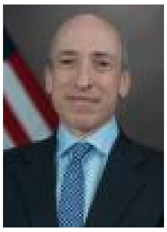
Speech

“The Name’s Bond:" Remarks at City Week



Chair Gary Gensler

April 26, 2022

Thank you. It’s good to be with City Week again. As is customary, I’d like to note that my views are my own, and I am not speaking on behalf of the Commission or SEC staff.

Since we are in London (at least virtually), I wanted to note that this year marks the 60th anniversary of the first James Bond film. I know there are various commemorations of this storied franchise going on in the U.K., but I want to focus my remarks on the lead character’s name.

Bond. James Bond.

Ian Fleming, the author of the spy novels, gave an interview with The New Yorker 60 years ago this month — several months before “Dr. No” hit theaters.

It turns out that Fleming wanted 007 to be “an extremely dull, uninteresting man.” In fact, he borrowed the name “James Bond” from the author of a beloved childhood book on birds. When he was brainstorming names for his lead character, he thought, “[T]hat’s the dullest name I’ve ever heard.”

He added, “Now, the dullest name in the world has become an exciting one.”[1]

Fixed Income Markets

That brings me to a different kind of bond: the $50 trillion-plus[2] U.S. bond markets.

The fixed income markets may not, on the surface, seem like the most cinematic part of the financial system. There are no “meme” bonds (at least, not yet). The nightly news is more likely to focus on stocks.

And yet, bonds are far from the “dullest” market in the world. They’re incredibly important — to individuals, companies, and governments in the U.S. and around the world. Fixed income markets, particularly government securities, money markets, and repurchase agreements (“repos”), are integral to how central banks around the globe administer monetary policy. As individual investors start to approach retirement, they often turn to fixed income as a lower-risk investment.

Altogether, the fixed income markets represent about half of the capital markets that the SEC oversees, making them just as big as the equity markets.

The $23 trillion Treasury marketis the base upon which so much of our capital markets are built. Treasuries are how we, as the U.S. government and as taxpayers, raise money: We are the issuer.

The non-Treasury fixed income markets also are so critical.

They include the $14 trillion of asset-backed securities, funding our mortgage, auto, and credit card markets.

They include $10 trillion of corporate bonds, enabling companies to raise money for factories, jobs, and innovation.

They include $4 trillion of municipal bonds, allowing local governments to fund essential projects, like bridges, roads, and schools.

Altogether, the non-Treasury fixed income markets are more than 2.5 times larger than the commercial bank lending market.[3] That's right — America turns more to bonds than to banks to fund their projects.[4]

Given the size and importance of these markets, it's worth asking how we can modernize our rules for today's economy and technologies, so these markets can be as fair as possible for investors and as efficient as possible for issuers of all types.[5]

The U.S. Congress and President Franklin Delano Roosevelt understood the importance of these markets when they came together to establish the securities laws in the 1930s. Among the many terms they used to define a security, they included "bond," "note," "debenture" — you get the picture.[6]

Initially, government bonds were exempt from many of the federal securities laws (outside of antifraud provisions).

Then, things changed. New York City almost went bankrupt in 1974; then-unregulated municipal securities dealers were taking advantage of returning Vietnam War veterans; and Congress brought municipal securities further under our statutory authority. In the 1980s, there were jitters in Treasury markets. After a dozen firms failed, such as Drysdale Government Securities[7] and E.S.M. Government Securities,[8] parts of the Treasury markets were folded into our remit.

In recent decades, bond markets also have evolved in response to new trends.

First, mortgages, credit cards, and other kinds of debt were bundled into tradable securities. Securitization, which started in the 1980s, really took off in the '90s. It shifted the U.S. debt markets even more from the banking sector to the securities sector.

Second, the fixed income markets increasingly have moved to electronic trading, including on platforms. The platforms, whether interdealer brokers or request-for-quote platforms, have a large and growing share of Treasuries, along with other asset classes. The COVID pandemic has only accelerated these trends.

Finally, a greater share of bond ownership has shifted to registered investment companies, like mutual funds, money market funds, exchange-traded funds, and closed-end funds.[9] This shift raises challenges for financial resiliency.

Given these trends, and the sheer size and importance of the fixed income markets, I think we should focus on how we can make improvements to them.[10] Thus, I will discuss some of the policy work at the SEC with respect to strengthening transparency, modernizing our rule sets for electronified platforms, and enhancing financial resiliency.

