Promoting Fair, Efficient, and Transparent Markets

2022 Market Structure Recommendations

Managed Funds Association

EXECUTIVE SUMMARY

The U.S. financial markets are the largest and most successful in the world due, in part, to their **strong regulatory frameworks.** U.S. markets promote competitive, open, fair, transparent, and efficient markets. MFA members are sophisticated managers, investing on behalf of **pension funds, charitable foundations, endowments, and family offices,** and have a strong interest in the robustness of U.S. markets. Markets continue to evolve with technological and product innovation, and MFA supports improvements to financial regulation to provide **reliable, stable marketplaces with integrity and global leadership** which meet the needs of investors, businesses, and the economy.

MFA urges financial regulators to consider ways to enhance competition and resiliency of U.S. markets and to promote market stability, liquidity, and integrity, in three primary areas:

Equity Markets

Further enhance the transparency, liquidity, and efficiency of U.S. equity markets and adapt to new trading practices and technology.

Treasury Markets

Modernize certain aspects of the Treasury market structure to meet the changing demands of the current markets.

Security-Based Swaps Markets

Adopt a regulatory regime that provides sufficient flexibility to market participants while maintaining regulatory protections and market integrity.

EQUITY MARKET STRUCTURE

The U.S. equity market structure is highly effective in **promoting transparency and liquidity for market participants.** It also allows for orderly trading during times of extreme market volatility. The framework to ensure orderly trading in times of uncertainty includes rules for market wide circuit breakers, limit up-limit down trading pauses for individual stocks, and Reg SHO to strengthen the short sale trading framework. During extreme market volatility in March 2020, brought on by the COVID-19 pandemic, these regulatory mechanisms ensured the strength and efficiency of the U.S. equity markets.

Updates to U.S. market structure will help the regulatory framework evolve with new trading practices and technology and reinforce the transparency, liquidity, and efficiency of the U.S. equity markets.

MFA makes the following recommendations for the benefit of investors, issuers and other market participants:

Aggregate Short Interest Transparency

MFA recommends that the Securities and Exchange Commission ("**SEC**") and/or the Financial Industry Regulatory Authority ("**FINRA**") provide investors with greater transparency of short interest in equities through disclosure of aggregated short positions per security across all broker-dealers on a weekly basis. Regulators should provide the aggregate information for both listed and non-listed equity securities in a consolidated place at no cost to investors.

Dissemination of aggregated information will increase market transparency without harming investors or revealing proprietary trading strategies.

The dissemination of aggregated information will increase market transparency without harming investors, sacrificing the market benefits of short selling, or revealing proprietary trading strategies. Individual short sale positions should not be publicly disclosed as it would deter research ferreting out corporate fraud, impede price discovery, harm individual market participants by allowing others to trade against them, and decrease market efficiency. This information at an account or investor level can be used to manipulate markets and exacerbate volatility.

Shorten to T+1 Settlement

MFA recommends that the SEC work with industry participants to shorten the settlement cycle for equity securities to the next day after a trade ("**T+1**"). Shortening the settlement cycle will promote operational efficiency, reduce counterparty risk, and provide investors with access to capital through lower margin requirements.

> Shortening the settlement cycle will promote operational efficiency and reduce counterparty risk.

Reduce Minimum Tick Sizes

MFA recommends that the SEC reduce the minimum tick size to a half-penny price increments for the most liquid securities to improve market quality. This includes symbols trading above $1.00 per share that are tick constrained in that they have a penny spread the overwhelming majority of the time ("the most liquid securities"). The move decimalization in 2001 resulted in a significant reduction in transaction costs. Reducing the tick size to half-penny increments for the most liquid securities would further increase savings for investors. It would improve market quality and benefit investors by improving price discovery and greatly reducing transaction costs in the most commonly traded securities.

Reduce Access Fee Caps

In conjunction with our recommendation for a reduction in the minimum tick size, MFA also recommends that the SEC reduce—for the most liquid securities—the maximum fees that a trading center can charge (or be allowed to charge) for the execution of an order against a protected quotation pursuant to Regulation NMS ("**access fees**"). A reduction from the current maximum access fee amount, 30 cents per 100 shares, for the most liquid securities reduces trading costs and benefits the price discovery process by encouraging exchange trading.

