U.S. Securities and Exchange Commission
Fixed Income Market Structure Advisory Committee

Recommendation for the SEC to Review the Framework

for the Oversight of Electronic Trading Platforms for Corporate and Municipal Bonds

July 16, 2018

The Technology and Electronic Trading Subcommittee (Subcommittee) of the Fixed Income Market Structure Advisory Committee (FIMSAC) was formed to consider the increased use of electronic trading platforms on the liquidity, efficiency and resiliency of the corporate and municipal bond markets. One early issue the Subcommittee identified is the varying regulatory treatment to which credit and municipal bond trading platforms in the U.S. are subject based on differences in trading protocols or business models. For example, some platforms are regulated as alternative trading systems (ATSs), some are regulated as broker-dealers, and other significant platforms operating the same or similar models are not regulated at all.

The regulatory differences were driven, in part, by the adoption of Regulation ATS and the establishment of a class of ATSs that were deemed to furnish services commonly performed by registered stock exchanges. The definition of an ATS in Regulation ATS, as well as significant aspects of the Regulation ATS ruleset, largely reflect the trading practices of the equity markets and not necessarily those of the fixed income markets. For example, as a practical matter, electronic RFQ platforms for corporate and municipal bonds are excluded from Regulation ATS based on the characteristics of the RFQ trading protocol. Accordingly, a large and growing fraction of the corporate and municipal bond volumes that trade electronically in the U.S. today occurs on platforms regulated only as broker-dealers.

On the other end of the spectrum, at least one fixed income trading platform with significant volume in municipal and corporate bond trading does not fall under any regulatory oversight in the U.S. This platform provides similar services to its participants as do electronic RFQ platforms and ATS systems (among which include organizing liquidity, trading functionality, and straight-through processing services). We note that in the E.U., this platform is regulated as a multilateral trading facility (MTF) for fixed income securities.

These distinctions in regulatory oversight complicate efforts to improve the efficiency and resiliency of the fixed income electronic trading markets. For example, recent regulatory proposals relating to electronic trading platforms in the equity markets, such as proposed Form ATS-N and Regulation SCI, are premised on the status of electronic trading venues as ATSs. To the extent a regulation applies only to ATSs in the fixed income market, such rules would capture only a small percentage of the notional volume of corporate and municipal bonds volumes that currently trades on electronic trading platforms. Without a unifying regulatory framework for all fixed income electronic trading platforms, market structures will likely fragment further as regulators adopt new regulations that apply to only one type of platform.

Harmonization of regulation will help ensure that regulatory arbitrage does not overly influence the competition to discover the best trading protocols and business models for various types of fixed income products. At the same time, the FIMSAC recognizes that the need for regulatory oversight may vary by trading protocol and business model.

Recommendation: The FIMSAC recommends that the SEC, FINRA and MSRB form a joint working group to conduct a review of the regulatory framework for oversight of electronic trading platforms used in the corporate and municipal bond markets:

(i) to ensure that the regulatory framework best promotes the growth of fair and effective fixed income electronic trading markets;
(ii) to ensure that no regulatory gaps or inconsistencies in the application of such regulation exist that increase the potential for investor harm, systemic risk or unfair competition;
(iii) to consider whether Regulation ATS (and any other applicable rules) should be amended to account for differences in protocols and market structures commonly used to trade fixed income as compared to equities;
(iv) to ensure that regulation is not unfairly promoting or impeding specific trading protocols and business models over others; and
(v) to consider whether any existing regulation impacting the fixed income electronic trading markets is unnecessary from a cost-benefit perspective.