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January 18, 2011

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F. Street, N.E.
Washington, DC 20549-1090

Via Electronic Submission

Re: File Number S7-34-10 – Proposed Rules: Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information

Dear Ms. Murphy,

Vanguard[1] appreciates the opportunity to provide the Securities and Exchange Commission (the "**Commission**") with our views on its proposals for reporting and publicly disseminating security-based swap information ("**Regulation SBSR**"), which the Commission proposed under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**").

As a part of the prudent management of our mutual funds and other portfolios, we enter into derivatives contracts, including security-based swaps[2] ("**swaps**"), to achieve a number of benefits for our investors including hedging portfolio risk, lowering transaction costs, and achieving more favorable execution compared to traditional investments. Throughout the legislative process and debate that preceded the enactment of the Dodd-Frank Act, Vanguard has been supportive of provisions to bring much-needed transparency and regulation to the derivatives markets, including efforts to give regulators appropriate information that they need to identify potential systemic risk.

Regulation SBSR sets forth rules for how swap information will be reported to a registered swap data repository ("**SDR**") or the Commission and disseminated to the public as well as which swap participants are obligated to make such reports. While we support the overall objectives of Regulation SBSR, we are concerned that the short time frame proposed for publicly reporting certain larger size swap trades ("**Block Trades**") may have unintended negative consequences for the market and for our investors. In addition, we believe that if swap end-users (e.g., funds) are obligated to make such reports, it could add significant costs and burdens which would be more appropriately borne by U.S. swap dealers or major swap participants or similar non-U.S. entities ("**Swap Dealers or MSPs**").

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[1] Vanguard offers more than 170 U.S. mutual funds with total assets of over $1.5 trillion. We serve approximately 23 million shareholder accounts.

[2] Under Section 3(a)(68) of the Securities Exchange Act of 1934, security-based swaps include (i) single name credit default swaps ("**CDS**"), (ii) CDS on narrow-based indices, (iii) equity swaps on single securities, and (iv) equity swaps on narrow-based security indices.

The discussion below presents Vanguard's recommendations and additional comments on the Commission's proposals.

- **Block Trades should be defined to appropriately address the relative liquidity of specific trades and maturities.** The definition of Block Trades should be tailored to current liquidity levels appropriate to the specific trade type, underlying instrument and term to reflect the challenges of executing in the more thinly traded segments of the swaps market.

- **Public dissemination of all information about Block Trades should occur no earlier than 24 hours after execution.** The proposed timing for the public dissemination of key information related to Block Trades (e.g., notional size) may not always provide enough of a delay to allow Swap Dealers to enter into mirror trades (or "lay-off" their positions) ahead of market knowledge of the Block Trades. If the Swap Dealer knows that any mirror positions will be priced by a market already anticipating the trade, the Swap Dealer's price for the original Block Trade will have to increase to avoid an overall loss and fund investors will suffer as a result. We believe that all information concerning Block Trades, rather than merely notional size, should be disseminated to the public on a delayed basis.

- **Equity total return swaps should not be excepted from the definition of Block Trade.** Consistent with other security-based swap transactions, real-time public reporting of equity total return swaps ("**Equity TRS**") in illiquid sizes will serve to convey to the market that Swap Dealer hedging activity, involving significant purchases and/or sales of specific equity securities, is imminent. This will enable the market to trade ahead of such hedging activity to the detriment of the Swap Dealer, thereby requiring the Swap Dealer to quote higher prices to the detriment of fund investors. For this reason, large size Equity TRS should qualify, where appropriate, for Block Trade delayed public reporting.

- **Non-U.S. Swap Dealers should be required to report swaps to a swap data repository when transacting with U.S.-based swap end-users.** In the event no U.S. Swap Dealer or MSP is a party to the trade, the proposed rules obligate the U.S. swap end-user to report swap data to an SDR notwithstanding that a non-U.S. Swap Dealer or MSP is the counterparty to the trade. As such reporting would be costly and burdensome for U.S. swap end-users, it is possible they could elect to trade only with U.S. Swap Dealers, potentially limiting their liquidity and raising the pricing of their swaps given the fewer dealers with which to transact. Non-U.S. Swap Dealers and MSPs, as well as clearinghouses, national securities exchanges, and swap execution facilities (collectively, "**Swap Utilities**") are more likely to have appropriate systems in place to facilitate reporting and a better approach would be to require these entities to report in the absence of a U.S. Swap Dealer or MSP.

