Dimensional

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June 11, 2019

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

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

Dear Ms. Asquith:

Dimensional Fund Advisors LP ("Dimensional") appreciates the opportunity to provide the Financial Industry Regulatory Authority ("FINRA") with our views on the proposed pilot program discussed in Regulatory Notice 19-12.[1] As a registered investment adviser that provides investment management services to mutual funds, institutional and financial adviser clients, Dimensional believes that a fair market is one where public information gets disseminated evenly to all market participants.

We strongly disagree with the proposed pilot program. Over the 12-month duration of the proposed pilot program, the dissemination of information about large trades of certain securities would be delayed for 48 hours rather than 15 minutes as is current market practice. This will reduce price transparency in the corporate bond market. We generally believe that greater price transparency is associated with lower bid-ask spreads and trading costs.[2] The bonds for which trading information would be delayed will also be held and traded by numerous Main Street investors and mutual funds and ETFs. We believe the pilot program has the potential to increase trading costs for these investors.

We also believe the pilot program will provide an informational advantage to certain market participants and investors. This may also increase the trading costs for Main Street investors, mutual funds, and ETFs without necessarily providing any additional benefits.

SEC Chair Clayton asked during the April 9, 2018 Fixed Income Market Structure Advisory Committee (FIMSAC) meeting on this subject to *ensure that "our reporting rules best serve the*

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1 FINRA Regulatory Notice 19-12 (April 12, 2019) ("Notice"), available online at https://www.finra.org/industry/notices/19-12.

2 *See* Michael A. Goldstein et. al. *Transparency and Liquidity: A Controlled Experiment on Corporate Bonds*, Oxford University Press (2006); Amy K. Edwards et. al. *Corporate Bond Market Transaction Costs and Transparency*, The Journal of Finance (June 2007); and Hendrik Bessembinder et. al. *Market Transparency, liquidity externalities, and institutional trading costs in corporate bonds*, Journal of Financial Economics (2006).

long-term interests of our Main Street investors."[3] We believe the currently proposed pilot program does not serve the long-term interests of investors saving for retirement or other future consumption needs. We find the proffered justification that the proposed reduced-price transparency will improve liquidity unpersuasive.

Increased transparency benefits investors

Since the introduction of TRACE in 2002, the corporate bond market has grown in size to all-time highs.[4] Secondary market trading volume continues to rise to all-time highs with each passing year.[5] Bid-ask spreads have shrunk to all-time lows.[6] The corporate bond market has never been as liquid as it has been in the TRACE era, with a corresponding decline in trading costs.[7] We believe it is the transparency brought about by TRACE that helped create these conditions. We believe that transparency is good for markets. Increased transparency inherently boosts investor confidence in the market. We are cautious and indeed skeptical that any program that reduces pricing transparency will improve liquidity and reduce trading costs.

According to the data tables included in FIMSAC's April 9, 2018 recommendation, between 2013 and 2017 the proposed 48-hour blackout period would have covered over 32% of the total par value of traded investment grade corporate bonds and over 40% of non-investment grade corporate bonds.[8] These are very sizeable portions of market trades that would lose their current 15-minute delayed price transparency. Many investors, including mutual funds and ETFs, rely on this transparency to accurately price the assets in their daily net asset value calculation. This can represent a significant cost to investors. We believe any program that may impose significant cost should have consensus support from the industry that the benefit is worth the cost. We do not see this for the proposed pilot's increased delay in block trade information dissemination.

As FINRA noted in its Notice, the "FIMSAC recommendation did not include written supporting rationale" for its pilot program recommendation.[9] Their recommendation appears to be based on the opinion that market liquidity is harmed by price transparency.[10] This is no different

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3 *See* https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsa-040918transcript.txt at page 6 (emphasis added).

4 *See* SIFMA's statistics on amounts outstanding in the U.S. bond market available at https://www.sifma.org/resources/research/us-bond-market-issuance-and-outstanding/.

5 *See* SIFMA's statistics on U.S. bond market average trading volumes available at https://www.sifma.org/resources/research/us-bond-market-trading-volume/.

6 *See* Mizrach (2015).

7 *See* id.

8 *See* https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-block-trade-recommendation.pdf.

9 *See* Notice at page 7.