Implement New Round Lot Definition

MFA recommends that the SEC implement as soon as practicable its new round lot definition that is tiered based on the price of a stock. This will provide investors with information about better-priced orders in high-priced stocks, help investors make more informed order routing decisions, and allow investors to receive best execution.

TREASURY MARKET STRUCTURE

Investors are active participants in the Treasury cash and repurchase agreement ("**repo**") markets. Treasuries are the deepest, most liquid market in the world and a benchmark for myriad other asset classes. **However, as the size of the Treasury market has quadrupled in the last fifteen years and is expected to continue growing, it is important to modernize Treasury market architecture.** Recent events, most notably the rush for liquidity in the initial stages of the COVID-19 pandemic, the 2019 repo market turmoil, and the 2014 flash rally, have highlighted vulnerabilities in market functioning. MFA calls for the Treasury market structure to be modernized to further enhance the **efficiency and resiliency** of this critical market.

MFA makes the following recommendations to enhance Treasury market structure:

Expand Central Clearing Solutions

MFA recommends that the SEC, Department of Treasury, Federal Reserve, and other relevant policymakers work toward expanding the development of voluntary central clearing in the dealer-to-customer segment of the Treasury market for both secondary cash market transactions and repos. Expanded central clearing solutions will enhance market resiliency, lead to greater market transparency and liquidity, and reduce credit and operational risks. It will also benefit investors and market participants by allowing them to more efficiently deploy resources and capital by netting offsetting transactions and having access to market-wide protections provided by a clearinghouse's default management framework.

The expanded availability of central clearing may also facilitate the development of all-to-all trading in Treasuries which would further strengthen market resiliency and functioning. The post-Dodd Frank introduction of derivatives central clearing has been shown to increase liquidity and reduce counterparty risk. Today, nearly 80 percent of interest rate swaps are centrally cleared, but only 13 percent of cash Treasuries. The Treasury market is too important to be left behind.

Enhance Regulatory Data Collection

MFA recommends that FINRA, the Federal Reserve, and other policymakers enhance regulatory data collection to improve the quality of Treasury data reported through TRACE. In 2017 FINRA began receiving some TRACE Treasury data, which has proven to be a critical resource for helping regulators analyze and understand trading and events in the Treasury markets, including during the most acute stages of the COVID-19 induced market crisis in March 2020. However, regulators have consistently asked for enhancements to the data – a call that MFA supports.

> FINRA's use of TRACE Treasury data has proven to be a critical resource for regulators analyzing trading and events in the Treasury markets.

First, FINRA should shorten the trade reporting timeframe for Treasuries. Second, FINRA should add a clearing arrangement indicator to TRACE transaction reports as well as other enhancements. Finally, while all FINRA members currently report Treasury market trading activity to TRACE, regulators should require all bank entities – even those that are not FINRA members – to report Treasury market activity to TRACE. Enhanced Treasury markets transaction reporting would improve the reliability of data for regulatory purposes.

Introduce Public Dissemination of Post-Trade Transaction Data

MFA recommends that FINRA work with other relevant U.S. policymakers to gradually introduce post-trade price dissemination of anonymized data on Treasury secondary market transactions through TRACE. So long as important and appropriate exceptions for above block size trades and appropriate dissemination delays are incorporated, MFA recommends that regulators expand the dissemination of Treasury post-trade data through TRACE to be consistent with the transparency available for corporate bond transactions. Regulators should take a phased-in approach and calibrate trade size disclosures and dissemination delays by market segment to protect the anonymity of trading counterparties and to avoid potential negative impact on market liquidity and efficiency that could otherwise result.

Rationalize Trading Venue Oversight

MFA recommends that the SEC extend Regulation ATS to alternative trading systems ("**ATSs**") that trade government securities or repo and reverse repo agreements on government securities. With the growth of electronic trading and electronic trading systems, it is important to investors that regulators ensure the effective regulation of critical market infrastructure and trading venues as well as the robust disclosure and transparency of information to investors about the operations of such infrastructure and venues. The SEC should also examine other electronic trading venues (*i.e.*, multilateral request-for-quote venues) that operate in the government securities markets and consider how similarly situated entities might be treated in a more similar manner to improve the efficiency and resiliency of trading in government securities.