Arguments in support of each of these recommendations are set forth below.

I. Block Trades should be defined to appropriately address the relative liquidity of specific trades and maturities.

"Block Trades" refers to trades of a relatively illiquid size based on a variety of factors related to trade type, underlying instrument, term, etc., and may be entered into by asset managers for trading an aggregation of positions to be allocated across managed funds. While multiple individual trades of a

more liquid size could be executed on a fund-by-fund basis, to achieve efficient execution and pricing, asset managers may solicit quotes on an aggregated basis with fund allocations of the relatively illiquid, larger position confirmed to the Swap Dealer shortly after trade execution.

Rather than establishing an arbitrary uniform test for Block Trade status, one tailored to the current liquidity levels appropriate to the specific trade type, underlying instrument and term should be used to reflect challenges in executing in the more thinly traded segments of the swaps market. Such an approach should recognize that a uniform test will not necessarily be constant given the fluctuating liquidity based on market demand for a particular trade type. As characteristics of swaps may change and evolve over time, rules should require periodic assessment of what constitutes a Block Trade for different types of swaps. Moreover, the rules should recognize that it may be appropriate to modify the definition of Block Trade to the extent that the liquidity of a swap changes as well as to allow new and unique types of swaps to benefit from Block Trading.

II. Public dissemination of all information about Block Trades should occur no earlier than 24 hours after execution.

The trading of relatively illiquid, larger positions is an important tool for asset managers to efficiently execute trades on a price-sensitive basis for allocation across multiple funds. Especially for asset managers with sizeable portfolios, the trading of aggregated positions serves to provide the necessary liquidity and ensures favorable pricing. While the prompt public dissemination of information related to Block Trades can provide enhanced transparency for the market, the relative illiquidity of such trades requires careful treatment to minimize the possible negative impact on the asset manager's ability to gain exposure to swaps needed for effect portfolio management in an efficient and cost-effective manner.

Section 13(m)(1)(E) of the Securities Exchange Act of 1934 requires that in establishing rules to provide the public with information about cleared swap transaction data the Commission must, among other things, (y) "specify the appropriate time delay for reporting [Block Trades] to the public," and (x) "take into account whether public disclosure will materially reduce market liquidity."

The proposed rules provide that an SDR publicly disseminate, in real time, a report including information related to price, type of swap, date and time of execution, fixed and floating rate payments, if any, notional size, and the transaction ID; ***provided, however***, that with respect to Block Trades, the notional size, plus the transaction ID and an indicator that the report represents a Block Trade shall be disseminated on a delayed basis. A complete report for Block Trades (including the notional size) must be disclosed on the following schedule:

- If the swap was executed on or after 5:00 coordinated universal time ("**UTC**") and before 23:00 UTC of the same day (12:00 midnight and 6:00 p.m. EST), the report must be disseminated at 7:00 UTC the following day (2:00 a.m. EST);
- If the swap was executed on or after 23:00 UTC and up to 5:00 UTC of the following day (6:00 p.m. until 12:00 midnight EST), the report must be disseminated at 13:00 UTC of that following day (8:00 a.m. EST).

Vanguard believes that it is appropriate to require real time reporting of Block Trades to an SDR as such reporting will allow the Commission to engage in surveillance of swaps markets and thereby

better understand and assess the risk in those markets. A mandate to publicly disclose any information about a Block Trade on a real time basis could have the unintended consequence of materially impacting transaction pricing while not significantly enhancing market transparency compared to a delayed reporting approach.

Given the Swap Dealer's primary role as a market maker, its business is to intermediate between clients acting as buyers and sellers without maintaining its own positions. Generally speaking, intermediation means that for each trade where the client is the "buyer", the Swap Dealer needs to find another client that is a "seller" to balance the market risk presented by the new trade. When a Swap Dealer commits a price for a Block Trade, it expects to have adequate time to enter into mirror trades in the market to balance the market risk.

