

MEMO# 32795

October 1, 2020

SEC Proposes to Apply Regulation ATS and Regulation SCI to US Government Securities Markets

[32795]

October 1, 2020 TO: Fixed-Income Advisory Committee RE: SEC Proposes to Apply Regulation ATS and Regulation SCI to US Government Securities Markets

On September 28, the SEC proposed amendments to Regulation ATS to require an alternative trading system (ATS) that trades government securities or repos and reverse repos on government securities ("Government Securities ATS") to comply with Regulation ATS and file a new form ("Form ATS-G").[\[1\]](#) The proposed amendments would also apply Regulation SCI requirements to ATSs with certain volume thresholds in government securities. The SEC also issued a concept release that requests comment on fixed income electronic platforms that trade corporate debt and municipal securities.[\[2\]](#) We summarize the releases, including relevant remarks by SEC Commissioner Elad Roisman, further below.

Comments are due 60 days after publication of the proposal and concept release in the Federal Register. We will schedule a member call shortly via Outlook to discuss the proposal and concept release.

Application of Regulation ATS to Government Securities ATS

The proposed amendments would eliminate the exemption from Regulation ATS for a Government Securities ATS that is registered as a broker-dealer or is a bank. Currently, Government Securities ATSs that limit their trading activity to government securities or repos and reverse repos are neither required to register as an exchange under Section 5 of the Exchange Act nor required to comply with Regulation ATS, which specifies conditions to be exempt from exchange registration. Further, an ATS that trades both government securities and other fixed income securities, e.g., corporate bonds or municipal securities, are not fully subject to certain provisions such as the Fair Access Rule, which does not apply to government securities trading.[\[3\]](#)

Given the growth of government securities trading on ATSs, however, the SEC is proposing to apply Regulation ATS to this activity. A Government Securities ATS would be defined as an ATS that limits its trading to government securities or repos and reverse repos and become subject to filing requirements under Rule 304.[\[4\]](#) An ATS that also trades other fixed income securities would be required to bifurcate its operations between (i) a Government Securities ATS that would be subject to Rule 304 and must file Form ATS-G,

described further below; and (ii) a non-Government Securities ATS that would file Form ATS and not be subject to Rule 304 requirements. Further, a Government Securities ATS would be required to comply with other Regulation ATS requirements under Rule 301, such as broker-dealer registration,[\[5\]](#) protections for subscriber confidential trading information, and separation of ATS functions from other broker-dealer functions, including principal and customer trading.[\[6\]](#) A Government Securities ATS that exceeds certain trading volume thresholds would also be subject to the Fair Access Rule,[\[7\]](#) which requires an ATS to adopt trading system access standards that are applied fairly and prohibit an unreasonable trading prohibition or limitation on any person.[\[8\]](#)

Form ATS-G

The proposed amendments would require a Government Securities ATS to file a new Form ATS-G that would provide detailed information about how the ATS operates. The SEC notes that most market participants currently have limited access to information that otherwise would permit them to adequately compare how their orders would be handled by different Government Securities ATSs. As proposed, this information would include identifying information and ownership; the ATS-related activities of the broker-dealer operator and its affiliates;[\[9\]](#) and the manner of operation of the Government Securities ATS.[\[10\]](#) The SEC would post the Form ATS-G on its website when it becomes effective, including amendments and other associated notices and orders. Each Government Securities ATS would also be required to post its Form ATS-G on its website.

Concept Release on Electronic Corporate Bond and Municipal Securities Market

The SEC also issued a concept release requesting comment on the regulatory framework for fixed income electronic platforms that trade corporate debt and municipal securities. The SEC stated that such information could help “regulators evaluate potential regulatory gaps that may exist among these platforms.”[\[11\]](#)

The SEC requests comment on whether

- the current regulatory framework contains gaps or key inconsistencies that create burdens on competition, including whether it unfairly promotes or impedes certain platforms or protocols;
- the combined regulation of the corporate and municipal debt markets would be effective and whether electronic trading platforms for these securities have common characteristics that warrant a common regulatory approach;
- the SEC should adapt its regulatory definition of “exchange” to adapt to these electronic trading platforms;
- ATSs that trade corporate or municipal debt securities should be subject to similar operational transparency rules and disclosure requirements as NMS Stock ATSs;
- the Fair Access Rule remains appropriate to capture ATSs with a significant percentage of the trading volume in corporate and municipal debt; and whether
- Regulation SCI should apply to ATSs that trade corporate or municipal debt securities.

Commissioner Roisman Comments on Government Securities ATS Proposal

On September 29, Commissioner Roisman gave a speech at the US Treasury Market

Conference discussing the proposed amendments and the concept release.^[12] Commissioner Roisman believes that the events of this past March underscore the importance of pursuing sound enhancements to the Treasury market. He described the SEC's proposal and outlined three other actions that he believes would further strengthen the Treasury market:

- Ensuring that regulators have a full view of secondary market trading. Commissioner Roisman noted that the enhancements to reporting of Treasury transactions to FINRA's TRACE system have contributed to improved data on these markets. He believes that more work needs to be done, however, particularly regarding efforts by the Federal Reserve Board to collect Treasury trade data from banks.
- Improving the SEC's understanding and, to the extent insufficient, oversight of key Treasury market participants. Commissioner Roisman observed that the Regulation ATS framework may not extend to all trading venues that utilize request-for-quote (RFQ) or streaming quote protocols, which he believes is a regulatory gap. He further recommends discussing the benefits and costs of extending Regulation ATS and SEC broker-dealer rules to market participants such as principal trading firms (PTFs) that are not currently regulated under these rules. He also discussed the benefits of imposing tailored capital requirements on non-dealer PTFs; concerns raised by placing the burden on ATSs to maintain controls under the SEC's market access rule with respect to non-dealer PTF activity; and whether the regulatory approach to liquidity providers in the securities markets needs to be reassessed.
- Broadening access to central clearing in the cash market. Commissioner Roisman believes that the market conditions in March raise the question of whether the universe of cash Treasury trades that are subject to central clearing should be broadened and discussed the potential benefit of expanding access to central clearing in this market.