SECURITY-BASED SWAPS (SBS) MARKET STRUCTURE

MFA supports the creation of a robust market structure for SBSs. Although certain types of SBS contracts will always remain bespoke to best meet investor needs, MFA supports the implementation of a regulatory framework that can accommodate and foster the development of **stable, efficient, and liquid markets.** We recommend that the SEC adopt a regulatory regime that **provides sufficient flexibility to market participants while affording the requisite regulatory protections and ensuring market integrity.** We also believe that the regulation of SBSs should be consistent, to the extent applicable, with the regulation of swaps by the Commodity Futures Trading Commission ("**CFTC**"), given the significant overlap of market participants and their use of strategies that involve both SBSs and many types of CFTC-regulated swaps.

MFA recommends that the SEC's regulatory structure for SBSs reflect the following considerations:

Development of Clearing Solutions

MFA supports the development of SBS clearing alternatives through SEC-registered clearing agencies, which we believe will improve counterparty credit risk management and promote greater liquidity in the SBS markets. MFA recommends that the SEC work with clearing agencies and market participants on clearing solutions that will protect against SBS counterparty credit risks while offering sufficient flexibility to attract a variety of market participants. For standardized contracts, a robust clearing framework will encourage the growth of liquid, transparent, and stable markets.

Promote Trading Certainty; Straight-Through Processing

MFA recommends the adoption of mechanisms that promote settlement certainty, such as straight-through processing requirements for SBSs, applicable to clearing brokers, exchanges, SBS execution facilities, and clearing agencies. A requirement that trades be accepted or rejected immediately provides certainty of execution and clearing, reduces costs, and decreases risk. This also requires coordination among SBS dealers, and execution and clearing venues. Greater assurance of execution and clearing will encourage broader trading activity, thereby enhancing liquidity and pricing. Both the CFTC and EU have adopted rules requiring straight-through processing, which apply to swap dealers, exchanges, swap execution facilities, clearing houses and clearing members.

Establish Block Trade Thresholds

MFA recommends the implementation of block trade public reporting thresholds for SBSs as soon as feasible. Establishing block trade thresholds at which the size of large trades is capped for dissemination purposes will protect market participants trading orders of large size, promote market integrity, and allow for real-time public reporting in line with CFTC rules for reporting swaps and FINRA rules for reporting corporate and municipal bond transactions.

The implementation of block trade thresholds and real-time reporting will greatly enhance market transparency.

The implementation of block trade thresholds and real-time reporting will greatly enhance market transparency in a way that balances the needs of investors and market participants, promotes competition, and maximizes market liquidity and efficiency. The CFTC and the swap execution facilities have adopted block trading exemptions, which have worked well and have facilitated use of the markets.

Access to Execution Facilities

MFA recommends the development of a SBS execution facility ("**SBSEF**") framework that promotes multilateral and competitive trading venues. To implement Dodd-Frank Act *impartial access* requirements, SBSEFs should provide access to all market participants meeting the definition of an "eligible contract participant" and should not be allowed to limit access to only broker-dealers.

SBSEFs should provide access to all market participants meeting the definition of an "eligible contract participant".

Such requirements will promote the safety and stability of SBS markets while facilitating more fair, open, competitive, and transparent markets. In this respect, the CFTC SEF rules have improved trading in each of these respective measures, and we recommend that the SEC consider adopting a consistent framework.

Post-Trade Name Give-Up

MFA recommends that centrally cleared transactions executed on SBSEFs that offer pre-trade anonymous trading protocols remain anonymous and that parties not be subject to post-trade identification ("**post-trade name give-up**"). Although post-trade name give-ups are essential in the over-the-counter uncleared market, they are not necessary when trades are executed anonymously on-venue and cleared as the counterparty to each party will be the clearinghouse. The practice of post-trade name give-up may actually impede the development of active and liquid markets by deterring market participants who do not want their identification revealed from participating. We note that the CFTC has adopted a rule prohibiting post-trade name give-ups for these reasons, and we recommend that the SEC harmonize and take the same approach.