Transparency

First, I'll turn to transparency, in particular post-trade transparency.

Post-trade transparency

What is post-trade transparency? It means making the details of individual transactions — most importantly, the price — available to the public in real time (or near-real time) after the trade is executed.

Post-trade transparency promotes liquidity and helps investors. There is something about that sunshine. It gives everyone a sense of where the current market is. The public gets to see details of the last trade that two counterparties just negotiated in that market.

As Adam Smith noted in The Wealth of Nations more than 200 years ago, the whole economy benefits when the price of information is lowered, or information is free. [11]

In the equities market, we've long had post-trade transparency through the ticker tape. We had little post-trade transparency in the fixed income markets until two decades ago, when the predecessor to the Financial Industry Regulatory Authority (FINRA) established the Trade Reporting and Compliance Engine (TRACE). Then, in 2005, the Municipal Securities Rulemaking Board (MSRB) adopted a similar dissemination tool for munis. The academic research overwhelmingly finds that post-trade transparency improves efficiency and competition in the markets they serve.[12]

The information reported to these systems, though, has not kept pace with changes in our markets and with technological advances.

One area where I think there could be some improvement is the length of time by which market participants must report transactions to TRACE[13] and the MSRB.[14] Currently, a trade has to be reported as soon as practicable but no later than within 15 minutes of the time of execution. Why couldn't the outer bound be shortened to no later than, for example, 1 minute?[15]

Another area is scope. A key improvement worth considering is to bring foreign sovereign bonds into TRACE. The European Union's debt crisis, and more recently Russia's invasion of Ukraine, have shown the value that regulatory reporting and public dissemination of foreign sovereign bonds would offer. FINRA has already consulted its members on this possibility, so I hope to see a filing soon.[16]

I also think it may be time for FINRA to consider allowing the investing public to see TRACE data on individual Treasury transactions.[17] Five years ago, TRACE was expanded to require broker-dealers to report Treasury transactions, but there isn't yet any public dissemination.[18] Last fall, the Federal Reserve finalized a rule to use TRACE to require certain banks to report transactions in Treasuries, agency debt, and agency mortgage-backed securities to TRACE.[19] Once more major firms have reporting requirements — the banks and potentially principal trading firms in the future — I think it could make sense to disseminate this information to the public.

Public dissemination of Treasury trade data could help enhance counterparty risk management and the evaluation of trade execution quality. It also could expand the provision of liquidity.[20]

Two other possible improvements might be reporting on (i) the trading protocol and platform fees paid to do a trade, and (ii) the "spread" relative to Treasuries, when that is the agreed-upon term of trade. Finally, as part of the overall effort to improve post-trade transparency on TRACE, I think it would be helpful for FINRA to consider codifying their existing dissemination protocols.

Platforms

Next, I'd like to turn to platforms. I think it's important that we consider revising the SEC's rules to reflect the increased use of electronic trading platforms in fixed income markets. In particular, I've asked staff to consider how we might enhance market integrity, access, and pre-trade transparency on these platforms.

Thus, in January, the Commission proposed a new definition for "exchange" that would cover additional fixed income platforms and some systems that bring together buyers and sellers for other securities asset classes.[21]

In addition, I've asked staff to consider ways to increase fair access to electronic trading platforms that would fall within the expanded definition of "exchange," with the goal of making the benefits of these systems more widely available to investors. I think we have an opportunity to augment investor protections and market integrity as well.

Further, many Commissioners over the years have identified pre-trade transparency on platforms as a key area for improvement in the fixed income markets. As former Commissioner Daniel Gallagher said, the lack of pre-trade price information "can inhibit robust competition among market participants to provide the best prices" to individual investors.[22]

Thus, I've asked staff to consider how quotes and pre-trade price information might be more broadly accessible, such as by updating Regulation ATS.

Separately, in 2020, the Commission amended Rule 15c2-11 of the Exchange Act, which governs the publication or submission of quotations by dealers outside of national securities exchanges. This rule applies to most fixed income dealers.[23] This is an important rule designed to prevent fraud, market manipulation, and deceitful practices in our capital markets.

Resiliency

Lastly, I'd like to turn to how we can better enhance the resiliency of the fixed income markets.