The current proposed timing for public reporting of a Block Trade's notional size may not always provide enough of a delay to allow Swap Dealers to enter into mirror trades (or "lay-off" their positions) ahead of market knowledge of the Block Trades. Moreover, a real time public report that includes all information concerning a Block Trade except for notional size will allow savvy market participants to determine that a significant swap trade has occurred at a size that is at least equal to the minimum threshold notional size for a Block Trade in the respective swap asset class. Notwithstanding the proposed public reporting delays for a Block Trade's notional size, we are concerned that once any information is disseminated that allows market participants to deduce that a Block Trade has occurred, market participants may be able to strategically establish positions in anticipation of the Swap Dealer's balancing of its book and thereby increase the overall price of such balancing activity. Such increased pricing for Block Trades will either cause asset managers to enter into less efficient small trades or raise the overall price of swaps trading for fund investors.

Initially, the Commission should include delays for public reporting of all data concerning a Block Trade including notional size until it has time to study how such reporting affects markets.[3] The delay should be longer than the proposed public reporting delays for notional size. Under the proposed rule, if a Block Trade is entered into late in the business day (e.g., 3:45 p.m. EST), the trade's notional size will be disclosed at 2 a.m. EST, the next business day. Such timing does not give a Swap Dealer meaningful time to lay-off the position, particularly as the bulk of the delay occurs after normal trading hours when liquidity is diminished. Under these circumstances, the Swap Dealer effectively has only a few business hours to lay-off the trade.

With this in mind, we recommend the Commission implement real time public reporting of all data concerning a Block Trade including notional size no earlier than 24 hours after the trade is executed. Information should be disseminated on a rolling basis. For example, if a Block Trade is executed at 11:15 a.m. EST on day one, all data concerning the Block Trade should be publicly reported at 11:15 a.m. EST on day two. This will give the dealer at least a full trading day to lay-off the position. It is possible that over time tighter time frames can be implemented, however we strongly believe that given the potential risks, a 24 hour delay would be a prudent approach at present.

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[3] If the Commission concludes, in the future and after study, that sooner public reporting of data concerning Block Trades will not harm pricing, transparency or liquidity in the swaps market, so that the interests of investors are protected, then it can propose appropriate revisions to its rules at that time.

In terms of the proposed reporting to be made with respect to Block Trades, we do not believe it appropriate for specific notional amounts to be publicly disseminated. Instead we strongly prefer, and believe adequate for the intended purpose for public dissemination, that notional amounts for such trades be reported identifying a notional size in excess of the amount established as the threshold for the specific Block Trade. As noted above, such amount will need to be regularly set based on current liquidity levels applicable to the relevant trade type, underlying instrument and term.

III. Equity total return swaps should not be excepted from the definition of Block Trade.

The proposed rules provide that an SDR may not designate as a Block Trade any swap that is an Equity TRS or is otherwise designed to offer risks and returns proportional to a position in the equity security or securities on which the swap is based. Under the proposed rules, if an Equity TRS qualifies as a Block Trade, certain information (e.g., notional size and block trade status) about the trade is publicly disseminated on a delayed basis. According the Commission, the rule is "designed to discourage [swap] market participants from evading post-trade transparency in the equity securities markets by using synthetic substitutes in the swap market."[4] This is because block trades in equity security cash markets are reported to the public without delay.

Because the Equity TRS markets function differently than cash markets, Block Trades of Equity TRS should be afforded different treatment for purposes of real-time public trade reporting. To that end, a large notional Equity TRS should be able to qualify as a Block Trade if aspects of the Equity TRS (underlying instrument, size, term, etc.) is of sufficient illiquidity for a Swap Dealer's related subsequent trading activity (whether in the cash or derivatives markets) to be impacted by the market's knowledge of the Equity TRS Block Trade.

