Vanguard®

P.O. Box 2600
Valley Forge, PA 19482-2600

June 11, 2019

Submitted electronically

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

Re: **Regulatory Notice 19-12; Request for Comment on a Proposed Pilot Program Related to Corporate Bond Block Trade Dissemination.**

Dear Ms. Asquith:

Vanguard[1] appreciates the opportunity to provide our comments to the Financial Industry Regulatory Authority ("FINRA") on its request for comment on a proposed pilot program to study changes to corporate bond block trade dissemination (the "Proposed Pilot").[2] We believe that the Proposed Pilot will harm investors and markets by significantly reducing post-trade transparency for a significant amount of trading activity, hindering the evolution and electronification of the corporate bond market, and creating an unlevel playing field without compelling justification.[3] Although FINRA's Notice correctly identifies that improved post-trade transparency is associated with lower transaction costs, it fails to identify empirical evidence demonstrating that corporate bond liquidity is currently constrained by post-trade transparency. As a result, the Proposed Pilot is a harmful solution to an unsubstantiated problem.

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[1] Vanguard is an SEC-registered investment adviser with aggregate assets under management of approximately $5.4 trillion as of April 30, 2019. As of April 30, 2019, Vanguard manages approximately $1.26 trillion in fixed income assets globally and approximately $1 trillion in U.S. fixed income assets.

[2] *See* Regulatory Notice 19-12 (Apr. 12, 2019) ("Notice"), *available at* http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-19-12.pdf.

[3] Vanguard expressed similar concerns with the related recommendations from the Securities and Exchange Commission's Fixed Income Market Structure Advisory Committee ("FIMSAC"). *See* Vanguard comment letter regarding FIMSAC's Preliminary Recommendation for a Pilot Program to Study the Market Implications of Changing the Reporting Regime for Block-Size Trades in Corporate Bonds (Jan. 2, 2019), *available at* https://www.sec.gov/comments/265-30/26530-4842061-177137.pdf.

I. The Proposed Pilot is Unnecessary

The Proposed Pilot is unnecessary because there is currently sufficient liquidity for corporate bonds that would be defined as "block trades" and the relevant academic literature discussed in FINRA's Notice demonstrates that post-trade transparency is associated with enhanced liquidity. We routinely trade corporate bond blocks much larger than the current dissemination caps and, consistent with FINRA's findings in figure 3 of the Notice, have observed that liquidity for corporate bond block trades has generally improved over time. Furthermore, consistent with the academic research highlighted in FINRA's Notice, there is no evidence that existing post-trade transparency has any negative impact on bond market liquidity generally or block trades in particular. Rather, as noted in FINRA's Notice, the post-trade transparency created by TRACE has been linked to reductions in trade execution costs over the past decade.

We note that trading volume, or the change in trading volume over time, is not an appropriate measure of corporate bond market liquidity and that any assessment of trading volume should account for the historical evolution of both trading and investing behavior. For example, the market share of electronic trading for investment grade corporate bonds has grown from 6.6% in 2008 to more than 20.7% today, which we would expect to facilitate an increase in smaller lot trade sizes due to reduced transaction costs associated with such trades. In addition, the evolution of how retail investors obtain corporate bond exposure has evolved over time from owning individual bonds, to owning active bond funds, to owning index bond funds. Turnover in the current corporate bond market—which can be expressed as trading volume as a percentage of market value—is significantly impacted by these developments as well as the buy and hold nature of bond investing, the distribution of an issuer's borrowing across many different bond issues, and the fact that many bonds are substitutes for one another based on common characteristics, such as issuer, sector, credit quality, and maturity. As a result, any assessment of corporate bond market liquidity should account for the various ways in which investing and trading behavior have evolved over time as well as the unique characteristics of the bond market.

II. The Proposed Pilot's Delayed Dissemination of Trade Data Will Harm Investors and Markets

Post-trade transparency is a critical component of the corporate bond market structure that fosters a level playing field among all market participants and facilitates innovation, which typically lowers costs for investors and enhances the fairness and efficiency of our markets. The Proposed Pilot would intentionally restrict market participants from acquiring a significant amount of critical information necessary to both evaluate the current state of the overall corporate bond market and the appropriate valuation of particular corporate bonds at any given time. As a result, the Proposed Pilot will harm investors and the corporate bond market by significantly reducing post-trade transparency for a significant amount of trading activity, hindering the evolution of corporate bond markets, and creating an unlevel playing field.