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endnotes

^[1] Regulation ATS for ATSs that Trade US Government Securities, NMS Stock, and Other Securities; Regulation SCI for ATSs that Trade US Treasury Securities and Agency Securities; and Electronic Corporate Bond and Municipal Securities Markets (Sept. 28, 2020) ("Proposing Release"), *available* at <https://www.sec.gov/rules/proposed/2020/34-90019.pdf>. "Government securities" is defined under Section 3(a)(42) of the Exchange Act and includes US Treasuries and "agency securities" issued by or guaranteed by US government corporations and US government-sponsored enterprises (GSEs).

^[2] Proposing Release at 199.

^[3] Rule 301(b)(5). Given that these ATSs do not limit their trading to government securities or repos, they must either register as an exchange or comply with Regulation ATS.

[4] Rule 304 currently applies to NMS Stock ATSs. The SEC noted that these proposed amendments are informed by prior comments related to Government Securities ATSs that it received in response to a 2015 Regulation ATS rule proposal, which would enhance operational transparency of NMS Stock ATSs. The SEC adopted a final rule in 2018. ICI submitted a comment letter supporting that proposal and recommended additional transparency for ATSs that facilitate fixed income trading. See ICI Memorandum No. 29733 (Feb. 25, 2016), available at https://www.ici.org/my_ici/memorandum/memo29733.

[5] The SEC proposes to amend Rule 301(b)(1) to allow an a Government Securities ATS to register as either a broker-dealer pursuant to Section 15 of the Exchange Act or as government securities broker or government securities dealer under Exchange Act 15C(a)(1)(A).

[6] Other requirements under include (i) cooperating with an SEC or SRO inspection, examination, or investigation; (ii) adhering to recordkeeping requirements; (iii) not using the word “exchange”; and (iv) filing Form ATS-R, which allows for periodic reporting of the ATS’s trading activities. The SEC notes, however, that a Government Securities ATS would not be subject to the order display and execution access provisions under Rule 301(b)(3) or the fees provision under Rule 301(b)(4)—these provisions would remain applicable only to NMS Stock ATSs.

[7] Proposed Rule 301(b)(5)(i)(E). The categories of securities subject to the Fair Access Rule currently include NMS stocks, equity securities that are not NMS stocks and for which transactions are reported to an SRO, municipal securities, and corporate debt securities.

[8] The Government Securities ATS would be subject to the Fair Access Rule if during at least four of the preceding six calendar months, it has (i) with respect to U.S. Treasuries, five percent or more of the average weekly dollar volume traded in the US; and (ii) with respect to agency securities, five percent or more of the average daily dollar volume traded in the US. These measures would be measured based on transaction data provided by the SRO to which such transactions are reported.

[9] This information would specifically include the trading activities of the broker-dealer operator and its affiliates on the ATS; whether subscribers to the ATS can opt out from interacting with orders and trading interest of the broker-dealer operator and its affiliates; arrangements between the broker-dealer operator or its affiliates and other trading venues to access the ATS services; products and services offered to ATS subscribers by the broker-dealer operator and its affiliates; the activities of service providers to the broker-dealer operator and its affiliates; and written safeguards and written procedures established to protect the confidential trading information of subscribers.

[10] This information would specifically include types of subscribers, the criteria for eligibility for ATS services, and conditions for excluding subscribers from ATS services; means of entry for orders and trading interest; connectivity and co-location procedures; order types, attributes, and order size requirements and procedures; use of and conditions governing indications of interest; hours of operations, opening, reopening, and closing processes, and procedures for trading outside of the ATS’s regular trading hours; trading services, facilities, and rules of the ATS; arrangements with any subscriber or the broker-dealer operator to provide liquidity; segmentation of orders and trading interest and the provision of notice regarding segmentation; counterparty selection; display of orders and other trading interest; functionalities or procedures to facilitate trading on, or source pricing for, the ATS using markets for financial instruments related to government securities; fees;

procedures for stopping or suspending trading; procedures regarding trade reporting, clearance, and settlement; sources and uses of market data; and aggregate platform-wide order flow and execution statistics provided by the ATS to one or more subscribers.

[11] The SEC issued the concept release in response to 2018 recommendations from the SEC Fixed Income Market Structure Advisory Committee's recommendation that the SEC form a joint working group with FINRA and the MSRB to review the regulatory framework for fixed income electronic trading platforms.

[12] Commissioner Elad L. Roisman, Remarks at the US Treasury Market Conference, (Sept. 28, 2020), *available at* <https://www.sec.gov/news/speech/roisman-2019-09-23>.

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