April 7, 2015

Via Electronic Mail (pubcom@finra.org)

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


Dear Ms. Asquith:

KCG Holdings, Inc. (KCG) respectfully submits this letter in response to Regulatory Notice 15-03 (the Regulatory Notice) published by the Financial Industry Regulatory Authority (FINRA). In the Regulatory Notice, FINRA requests comment on a proposal to require alternative trading systems (ATSs) to submit quotation information relating to corporate and agency debt securities to FINRA for regulatory purposes.

KCG’s View

KCG appreciates the opportunity to comment on the proposal and commends FINRA generally on its series of recent initiatives relating to market structure and automated trading activities. KCG supports the underlying goal of this initiative to improve FINRA’s automated surveillance of fixed income trading and to better understand the differences between the fixed income and equity markets. As discussed in more detail below, however, KCG believes the scope of the reporting requirement, as proposed in the Regulatory Notice, is too narrow in two respects: (i) it focuses on collecting quotation information solely from fixed income ATSs and excludes gathering data from other non-ATS fixed income platforms and venues; and (ii) it seeks to collect only priced quotations and omits requests-for-quotes (RFQs). Given the stated goal of collecting data for use in conducting market surveillance and informing regulation, KCG believes it is important for FINRA to expand the proposed reporting requirement (i) to include other non-ATS fixed income platforms and venues and
(ii) to capture RFQ mechanisms as well as priced quotations. We therefore recommend that FINRA revise the proposal prior to filing it with the Securities and Exchange Commission (Commission).

**Background on KCG BondPoint**

KCG BondPoint (KBP) is a leading provider of electronic fixed income trading solutions that supplies market participants with access to a centralized pool of liquidity and automated trade execution services. Founded in 1999, KBP assists the fixed income marketplace through product distribution, security analysis, price discovery, and automation of manual trading processes, which ultimately lead to a more transparent and efficient secondary bond market.

KBP operates as a Commission registered ATS, where broker-dealers and institutional investors (subscribers) electronically post bids and offers or submit RFQs in a variety of fixed income securities. Likewise, subscribers may also electronically place orders and execute trades against prices posted by other participating subscribers on the KBP platform. KBP deploys a cost effective platform micro-structure that enables broker-dealer subscribers to clear and settle ATS transactions directly. Doing so eliminates the need for KBP to serve as a central counter-party on dealer platform activity and helps to decrease associated clearance and settlement fees. We believe this cost minded model has a downstream effect in allowing broker-dealers to offer more competitive executions to their clients.

**Discussion**

Under the proposal, ATSSs would be required to submit to FINRA for regulatory purposes "quotation information" for TRACE-eligible corporate and agency debt securities. According to the *Regulatory Notice*, fixed income quotation information reported to FINRA would not be publicly disseminated and would be used solely for regulatory and surveillance purposes. KCG would like to highlight that the reporting requirement as proposed could result in several unintended consequences on quotation activity in fixed income trading unless the scope of the reporting requirement is modified (i) to include both ATS platforms and other electronic platforms and venues for trading TRACE-eligible corporate and agency securities; and (ii) to capture RFQs as well as priced quotations.
1. FINRA should capture data from ATSs and non-ATS platforms alike.

As proposed, the reporting requirement would apply only to ATSs that display quotations in TRACE-eligible corporate and agency debt securities. There are, however, a number of non-ATS platforms that electronically disseminate quotations -- both streaming and RFQ -- that would not be subject to the reporting requirement as proposed.

KCG believes the scope of the proposed reporting requirement is inappropriately narrow. By focusing solely on registered ATSs and excluding other fixed income trading platforms from the reporting requirement, FINRA is unnecessarily limiting the extent of the data it will receive concerning pre-trade activity. As FINRA recognizes, “there are other significant electronic fixed income trading platforms that are not ATSS” that will not be covered by the proposal.¹ Dealer activity plays a key role in the secondary market for fixed income securities and dealers have several methods to trade among themselves in the interdealer market other than on ATS platforms. By failing to capture pre-trade activity occurring on non-ATS platforms and venues, FINRA will by design receive an inherently limited and incomplete view of pre-trade price information in the fixed income market.

