



Via Electronic Submission

June 11, 2019

Marcia E. Asquith  
Office of the Corporate Secretary  
Financial Industry Regulatory Authority  
1735 K Street, NW  
Washington, D.C. 20006-1506

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

Dear Secretary Asquith,

Pacific Investment Management Company LLC (PIMCO) appreciates the opportunity to comment on the Financial Industry Regulatory Authority's (FINRA) proposed pilot program to evaluate modifications to the TRACE reporting regime and its effects on market liquidity in the corporate bond market, based on the recommendations of the U.S. Securities and Exchange Commission's (SEC) Fixed Income Market Structure Advisory Committee (FIMSAC).

PIMCO is a registered investment adviser with the SEC, and as of March 31, 2019, managed approximately \$1.76 trillion in assets on behalf of millions of individuals and thousands of institutions globally, including university endowments, unions, corporate pension plans, 401(K) plans, state retirement plans, and pension plans for teachers, firefighters and other government employees. PIMCO is engaged in the long-term management of our clients' assets as a fiduciary, where our goal is to make long-term investments that will meet our clients' objectives and provide them with returns that are consistent with their risk preferences over their desired time horizons. Importantly, PIMCO manages assets in a fiduciary capacity on behalf of its clients and does not engage in any proprietary trading. In addition to our goal of maximizing returns for our clients given their risk preferences, we also look to minimize transaction costs, including the cost of execution, because those costs are borne by our clients, not by PIMCO.

In addition to our primary role as a fiduciary, we are also stewards of the markets in which we transact given our large presence and longstanding commitment to the fixed income markets. As overseers, we care deeply about the liquidity, resiliency, stability and overall integrity of the markets in which we operate. It is with these two perspectives in mind that we provide the following comments.

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**I. The pilot program will provide critical information on the impact of public dissemination of transaction data in the bond market and should be implemented.**

PIMCO has been honored to serve on the SEC’s FIMSAC and to provide the perspective of an active fixed income manager. During our involvement with the FIMSAC, we have been encouraged by the substantive nature of the debate among FIMSAC members and the thoughtfulness and evidence-based approach that the FIMSAC subcommittees have used to evaluate and formulate recommendations on issues associated with fixed income market structure. We commend SEC Chairman Clayton and his staff for forming a committee comprised of a diverse group of industry participants with well-informed viewpoints and the autonomy and agency to bring forth recommendations to the SEC.

One of the most important recommendations that the FIMSAC has produced – and that FINRA has now advanced for public comment— is the creation of a pilot program to study the effects of the FINRA TRACE reporting rules on investment grade and high yield bonds. The pilot program will allow policymakers and the industry to better evaluate the impact of immediate reporting, including its effect on liquidity conditions in the corporate bond market. In particular, the pilot program will help to answer two important questions for fixed income market participants and policymakers:

- 1) Does increasing the dissemination caps for high yield and investment grade to \$5mm and \$10mm, respectively, improve liquidity for this sector of the market, which is typically dominated by individual and retail participants?
- 2) Does increasing the dissemination delay from 15 minutes to 48 hours for block trades above the \$5mm and \$10mm caps increase liquidity for this sector of the market, which is exclusively dominated by large institutional asset managers and asset owners, by reducing information leakage and improving liquidity for block transactions?

We believe the pilot program will help to answer these questions, while at the same time, continue the existing immediate reporting of transaction data to regulators, which we believe is critical as it allows regulators to better understand market dynamics, and detect financial stress and market manipulation.

As FINRA may be aware, there has been a significant amount of dialogue over the years between members of the industry and policymakers on the impact of near immediate reporting of transaction data on liquidity in the bond market. The FIMSAC recommendations, which were supported by a vast majority of the FIMSAC membership, underscore the significance of further examining the intersection and interaction of immediate reporting of transaction data and liquidity in the corporate bond market.<sup>1</sup> The proposed year-long pilot, which has been

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<sup>1</sup> U.S. Securities and Exchange Commission, 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), <https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-block-trade-recommendation.pdf>.

thoughtfully designed by the FIMSAC and further revised by FINRA, is a significant first step in collecting the necessary data to evaluate this critical issue.

