

June 11, 2019

Emailed to pubcom@finra.org

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

Re: Comments on Proposed Pilot Program to Study Recommended Changes to Corporate Bond Block Trade Dissemination

Dear Ms. Asquith:

BlackRock, Inc. (together with its affiliates, “BlackRock”)¹ is pleased to have the opportunity to respond to the Proposed Pilot Program to Study Recommended Changes to Corporate Bond Block Trade Dissemination.² As a fiduciary for our clients, BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets, while preserving consumer choice and assessing benefits versus implementation costs. A stable and well-functioning corporate bond market is critical to the economy, providing capital for issuers and investment opportunities for a broad array of savers and investors. We believe that all market participants benefit when capital markets are deep and liquid and support the participation of a diverse range of market participants.

BlackRock has long supported the post-trade public transparency afforded by TRACE and believes that when properly calibrated, post-trade transparency is the primary and most effective means of facilitating price discovery. The creation of TRACE has largely benefitted end-investors and the fixed income market since its creation more than a decade ago. Since that time, however, corporate bond markets have undergone profound structural changes driven in large part by record new issuance and financial regulatory reforms. BlackRock has written extensively on the evolution in bond market liquidity and transparency. A list of our publications on this topic has been included in Appendix A.

As the corporate bond market has evolved, so too have the trading practices of market participants. Market participants, including BlackRock, have largely adapted to changes in market structure by modifying their trading behaviors and building out technology solutions to connect to electronic trading platforms and aggregating more fragmented liquidity. Despite this significant and ongoing evolution, the reporting regime for corporate bonds on TRACE has not been revisited in recent years. To this end, we

¹ BlackRock is one of the world’s leading asset management firms, managing assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

² FINRA Regulatory Notice 19-12: Trade Reporting and Compliance Engine (TRACE) (Apr. 12, 2019). Available at https://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-19-12.pdf.

believe it is timely and appropriate for FINRA to evaluate whether TRACE reporting is fit for purpose in light of the current state of US corporate bond markets.

We appreciate the opportunity to comment on the proposed pilot program. At a very high level, our views and recommendations can be summarized as follows:

- (i) When properly calibrated, post-trade reporting is the primary and most effective means of facilitating price discovery in corporate bond markets.*
- (ii) The calibration of post-trade reporting is important, as improper calibration runs the risk of reducing both liquidity and trading activity.*
- (iii) Corporate bond markets have undergone a profound evolution in the past several years, but the TRACE reporting methodology for corporate bonds has not been updated.*
- (iv) It is timely and appropriate for FINRA to evaluate whether TRACE reporting for corporate bonds is properly calibrated and /or whether it could be improved.*
- (v) Significant changes to the proposed pilot program must be made before FINRA finalizes this proposal, namely:
 - (i) Test Group 1 (48 hour delay with no cap increases) should be eliminated.*
 - (ii) Test Group 1 should be replaced with a test group that entails lower caps and no delay.*
 - (iii) The scope of the pilot should be reduced so that fewer bonds are included in a test group.*
 - (iv) Bonds should not be rotated after 6 months.*
 - (v) FINRA should more clearly specify how information about which bonds are included in which test group will be disseminated to the market.**
- (vi) In conjunction with the proposed pilot program, we recommend FINRA reduce the lag time before uncapped transaction data is released from 6 months to 1 month.*

The remainder of this letter provides further detail on our recommendations to improve the structure of the proposed pilot program.

I. Background and Guiding Principles

BlackRock first encouraged revisiting TRACE reporting for block trades in 2015.³ At that time, we suggested two potential solutions to improve market depth, either: (i) delaying post-trade reporting for block trades; or (ii) reducing the threshold (or ‘cap’ sizes) for block trades. We continue to be supportive of testing the effect of both changes to cap sizes as well as delays for a small segment of transactions whose liquidity might be negatively impacted by dissemination of the transaction within 15 minutes. Conducting a pilot program to test the effect of changes to the current calibration of TRACE reporting on the market is a prudent approach.