The equity markets provide a helpful point of reference with respect to reporting obligations of pre-trade information. All FINRA member firms, regardless of their role (e.g., dealer, ATS operator, etc.), are subject to reporting obligations with respect to orders in the equity markets. By placing the reporting obligation on all FINRA members -- instead of isolating the reporting requirement solely upon ATSs -- FINRA is able to ensure that it obtains information regarding member quotation activity regardless of where FINRA members enter quotations. KCG believes FINRA should take a similarly comprehensive approach with respect to reporting of pre-trade quotation information for TRACE-eligible corporate and agency debt securities.

In addition, failing to expand the proposal to include non-ATS platforms will result in an inappropriately narrow surveillance focus that will concentrate solely on ATSs. As the Regulatory Notice makes clear, one of the primary reasons for obtaining the quotation data is to allow FINRA to use the data for surveillance purposes to “detect compliance violations

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¹ See FINRA Regulatory Notice 15-03 at 3.
and potentially manipulative behaviors in fixed income instruments more effectively.\textsuperscript{2} If it only obtains pre-trade information from ATSS and elects not to receive information from other non-ATS market participants, FINRA’s surveillance efforts will be limited to reviewing quotations on ATSS, which will result in significantly increased compliance and regulatory burdens on ATSS (and their subscribers) and preclude FINRA from conducting a more holistic surveillance program across the market for TRACE-eligible corporate and agency debt securities.

2. FINRA should include RFQs (and RFQ only platforms) within its data collection.

Under the proposal, the reporting requirement would not apply to RFQs, whether launched on ATSS or RFQ-only platforms. Instead, the reporting requirement essentially will be limited to priced quotations.

KCG believes it is inappropriate to restrict the reporting requirement to priced quotations while ignoring RFQs. By excluding RFQs from the reporting requirement, FINRA is limiting itself to obtaining a small portion of the pre-trade activity in the fixed income market. Subscribers to ATSS and RFQ platforms typically have two options, execute against a two-sided quote or launch an RFQ and execute against a response. By excluding RFQs from the proposal, FINRA will miss a significant component of fixed income pricing and market data. Indeed, approximately 50\% of sell trades executed in corporate bonds on KCG BondPoint over the last two years originated from an RFQ bid wanted price discovery process. We suspect this is the case at other venues as well.

Including RFQ information is especially important with respect to less liquid fixed income securities. Less liquid securities are generally more reliant on RFQ protocols than they are on two-sided market quotations. Therefore, modifying the proposal to include RFQs within the proposed reporting requirement would provide regulators with increased transparency in the fixed income market where it is most needed, in the less liquid securities.

\textsuperscript{2} See FINRA Regulatory Notice 15-03 at 2 and 4.
3. The proposed reporting requirement may result in several unintended consequences if not expanded to include non-ATSs platforms and RFQs.

KCG believes restricting the proposed reporting requirement as discussed above is incongruous with FINRA’s stated aim of strengthening its overall regulation of fixed income trading and particularly its automated surveillance. If the scope of the reporting requirement is not expanded to cover non-ATS platforms and to include RFQs, the proposal may result in several unintended consequences, which we believe may be especially impactful for retail investors. As noted by SEC Chair Mary Jo White when discussing fixed income initiatives, it is important for regulators to “be mindful to strike the right balance of compelling the disclosure of meaningful pre-trade pricing information without discouraging market participants from producing it because of concerns that it will compromise trading positions.”

Below is a discussion of several potential unintended consequences that may flow from the reporting requirement as currently proposed.

*Drive dealers away from quoting on ATSSs.* Because fixed income transactions may be executed on various types of platforms and venues, placing the reporting requirement solely on ATSSs may result in dealers deciding to discontinue or reduce quoting on ATSSs. Dealers may instead opt to limit their quoting activity to those non-ATS platforms and venues that are not subject to the burdens of meeting FINRA’s proposed reporting requirement and that are not subject to FINRA’s increased pre-trade surveillance focus on ATSSs. This may significantly impact ATS liquidity, which would negatively influence price discovery, price transparency and choice for retail investors. Even if dealers continued quoting on ATSSs, they may nonetheless provide less aggressive pricing, which would also negatively impact retail investors. To the extent there is pre-trade price transparency in the fixed income market, it tends to be provided largely through ATSS platforms, thus we encourage FINRA not to impose a rule that could negatively impact this transparency.

*Increase segmentation between retail and institutional markets.* Today, a dealer using an order management system has the ability to produce multiple levels of priced quotations. If FINRA only imposes the reporting requirement on ATSSs it may inadvertently dis-incent dealers from providing their best prices to ATSSs and thereby place a greater burden on members in performing their best execution obligations. The segmentation of requiring

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solely retail ATSS to submit quotations might have a negative effect of widening spreads between retail and institutional markets.

