BMO Capital Markets

By Email

October 3, 2022

Jennifer Piorko Mitchell
Office of the Corporate Secretary
Financial Industry Regulatory Authority ("FINRA")
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 22-17 FINRA Requests Comment on Shortening the Trade Reporting Timeframe for Transactions in Certain TRACE-Eligible Securities from 15 Minutes to One Minute

Dear Ms. Mitchell,

BMO Capital Markets[1] ("BMO CM" or "We") welcomes the opportunity to provide comments to FINRA with respect to the above referenced proposal on Shortening the Trade Reporting Timeframe for Transactions in Certain TRACE-Eligible Securities from 15 Minutes to One Minute (Regulatory Notice 22-17). The proposal would require members to submit a report to TRACE within one minute from the time of execution for transactions in corporate bonds, agency debt securities, asset-backed securities ("ABS"), and agency pass-through mortgage-backed securities traded to-be-announced for good delivery ("TBA GD").

As a participant in fixed income markets, BMO CM appreciates FINRA's continued efforts to increase efficiency and ensure that the fixed income market operates equitably. Further, we recognize the critical role that the TRACE reporting framework plays in capital markets. However, we do not believe that this proposal will benefit market participants and, instead, will result in adverse impacts to the fixed income market's liquidity, structure, and integrity. We are concerned that this proposal is in essence an electronic trading mandate and, as we detail below, a one minute reporting timeframe will be impossible to achieve for products for which the market mostly uses manual trading methods.[2]

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[1] BMO Capital Markets is a trade name used by BMO Financial Group for the wholesale banking businesses of Bank of Montreal, BMO Harris Bank N.A. (member FDIC), Bank of Montreal Europe p.l.c, and Bank of Montreal (China) Co. Ltd, the institutional broker dealer business of BMO Capital Markets Corp. (Member FINRA and SIPC) and the agency broker dealer business of Clearpool Execution Services, LLC (Member FINRA and SIPC) in the U.S., and the institutional broker dealer businesses of BMO Nesbitt Burns Inc. (Member Investment Industry Regulatory Organization of Canada and Member Canadian Investor Protection Fund) in Canada and Asia, Bank of Montreal Europe p.l.c. (authorized and regulated by the Central Bank of Ireland) in Europe and BMO Capital Markets Limited (authorized and regulated by the Financial Conduct Authority) in the UK and Australia. "Nesbitt Burns" is a registered trademark of BMO Nesbitt Burns Inc., used under license. "BMO Capital Markets" is a trademark of Bank of Montreal, used under license. "BMO (M-Bar roundel symbol)" is a registered trademark of Bank of Montreal, used under license. ® Registered trademark of Bank of Montreal in the United States, Canada and elsewhere. ™ Trademark of Bank of Montreal in the United States and Canada. © 2020 BMO Financial Group.

[2] Throughout this comment letter we will refer to both "manual trading" and pure "electronic trading". By manual trading we are referring to instances where details of a trade are initially agreed to over email, chat or voice communication tools (or

We believe that dealers will need to fully adopt electronic trading for all in-scope products in order to be compliant. Consequently, these dealers will be unable to trade with clients who do not follow suit without risking non-compliance with the reporting deadlines and being subject to the resulting fines. A proper cost-benefit analysis of this proposal, therefore, cannot exclude the significant costs dealers and investors will be compelled to incur in adopting pure electronic trading, as well as the associated overhauling of related processes, should they wish to remain in these markets.

Below, we provide an overview of TRACE reporting requirements followed by a product-by-product analysis of how BMO CM currently trades each in-scope product, including challenges that we and the industry will confront in meeting the proposed one-minute reporting deadline.

TRACE Reporting Overview

Accurate and timely reporting of TRACE-eligible transactions for fixed income products outlined in the proposal involves several critical business functions including sales, trading desk, and back-office. The market practice is often manual (e.g., voice or chat), as opposed to purely electronic, requiring individuals to confirm and enter all the required TRACE data fields in order to correctly report the trade. At a minimum, dealers must verify multiple data elements, including counterparty information (e.g., a customer, MPID, or affiliate), capacity (e.g., principal, agent, or principal agent), commissions data, settlements data, and other trade modifiers, in order to correctly report TRACE requirements.