Delays. Properly calibrating post-trade transparency for corporate bonds requires finding a delicate balance between providing immediate transparency to the marketplace while permitting market makers to effectively manage their risk and hence, provide liquidity to the market. While the corporate bond market is evolving towards a more hybrid principal-agency structure, a large portion of the market continues to be intermediated by market makers acting as ‘principal’. When a market maker is trading as principal, once the market maker has purchased bonds, she usually endeavors to re-sell at least part of the purchase to manage her inventory and hence, risk. If that market maker’s competitors have observed the initial trade on TRACE, they may be tempted to react opportunistically; knowing the liquidity supplier needs liquidity and is willing to pay for it, the market maker’s competitors will adjust their prices. Thus, after large trades, liquidity suppliers trying to unwind inventory can be in a weak bargaining position. This will increase the liquidity premium or widen the bid-ask spread market makers will require from investors to offer liquidity in the first place. This would ultimately increase costs to end-investors, while reducing market depth. Alternatively, market makers may simply choose not to provide liquidity for certain trades, particularly for larger transactions or less liquid securities, if they believe that post-trade reporting may undermine their ability to manage the risk associated with intermediating the transactions. In other words, improperly calibrated post-trade transparency may have the adverse effect of reducing market liquidity and trading activity.

The portion of the market traded as ‘principal’ as well as the larger number of CUSIPs belies the differences in appropriate post-trade reporting regimes for fixed income relative to equities. For corporate bond markets, the benefits of near real-time transparency must be carefully balanced with the need to preserve market liquidity. To this end, short delays for a small portion of transactions provide market makers with some time to manage their risk when providing liquidity before the market is alerted to the fact that a trade has taken place. As a result, we believe it is likely that short delays for block trades will encourage market makers to provide more liquidity than they do today for such trades. That said, the potential benefits to liquidity of reporting delays must be balanced with the importance of ensuring that price formation continues to take place effectively. As such, delays should be considered only for short periods of time and applied only to a small portion of transactions.

³ See BlackRock, *ViewPoint: Addressing Market Liquidity* (July 2015). Available at <https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-addressing-market-liquidity-july-2015.pdf>.

We were pleased that the Fixed Income Market Structure Advisory Council (“FIMSAC”) considered this important issue in its April 9, 2018 meeting and ultimately voted to propose a one year pilot program that would raise the dissemination caps from \$5 million to \$10 million for investment grade bonds and from \$1 million to \$5 million for high yield bonds combined with a 48 hour delay in the dissemination of trades above the new thresholds. In our view, it would be worth testing this proposal as it will result in greater immediate transparency than exists today as to the full size of a larger number of trades, while reducing some of the risk faced by broker-dealers from the immediate dissemination of block trades. Together, these two changes might strike a better balance between immediate transparency and liquidity in today’s marketplace thereby improving market depth and ultimately reducing transaction costs borne by end-investors.

We recognize that some commentators view delays for any portion of the market as problematic due to the reduction in immediate price transparency. In our view, if cap sizes are set appropriately to permit delays to apply to only a very small portion of large trades, the result may very well be more price discovery and transparency, not less. This is because, as discussed previously, when a market maker has purchased bonds, the market maker usually endeavors to re-sell at least part of the purchase. The purpose of the delay is to provide the market makers some time to conduct these risk reducing transactions when they have provided liquidity for a large block trade. This activity entails smaller transactions in that bond during the period when the initial transaction was subject to a delay. The smaller transactions would be disseminated on TRACE within 15 minutes of the trade occurring, with the price and full size of the transaction, providing pricing information to the market.