*Impact transparency and best execution for retail.* Given the proposed ATS-only reporting obligation, quoting dealers might look to establish direct dealer-to-dealer price quotation feeds that bypass ATSS altogether. Such a practice could have a negative impact on both retail pricing transparency (wider spreads) and best execution. These potential results seem at odds with the goals set forth in the Regulatory Notice, especially given FINRA’s recognition of the expanding “use of ATSS for retail size bond orders”\(^4\) as well as the Commission’s interest in increasing liquidity and price transparency in the markets for fixed income securities.\(^5\)

*Increase one-sided quotations.* Because, unlike priced quotations, quotations in response to RFQs will not be captured in the reporting requirement, dealers may decrease (or stop) quoting two-sided markets and thus the market may revert back in time to a less efficient and less transparent RFQ protocol. Such a transformation in the market would be most impactful for retail investors as they would be subject to decreased pre-trade price discovery, more limited market quotations, reduced market efficiencies, and potentially higher execution costs.

4. **Implementation and operational issues related to the proposed reporting requirement.**

KCG also believes there are several implementation and operational issues that FINRA should address before filing the proposal with the Commission as a proposed rule filing.

*Real-time reporting should be permitted.* FINRA is proposing to require ATSS to report one week’s worth of quotation information on a weekly basis. For example, an ATSS would be required to report by the end of week two all quotation information for the prior week one. According to FINRA, real-time reporting of quotation information is not warranted given it will use the data for regulatory and post-trade surveillance purposes. Although FINRA may

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\(^4\) See FINRA Regulatory Notice 15-03 at 2.

not need the data any sooner than on a weekly basis, KCG believes reporting firms should have the option of submitting quotation information on a near real-time basis via existing FIX protocol. Given our recent experience producing similar quotation, order and trade data to the Commission, running a file in arrears for one week’s worth of pre-trade data would be inefficient and prone to issues and errors. In order for ATS operators to develop a regular and reliable batch process it would be necessary to develop a separate method to capture, store, package and deliver the data with the required elements. KCG estimates this would require a one-time expenditure of approximately $250,000 and ongoing annual costs of approximately $75,000. As an alternative, ATSs typically provide subscribers with a market data feed and thus already have a mechanism to export this type of information in a timely fashion. The costs associated with this alternative type of delivery would be substantially lower given it is part of normal business workflow.

*Designation of party capacity is unnecessary.* Among the specific quotation information that an ATS would need to report under the proposal is the party’s capacity (i.e., agent or principal). Generally, an ATS would not be aware if a given dealer is acting in an agent or principal capacity when the dealer is providing the ATS with a quotation. Dealers are not required to provide this information and it is irrelevant for the ATS. Accordingly, ATSs do not collect this information. In addition, should ATSS nonetheless be required to collect party capacity, it will necessitate a change for the entire industry in the way they submit price quotations to ATSS. If party capacity is necessary for surveillance purposes, FINRA should expand the reporting requirement to include dealers so that it can capture party capacity directly from the best source of such information, the member firm providing the quota.

5. Need for coordination and uniformity among regulators.

Several regulators have recently collected (or sought to collect) similar information concerning pre-trade pricing in the fixed income markets, so it is important that FINRA’s data collection efforts coordinate with and take a uniform approach to the data collection efforts of other regulators. Last year the Commission collected a sample of pre-trade data from fixed income ATS operators. Also, the Municipal Securities Regulatory Board issued a concept release in July 2013 that contemplates a collection of similar data. Given the high level of interest among regulators, it is essential that all data collection efforts are highly coordinated.

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and designed to avoid increasing compliance and technology risks and costs for market participants.

Conclusion

Given FINRA’s goal of collecting data for use in conducting market surveillance and informing regulation, KCG believes it is important for FINRA to broaden the proposed reporting requirement (i) to include other non-ATS fixed income platforms and venues and (ii) to capture RFQ mechanisms as well as priced quotations. Accordingly, we respectfully request that FINRA revise the proposal prior to filing it with the Commission.

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KCG greatly appreciates FINRA’s consideration of the issues raised above concerning the Regulatory Notice. KCG would be pleased to discuss these comments in greater detail. If you have any questions, please do not hesitate to contact John A. McCarthy (at 646-428-1615 or jmccarthy@kcg.com) or William Vulpis (at 201-386-2893 or bvulpis@kcg.com).

Sincerely,

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