

The role of FIX in regulation



By Daniel Doscas, Senior Vice-President, Lehman Brothers, Fixed Income Connectivity,
FPL Chair of Global Fixed Income Committee



This article relates to the proactive approach of the Global Fixed Income Committee of FIX Protocol Ltd. towards the regulatory bodies and associations who oversee capital markets. As the adoption of FIX transforms the trading of fixed income it is useful for regulators to be educated about the Protocol and its contribution to ensuring that fixed income markets are fair, efficient and transparent.

The focus of regulators for secondary trading is the maintenance of “fair and equitable rules that strike an appropriate balance between the demands of different market participants, the promotion of transparency of trading, the detection and deterrence of manipulative trading, and the proper management of large exposures, default risk and market disruption.”¹

The Bond Market Association's “Plain English Documents”² served as the basis for the extension of FIX to the fixed income markets and were a collaboration by fixed income professionals that defined market practices for the industry. These “best practices” were the codification of the fair and equitable rules between different market participants and represent the industry's methods of self regulating.

¹ “Objectives and Principles of Securities Regulation” page iii, International Organization of Securities Commissions, May, 2003, Madrid, Spain

² “Fixed Income Protocols Initiative Business Practices Documentation in Plain English” The Bond Market Association, 2001, New York, NY, USA

To borrow a line from a colleague formerly at The Bond Market Association, “a good regulator is an educated regulator”. So goes the industry’s continuous work with regulators in providing accurate and balanced information about market practices. The Global Fixed Income Committee (GFIC) is actively engaged in informing our partner associations and regulators about evolving market practices that utilize new forms of electronic trading and encouraging the adoption and integration of the FIX Protocol as a useful standard for reporting responsibilities.

How we came to be governed - a U.S. case study

Initially the responsibility for regulating financial services was through state laws, referred to as “blue sky” laws. Although many blue sky laws remain in place today, the U.S. government took a significant and historic step in the aftermath of the stock market crash of 1929 by enacting two pieces of legislation which would change market practices. The Securities Act of 1933 and Securities and Exchange Act of 1934 set in motion the process by which regulators and the financial services industry communicate, define market practices and oversee the industry.

Securities Act of 1933

The first federal law regulating the securities industry required registration and disclosure and included measures to discourage fraud and deception. In general, securities sold to the public in the U.S. must be registered by filing a registration statement with the SEC. The prospectus, which is the document through which a company’s securities are marketed to a potential investor, is generally filed in conjunction with the registration statement. It must explain the offer, including the terms, issuer, objectives (if mutual fund) or planned use of the money (if securities), historical financial statements, and other information that could help an individual decide whether the investment is appropriate.

Securities and Exchange Act of 1934

The act which created the Securities and Exchange Commission (SEC) outlawed manipulative and abusive practices in the issuance of securities, required registration of stock exchanges, brokers, dealers, and listed securities, and required disclosure of certain financial information and insider trading.

Securities and Exchange Commission

The SEC is the primary federal regulatory agency for the

securities industry, whose responsibility is to promote full disclosure and to protect investors against fraudulent and manipulative practices in the securities markets. The Securities and Exchange Commission enforces, among other acts, the Securities Act of 1933, the Securities Exchange Act of 1934, the Trust Indenture Act of 1939, the Investment Company Act of 1940 and the Investment Advisers Act.

The SEC delegates supervision of broker/dealers to the self-regulatory bodies of the exchanges (SROs). SROs exercise oversight authority and have responsibility for policing their members and affiliated markets. SROs must have rules that regulate broker-dealers’ conduct, trading practices, and for establishing measures to ensure market integrity and investor protection. The SEC comprehensively oversees SRO rules and publishes proposed rules for comment before final SEC review and approval. SROs must enforce their rules and may discipline or expel members.

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Examples of SROs include the New York Stock Exchange (NYSE), the National Association of Securities Dealers (NASD), and the Municipal Securities Rulemaking Board (MSRB) among others.

Organizing around common purposes

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Securities Industry Association

The Securities Industry Association (SIA) was established in 1972 through the merger of the Association of Stock Exchange Firms (1913) and the Investment Banker’s Association (1912).

The Securities Industry Association brings together the shared interests of nearly 600 securities firms to accomplish common goals. SIA's primary mission is to build and maintain public trust and confidence in the securities markets. SIA members (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance.