Dealers then enter this information into our trade capture system, after which both sales and the trading desk review it prior to submitting it into TRACE. In this context, correctly reporting relatively straightforward bi-lateral trades within a minute would be impossible and mandating this will only serve to increase corrections and fines. We, therefore, believe that it is critical that FINRA consider the unique trading nature of each product type as well as the associated challenges prior to FINRA recommending that the Securities and Exchange Commission adopt this proposal.

Impact of Proposal by Product Type

1. TBA GD Securities

BMO CM conducts most of its transactions in TBA GD securities employing market standard manual trading methods with over 60% of trades being conducted via voice or chat. Although there is some electronic trading of TBA GD securities, the complexity of products and diverse mix of market participants, including large and small firms, necessitates most trading to be executed manually. Further, while some dealers and clients deploy a mix of manual and pure electronic trading, some market participants, particularly smaller investors, are still entirely reliant on manual trading since they do not have the capital to adopt pure electronic solutions.

Meeting the one-minute timeframe as proposed for manually conducted trades in TBA GD is not a realistic standard. To better illustrate the difficulty this would impose on a dealer, we have outlined an example of a specified pool trade for which a CUSIP has not yet been issued. After a trade is agreed to, a new temporary CUSIP needs to be setup for the security in order to accurately record the terms of the trade. Once this is complete only then can the trade be booked and reported as either GD TBA or non-GD TBA,

similar) after which the details still need to be manually entered into a trading platform. Pure electronic trading refers to instances where further input of trade details is not required after a trade has been agreed to.

with the TRACE submission subsequently updated with the appropriate TBA CUSIP. Since these trades are conducted via voice/chat, there is no straight-through processing available and it will not be possible to execute the entire process, including setting-up the product, dual-entry booking, and updating the TBA CUSIP, within a one-minute timeframe.

In another common scenario, we have observed that our clients mostly rely on voice or chat to buy a specified pool on swap from BMO CM and then sell TBA to BMO CM as part of one single trade. In this situation, booking the TBA side of the trade would be impossible to execute within a minute.

Moreover, reporting TBA GD trades accurately within the currently permitted 15-minute timeframe, although achievable, has been a challenge for the market. Restricting the permissible time for reporting TBA GD trades further would require all market dealers to move to purely electronic trading to meet the new regulatory requirement and force them to cease trading with counterparties unable to migrate to electronic trading. This will result in market participants exiting the TBA GD market as the costs of participation become too high, which would have an adverse impact on market liquidity.

2. ABS

Currently, ABS sales and trading activity at BMO CM is conducted manually with the trade execution process involving two parties agreeing to a trade by either voice, chat, or email. The salesperson then enters the ticket which the trading desk affirms (or rejects), followed by the ticket being sent to the client to be matched, and then finally reported into TRACE. There is no pure electronic trading occurring in this process and we are unaware of any pure electronic trading solutions on offer for these products in the market.[3] Therefore, and as described below, we do not believe that the proposed one-minute time limit for reporting ABS trades is plausible.

The primary reasons behind the lack of adoption of electronic trading in ABS include:

i) *Complexity of ABS products*, including the highly diversified nature of underlying collateral pools, varied bond positioning based on risk profile in an inherently complex capital structure, as well as pricing dynamics which involve numerous model parameters (e.g., rates of defaults in collateral pools, nature of payments) that would be difficult to satisfactorily account for electronically.

ii) *Complexity of the ABS trade execution lifecycle*, including the manual intervention of several active business functions such as the salesperson, trader, middle office, and the client, with very limited automation taking place or available during the process.

iii) *Lesser trading frequency and visibility,* relative to other markets such as the Treasury market.