As the 2008 financial crisis showed, fixed income markets, such as mortgage-backed securities, can have broader implications for the financial sector and the real economy. During the start of the COVID crisis, we saw once again how fixed income markets can raise issues of financial stability.

In March 2020, prime money market funds, municipal bond funds, and taxable bond funds saw significant outflows as investors evaluated their liquidity and investment needs in response to the pandemic.[24] We also observed challenges in the Treasury market.

Today, we are in the midst of uncertain geopolitical events. What's more, around the globe, central banks have started to transition from an accommodating to a tightening policy stance. In such times of uncertainty and transition, we don't want the market to be "exciting" for the wrong reasons, as Ian Fleming might have put it.

In light of this history, we have a number of ongoing resiliency projects related to Treasury and non-Treasury fixed income markets.

The Commission recently voted to propose amendments to rules governing money market funds, designed to enhance resiliency in this key segment of the short-term funding markets. Money market funds and open-end bond funds, by their design, have a potential liquidity mismatch — between investors' ability to redeem daily on the one hand, and funds' portfolio holdings that may have lower liquidity. I've asked staff to make recommendations for the Commission regarding the fund liquidity rule, fund liquidity risk management, and fund pricing of liquidity costs.

In addition, I've asked staff for recommendations for the Commission's consideration around strengthening central clearing in Treasuries, both cash and repos. This could include better facilitating customer clearing, enhancing risk management of the clearinghouses, and broadening the scope of central clearing.

In March, we proposed to further define the kinds of activities that would cause proprietary trading firms and others that engage in certain liquidity providing activities to register with the SEC as dealers.

Finally, in the fall, we proposed to shorten the settlement cycle[25] — the time it takes for cash and securities to change hands. This proposal would cover many kinds of fixed income securities.

Conclusion

While I spoke about these markets and principles in isolation, the reality, of course, is that they are interrelated. Together, through driving greater transparency, modernizing rule sets for electronified platforms, and enhancing financial resiliency, we can help investors and issuers in the bond markets get the same benefits as many other parts of our capital markets.

The bond markets don't have to be as "exciting" as James Bond — but I think we can make them better for issuers and investors alike. Thank you.

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[1] *See* Geoffrey T. Hellman, "James Bond Comes to New York" (April 13, 1962), *available at* https://www.newyorker.com/magazine/1962/04/21/bonds-creator#ixzz1XRLtznvp.

[2] Market sizes as of Q4 2021. *See* SIFMA, "Research Quarterly: Fixed Income – Outstanding," *available at* https://www.sifma.org/resources/research/research-quarterly-fixed-income-outstanding/.

[3] Commercial lending of about $11 trillion as of April 6, 2022. *See* Federal Reserve, "Assets and Liabilities of Commercial Banks in the United States," Table 2, Line 9, *available at*

https://www.federalreserve.gov/releases/h8/current/default.htm.

[4] As another example of this, debt capital markets account for 80 percent of financing for non-financial corporations in the U.S. In the rest of the world, by contrast, nearly 80 percent of lending to such firms comes from banks. *See*World Bank data: https://data.worldbank.org/indicator/NY.GDP.MKTP.CD

[5] *See* Gary Gensler, "Dynamic Regulation for a Dynamic Society" (Jan. 19, 2022), *available at* https://www.sec.gov/news/speech/gensler-dynamic-regulation-20220119.

[6] *See* "Securities Act of 1933," *available at* https://govtrackus.s3.amazonaws.com/legislink/pdf/stat/48/STATUTE-48-Pg74.pdf.

[7] See "How Drysdale affair almost stymied US securities market" (May 27, 1982), available at https://www.csmonitor.com/1982/0527/052737.html.

[8] See "E.S.M. Collapse: A Lesson in Safety" (March 8, 1995), available at https://www.nytimes.com/1985/03/08/business/esm-collapse-a-lesson-in-safety.html.

[9] Such funds held about 5 percent of publicly available debt in the early 1980s. Their share continued climbing, reaching a peak of 19 percent in early 2021. *See* Financial Accounts of the United States, published March 10, 2022 (L.208) – money market funds (FL634022005), mutual funds (LM654022005), closed-end funds (LM554022005), ETFs (LM564022005), and total debt securities (FL894022005).

