

# COMMITTEE ON CAPITAL MARKETS REGULATION

January 18, 2011

David A. Stawick  
Secretary of the Commission  
Commodity Futures Trading Commission  
Three Lafayette Centre, 1155 21st Street NW  
Washington, DC 20581

Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549

Re: Real-Time Public Reporting of Swap Transaction Data; Proposed Rule, 75 Fed. Reg. 76,140 (RIN 3038-AD08); Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information; Proposed Rule, 75 Fed. Reg. 75,208 (SEC File No. S7-34-10, RIN 3235-AK80)

Dear Mr. Stawick and Ms. Murphy:

The Committee on Capital Markets Regulation (Committee) appreciates the opportunity to comment on the proposed rules of the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) regarding the real-time, post-trade public reporting and dissemination of swap and security-based swap transactions under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).<sup>1</sup> The Committee is commenting in this letter on proposals from both the CFTC (CFTC Proposed Rules)<sup>2</sup> and the SEC (SEC Proposed Rules),<sup>3</sup> as it wishes to encourage the Commissions to adopt a uniform and consistent approach to the reporting of swap and security-based swap transactions. While many areas within the CFTC and SEC Proposed Rules are quite similar, the Committee sees no reason why an identical approach should not be used for both.

Since 2005, the Committee has been dedicated to improving the regulation of U.S. capital markets. Our research has provided an independent and empirical foundation for public policy. In May 2009, the Committee released a comprehensive report entitled *The Global Financial Crisis: A Plan for Regulatory Reform* (May 2009 Report), which contains fifty-seven recommendations for making the U.S. financial regulatory structure more integrated, more effective, and more protective of investors in the wake of the financial crisis of 2008.<sup>4</sup> Since then, the Committee has continued to make recommendations for regulatory reform of major areas of the U.S. financial system.

<sup>1</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, §§ 723, 727, 763, 766 [hereinafter Dodd-Frank Act].

<sup>2</sup> Real-Time Public Reporting of Swap Transaction Data, 75 Fed. Reg. 76,140 (proposed Dec. 7, 2010) [hereinafter CFTC Proposed Rules].

<sup>3</sup> Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, 75 Fed. Reg. 75,208, (proposed Dec. 2, 2010) [hereinafter SEC Proposed Rules].

<sup>4</sup> COMM. ON CAPITAL MKTS. REG., *THE GLOBAL FINANCIAL CRISIS: A PLAN FOR REGULATORY REFORM* (May 2009).

In its May 2009 Report, the Committee recommended that certain aggregate data, including trading volume, transaction prices, quotations, and open interest be publicly reported in order to enhance the price discovery process and reduce risk for market participants in the over-the-counter (OTC) swap market.<sup>5</sup> We applaud the goal of bringing increased transparency and liquidity to the swap market, but caution that such implementation requires care because swaps have never before been publicly and comprehensively reported. Also, the Commissions should take care not to discourage large transactions, or block trades, which would in turn reduce market liquidity, create price distortions, and ultimately raise the cost of capital.

The Committee believes, first and foremost, that these reporting rules should be phased in over time, allowing regulators to learn from experience. In addition, the special rules for block trades should have longer reporting delays and lower size thresholds, along with appropriate categories of instruments to which these requirements will be applied. The need to promote transparency in the swap market must be balanced against the costs, operational burdens, and reduced liquidity that may result if the Commissions do not satisfactorily consider the complex dynamics of the OTC swap market.

### **Staged Implementation**

In order to avoid disruptions and set appropriate thresholds, the reporting and recordkeeping requirements should be implemented gradually over time, beginning with a pilot program covering the most liquid contracts that are centrally cleared and have the highest volumes. By staging the implementation in this manner, the Commissions will be able to monitor how the market reacts and adjust their rules accordingly. For example, when the Financial Industry Regulatory Authority (FINRA) implemented the TRACE reporting system, it did so through a staged process that subjected an increasingly broad portion of the market to reporting over a period of three years, while the delays in reporting were also gradually decreased.<sup>6</sup> TRACE took this cautious approach even though it was implemented for a single asset class, corporate bonds.

Without a staged implementation, the reporting requirements may cause market disruptions as the market reacts to the new transparency requirements. Certain participants may exit, resulting in reduced liquidity, as dealers withhold capital until they can determine whether the reporting requirements will have an adverse impact on their ability to manage risk. Market participants must also be given time to develop and implement appropriate reporting and compliance systems and procedures.

<sup>5</sup> *Id.* at 48–49; Letter from the Comm. on Capital Mkts. Reg. to Christopher Dodd, Chairman, Richard Shelby, Ranking Member, S. Comm. on Banking, Hous. & Urban Affairs and Barney Frank, Chairman, Spencer Bachus, Ranking Member, H. Comm. on Fin. Servs. 24.

<sup>6</sup> *See* 70 Fed. Reg. 67,523, 67,525; *see also* Securities & Exchange Commission, Notice of Filing of Proposed Rule Change Relating to Dissemination of Information on TRACE-eligible Securities Transactions (Release No. 34-52700; File No. SR-NASD-2005-120 (describing “NASD’s experience with TRACE of more than three years, specifically the experience gained from its measured, gradual implementation of full transparency”); FINRA, NASD Notice to Members 04-51 - July 2004, <http://www.finra.org/Industry/Regulation/Notices/2004/P006135> (describing how “[i]n the first stage (Stage One), the period to report a transaction in a TRACE-eligible security will be reduced from 45 minutes to 30 minutes. In the second stage (Stage Two), that period will be reduced to 15 minutes”).