We conducted an analysis of uncapped TRACE data for the period January 1, 2015 – September 30, 2018 to answer the question: on days when a block trade occurred (defined as \$5 million for high yield and \$10 million for investment grade), what percentage of the time did a smaller trade occur for the same bond on the same day? We found that for the 1.0% of investment grade trades that were greater than \$10 million, 78.6% of the time a smaller trade in the same bond was observed on the same day. The corresponding average price difference in between trades above / below the new cap was 0.2%. For the 2.6% of high yield trades that were larger than \$5 million, 79.8% of the time we observed a smaller trade in that bond on the same day.⁴ The corresponding average price difference in between trades above / below the new cap was 0.5%. This analysis is based on historical data where trades took place under the current TRACE reporting regime and the trader knew that the block trade would be disseminated within 15 minutes of the trade occurring. There is no way to accurately predict how behavior change from the introduction of a 48-hour delay could impact the results of this analysis. That said, it is reasonable to believe that were the 48-hour delay to successfully increase liquidity for block trades, the protection afforded to the market maker during the delay period would likely encourage the market maker to conduct their hedging activity during that period and hence increase the likelihood that smaller transactions would take place during that time.

In the current regime, market makers may simply choose not to provide liquidity for certain block transactions given the near immediate signaling to the market. By delaying transparency for large block transactions, there is the potential to encourage more trading

⁴ Note that this analysis excludes small retail trades, defined as trades that were smaller than \$100,000.

activity that could result in more pricing information disseminated to the market (in other words, liquidity begets liquidity). In our view, testing whether the proposed caps are set appropriately in the form of a pilot program before moving forward with more permanent change is a prudent approach.

Lower Cap Sizes. It is entirely possible that lowering cap sizes may be equally or more effective in balancing the aforementioned tradeoffs and improving market depth. This approach seeks to balance the tradeoffs in a different manner by preserving the immediate dissemination of pricing information, but delaying the dissemination of size information for a larger portion of transactions. This approach could equally facilitate market maker risk management by making it more difficult to discern the exact size of a transaction that has just taken place. This approach will make the dissemination of trades above the cap more frequent and thus less likely to be a market moving indicator. To this end, we were pleased to see the alternative approach suggested in the letter submitted by Larry Harris, Kumar Venkataraman, and Elisse Walter in response to the FIMSAC recommendations (“Harris Letter”), which suggested a version of this type of solution.⁵ We believe that this proposal warrants serious consideration in addition to the FIMSAC proposal, though more analysis may be needed to determine the appropriate cap sizes for such a proposal to be effective.

II. Comments on the Proposed Pilot Program

Although we are supportive of FINRA testing the calibration of TRACE reporting in today’s corporate bond market, **we believe that there are significant limitations of the proposed approach that should be addressed before FINRA moves forward with the pilot.** Specifically, we recommend the following changes:

- (i) *Test Group 1 (48 hour delay with no cap increases) should be eliminated.*
- (ii) *Test group 1 should be replaced with a test group that entails lower caps and no delay.*
- (iii) *The scope of the pilot should be reduced so that fewer bonds are included in a test group.*
- (iv) *Bonds should not be rotated after 6 months.*
- (v) *FINRA should more clearly specify how information about which bonds are included in which test group will be disseminated to the market.*

Exhibit 1 on the following page provides an illustration of the changes we believe should be made to the proposed structure of the pilot.

⁵ Letter from Larry Harris, Fred V. Keenan Chair in Finance, USC Marshall School of Business, Jumar Venkataraman, James M. Collins Chair in Finance, Southern Methodist University, and Elisse Walter, Former Chairman, SEC, to Mr. Brent J. Fields, Federal Advisory Committee Management Officer and Secretary Re: Fixed Income Market Structure Advisory Committee, SEC File No. 265-30 (Aug. 21, 2018) (“Harris Letter”). Available at <https://www.sec.gov/comments/265-30/26530-4268151-173129.pdf>.

