HeadlandsTech
Global Markets

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Submitted Electronically

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, D.C. 20006-1506
pubcom@finra.org

Re: FINRA Notice 20-29: Request for Comment on the Practice of Pennying in the Corporate Bond Market

Dear Ms. Mitchell:

Headlands Tech Global Markets, LLC ("HTGM") appreciates the opportunity to comment on the Financial Industry Regulatory Authority's ("FINRA") above-referenced notice on the practice of pennying in the corporate bond market. HTGM applauds FINRA's inquiry into this anti-competitive practice and agrees with the Securities and Exchange Commission's Fixed Income Market Structure Advisory Committee's ("FIMSAC") June 11, 2019 Recommendations Regarding the Practice of Pennying in the Corporate and Municipal Bond Markets ("Recommendations").

HTGM is a quantitative trading company that is a Securities and Exchange Commission registered, FINRA member broker-dealer.[1] HTGM launched its bond trading business in March 2014 and uses proprietary models to price bonds electronically. Over its six plus years in business, HTGM has frequently encountered the practice of pennying, wherein the dealer observes the prices submitted to a completed auction and decides to execute themselves at a price at least equal to or slightly better than the winning bid.

The FIMSAC is correct in its Recommendations that pennying harms competitiveness by deterring aggressive pricing and participation by dealers in the bid-wanted process who know the submitting dealer may step in front of their winning bid. Pennying creates a disincentive to "put your best foot forward," or even bid at all, if you know it is for naught and simply a form of price discovery by the selling dealers.

Data supports HTGM's assertions that pennying is prevalent in the bond market. For the municipal bond market, HTGM uses information from a variety of sources, including Municipal Securities Rulemaking Board ("MSRB") trade prints and color report data provided by trading venues, to attempt to piece together what happens in a bid-wanted auction when HTGM determines it submitted the winning bid

[1] HTGM is a widely recognized participant in the municipal bond market, executing approximately 1,300 plus trades per day with over 400 counterparties, responding to more than 13,000 bid-wanted auctions per day, and ranking as a top participant on all major municipal bond ATS platforms. This volume makes HTGM a significant liquidity provider and one of the country's largest dealers in the municipal bond secondary market. HTGM is also a significant liquidity provider in the corporate bond market.

price. On several venues, up to a third of HTGM's winning bids are subject to the practice of pennying. These are instances where HTGM clearly wins an auction but does not receive an execution.[2]

Importantly, dealers are choosing to use this practice despite the competitiveness of the bid-wanted auction process. On average, HTGM sees seven bidders per auction. With such participation, there is no justifiable need for pennying. And the auctions would likely have even more participation if pennying were not being abused by dealers.

Pennying also appears to be similarly used in the corporate bond market. Municipal and corporate bonds trade via the same request for quote ("RFQ") process on the same platforms amongst many of the same market participants. As these two markets operate in a similar manner, there is no reason to believe that pennying would be prevalent in one market but not the other. Accordingly, this makes it imperative that FINRA coordinate with the MSRB in addressing the practice of pennying across both products and markets.

HTGM is in favor of the MSRB and FINRA proposing rules against the use of pennying, except in limited circumstances. The rule should set the clear expectation that the use of pennying should occur only in the rare situation when a dealer does not receive a reasonable response to a request for bid-wanteds and/or needs to use the practice to conform with best execution responsibilities. The rule should require dealers that want to use pennying in such exceptional circumstances to have clearly written policies and procedures in place as to when it may be used. This gives dealers flexibility to carry out their duties and responsibilities but makes it clear that abuse of the process will not be tolerated. Moreover, a rule would give regulators specific guidelines and exceptions to review and enforce to eliminate any abusive use of pennying.

Requiring a submitting dealer to place its own prices in the competitive auction and RFQ process for bid-wanteds with all other participants would put all liquidity providers on equal footing and encourage more frequent and aggressive pricing by auction participants, thereby improving pricing quality for customers. Additionally, it is difficult to comprehend how this requirement would place an unreasonable burden on the submitting dealer. Such rulemaking is the only way to guarantee competitiveness and transparency of the overall bond market.

Thank you for this opportunity to provide our comments. We welcome any questions from FINRA regarding this important issue.

Sincerely,

Martin Mannion
Co-CEO & President

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[2] For detailed market analysis on the use of pennying in the municipal bond market, please refer to HTGM's October 26, 2018 comment letter to the MSRB Notice 2018-22 regarding its Draft Interpretative Guidance on Pennying available at https://www.msrb.org/RFC/2018-22/ANDRESEN.pdf.