PIMCO believes that now is the time to implement the pilot given the low-level of market volatility, the robust pace of primary bond issuance, and the relatively well-functioning of the credit markets.<sup>2</sup> If FINRA delays examining these changes – or chooses not to proceed with the study at all – it may take another financial market crisis to expose some of the concerns that numerous market participants have raised regarding the impact of the existing reporting regime on liquidity, and may make trading in blocks, at the very time when it is crucial, even more difficult than it is today.

## **II. The immediate dissemination of block transaction data has led to lower liquidity and less efficient risk transfer in fixed income markets.**

PIMCO, in its capacity as an investment manager, supports the ultimate transparency of corporate bond transactions. We believe that increased market transparency oftentimes leads to more resilient, stable, and liquid markets. For this reason, PIMCO supports the FIMSAC recommendation to increase size transparency under the TRACE reporting regime for high yield and investment grade bonds from \$1mm and \$5mm to \$5mm and \$10mm, respectively. However, we emphasize that the impact of immediate reporting of transaction details, especially larger block trades, should be further examined given the countervailing concerns about market impact in the short-term. Markets are *not* one-size-fits all, and in certain sectors of the fixed income market, due to their idiosyncratic nature and structural features, immediate reporting can and does have the opposite of its desired effect and can lead to choppy, less deep and less liquid markets that are more difficult to transact in, which invariably leads to less efficient risk transfer and pricing.

This is particularly true for the investment grade and high yield markets, which tend to be particularly heterogeneous and fragmented relative to other liquid markets, especially the equity market.

In terms of the heterogeneity of the corporate bond market, while a corporation may only issue one equity security, it may issue several, if not dozens, of corporate bond securities. An example is General Electric, which has one listed stock in the U.S. that trades on the NYSE, and yet has more than 50 different corporate bonds outstanding, ranging in various maturities, yields and amounts outstanding. The indices that track these markets underscore this dynamic as well: The S&P 500 is composed of 500 discrete equity securities with “widget-like” characteristics, while the Bank of America Merrill Lynch Investment Grade Index includes nearly 8,000 disparate corporate bond securities, representing more than 1,000 different corporate issuers with different maturities, yields and amounts outstanding. The heterogeneity of this massive market means, among other things, that matching buyers and sellers is inherently more difficult.

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<sup>2</sup> Staff of the Federal Reserve Board, “Staff Q2 2017 Report on Corporate Bond Market Liquidity,” (2017), <https://www.federalreserve.gov/foia/files/bond-market-liquidity-report-2017Q2.pdf>.

In addition to being more heterogeneous, the corporate bond market is also significantly fragmented and intermediated. While electronic trading levels in the bond market have incrementally increased relative to even a few years ago, only a minority of the volume of investment grade bonds trade electronically today and the transactions that do occur on electronic platforms are typically smaller in size.<sup>3</sup> Practically, this means that the majority of the investment grade and high yield bond market is traded as it has historically – through intermediaries on an “over-the-counter” basis. Broker-dealers typically trade lower-liquidity securities on a principal basis, in other words, by buying the securities themselves with the assumption and expectation they will be able to sell them, or at least hedge the associated exposure, post trade.

Because the corporate bond market is both heterogeneous and largely traded through intermediaries, as opposed to on exchanges, most large asset managers prefer to aggregate client trades across multiple accounts and trade in large sizes or “block trades.” The primary advantage of trading in large size is the ability to obtain similar pricing for similarly situated client accounts, which is consistent with PIMCO’s goal as a fiduciary to apply a consistent strategy at consistent prices and execution costs for accounts with similar investment objectives, guidelines and risk tolerances.

Trading in large block sizes, however, has become increasingly difficult in the corporate bond market, in part because of the TRACE reporting regime, which disseminates important transaction details nearly immediately to the marketplace. Such information contains substantial proprietary information. The premature public dissemination of this proprietary information in many instances leads those involved in the trade to speculate and move the market around the price level that was disseminated before the risk has transferred to an end user, thereby leading to a lower alacrity to take risk and larger price changes (potentially higher cost) when it is necessary.