Exhibit 1: BlackRock Recommended Changes to Proposed Pilot Program Structure

| | NEW TEST GROUP | CONTROL GROUP | TEST GROUP 1 | TEST GROUP 2 | TEST GROUP 3 |
|----------------------------|---|--|---|---|---|
| Cap Size | Inv. Grade: \$2.5MM High Yield: \$750K | Status Quo Inv. Grade: \$5MM High Yield: \$1MM | Status Quo Inv. Grade: \$5MM High Yield: \$1MM | Inv. Grade: \$10MM High Yield: \$5MM | Inv. Grade: \$10MM High Yield: \$5MM |
| Dissemination | Status Quo 15 minutes | Status Quo 15 minutes | 48 hour delay for trades above cap | Status Quo 15 minutes | 48 hour delay for trades above cap |
| % of Bonds in Group | 5% | 85% | | 5% | 5% |

(i) Test Group 1 (48 hour delay with no cap increases) should be eliminated.

While we support an effort to test the effect on market depth of implementing a 48 hour delay for block trade dissemination, we acknowledge that introducing a delay to the current TRACE reporting framework involves tradeoffs that must be carefully considered. In particular, delaying too large a portion of trades may impede price discovery and/or the accuracy of pricing services, which play an important role across the marketplace. It is for this reason that we strongly recommend that Test Group 1 be eliminated.

Based on our analysis of January 1, 2015 – September 30, 2018 uncapped data, Test Group 1 would subject 3.1% of investment grade and 18.2% of high yield trades to the delay. This equates to 57.5% of investment grade trading volumes and 87.0% of high yield trading volumes. We believe that this represents too large a portion of the market to subject to the delay and we are concerned that the inclusion of Test Group 1 would likely have a detrimental impact on price discovery.

In our view, Test Group 3, which involves a delay but also raises the caps from \$5 million to \$10 million in investment grade and \$1 million to \$5 million in high yield subjects a much smaller and more appropriate portion of trades to the delay. It also more effectively balances the tradeoffs by increasing size transparency while reducing immediate price transparency for a small portion of the market. Specifically, under Test Group 3, the delay would apply to approximately 1.0% of investment grade trades and 2.6% of high yield trades. These trades represent 36.8% of investment grade trading volumes or 47.8% of high yield trading volumes (when summed over the January 1, 2015 – September 30, 2018 period).

(ii) Test Group 1 should be replaced with a test group that entails lower caps and no delay.

Recognizing our prior position that reducing the thresholds for block trade reporting without implementing a 48-hour delay could be another means of improving market depth, we believe that it would be worthwhile to test the effect of lower caps on liquidity. This proposal seeks to balance the tradeoffs in a different manner than the 48-hour delay by preserving the dissemination of pricing information within 15 minutes of the transaction occurring, but delaying the dissemination of size information for a larger

portion of transactions (thereby masking large block trades while retaining price transparency of these transaction). This approach has the potential to provide protection to market makers in providing liquidity for block trades by making block trade dissemination on TRACE stand out to a lesser degree. This approach could encourage more block trading since the dissemination of a large block transaction would not become a stand-out market moving indicator.

Given that we have recommended the elimination of Test Group 1, we believe the alternative proposal could be integrated into the pilot specification with the inclusion of an Alternative Test Group 1 that would reduce the cap sizes. We have tentatively suggested the thresholds included in the Harris Letter (\$2.5 million for investment grade and \$750,000 for high yield). However, were FINRA to adopt this suggestion, we recommend further analysis be conducted to confirm these are the most appropriate caps. This would help FINRA to compare the effect on liquidity from lowering the cap sizes relative to the effect of increasing the cap sizes paired with a 48-hour delay.

(iii) The scope of the pilot should be reduced so that fewer bonds are included in a test group.

It goes without saying that any real time changes to market structure and functioning should be handled with the utmost care and prudence. The impact of the various parameter changes in each of the test groups on price discovery and the accuracy of pricing services is unknown. Given that pricing data plays an extremely important role across the marketplace, particularly for striking the NAVs of mutual funds and ETFs, we believe it is prudent to limit the portion of the corporate bond market that is included in one of the test groups. Specifically, we recommend that 85% of bonds be included in the control group and the remaining 15% be distributed across the three test groups using the proposed stratified sampling method. While this may marginally reduce the data collected in relation to the pilot, it will also more effectively limit any unforeseen negative effects to a smaller portion of the market.