[10] *See* "Prepared Remarks before the SIFMA Annual Meeting" (Nov. 2, 2021), *available at* https://www.sec.gov/news/speech/gensler-sifma-110221.

[11] *See* Gary Gensler, "Keynote Remarks of Chairman Gary Gensler before the Americans for Financial Reform and Georgetown University Law Center's Financial Transparency Symposium" (Oct. 11, 2013), *available at* https://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-147b.

[12] *See,* e.g., Hendrik Bessembinder, Chester Spatt, and Kumar Venkataraman, "A Survey of the Microstructure of Fixed-Income Markets" (Journal of Financial and Quantitative Analysis, Vol. 55, No. 1, Feb. 2020, p. 1-45), *available at* https://www.sec.gov/spotlight/fixed-income-advisory-committee/survey-of-microstructure-of-fixed-income-market.pdf, and Simon Z. Wu, "Transaction Costs for Customer Trades in the Municipal Bond Market:

What is Driving the Decline?" (July 2018, MSRB), *available at* https://www.msrb.org/~/media/Files/Resources/Transaction-Costs-for-Customer-Trades-in-the-Municipal-Bond-Market.ashx.

[13] *See* FINRA, "TRACE Reporting and Dissemination," *available at* https://www.finra.org/filing-reporting/trade-reporting-and-compliance-engine-trace/trace-reporting-timeframes.

[14] *See* MSRB, "Trade Data," *available at* https://www.msrb.org/Market-Transparency/Trade-Data.

[15] For example, about a decade ago, nearly three-quarters of all muni trades were already being reported within one minute. *See* "MSRB Notice 2013-02" (Jan. 17, 2013), *available at* https://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2013/2013-02.

[16] *See* "FINRA Requests Comment on a Proposal to Require Reporting of Transactions in U.S. Dollar-Denominated Foreign Sovereign Debt Securities to TRACE" (exp. Sept. 24, 2019), *available at* https://www.finra.org/rules-guidance/notices/19-25.

[17] *See* Gary Gensler, "Prepared Remarks at the U.S. Treasury Market Conference" (Nov. 17, 2021), *available at* https://www.sec.gov/news/speech/gensler-us-treasury-market-conference-20211117.

[18] *See* FINRA, "TRACE Reporting of Transactions in U.S. Treasury Securities: Demonstration of Forms" (April 6, 2017), *available at* https://www.finra.org/filing-reporting/trace/us-treasury-securities-demonstration-forms.

[19] *See* Federal Register (Vol. 86, No. 206, Oct. 28, 2021), *available at* https://www.govinfo.gov/content/pkg/FR-2021-10-28/pdf/2021-23432.pdf.

[20] *See* Group of Thirty Working Group on Treasury Market Liquidity, "U.S. Treasury Markets: Steps Toward Increased Resilience," (July 2021), *available at* https://group30.org/publications/detail/4950.

[21] As part of this proposal, the Commission also proposed to bring Treasury trading platforms with significant volume under Regulation Systems Compliance and Integrity. *See* Gary Gensler, "Statement on Government Securities Alternative Trading Systems" (Jan. 26, 2022), *available at* https://www.sec.gov/news/statement/gensler-ats-20220126.

[22] *See* Daniel M. Gallagher, "Remarks Regarding the Fixed Income Markets at the Conference on Financial Markets Quality" (Sept. 19, 2012), *available at* https://www.sec.gov/news/speech/2012-spch091912dmghtm.

[23] *See* Sept. 24, 2021, Letter from Josephine J. Tao, Assistant Director of the Division of Trading and Markets, *available at* https://www.sec.gov/files/rule-15c2-11-fixed-income-securities-092421.pdf.

[24] During the two-week period of March 11 to 24, 2020, publicly offered institutional prime money market funds had a 30 percent redemption rate (about $100 billion). *See* https://www.sec.gov/rules/proposed/2021/ic-34441.pdf. In March 2020, bond mutual funds experienced $255 billion in net outflows while bond ETFs experienced $21 billion in outflows. Municipal bond funds and ETFs experienced $44.5 billion in outflows in that period. *See* https://dcm.sec.gov/files/US-Credit-Markets_COVID-19_Report.pdf.

[25] *See* "SEC Issues Proposal to Reduce Risks in Clearance and Settlement" (Feb. 9, 2022), *available at* https://www.sec.gov/news/press-release/2022-21.