The practical implication of this is twofold:

- 1) *There are simply fewer large transactions occurring in the investment grade and high yield markets given the costs associated with transacting in large size.* According to proprietary data collected by one FIMSAC participant, large transactions in the investment grade bond market (defined as \$10 million or above) have declined from 49% of the market in 2007 to 34% of the market in 2017, while smaller transactions (smaller than \$5mm) have increased from 26% of the market to 43% of the market in the same time period.<sup>4</sup> According to another source, the average trade size for the 1,000 most active issuers has decreased by almost 35% between 2007 and 2013.<sup>5</sup> This is consistent with PIMCO’s observation; we regularly resort to trading in smaller

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<sup>3</sup> Greenwich Associates, *Corporate Bond Trading in 2019, Competition is Good, Complexity is Not*, Q1 2019.

<sup>4</sup> See Citi Submission to the FIMSAC, at p. 2.

<sup>5</sup> Bruce Mizrach, FINRA Office of the Chief Economist, “*Analysis of Corporate Bond Liquidity*,” FINRA Research Note, at p. 1 (Dec. 2015), [https://www.finra.org/sites/default/files/OCE\\_researchnote\\_liquidity\\_2015\\_12.pdf](https://www.finra.org/sites/default/files/OCE_researchnote_liquidity_2015_12.pdf).

increments because the liquidity for large transactions simply does not exist or it is too costly to transact in certain segments of the market.

- 2) *Large transactions that do occur tend to be more expensive and involve higher transaction costs.* This is caused by the fact that the price at which a dealer offers to make a market for a large transaction reflects the likelihood that bid-ask spreads will widen as soon as the trade is executed upon the details of the trade being prematurely disseminated to the market. In our experience, there have been instances where dealers have pulled back from making markets because they realize the price to transact is simply too high.

We believe that the pilot program as proposed by FINRA is an important step in collecting data that will help policymakers and market participants assess whether these anecdotal observations by PIMCO and other asset managers,<sup>6</sup> and broker-dealers are more pervasive and whether a more tailored transparency regime is therefore warranted on a permanent basis.

### **III. PIMCO largely supports the design of the pilot.**

As a member of the FIMSAC Subcommittee on Transparency, PIMCO supported the Subcommittee's final proposal that was voted on and passed by a significant margin of the broader FIMSAC membership. While PIMCO continues to support the FIMSAC's pilot recommendation based on its simple design, we believe that the proposal is reasonably designed to obtain relevant data that would enable both FINRA and other policymakers to evaluate the impact of transparency on block trade liquidity across investment grade and high yield bonds. Furthermore, the design of the pilot and granularity of the data that will be collected and evaluated, including data on changes in dealer behavior and whether the trades are dealer-to-dealer or dealer-to-customer, will allow FINRA to identify and appropriately address any anomalies in trading patterns that might be reflective of non-bona fide trading or other inappropriate trading conduct.

In terms of suggested changes to the proposed pilot design, PIMCO recommends that FINRA consider extending the duration of the pilot from the proposed one year to at least 18 months or even 2 years. A longer pilot would lead to better quality data and more meaningful analysis by allowing FINRA to evaluate relevant market activity across a longer time horizon and identify whether certain activity may be representative of market noise or other cyclical factors inherent in the market.

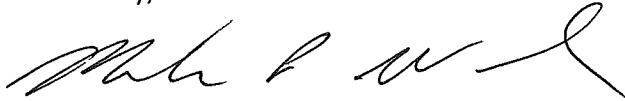
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<sup>6</sup> See Jed Stevenson, Wellington Management Company LLP, Submission to SEC-FIMSAC Recommendation (Feb. 4, 2019), <https://www.sec.gov/comments/265-30/265-30.htm>; Michael O'Brien, Eaton Vance, Submission to SEC-FIMSAC Recommendation (Sept. 24, 2018), <https://www.sec.gov/comments/265-30/26530-4406764-175664.pdf>; see BlackRock, "The Next Generation Bond Market," Lit. No. WP-NG-BOND-0917 (2017).

PIMCO thanks FINRA for the opportunity to comment on the proposed pilot program and for FINRA's consideration of our views on this important proposal. If you have any questions, please do not hesitate to call me at (949) 720-6000.

Sincerely,

A handwritten signature in black ink, appearing to read "Mihir Worah". The signature is fluid and cursive, with a long horizontal stroke at the end.

Mihir Worah  
Managing Director, Chief Investment Officer  
Pacific Investment Management Company LLC