation. How does this change for a 2 second window? In a study conducted by Larry Harris, Chair in Finance USC Marshall School of Business, entitled "Transaction Costs, Trade Throughs, and Riskless Principal Trading in Corporate Bond Markets", corporate bond trades that occurred with a matched side within 2 seconds represented 41.7%

of all trades. As corporates can be sold short, this number suggest that for municipals a matched trade number should be higher, and therefore the suggested MSRB 2 hour time window may be an effort to prevent firms from engaging in manipulative behavior as opposed to truly identifying matched trades. Thus, we would support defining a riskless transaction for purposes of mark-up disclosure and adding language similar to the MSRB's Rule G-14 that prohibits positioning bonds in a fictitious manner or in furtherance of any fraudulent, deceptive or manipulative purpose.

We further support this methodology as, under the current proposal, the integration of systems to calculate the reference price will be expensive and, for some firms, nearly impossible to effect with current infrastructure. For example, TMC has clients who use a principal trading account to facilitate buying and selling bonds. There is no cost system for tracking P&L on the individual trades with this type of account; only the remaining cash balance in the account defines the theoretical P&L for the day. While the MSRB stated that most firms already know their cost due to regulatory requirements, many firms use a defined matrix that determines the mark-up to insure that the advisor works for a reasonable profit and thus track the mark-up, not the cost. This proposal would require these types of firm to build out a new system to track costs on an individual trade basis. Furthermore, in an environment that is encouraging firms to report, settle, and transact at faster times, the extra point of friction to calculate a reference price hours after a trade has occurred, will require a batch process whereby most firms will be sending an end-of-day reference price file to their clearing partners for producing customer confirmations. The concept of true straight-through-processing, a long standing industry goal, dies here. Additionally, the clearing firms themselves may have their own challenges, as they will now have to accept an end-of-day file that will need to be batch processed prior to the creation of the confirmation.

TMC's clearing firm has already expressed its inability to perform this task, based on its current system architecture.

If the regulators are seeking to disclose mark-ups based on a defined set of variables, then the data already resides with both the MSRB and FINRA. Why would it be appropriate to delegate the calculation to each firm when one central party already has all the data and can readily calculate the value? By having the regulators add the tag to its existing pricing feed, thousands of firms would be spared the burden of attempting to integrate systems and independently calculate a reference price. As the price could be disseminated in near real-time, assuming an appropriate time parameter, this would eliminate the complexity of adding batch processing to the clearing process. Furthermore, as the regulator mines the data, the algorithm could be adjusted to changing markets without tasking thousands of firm to coordinate systems. Similarly, if the trades were truly riskless, the cost basis of each trade would be known at the time of execution and could be easily added to a trade report or clearing ticket and thus promote the benefits of straight-through-processing.

While the goal of disclosing riskless principal mark-ups is laudable, the current proposal's attempt to define this type of transaction is too general. By inadvertently including risk trades, using a broad time frame definition, a customer will never have an apples to apples comparison when reviewing a trade confirm. We believe greater examination of definitions, surrounding transaction types such as bids wanted and true matched trades when buying for customers, will provide a more reasonable basis for defining a riskless trade. Furthermore, the economics of having a decentralized process whereby each dealer is responsible for determining either a reference trade price or mark-up value, would be costly, complex, and cause friction for the efficient settlement of trades.

We greatly appreciate the opportunity to respond and are available for any further conversations.

Sincerely,

Thomas S. Vales
Chief Executive Officer