

[Securities Regulation Daily Wrap Up, TOP STORY—FIMSAC criticizes pennying, reaffirms support for new issue corporate bond database, \(Jun. 12, 2019\)](#)

Securities Regulation Daily Wrap Up

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FIMSAC recommendations drew on lessons from the municipal securities market in discouraging pennying and providing a comprehensive database.

The SEC's Fixed Income Market Structure Advisory Committee (FIMSAC) has approved a preliminary recommendation on "pennying" in the corporate and municipal bond markets, criticizing it as harming competitiveness due to dealers using the auction process for price discovery purposes. FIMSAC also approved a comment letter to the SEC expressing its support for a FINRA proposal that would establish a corporate bond new issue reference data service. FIMSAC recommended combining some of the proposed data fields and proposed new fields for the service.

Pennying. Pennying, according to FIMSAC's [recommendation](#), occurs when the dealer, after reviewing the auction information received back in a bid wanted (BWIC) or offer wanted (OWIC), either matches the best price or executes the bond at a price that is slightly better than the best price. Despite this practice appearing on the surface to benefit the customer, FIMSAC believes that it actually harms competitiveness. The use of pennying can deter participation in the auction by other dealers because they fear the submitting dealer is using the auction process solely for price discovery purposes, FIMSAC explained. As a result, competing dealers may face diminished incentives to even submit a price into the auction.

FIMSAC's recommendation notes that the Municipal Securities Rulemaking Board (MSRB), following outreach on pennying in the municipal bond market, published for comment draft interpretive guidance observing that pennying is prevalent in the municipal market and widespread pennying disincentivizes participation in auctions, which can impact market efficiency. FIMSAC applauded the MSRB's approach to pennying and warned that it is also utilized by dealers in the larger corporate bond market.

The FIMSAC recommendation urges the SEC to encourage FINRA to follow in the MSRB's footsteps and issue a similar request for comment from corporate bond market participants. FIMSAC also requested that the SEC make a statement disapproving the use of pennying in both the municipal and corporate bond markets on electronic trading venues because it harms price discovery and market efficiency.

FIMASAC member Richard McVey, chairman and CEO of MarketAxess, said at the meeting that the recommendation was revised after feedback requesting clarification on the difference between pennying and "last look" pricing, which refers to the valid process of a dealer reviewing auction responses as part of its best execution practices before executing a customer order. According to McVey, the recommendation includes a better definition of pennying, as well as clarifying that "last look" is an acceptable practice.

Database for new issue corporate bonds. In addition to expressing its support for FINRA's [proposal](#) to use its TRACE database to disseminate new issue reference data for corporate bonds, FIMSAC's [letter](#) addresses reservations that have been raised about the proposal. The letter observes that there is no current regulation or commercial imperative that requires underwriters or issuers to provide the pertinent information about a new issue of a corporate bond to all reference data providers at the same time. In contrast, FIMSAC pointed to the New Issue Information Dissemination Service (NIIDS) system operated by DTCC for municipal bonds as a positive comparison for a similar service for corporate bonds. According to FIMSAC, the creation of NIIDS benefited market participants without harming municipal bond reference data providers.

In response to concerns that a central database might erode competition in the data services market, FIMSAC observed that it has recommended requiring underwriters to report only the limited set of information that would be required to value, trade, and settle a newly issued corporate bond trade. FIMSAC also noted that the service proposed by FINRA is not exclusive and that underwriters would not be prohibited from providing the same or enhanced data to reference data vendors as they currently do under existing arrangements.

In its letter, FIMSAC acknowledged comments that expressed concerns about whether a centralized system run by FINRA should be established instead of one by private sector providers. FIMSAC stood firm in its support of FINRA as "the most logical and impartial choice" to operate the database. Not only would the service be a logical extension of TRACE, FINRA is better prepared to provide the collected data to all market participants on objective and non-discriminatory terms compared to a private sector provider, FIMSAC explained.

The letter was approved unanimously by FIMSAC committee member Larry Tabb, founder and research chairman of TABB Group, who said that he had mixed feelings about the recommendation, but in the end decided to vote for it. He said he was worried about centralizing all information within one entity and propagating what might not be clean data out to the marketplace. However, at the end of the day, he said, a centralized database of this information will be valuable to the market.

Lynn Martin, president and COO of ICE Data Services, voiced her support as representative of a reference data provider for the FINRA database. A centralized new issue database would benefit the market, not only from a transparency perspective, but also from a liquidity perspective by allowing those issues to trade as soon as possible when the secondary market is enabled, Martin advised.

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