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SEC Warned Against Regulation of Electronic Muni Platforms.

Broker-dealers and operators of electronic trading platforms are warning the Securities and Exchange Commission that expanding alternative trading system regulation to request for quote functions would harm the municipal market.

In comment letters filed to the SEC on Monday regarding a concept release to update the current alternative trading system regime to create uniformity, broker-dealers cautioned the SEC against using stringent regulatory requirements on all electronic platforms without first conducting a study on the impact of additional regulations.

"Electronic trading of corporate and municipal bonds is still developing and creating significant regulatory burdens on electronic platforms could harm the customer interactions with their broker-dealers and ultimately reduce the number of different platforms available when most retail investors generally want their orders exposed to multiple platforms to obtain the best price," the Securities Industry and Financial Markets Association said.

The SEC's request for comment closely follows 2018 recommendations from the SEC's Fixed Income Market Structure Advisory Committee. FIMSAC said at that time that some platforms were regulated as ATS', or regulated as broker-dealers, and others that operate on the same or similar models are not regulated.

Regulatory differences were driven by Regulation ATS, an SEC rule that established a regulatory framework for ATS' in 1998. To comply, an ATS must register as a broker-dealer and file an initial operation report with the SEC. In 2018, the SEC voted on amendments to Regulation ATS to improve transparency, such as requiring certain ATSs to file detailed public disclosures.

Further regulation could negatively impact broker-dealers ability to provide best execution to retail investors who hold over 72% of the market, SIFMA said.

SIFMA also said that platforms that act just as platforms that provide RFQs but where transactions get executed independently should remain outside the scope of Regulation ATS.

"Significant changes to Regulation ATS and/or the definition of exchange are not warranted and could have unintended negative consequences on the growth and development of electronic trading in these markets," SIFMA said.

Instead of creating new regulations for municipal ATS' the SEC could instead act through interpretive guidance, SIFMA said.

The current equity-focused ATS framework won?t work for fixed-income, electronic trading platform MarketAxess (MKTX) warned. Platforms that aren't regulated at all should be regulated and minimum standards should be created in a newly formed ATS rule that works for fixed income, MarketAxess (MKTX) said.

Rules related to ATS' should not be applied to requests for quotes, MarketAxess (MKTX) added. MarketAxess (MKTX) itself allows participants to post requests for quotes and execute deals on its platform. Securities Exchange Act Rule 15c3-5 requires a broker-dealer providing market access on an exchange or ATS to have a variety of financial and regulatory risk management controls.

MarketAxess (MKTX) told the regulator that electronic trading has grown rapidly and that any future regulation should not upset that momentum.

SEC rules such as SEA Rule 15c3-5 should not be applied to an RFQ and if RFQs were to be included as an ATS, the SEC should be wary of that and other rules that rely on Regulation ATS, MarketAxess (MKTX) said.

Electronic trading platform Tradeweb Markets Inc. (TW) said while it supports the SEC's efforts to tailor regulation to fixed income trading platforms, it will be complicated. Tradeweb offers a RFQ platform that was, but that is no longer registered as an ATS.

The group said it is important that platforms have similar trading protocols but that the SEC should not take a "one size fits all" approach.

SEA Rule 15c3-5 should not be applied to RFQs, Tradeweb said.

"… fixed-income trading platforms do not uniformly provide for arrangements between broker-dealers and customers for automated and anonymous trading platforms," Tradeweb argued.

The Bond Dealers of America said current regulation is inconsistent and could motivate regulatory arbitrage if new electronic trading entrants choose a structure that minimizes regulatory duties. Regulatory arbitrage is the practice of exploiting loopholes in rules by taking advantage of inconsistent standards.

Investor protections aren?t currently applied when two customers trade with each other.

"BDA supports applying key investor protection rules to trades executed on electronic platforms regardless of the parties to the trade," said Michael Decker, BDA senior vice president for public policy. "In a transaction where a dealer's counterparty is a non-dealer and their identity is known to the dealer, the dealer should bear customer protection responsibility."

If two non-dealers are trading, the trading platform should shoulder that responsibility, Decker said. That doesn't happen often, though, Decker said.

"The trading platform should have the responsibility for ensuring that the trade was conducted at a fair price so that the trade complies with Municipal Securities Rulemaking Board fair pricing rules or that the trade met suitability or best interest guidelines," Decker said. "All of the kinds of regulations that apply to a dealer when a dealer is conducting a trade on behalf of a customer should apply to the trading platform when there is no dealer involved."

Decker said the request for comment was just the start of a long rulemaking process.

The MSRB also weighed in, noting that ATS' have become a significant component of liquidity in the market – MSRB trade data for 2020 also shows that ATSs were involved 21% of all trades and 55% of all inter-dealer trades.

"Consistent with the FIMSAC recommendation, the MSRB looks forward to working collaboratively with the SEC and the Financial Industry Regulatory Authority to review the regulatory framework for oversight of the fixed income electronic trading platforms," said Ed Sisk, MSRB chair.

FINRA also commented Monday, saying it was difficult to harmonize rules to fixed income trading platforms without updates to Regulation ATS.

"In addition, given the Commission's broker-dealer interpretive role, and its supervisory role over the fixed income markets, FINRA believes the SEC should update trading platform classifications in the unified manner recommended by the FIMSAC," FINRA said.

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