SIA works to foster an effective capital-raising and investment process; presents member-firm views to legislative and regulatory bodies at the federal and state levels; serves as a forum to address key industry issues; acts as a source of information and a catalyst for ideas; and, offers a broad range of services to assist member-firm executives in their management responsibilities.

The Bond Market Association

The Bond Market Association (TBMA) is the dealer trade association representing the largest securities markets in the world, the estimated \$44 trillion debt markets. As the industry's voice, the Association speaks for the global bond industry, advocating its positions and representing its interests in New York; Washington, D.C.; London; Frankfurt; Brussels and Tokyo; and with issuer and investor groups worldwide.

The Bond Market Association's success in fostering improvement in the legislative, regulatory, educational and market practice arenas for all participants in the bond markets is the result of a productive partnership between the Association's membership and its staff.

The BMA and FPL have operated under a Statement of Understanding since 2001. The success of this partnership was demonstrated by the important contribution of the "Plain English Documents" to the development of the latest version of the FIX Protocol, FIX 4.4. On-going FIX initiatives such as Prime Brokerage, Allocations and e-Syndication continue to receive support and professional expertise from the BMA.

The SIA and TBMA are but two of the many industry association and advocacy organizations both here in the U.S. and abroad. What the organizations offer their membership is the opportunity to engage the regulators for the common good of the financial services industry.

FIX Protocol Limited

FIX Protocol Limited (FPL) is a relatively young trade association established in 1994. The purpose of FPL is comparatively narrow and relates to the establishment and promotion of global standards for the electronic trading of financial securities. Because trading is central to the fair functioning of securities markets the communication of new standards is of value to market participants and to regulators.

The Global Fixed Income Committee (GFIC) encourages efforts to improve the standardization and distribution of fixed-income information and enhanced transparency of the markets. Recent examples of FPL's active approach were evident in the response to the SEC's Concept Release on securities settlement and the recent comment letter regarding Regulation SHO. These and ongoing efforts demonstrate FPL's commitment to engage regulators and educate its members about the important role that standards have in efficient market functioning.

The GFIC will seek opportunities with both NASD and DTCC to determine if FIX messages can be utilized to improve integration

An increased focus on trade reporting and regulatory communication continues to be an important topic within the Global Fixed-Income Committee. GFIC is reviewing opportunities to utilize FIX 4.4 for trade reporting. The GFIC will participate in a dialogue between the MSRB, TBMA and FPL with the hope of expanding the utilization of the MSRB's RTRS by implementing FIX message reporting. The enhancement of providing an additional communication format utilizing FIX messages for trade reporting and for the dissemination of the trade data to data consumers would be another significant building block for straight through processing for market participants and prove an additional catalyst for FIX 4.4 adoption.

Recent regulatory issues that the FIX Protocol relates to....

Reduction of default risk and market disruption - The SEC concept release on Securities Transactions Settlement

In March 2004, the SEC distributed a Concept Release to the securities industry, attempting to address three key issues/questions:

- The possibility of creating a rule that would require that the confirmation and affirmation process be completed on trade date, in certain instances.
- The Commission requested comment on the benefits and costs associated with implementing a shorter settlement cycle (i.e. less than the current T+3).
- The Commission requested industry feedback on dematerialization and immobilization.

To date the SEC received over fifty responses to its Concept Release from individual firms and various industry groups including The Bond Market Association (TBMA) and FIX Protocol Limited (FPL). Both organizations responded independently of each other but, came to similar conclusions:

- Electronic affirm/confirm - fixed income trades should be confirmed & matched at block level on trade date, and the utilization of FIX 4.4 as the standard message protocol is strongly encouraged
- Reduced settlement cycle - mandatory reduction of settlement cycle is unnecessary since many fixed income products follow shortened settlement. Efforts should continue to focus on reducing risk and improving efficiency within the fixed income market place
- Dematerialization of security certificates - support dematerialization of paper securities

Enhancing Transparency - Trade Reporting - TRACE

In July 2002, NASD launched the first intraday "consolidated tape" in the U.S. over-the-counter corporate bond markets. The Trade Reporting and Compliance Engine (TRACE) enables investors to access current price information for U.S. corporate bonds. All broker-dealers regulated by NASD have an obligation to report transactions in TRACE eligible securities under rules approved by the SEC. Currently, more than 29,000 corporate debt securities are subject to TRACE reporting requirements. The list of TRACE eligible securities now includes the following security types:

- Investment grade debt
- High-yield debt of U.S. companies and foreign

private issuers

- Medium term notes
- Convertible debt
- Capital trust securities
- Floating rate notes
- Global bonds issued by U.S. and foreign private issuers

Not included under TRACE reporting are U.S. Treasury bonds, municipal securities, mortgage and asset backed securities, and money market instruments. During the past two years NASD has worked with the bond trading community to expedite public reporting of TRACE data. Upon the inception of TRACE in July 2002, bond dealers had 75 minutes to report trades into TRACE. This requirement was reduced to 15 minutes for 2005.