## **Block Trades**

Block trades enable market participants to execute a large order at a single, negotiated price, without disclosing to the market information about one's position or trading strategy. Robust and flexible block trading is essential to swap market depth and liquidity. We recognize that the Commissions are cognizant of the problems associated with real-time reporting of block trades and intend to address them through different reporting rules for such trades. However, the rules, as proposed, generally suffer from three problems: (1) the delays in reporting are too short, (2) the size thresholds for what constitutes a block trade are too low, and (3) the terms "swap instrument" and "security-based swap instrument" must be properly defined.

### *1. Reporting Delay*

The CFTC Proposed Rules contemplate a 15-minute delay for the public disclosure of all block trades.<sup>7</sup> The SEC Proposed Rules, on the other hand, contemplate delays of between 8 and 26 hours, depending on when the trade was executed.<sup>8</sup> Due to their size, market participants frequently need several hours to hedge or work out of (or into) certain block trades in order to ensure that they can maintain a matched book and not have any outstanding market risk. An appropriate delay is therefore necessary to avoid speculative front running by opportunistic market participants looking to trade ahead of the hedging (or risk-offsetting) transaction.

The CFTC's statutory mandate to evaluate the costs and benefits of its rules and the SEC's mandate to evaluate the efficiency and effect of its rules on competition and capital formation<sup>9</sup> require the Commissions to base the block trade rules on sound data and analysis. The CFTC did consider data from the equities, bonds, and futures markets. We applaud that empirical approach. But block trade delays in other markets are of only limited relevance, however, because swaps are not as liquid or traded as frequently as futures or equities, thus longer delays are needed for swaps. The Commissions should provide a time of delay for block trades based on current practices, at least at inception of these rules. Adjustments can be made later if necessary.

### *2. Categories of Instruments*

The Commissions have requested public input into how broadly or narrowly to define each of the categories of "swap instrument" and "security-based swap instrument."<sup>10</sup> A different block size threshold will be calculated for each category of swap instrument, so the boundaries of those categories will greatly impact market participants' ability to engage in block trading. We would advise that instruments be classified in as few categories as possible, based on established segments of the markets, to avoid overly complex rules, but they must respect important differences in key characteristics such as the size of trades and liquidity. The trading patterns in these categories should then be investigated for the appropriate size of block trades.

<sup>7</sup> CFTC Proposed Rules § 43.5(k)(2), 75 Fed. Reg. at 76,176.

<sup>8</sup> SEC Proposed Rules §§ 902(b)(1), (2), 75 Fed. Reg. at 75,285–86.

<sup>9</sup> 7 U.S.C. § 19(a) (CFTC); 15 U.S.C. §§ 78c(f), 78w(a)(2) (SEC).

<sup>10</sup> SEC Proposed Rules, 75 Fed. Reg. at 75,234 cmmt. 116; CFTC Proposed Rules, 75 Fed. Reg. at 76,153–54.

### 3. *Thresholds*

The thresholds for determining the size of “block trades” are of concern to the Committee. The CFTC Proposed Rules contain a two-test model to determine the minimum threshold, with the larger result being the applicable threshold.<sup>11</sup> Under the distribution test, 5% of swaps in a category would be block trades, based on transaction sizes over the prior calendar year.<sup>12</sup> Under the multiple test, a swap transaction would be considered a block trade if it is larger than the largest of five times the mean, median and mode of transactions in the category over the prior calendar year.<sup>13</sup> We believe that under those rules many transactions that should be treated as block trades would not qualify.

The SEC Proposed Rules, on the other hand, provide only general criteria for the calculation of block trade thresholds;<sup>14</sup> we believe specific appropriate thresholds must be specified in advance and readjusted over time in order to provide certainty to the market and ensure those transactions that are block trades are treated as such by the Commissions.

The Commissions should set the thresholds low at first in order to collect data that will enable them to make informed decisions about the final delay and threshold determinations, which would be phased in over time. This cautious approach is far better than haphazardly setting the delay too short and the threshold too high, which risks causing significant market disruptions.

#### **Additional Information About Swaps**

Some uncleared swap transactions have features that may distort the accurate reporting of prices. For example, some swaps are subject to margin agreements while others are not. Reporting prices of swaps of these two types of transactions together, even though they represent different risks, could mislead the market about the intrinsic prices of the underlying contracts. The CFTC Proposed Rules include a field for “additional price notation,” which is to be used when “needed to describe the reportable swap and to help market participants and the public evaluate the price of the reportable swap transaction.”<sup>15</sup> It includes characteristics such as margin and collateral. Although the SEC anticipates “some flexibility” in how to report price,<sup>16</sup> we encourage the Commissions to harmonize their approaches in order to ensure the market has an accurate picture of prices.

<sup>11</sup> CFTC Proposed Rules § 43.5(g)(1), 75 Fed. Reg. at 76,174.

<sup>12</sup> *Id.* § 43.5(g)(1)(i)(B), 75 Fed. Reg. at 76,175.

<sup>13</sup> *Id.* §§ 43.5(g)(1)(ii)(A), (B), 75 Fed. Reg. at 76,175.

<sup>14</sup> SEC Proposed Rules, 75 Fed. Reg. at 75,228–32.

<sup>15</sup> CFTC Proposed Rules, 75 Fed. Reg. at 76,179, Table A1.

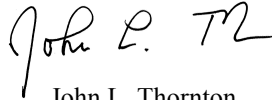
<sup>16</sup> SEC Proposed Rules, 75 Fed. Reg. at 75,214; *see also* SEC Proposed Rules § 242.901(c)(11), 75 Fed. Reg. at 75,285 (allowing for “an indication that the transaction does not accurately reflect the market”).

Thank you for considering our comments. Please do not hesitate to contact us at (617) 384-5364 if we can be of any further assistance.

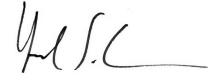
Respectfully submitted,



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