(iv) Bonds should not be rotated after 6 months.

We are concerned that the rotation of bonds to different buckets in 6 months will introduce confounding factors into the analysis, which may make it difficult to attribute any effects on liquidity to the Test Group specifications. In particular, the lifecycle of bonds or on/off-the-run status may dominate the effect on liquidity. Similarly, seasonal liquidity effects may also confound the analysis and limit its ability to draw statistically significant results. We do not think stratification alone can mitigate these confounding effects. As such, we recommend eliminating the rotation of bonds into different test groups after 6 months.

(v) FINRA should more clearly specify how information about which bonds are included in which test group will be disseminated to the market.

The Release did not specify exactly how FINRA intends to disseminate the information as to which bonds are included in which test group to the marketplace. We believe this is an important detail that should be clearly laid out at the outset so as to avoid confusion as the pilot program is implemented.

III. Dissemination of Uncapped Trade Data

One element of the original FIMSAC recommendation that was not addressed in the proposed pilot program is the question of when uncapped trade information should be disseminated. At present, uncapped TRACE trade data is not disseminated until 6 months after the transaction has occurred. The FIMSAC recommendation suggested that the lag time be reduced to 3 months.⁶ We agree with the FIMSAC assessment that more contemporaneous dissemination of uncapped data would benefit market participants. In particular, the availability of more recent uncapped data would be helpful to efforts to model and forecast aspects of market liquidity including expected volume and transaction costs. With this in mind, such data would be beneficial to fund liquidity risk management programs as required under the SEC's Rule 22e-4 and other standards. It is our view that the US corporate bond market would benefit from dissemination of uncapped data within 1 month of the transaction. As such, we recommend that FINRA propose a rule to reduce the time period for dissemination of uncapped trade data to 1 month for all corporate bonds.

We commend the leadership of FINRA, the SEC, and FIMSAC in undertaking this important effort to consider how the US corporate bond market structure can be modernized and improved. We thank FINRA for providing BlackRock the opportunity to comment on the proposed pilot program.

Sincerely,

Dan Veiner
Global Head of Fixed Income Trading

Alexis Rosenblum
Director, Global Public Policy Group

⁶ SEC Fixed Income Market Structure Advisory Committee, Recommendation for a Pilot Program to Study the Market Implications of Changing the Reporting Regime for Block-Size Trades in Corporate Bonds (Apr. 9, 2018). Available at <https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-block-trade-recommendation.pdf>.

CC:

The Honorable Jay Clayton, Chairman, US Securities and Exchange Commission

The Honorable Robert J. Jackson, Commissioner, US Securities and Exchange Commission

The Honorable Hester M. Peirce, Commissioner, US Securities and Exchange Commission

The Honorable Elad L. Roisman, Commissioner, US Securities and Exchange Commission

Brett Redfearn, Director, Division of Trading and Markets, US Securities and Exchange Commission

Robert W. Cook, President and Chief Executive Officer, Financial Industry Regulatory Authority

Robert L. D. Colby, Executive Vice President, Chief Legal Officer, Financial Industry Regulatory Authority

Thomas Gira, Executive Vice President, Market Regulation and Transparency Services, Financial Industry Regulatory Authority

Jonathan Sokobin, Senior Vice President and Chief Economist, Financial Industry Regulatory Authority

Michael Heaney, Committee Chairman, Fixed Income Market Structure Advisory Committee Chairman, US Securities and Exchange Commission

