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Systematic Pennyning on SEC's Agenda.

WASHINGTON — The Securities and Exchange Commission is discussing two new rule recommendations to address systematic “pennyning.”

The SEC's Fixed Income Market Structure Advisory Committee and its Technology and Electronic Trading Subcommittee at a panel on Monday dug into pennyning, discussing two preliminary recommendations, which would address the practice.

“Although the increased use of electronic trading has had a variety of positive impacts on both the corporate and municipal bond markets, one troubling trading practice immediately came to the Subcommittee's attention: the systematic use of last-look, often referred to as ‘pennyning,’ by certain bond dealers,” the subcommittee wrote.

“Pennyning,” sometimes also referred to as “last-look,” occurs when a dealer purchases bonds for its own account, following the dissemination of a bid-wanted (through either an alternative trading system or a broker's broker) for a customer who is seeking to sell a municipal security, according to the Municipal Securities Rulemaking Board.

The dealer, after reviewing bid information received, either matches the high bid received in response to the bid-wanted or purchases the bonds at a price that is nominally higher than the high bid. The dealer technically provides the customer a price equal to or better than the best bid, but the MSRB said last year it was concerned that widespread pennyning disincentivizes participation in the bid-wanted process, discourages bidders from giving their best price in a bid-wanted and “may impact the efficiency of the market.”

The SEC subcommittee said the SEC should make a statement disapproving of the repeated use of last-look in either the municipal or corporate bond markets on any electronic trading venue, as the practice harms price discovery and market efficiency.

“The SEC should consider setting the clear expectation that the use of last-look should occur only in the rare situation when the dealer does not receive any reasonable response to an auction request and/or needs to use the practice to conform with its best execution responsibilities,” the subcommittee wrote.

It added that last-look shouldn't be a part of the dealer's everyday practice and the SEC should encourage dealers to have clear policies and procedures in place delineating when last-look may be used.

It also asked the SEC to encourage the Financial Industry Regulatory Authority to publish a request for comment on the use of last-look in the corporate bond market, similar to the MSRB's 2018 Request for Comment. The committee also asked the SEC to encourage FINRA and the MSRB to coordinate their respective final response.

SEC Chair Jay Clayton said the commission should be concerned about systematic bidding but also

be cautious with being prescriptive in not eliminating good bidding while trying to get rid of bad bidding.

"I do get the sense that this is something you think the commission should continue to look at," Clayton said.

"The subcommittee was concerned by the systematic use of last-look on alternative trading platforms ATS platforms, known as pennyng, so there was a differentiation there of a type of last-look that we would deem to be most problematic," Rick McVey, a member of the SEC's Fixed Income Market Structure Advisory Committee, and founder of MarketAxess (MKTX), said.

After the meeting, the subcommittee asked for two days to refine the recommendations and clarify systematic pennyng versus last-look.

By Sarah Wynn

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