10 *See* Bruce Mizrach *Analysis of Corporate Bond Liquidity*, FINRA Office of the Chief Economist Research Note (2015) ("Some industry participants have become alarmed about the decline in liquidity in the corporate bond market. Based primarily on evidence collected by FINRA through TRACE, there does not appear to be strong

than the concern expressed about the original introduction of TRACE reporting,[11] even though it has been shown to be overwhelmingly beneficial to investors.[12] We believe a more objectively persuasive reason for reducing price transparency should be put forth along with supporting data before FINRA moves forward with the proposed pilot program.[13]

Pilot program's objective better addressed by increasing transparency

The proposed pilot program's objective seems to be to increase liquidity conditions for corporate bonds and the ability to execute block trades. Rather than reduce price transparency in the market in an attempt to achieve this objective, we would suggest testing complete and immediate dissemination of all trade data with no dissemination caps and no 15-minute delay. Perhaps FINRA could start with a small subset of securities much like it did at the initial launch of TRACE in 2002.

We believe to improve liquidity, complete and immediate post-trade data dissemination for all securities in the market should be the ultimate objective of any program. This model has proven to be fair and effective in the equity markets over many decades.

Liquidity cost unnecessarily shifted to smaller market participants

Participants in the market understand that demanding immediate liquidity from broker-dealers or other market participants comes at a cost. This cost is a function of the size of the trade and the immediacy with which the trade must be executed. As size goes up, cost generally goes up. As immediacy goes up, cost generally goes up. In general, the party seeking the liquidity bears the cost of that liquidity. Large participants may desire immediacy when they are looking to sell a large block of bonds. Large dealers claim they are only willing to provide this immediacy if we reduce market transparency. By creating this information asymmetry, the seller may shift the cost of that liquidity onto one or more unsuspecting buyers of the bond who are at an information disadvantage for the next 48 hours. These buyers may be Main Street investors or mutual fund or ETF investors.

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evidence to support this view. New issuance is strong, secondary market trading volume continues to rise and bid-ask spreads continue to fall.").

11 *See* Edwards (2007), at p. 1422, stating that the trade association for bond dealers, the Bond Market Association, had concerns that transparency will hurt liquidity; *see also* "Corporate Bond Market Transparency and Debt Mark-Up Regulation," Morgan, Lewis & Bockius LLP (2002), stating that over half of the commenters on the TRACE proposal in 1999 expressed concern over possible adverse effect on liquidity.

12 *See* Hendrik Bessembinder and William Maxwell *Transparency and the Corporate Bond Market*, Journal of Economic Perspectives (2008); *see also* Goldstein (2006).

13 *See* Professor Harris' recently submitted comment to the Notice in which he also expresses his opposition to doing the proposed pilot program (June 3, 2019) ("I argue further that no pilot study should be undertaken until the results of simpler, much less costly studies are known. I further argue that any study undertaken should address only the minimum changes necessary to achieve the objectives of the FIMSAC recommendation.").

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Delaying the price data dissemination and thus creating an information asymmetry, does not eliminate the cost of liquidity. It merely shifts it from the informed participant to the uninformed participant (those on the short end of the information asymmetry, which will be all market participants other than the principals of the large trade) and doing so would largely be to large institutional investor or dealers' benefit.[14]

Pilot program challenges

The data collected from any pilot may be biased. Generally, this is more likely when a group of market participants have a strong desire for one outcome over another. For example, it will be straightforward to determine which securities have been assigned to which of the three test groups and one control group during the pilot program. If some market participants alter their behavior for the duration of the pilot program in an attempt to skew the results in their preferred direction, the data collected during the pilot program will not be useful to determine the long-term expected benefit of delaying information dissemination. Because we believe this pilot program is very likely to impose costs on investors, and because of potential data biases, we strongly urge caution.

We are counting on our regulators to continue to strive to keep the markets fair for all participants. Please consider rejecting the flawed proposal for a 48-hour dissemination delay.

We appreciate FINRA's efforts to examine these issues and are grateful for this opportunity to provide our comments.

Sincerely,

/s/ Gerard O'Reilly

Gerard O'Reilly
Co-CEO and Chief Investment Officer

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[14] *See* Harris (2019) ("The bond markets . . . will benefit from increasing electronic trading. The FIMSAC recommendation seeks to protect an old way of doing business. Reducing price transparency to maintain incumbent dealers facing increasing competition from lower-cost players is unwise.").