October 16, 2020

<u>**Via Electronic Mail (pubcom@finra.org)**</u>

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

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

Dear Ms. Mitchell:

SumRidge Partners, LLC ("SumRidge" or "the Firm") appreciates the opportunity to respond to the above referenced request for comments on the practice of pennying in the corporate bond market. SumRidge is a fixed income specialist firm and principal based market maker in Investment Grade and High Yield Corporate Bonds, Municipal Bonds, and Institutional Preferred Securities. As a fixed income market maker, the Firm provides liquidity to sophisticated market participants and transacts in principal capacity with institutional counterparties. The following comments are in response to the FINRA's questions in the above referenced request for comments.

1. **Do you agree with the FIMSAC's definitions of pennying and last look practices and the distinction between the two? If not, how would you propose differently to define or distinguish between the two practices?**

   We agree with the definitions FIMSAC has provided and the distinction between the two definitions.

2. **Do the results of FINRA's sample study accurately represent the nature or frequency of practices you observe in the markets? Do the results of the sample study demonstrate that in the corporate bond market, last look is a common practice to achieve best execution, or the practice of pennying is prevalent, or both?**

   We observe pennying in both the corporate and municipal markets. The amount of trades that reach ECN's given our historical trading volumes and data with various counterparties generally dictates how competitive we will price bid-wanteds, offer-wanteds, and pre-trade transparency.

In our observation, there isn't much differentiation between trading platforms and seems to be more of a desk decision or practice by counterparties. Many counterparties use multiple ATS platforms so the decision is likely made more by the counterparties than the ATS. However, one important distinction is between desks that have to trade external compared to the desks that have the ability to commit capital and internalize trades. A second important distinction is ATSs/platforms that allow a firm time stated by the liquidity provider (the bid is good for x hours post bid time, then goes subject), operates with a shorter completion time (bid by, firm until) or allows an all-day firm time/around time posted by the RFQ provider.

3. **If pennying is defined as a pattern or practice of internalization with no or slight price improvement after viewing prices obtained through an RFQ, what amount of price improvement should be considered meaningful and what level of regularity would constitute a pattern or practice?**

If best execution is the rationale for a broker-dealer to have the ability for a last look, and that is the reason for the price improvement, the competitiveness of the corporate bond auction should not weigh into the level. With respect to municipals, a price improvement of 25bps would be significantly more meaningful for an auction of 20+ responses vs. an auction with one or two responses. Municipals are more illiquid than corporates due to a variety of factors including smaller issuers, smaller deal sizes, variety of obscure credits, and the inability to short municipals.

We believe that the price improvement should be considered utilizing a common metric across all trade sizes and the transaction costs should be included.

4. **What are the market quality and economic consequences of pennying? Does or will pennying harm overall auction competitiveness over time, for example by causing fewer firms to provide bids in response to auctions, or by causing responding firms to bid less aggressively? How can the impact of pennying be measured?**

As an independent market maker with limited resources, we focus on potential trades with counterparties and venues with a higher probability of a trade occurring. In March, we participated in the volatile market daily with a focus on trading with disclosed customers on platforms with higher hit rates. Those venues or counterparties where hit rates are low, as a result of pennying or otherwise, are likely to receive less responses or worse prices. In addition, we focused on venues or platforms that had shorter firm times for municipal bid wanteds. Therefore, over time, pennying results in less responses from market participants and ultimately worst prices for investors.

Potential ways to measure the impact of pennying include examining the percentage of internalized trades over time intervals, the percentage of trades that make it external to the marketplace, and market moves from a set time of bidding to the time of the execution and the percentage of trades that are improved to internalize during favorable market moves and routed external on adverse market moves.

We encourage counterparties to disclose the firm requesting the bwic or owic in the market as those firms that do not internalize or penny will generally receive more resources, in the form of participation and pricing, over time. Formalized official disclosure of a firm's pennying/last look policies may prove helpful in encouraging more dealers to price more competitively during a firm's auction.

5. **During FIMSAC discussion of the Recommendation, there was some support for a requirement that dealers "bid blind" in response to auctions their firm initiates. Under this kind of requirement, dealers would need to bid on auctions initiated by their firm on a blind, competitive basis during the auction period, the same as any other firm, without the opportunity to review other firms' auction responses before entering the firm's own order.**

   We believe that a full external bidding and offering in a blind approach would be the most competitive market format. This format would incentivize all market participants to put their best foot forward when participating in auctions.

   However, if a reserve level, Portfolio Manager (PM) limit, or just a simple did-not-trade (DNT) could put a bind on a firm and if there is a reserve or PM limit that was submitted at time of trade and was not achieved at the time of the competitive bidding process, the firm should be allowed to execute the trade at that level for the customer without having to go back externally for a new auction.

6. **As FINRA continues to coordinate on pennying with the MSRB, consistent with the FIMSAC Recommendation, are there any differences between the corporate and municipal bond markets for which FINRA and the MSRB should account?**

   In the corporate bond market, the one additional concern is competitive pricing intelligence. Some firms have algorithms that utilize third party dealers to price their own algorithms and therefore, only improve by a de minimis amount. For example, if Firm A is utilizing an algorithm to improve pricing based upon Firm B's prices, the price is only as good as the price it receives from Firm B. If trades are allowed to be penny'ed or internalized, Firm B is not incentivized to give Firm A its best price without a potential trade occurring. Additionally, Firm B also aids Firm A for all in competitive trades that may occur. Over time, Firm B will not have the ability to be as competitive and will widen bid/ask. Since Firm A is algoing Firm B, Firm A's bid/ask will now be wider than the initial bid/ask spread. Therefore, internalization/pennying not only is causing worse execution than going to the marketplace, it discourages competition and better pricing over time.

In contrast, the municipal bond market pennying derives predominantly from the bwic process. Most participating firms put bwics on multiple platforms to satisfy the best execution requirements and obtain the best external bid in the market place. As noted above, if this were a blind process, the bwic provider's bid level would be obtained in the blind and fully open bwic process. The current structure of the market allows for pennying/last look to occur on most platforms and venues as all day firm times or around times create the framework for the bwic provider to get a free look at the market and determine after the final municipal market scale adjustments whether or not to internalize the bwic or sell it externally. As MSRB looks at the structure of the municipal market, one action to alleviate pennying would be to implement a market reform that places limits on the firm times of bwics to no more than two hours after the bid time.

If you have any questions or would like to discuss above comments, please do not hesitate to contact me at [Redacted] or via email at [Redacted].

Sincerely,

Katherine Shim
Chief Compliance Officer