

WILLIAMS & JENSEN, PLLC

Fr: Alex Barcham and Thomas McGrath

Re: Security Traders Association 86th Annual Market Structure Conference – Day 2, ETFs and Fixed Income panel

Dt: October 3, 2019

Fireside: ETFs & Fixed Income

Moderator:

Amy Hong, Global Head, Market Structure Strategy, Securities Division, Goldman Sachs

Panelists:

Chris Concannon, President and Chief Operating Officer, MarketAxess

Jim Ross, Executive Vice President, State Street Global Advisors

Amy Hong (Goldman Sachs) said fixed income exchange traded funds (ETFs) have been a major topic of discussion recently. She asked about Concannon's experience since moving into the fixed income market. **Chris Concannon (MarketAxess)** said it has been a great experience. He stated that the fixed income market is evolving quickly. He said there has been a lot of market evolution in equities as a result of ETFs, suggesting that this is also occurring in fixed income. He noted that fixed income is much larger than the equities market, but there is no place to post a quote. He suggested that fixed income is one of the darkest markets on the planet, which he initially found baffling.

Hong said the emergence of fixed income ETFs is a recent development. She noted that fixed income ETFs make up only 20 percent of the ETF market, but they are growing rapidly. **Jim Ross (State Street Global Advisors)** said the first investors in fixed income ETFs were retail investors and not institutional investors. He stated that fixed income ETFs have grown rapidly over the past five years. He suggested that there is not a mismatch in liquidity, commending market makers for making markets and compressing spreads. He said there is now greater confidence that there will be liquidity during times of stress.

Hong said growth of the market is iterative. She asked how market structure in the fixed income markets has evolved to be more encouraging of ETFs. **Concannon** said fixed income ETFs are narrowing spreads in the underlying markets and are bringing liquidity into the market. **Hong** suggested that having a robust ETF market has facilitated price discovery during times of stress. **Ross** agreed that ETFs are being used for price discovery, suggesting that this is a benefit to the market. **Concannon** said the market is still in the early days of fixed income ETF innovation, suggesting that more indices will be coming. He suggested that new investment vehicles will be brought into ETFs. **Hong** asked what types of indices the market will gravitate towards. **Concannon** said there will be sector and factor indices. **Ross** suggested that it will go even further, suggesting that environmental, social, and governance (ESG) ETFs will come to fixed income. He noted that fixed income ETFs are still only 2 percent of the fixed income market, so there is tremendous opportunity for growth.

Hong asked how fixed income investors are using fixed income ETFs. **Ross** said it varies by investor, suggesting that some are using it as a “liquidity sleeve.” He pointed to the use of fixed income ETFs by a pension plan which wanted access to the high yield fixed income market, but did not have approval to get into it. He stated that they can be used as a transition vehicle.

Hong asked what other developments will help to liquefy the fixed income market. **Concannon** said the fixed income market is less automated than the equities market. He stated that algorithms with analytics will eventually move into fixed income. He suggested that evolution is coming to fixed income. **Ross** said technology will play a major role.

Hong asked about the ongoing debate on whether there is a liquidity mismatch between the daily redemptions of ETFs and the less liquid underlying assets. She asked how concerned the market should be about liquidity. **Ross** argued that there is not a liquidity mismatch. He stated that ETFs allow fixed income to benefit from the equity structure. He argued that ETFs are reducing spreads in the fixed income market by increasing trading. He suggested that there are structural benefits to ETFs. **Concannon** stated that fixed income ETFs are tiny compared to the overall size of the market, suggesting that they are too small to cause disruptions of the underlying market. **Ross** suggested that bonds will want to be in ETFs, because it will get them more flow.

Hong asked what MarketAxess is planning to further enhance price discovery in trading of underliers. **Concannon** said ETFs use MarketAxess to trade the underliers. He noted that they have 1,600 institutional clients across the planet. He noted that much of the volume on MarketAxess is fully disclosed. He suggested that the market is slower because it is auction-based, noting that they will be implementing a limit order book for more liquid assets. He said there will be a market data fee. **Hong** asked if this is what people mean when they say MarketAxess will be equitizing fixed income. **Concannon** said there will be a “patient walk” to a more electronic market. He suggested that less liquid bonds do not need to be on the order book. He said all of the protocols will be available for clients to choose from. He said the concept of working orders has not yet reached the fixed income market, suggesting that there will be evolution in this area. **Hong** agreed there should be many different ways for the market to transact different bonds, suggesting that they should be able to self-select. She said there is a slice of the market which is very liquid, but much of the market is not. She emphasized the need to have both an order book and requests for quote (RFQ).

Hong asked about the SEC’s recently finalized ETF rule. She asked what is most notable for fixed income ETFs. **Ross** asserted that it is a good rule, though it took a long time. He said the rule eliminates exemptive relief, reduces barriers to entry, and levels the playing field. He stated that the rule allows more flexible basketing, which is a benefit for the fixed income ETF marketplace. He suggested that the rule will lead to compressed spreads for fixed income ETFs, which will benefit retail investors. He said the most important thing in the rule was leveling of the playing field for fixed income basketing.

An audience member asked about the SEC pilot program on transparency for block trades. **Concannon** said he is very supportive of transparency, but stressed the need to be careful about disruptive transparency. He said there were objections about the complexity of the pilot, even though the industry was supportive of more transparency. He noted that the Treasury market is still not reported to the Trade Reporting and Compliance Engine (TRACE), suggesting that the U.S. government runs the “largest dark pool on the planet.”

An audience member asked if Ross has concerns about how retail investors use fixed income ETFs. **Ross** said he has concerns about retail investors using any product which they do not understand, but not specifically about fixed income ETFs. He urged investors to get financial advice so they can understand the product they are buying. **Hong** said clear and simple taxonomy is important for investor education.

Hong asked what would be the best thing to import from the equity market to the fixed income market. **Concannon** said the U.S. equity market has very tight spreads and is very efficient. He said importing this transparency to fixed income would save investors billions of dollars. He suggested that the mandatory order book would not be healthy for fixed income, but fixed income would benefit from electronification. **Ross** said he would like to see some more transparency, but not the same level as in the equity market. He stated that there are innovations in the equity markets which could improve efficiency in the fixed income market.