Delaying price dissemination is particularly concerning because it would restrict market participants from receiving the most current market information associated with approximately 34% (investment grade) and 40% (non-investment grade) of the recorded market volume in 2018 when including trades below $1 million in trade size and approximately 40% (investment grade) and 47% (non-investment grade) when excluding trades below $1 million in trade size.[4] Intentionally restricting market participants from acquiring pricing information for a third or more of the market volume will have a meaningful negative impact on cost. We expect that these increased costs will also negatively impact an ETF's spread in the secondary market.

Restricting market participants from acquiring current transaction information will also hinder the evolution and electronification of the corporate bond market. Post-trade transparency serves as a foundational building block to foster technological changes and innovation in the fixed income markets. Information obtained through post-trade transparency will increasingly facilitate liquidity as fixed income markets evolve from principal-based market making to agency and electronic market structures.

Restricting market participants from acquiring current transaction data in a significant amount of trading activity may create winners and losers in the market due to the information asymmetry between liquidity providers and liquidity seekers. Liquidity providers may have significantly more information than those with which they transact, putting most investors at a disadvantage when transacting with bond dealers. By bifurcating the market into those with access to information and those without, the Proposed Pilot may even create additional barriers to entry for newer or smaller market participants, and further entrench the largest market participants.

III. The Proposed Pilot is Fundamentally Flawed

In addition to negatively impacting investors and markets, fundamental flaws associated with the Proposed Pilot will undermine the credibility of information arising from the Proposed Pilot. We believe that the results associated with the Proposed Pilot's test groups can be manipulated by market participants due to the limited number of bonds in each test group and the relatively short timeframe of the pilot. Trading data over a one-year period (September 2017-October 2018) shows that, on average, approximately fifteen unique CUSIPs per day will fit into any one of the test groups. Furthermore, 89% of U.S. investment grade corporate bond trading volume, and 80% of U.S. non-investment grade corporate bond trading volume, comes from 20% of the bonds outstanding in their respective markets.[5] As a result, we believe this is too limited a sample size to carry relevant statistical significance.

[4] *See* Notice at Table 3. We believe that retail trades below $1 million notional size should be excluded because they likely include commissions associated with private banking fees and are therefore not useful for price transparency.

[5] US Credit Market Liquidity: Year-End 2018 Update, J.P. Morgan (Jan. 25, 2019).

In addition, the Proposed Pilot's definition of a block trade (e.g., trades above $10 million in investment grade corporate bonds and $5 million in non-investment grade corporate bonds) is far too low and doesn't reflect the industry's understanding of a block trade. In fact, we believe that FINRA should consider permanently increasing the trade dissemination size caps to enhance existing transparency. To the extent regulators seek to examine the interplay between post-trade transparency and liquidity of corporate bond block trades, such review should be informed by a data-driven assessment examining where liquidity and post-trade transparency result in meaningful conflict for market participants. Furthermore, to the extent regulators assess post-trade transparency relative to liquidity, we urge regulators to be deliberate in selecting relevant data and avoid oversimplification of liquidity metrics as purely based on trading volume.[6]

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Vanguard appreciates the opportunity to comment on the Proposed Pilot. If you have any questions about Vanguard's comments or would like any additional information, please contact Jillien Flores at 202-824-1283 or Brian P. Murphy at 610-669-1605.

Sincerely,

/s/ Gregory Davis

Gregory Davis
Chief Investment Officer
Vanguard

cc:

Robert W. Cook, President and Chief Executive Officer, FINRA
The Honorable Jay Clayton, Chairman, Securities and Exchange Commission ("SEC")
The Honorable Robert J. Jackson Jr., SEC Commissioner
The Honorable Hester M. Peirce, SEC Commissioner
The Honorable Elad L. Roisman, SEC Commissioner
Brett Redfearn, Director, SEC Division of Trading and Markets

[6] For example, we question the utility of corporate bond block trade data during the period surrounding the financial crises of 2008 given the unique markets at that time, the evolution of regulations governing bank capital, and the amount of leverage employed by bond dealers and hedge funds at that time. We also note that a lack of correlation among corporate bond new issues and block trades, or periods of lower turnover, are not evidence of declining liquidity.