To reiterate, since all ABS trades are conducted manually, meeting the one-minute timeframe for reporting would not be possible, as we highlight in the following example. Once a portfolio of bonds is introduced into the market via a bids wanted in competition ("BWIC") process (a popular method for investors to sell assets), an ABS client closes its list, allocates the selling of bonds, and generates an email to the winners. This is followed by a ticketing process involving several functions including the

[3] We are aware of limited electronic trading tools for ABS trades; however, their use is mostly limited to sorting and as a result play a minimal role in the current trading lifecycle for ABS products.

dealer's salesperson and trading desk, the seller's trader, analyst, portfolio manager, and possibly operations personnel on both sides. In the case of agency trades where a third market participant has bid bonds on the BWIC, the dealer involved must complete another round of ticketing. This results in a chain of several people, numbering anywhere from 10 or more, working manually to ensure that every iteration along the trade cycle is accurate, which is then followed by details being finally submitted into TRACE. Executing multiple trade transactions, which tend to be common in ABS, has been difficult within the current 15-minute timeframe and would be impossible to achieve within a minute.

Given these challenges, we fear that the shortened timeframe will increase reporting of inaccurate or incomplete information due to the heightened pressures on the business functions to operate within the timeframe. Rather than providing any material benefit to the ABS market, a one-minute timeframe will only serve to decrease liquidity as participants will inevitably choose to exit the market.

Furthermore, the proposal seems to assume that ABS market participants could meet the one-minute reporting timeline by incurring modest costs in establishing automated reporting systems. We, however, believe that compliance with the proposal would require a complete overhaul of the ABS market, including significant costs for market participants in developing and adopting electronic trading systems that, as highlighted earlier, do not currently exist in ABS trading. If pure electronic trading in the ABS market is something that the regulators would like to encourage, it is imperative that regulators work with market participants to first explore the feasibility of such a development. Only once such processes are developed and established in the ABS marketplace, will dealers be in a position to work with regulators to meet the requirements of a one-minute reporting deadline.

3. Corporate bonds

While pure electronic trading occurs in the corporate bond market, our experience is that the market still relies on manual methods, with over 60% of trading in corporates at BMO CM involving the manual execution of trades. Furthermore, our experience is that electronic trading is more common for trades in corporates that are $5 million or less. Larger blocks are still overwhelmingly traded via voice or chat.

Requiring the reporting of manual trades within one minute would expose dealers to increased risks of fines for late reporting and inevitably result in more errors. If dealers are required to report trades in corporates within a minute, the increased compliance costs would inevitably push participants away from this market segment resulting in decreased liquidity.

Our concern is that this proposal is a solution without a problem. Market participants have not voiced concerns with the current reporting timeframes or the associated information availability. Nor do we think that these concerns would be different for retail or institutional investors. Dealers are already challenged in meeting the 15-minute timeframe and we are unaware of dealers deliberately delaying trade reporting to gain any advantage under the current reporting requirements.

We are further concerned that the only market participants that would benefit from this proposal are niche "fast money" entities that specialize in developing and employing algorithmic trading. The reduced reporting timeframe will likely result in the increase of unnecessary intermediation from these participants who would be incentivized to get in front of real investors. The result will be increased costs for these investors, both retail and institutional.

Conclusion

BMO CM is committed to the fair and efficient functioning of fixed income markets, including the timely reporting of trades. However, we believe that further reductions in trade reporting timeframes should directly translate to benefits for investors in the specific product being contemplated. Otherwise, regulators will risk compromising market liquidity, integrity and structure, without any corresponding benefits.

BMO CM urges FINRA to reconsider this proposal at this time and pursue an in-depth review of trading in fixed income markets, including revisiting the data outlined in the proposal and conducting a product-by-product analysis looking at the benefits and challenges of moving to a one-minute timeframe for each unique product type. We recommend that FINRA consult industry in this process and solicit diverse viewpoints, including from both institutional and retail investors, and consider alternative approaches to achieve policy outcomes with minimal market disruption. Not only will this approach help mitigate industry concerns, but it will also ensure that fixed income markets continue to function efficiently and equitably.

If you have any questions on our comment letter, please feel free to contact the undersigned.

Sincerely,

"Stephen Thom"	*"Eric Jacks"*	*"Michael Forlenza"*
Stephen Thom Managing Director, Head of Global Credit Trading BMO Capital Markets	Eric Jacks Managing Director, Head of Global Markets Origination BMO Capital Markets	Michael Forlenza Chief Compliance Officer US BMO Capital Markets BMO Capital Markets