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Throughout the first two years of TRACE reporting, the NASD's Board of Governors has voted to make all TRACE eligible securities subject to public dissemination. Under this policy information on 100% of TRACE eligible issues is accessible to the public, thereby providing investors with marketplace pricing and transaction data on a delayed basis. Some firms have taken this opportunity to provide their clients with a customized solution. MarketAxess' Corporate BondTicker combines TRACE information along with proprietary tools and data to provide clients with a comprehensive view of corporate bond trading.

Currently TRACE and DTCC's Real-Time Trade Matching (RTTM) share an interface and the GFIC will seek opportunities with both NASD and DTCC to determine if FIX messages can be utilized to improve integration between the two trade reporting applications.

Enhancing Transparency - Trade Reporting - RTRS

On January 31, 2005, the Municipal Securities Rulemaking Board (MSRB) began disseminating real-time, or immediate, municipal bond prices. Real-time Transaction Reporting System (RTRS) requires dealers to report their

municipal securities to the MSRB within 15 minutes of the time of trade. The MSRB is a self-regulatory organization created by Congress in 1975, to write rules regulating the behavior of bank and securities firms in the municipal securities market. The Board is subject to oversight of the SEC, and its rules, once approved by the SEC, have the force and effect of federal law.

The MSRB publishes data about real-time municipal bond trades to subscribers of RTRS over the internet or leased lines via TCP sockets or IBM MQ series protocol. Subscribers of RTRS are responsible for developing software, configuring firewalls, security and integration with

their systems. MSRB maintains a hot-site for business continuity purposes, access to the hot-site is available through leased lines and internet connections.

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A quick look at RTRS messages for example reveals similar message tags and descriptions between FIX 4.4 and RTRS. These fields can be found in the Instrument Component Block of nearly every FIX message in FIX 4.4.

Looking forward

As fixed income markets increasingly adopt the use of the FIX Protocol for securities trading it is important for FPL to inform and educate regulators and our companion trade associations on the value and purpose of the standard.

Although FPL will not formally seek endorsement of the Protocol by regulators, the market practices embodied within the Protocol serves as a benchmark for regulators to evaluate the trading practices of individuals and firms. In demonstrating and documenting best practices, FPL makes a declaration that the industry has considered its methods and developed a common approach "that strike an appropriate balance between the demands of different market participants " and maintains "fair and equitable rules" for the secondary trading of fixed income securities.

The Global Fixed Income Committee will continue to demonstrate to our member firms, the industry and regulators our collaborative, open and proactive approach in dealing with industry issues. **FIX**

Any thoughts on this or other articles?

Please send any comments, referring to this article as Vol 1 Issue 5 AM1, direct to Edward at edward@fixglobal.com

CUSIP

The CUSIP number of the issue traded.

Security Description

Text description of the security obtained from the CUSIP Service Bureau.

Dated Date

Dated date of the issue traded obtained from the CUSIP Service Bureau.

Coupon (if available)

Interest rate of the issue traded (blank for zero-coupon bonds) obtained from the CUSIP Service Bureau.

Maturity Date

Maturity date of the issue traded obtained from the CUSIP Service Bureau.

When-Issued Indicator (if applicable)

Indicates whether the issue traded on or before the issue's initial settlement date obtained from Standard and Poor's.

Assumed Settlement Date (if applicable)

For new issues where the initial settlement date is not known at the time of execution, this field is a date 15 business days after trade date. If this field is populated there will be no data in the settlement date field.

Trade Date

The date the trade was executed as reported by the dealer.

Time of Trade

The time of trade execution as reported by the dealer.

Settlement Date (if known)

The settlement date of the trade if reported by the dealer will be shown. If this field is populated there will be no data in assumed settlement date field.