



Eduardo Repetto
Chief Executive Officer
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November 6, 2012

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

**Re: FINRA Request for Comment on Trade Reporting and Compliance Engine
("TRACE") (FINRA Notice 12-39)**

Dear Ms. Asquith:

Dimensional Fund Advisors LP ("Dimensional") appreciates the opportunity to provide the Financial Industry Regulatory Authority ("FINRA") with our views on the TRACE dissemination issues discussed in Regulatory Notice 12-39.¹ As a registered investment adviser that provides investment management services to mutual funds, institutional and financial adviser clients, Dimensional is in full support of efforts to provide and improve post-trade transparency to market participants.

At the time TRACE was created, FINRA implemented a phase-in approach that limited public dissemination of TRACE information to certain types of fixed income securities. In addition, TRACE-eligible securities were subject to specified dissemination caps, under which the actual size of a transaction over a certain par value is not included in disseminated TRACE data. This approach was largely in response to concerns that transparency could cause reduced liquidity in the marketplace. Now that TRACE has been in operation for some time, FINRA is seeking input on: (i) whether it should maintain or modify current TRACE dissemination caps and (ii) whether transactions in TRACE-eligible securities effected pursuant to Securities Act Rule 144A ("Rule 144A Transactions") should be disseminated.

Increased transparency benefits investors

Since the introduction of TRACE, there have been measurable benefits to investors, primarily in the form of lower transaction costs due to increased transparency. There are multiple studies of the impact of increased transparency in the corporate bond market. Despite the use of different methodologies and samples, the consistent finding across these studies is that

¹ FINRA Regulatory Notice 12-39 (September 2012) ("Notice"), available online at: <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p163711.pdf>.



the introduction of TRACE was associated with a decline in trading costs.² Armed with more information, investors have an enhanced ability to negotiate terms for bond trades. We also believe that increased transparency inherently boosts investor confidence in the market.

The impact of increased transparency has been particularly striking on more actively traded bonds. Importantly, these studies have had considerable success in separating causation from correlation; the evidence indicates that increased transparency resulted in *subsequent* decreases in trading costs. Edwards, Harris and Piwowar, report that transparency decreases customer transaction costs by roughly five basis points.³ Similarly, Bessembinder et. al. indicate an approximately 50% reduction in trade execution costs for bonds eligible for TRACE transaction reporting.⁴ Given these observations, we believe that increased transparency would be to the benefit of our clients and all investors in the corporate debt market.

Separately, a reduction in trading costs will also reduce borrowing costs for issuers. Such reductions may entice more borrowers to the marketplace and could further enhance the bond market.

No observed adverse liquidity impact

When FINRA first proposed the introduction of TRACE, many commenters expressed concern that the immediate dissemination of bond transaction data could have a potential adverse impact on liquidity.⁵ However, the previously cited research shows no negative impact on liquidity from TRACE eligible securities. Quite the contrary, these studies show substantial reductions in trading costs. Even the most conservative estimates in Goldstein and Sirri (2006) indicate that increased transparency has either a neutral or a positive effect on market liquidity, depending on the trade size.⁶

It is possible, however, that commenters may again raise the concern that eliminating or increasing the level of dissemination caps could adversely impact market liquidity. In particular, we are aware that some industry members are concerned that if dissemination caps are removed then dealer inventory could be identified in a way that could be used against dealers. The argument they make is that dealers could become disincentivized from providing liquidity. It is important to recognize that the disseminated data under TRACE does not reveal which dealer

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).

³ See Edwards (2007).

⁴ See Bessembinder (2006); it was also observed that trade execution costs for bonds not eligible for TRACE reporting also decreased by approximately 20% since the introduction of TRACE, which implied a liquidity externality where better pricing information reduced execution costs for related bonds.

⁵ 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.

⁶ See Goldstein (2006).



participated in a transaction, just that a dealer was involved. Based on that information alone, it is not clear that the inventory of any specific dealer could be gleaned from the TRACE data. Furthermore, because dealers can pass inventory between them and have those recorded as inter-dealer trades, it would be difficult for market participants to reverse engineer dealer inventory based on the data disseminated via TRACE. It is for these reasons that we believe this argument to be flawed.

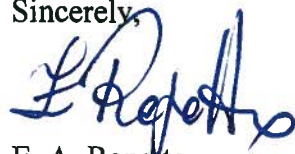
Response to FINRA requests for comment

We wanted to respond to the two principal issues that FINRA was seeking comment on: (i) whether it should maintain or modify current TRACE dissemination caps and (ii) whether transactions in TRACE-eligible securities effected via Rule 144A Transactions should be disseminated.

First, based on the evidence that TRACE data has been beneficial to investors, we support the elimination of dissemination caps. If FINRA decides to maintain dissemination caps, however, then we would support increasing the caps since any increase in the amount of post-trade data available to market participants would be, in our view, in the best interests of investors. An incremental increase in the dissemination caps⁷ may be a reasonable middle ground approach that takes into consideration the clear benefits of increased transparency along with any other commenters' concerns regarding a potential reduction in liquidity. Such an approach would allow time for additional studies on the effect of the incremental increases in the caps to address concerns regarding liquidity and would also appear consistent with the approach taken thus far in implementing TRACE in phases.

Second, on the question of Rule 144A Transactions, we believe that information regarding Rule 144A transactions should be disseminated just as other transactions for TRACE-eligible securities. For the same reasons, investors such as our clients that participate in Rule 144A transactions would benefit from increased transparency.

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

Sincerely,


E. A. Repetto

⁷ For example, increasing the par value cap level from \$5 million to \$10 million for short and intermediate-term investment grade bonds and agency debt securities and increasing the par value cap level from \$1 million to \$5 million for short and intermediate-term non-investment grade corporate bonds. We also believe that the par value cap levels should be set higher for long-term bonds across all categories.