**Appendix A: List of BlackRock Publications Discussing
Corporate Bond Market Liquidity and Transparency**

| Title | Description |
|--|--|
| <p><u>Letter to IOSCO Re: Regulatory Reporting and Public Transparency in the Secondary Corporate Bond Markets</u> October 16, 2017</p> | <p>This comment letter expresses our support of public transparency of corporate bond market data when it is calibrated properly and promotes fairness and the efficient functioning of markets. However, we caveat that these benefits should be balanced with the need to properly calibrate public transparency so as to preserve market liquidity.</p> |
| <p><u>Liquidity in Financial Markets – Remarks by Barbara Novick at the Brookings Institute</u> November 15, 2016</p> | <p>These remarks focus on bond market liquidity, fund redemption risk, and the linkages between the two. The speech highlights the distinctions between market liquidity and fund redemption risk, while assessing incorrect assumptions that have conflated the two concepts.</p> |
| <p><u>ViewPoint – Addressing Market Liquidity: A Broader Perspective on Today’s Bond Markets</u> Updated and re-issued November 2016; originally published February 2016</p> | <p>This <i>ViewPoint</i> is intended to inform discussions about bond market liquidity by integrating data we have known about for a long time (e.g., bond ownership by pensions and insurers) with newer data that highlights structural changes to bond market liquidity. We make a number of observations to provide a more comprehensive foundation for the dialogue on bond market liquidity.</p> |
| <p><u>Letter to IOSCO Re: Examination of Liquidity of the Secondary Corporate Bond Markets</u> September 30, 2016</p> | <p>This comment letter provides a series of observations about corporate bond market liquidity. We make comments about secondary market liquidity, the cumulative impact of regulation, the dynamic market environment, and data limitations in this space.</p> |

| | |
|--|---|
| <p><u>ViewPoint – Breaking Down the Data: A Closer Look at Bond Fund AUM</u> June 2016</p> | <p>This <i>ViewPoint</i> explores the diversity of US bond funds, highlighting the various investor responses to historical market stress events based on the type of bond fund.</p> |
| <p><u>Market Liquidity and Fund Redemption Risk – Remarks by Barbara Novick at the Exchequer Club</u> March 16, 2016</p> | <p>These remarks address market liquidity and fund redemption risks, while exploring data on bond markets. This speech concludes by pointing out that “market risk” and “systemic risk” are not the same, nor are “market liquidity” and “fund redemption risk”.</p> |
| <p><u>ViewPoint – Bond ETFs: Benefits, Challenges, Opportunities</u> July 2015</p> | <p>This <i>ViewPoint</i> discusses the benefits of bond ETFs, including transparency and price discovery. We identify some challenges at the time of writing and offer suggestions for concrete regulatory action to extend the benefits of ETFs to a broader investor base while improving financial stability.</p> |
| <p><u>ViewPoint – Addressing Market Liquidity</u> July 2015</p> | <p>This <i>ViewPoint</i> defines the different concepts that have been referred to as “liquidity” that are often conflated, highlights some of the ways that asset managers are already adapting to the liquidity environment, and provides recommendations to improve the market ecosystem. Our recommendations take a three-pronged approach: (i) market structure modernization, (ii) enhance fund “toolkit” and regulation, and (iii) evolution of new and existing products.</p> |
| <p><u>ETFs Help Improve Market Stability: A Closer Look at Fixed Income ETF Behavior During Recent Bond Market Movement</u> October 2014</p> | <p>This publication examines the behavior of bond markets and fixed income ETFs during the period of significant asset flows in the early Fall of 2014. This case study illustrates how fixed income ETFs provide liquidity, price transparency, and fair allocation of costs during times of both market stability and instability.</p> |

| | |
|---|---|
| <p><u>ViewPoint – Who Owns the Assets? A Closer Look at Bank Loans, High Yield Bonds and Emerging Markets Debt</u> September 2014</p> | <p>This <i>ViewPoint</i> analyzes the dynamics of bank loans, high yield bonds, and emerging markets debt (EMD) and examines the liquidity risk management practices of mutual funds that hold these asset classes.</p> |
| <p><u>ViewPoint – Corporate Bond Market Structure: The Time For Reform Is Now</u> September 2014</p> | <p>This <i>ViewPoint</i> reviews how the corporate bond market is structured and identifies areas and recommendations for reform at the time of writing.</p> |