

Price Transparency and the ABS Market

FINRA's plan, announced in July, to disseminate pricing on after-market transactions in securities backed by credit card receivables, automobile and student loans and other assets through TRACE should transform this market as we know it.

The "inexorable force," as it was described in 2003 by former **Securities and Exchange Commission** chief **Mary Schapiro** has proven its strength. TRACE, the transaction and reporting compliance engine, started in 2002, four years after then-SEC Chairman **Arthur Levitt** called for price transparency in all markets. But it began initially only for corporate bonds.

Not until 2007, in a panel I organized

OBSERVATION

at an investor conference, was there a public discussion about bringing this type of transparency to MBS/ABS. The ensuing credit crisis made it difficult to resist providing transparency, at least to regulators. Opponents basically conceded the effort to fight more troublesome regulation.

What FINRA observed from the crisis was that trading volumes were down 44% for par value traded in full-year 2008 vs. 2007 in the still-opaque Rule 144A market, while volumes in the transparent TRACE-eligible markets were down only 7%. As the markets recovered in the first half of 2009 vs. 2008, the numbers were up 10% vs. 24%. Though not solely due to transparency, the regulator concluded that transparency wouldn't hurt the market.

So, FINRA proposed rules in 2009, made effective by 2011, which required all ABS participants to report trades through TRACE. Swiftly, and almost silently, one of the biggest obstacles to full transparen-

cy was eliminated: the fear that the technology required to report trades would be burdensome and prohibitively costly. And surprisingly the buy side and dealers were finding value in the corporate bond information.

But providing ABS transparency to after-market participants (as opposed to regulators), that has been another story. Some brokers still believe transparency is "killing the market," while others think it just prevents brokers from "making a killing." How much spread do brokers really need to make markets? It's a legitimate

question and an important one. With technology driving efficiency and productivity in finance, and greater direct retail participation, and many institutions sitting on sidelines, a broader, deeper market for ABS can only help lift all boats. But if brokers refuse to participate as a result of tighter bid-asked spreads, will investors be better off?

Institutional investors are under increased pressure to properly value ABS in a "marked to market" manner. Transparency helps but certainly does not solve the problem. It is only a data point to be included in a more sophisticated analysis, especially for complex ABS. The fear, largely anecdotal, is that a disclosed transaction price becomes the baseline that can't be avoided—and a confusing one.

FINRA has moved cautiously but deliberately. It has listened to critics and examined the data, both anecdotal and academic. Some think it has not moved fast enough to level the playing field, particularly since student loan ABS has been transparent through the **Municipal Secu-**

rities Rulemaking Board's EMMA system for a while without a hitch.

Unlike the corporate bond market, where TRACE data revealed a large retail component that was not believed to exist, two years of ABS data collection produced no surprises. ABS is an institutional market, and that's what FINRA found. Yet with the phased-in approach, brokers have come to see value in transparency.

FINRA made concessions along the way. TRACE basically is a CUSIP-level disclosure. But, in some securities like

specific pools, where this could give away too much information on investor trading strategies, there is more limited data.

The proposed rules coming in the fall will still be subject to industry comment so there may be other adjustments to minimize effects on liquidity and trading strategies. And collateralized mortgage obligations won't be included; these are still "under review." Dissemination of Rule 144A transactions is subject to a separate a rule filing pending with the SEC.

In 2003, when she was still at FINRA, Schapiro outlined the rationale for what is now coming to fruition: "transparency [is] such a powerful and magnetic concept because it puts upon the industry the responsibility to answer this question: why shouldn't the public know the execution price for all transactions?"

So, as transparency marches on, may the force be with you.



Joseph S. Fichera

Joseph S. Fichera is chief executive of Saber Partners LLC