Following the sale of an Equity TRS, a Swap Dealer is likely to either seek to buy a similar Equity TRS or hedge some or all of its exposure by making follow-on purchases and/or sales of equity securities in the cash markets. For example, if a fund buys an Equity TRS from a Swap Dealer at an illiquid Block Trade size of 1 million shares of Company Y for 5 years, the Swap Dealer will likely make follow-on purchases of such shares in the cash market, which follow-on shares will be reported to the public in real time. If the Equity TRS between the fund and Swap Dealer is required to be reported in real time, market knowledge of the trade, and the Swap Dealer's likely follow-on market activity, is very likely to negatively impact the price that the Swap Dealer is able to obtain on mirror or hedging trades. Such potential negative impact will necessarily lead the Swap Dealer to quote worse pricing to the fund for the Equity TRS, thereby constraining the liquidity of such Equity TRS. Similar to other Block Trade types, real-time reporting of the illiquid Equity TRS will effectively serve to alert the markets that significant purchases or sales of certain equity securities are very likely to occur in the near term, and the market will be able to act on that information to the detriment of Swap Dealer and thereby the fund investors. It is appropriate to make a distinction between cash equity trades and Equity TRS (where there is no reporting delay for cash equity trades) as the cash market does not necessarily involve follow-up trading or hedging.

We do not believe that by itself, delayed reporting for Equity TRS Block Trades would cause an investor to choose investing in an Equity TRS over investing in the cash market. The delay we have

[4] See Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information, Release No. 34-63446 (November 19, 2010) (the "Proposing Release") at 89.

proposed is not so significant to influence product choice, but will have a significant impact on product pricing, and thereby product liquidity for fund investors.

For the above reasons, Equity TRS should not be excepted from treatment as a Block Trade.

IV. Non-U.S. Swap Dealers should be required to report swaps to an SDR when transacting with U.S.-based swap end-users.

The proposed rules require that swap counterparties are responsible for reporting swaps to the appropriate registered SDR[5] and, in certain circumstances, the Commission (i.e., if no SDR would receive the swap information). If both parties to a swap are U.S. persons and only one party is a Swap Dealer, then the proposed rules require the Swap Dealer to report the swap. If only one party is a U.S. person, then that party is required to report regardless of whether that party is a Swap Dealer, MSP or a buy-side swap end-user. Therefore, the proposed rule, as applied, requires a U.S. swap end-user (e.g., fund) transacting with a non-U.S. Swap Dealer or MSP to report the swap to the SDR.

Such a reporting obligation will be costly and burdensome for swap end-users and ultimately their individual investors, especially if such entity enters into swaps on an isolated basis. Swap end-users would have to develop and implement costly systems to facilitate reporting if they choose to transact with a non-U.S. Swap Dealer. Such systems would need to collect appropriate swap information and be able to transmit such information in real time to an SDR or the Commission. According to the Commission, reporting persons including end-users would also need to implement and sustain compliance programs as well as "technical, administrative and legal support" for the operation of the systems.[6]

While large institutions are certainly active in the security-based swap market, smaller end-users also actively trade with Swap Dealers and would be required to commit significant capital and resources to build out their reporting systems if they wanted to trade with non-U.S. Swap Dealers. The costs for building out these systems will harm U.S.-based swap end-users. Swap Dealers and MSPs as well as Swap Utilities are more likely to have appropriate systems in place to facilitate reporting and a better approach would be to require these entities to report.

We recognize that the proposed rules do not prevent a reporting person from engaging a third party (e.g., Swap Utility) to report the swap to an SDR. Engaging a third party to facilitate reporting will not be without costs and, in the long run, could even be more costly than building out internal systems to facilitate reporting. In view of these heightened costs, one unintended consequence of the proposed rules could be to discourage U.S.-based swap end-users from engaging in swaps with non-U.S. Swap Dealers. In other words, end-users could be more likely to transact only with U.S. Swap Dealers and MSPs. Ultimately, this could serve to increase concentration risk and could even impact pricing as the U.S.-based swap end-users would effectively have fewer entities with which to transact.

Alternatively, the rules should provide that if a non-U.S. Swap Dealer or MSP reports the swap (or agrees to report), then such report should satisfy the U.S.-based swap end-user's reporting

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[5] Section 3(a)(75) of the Securities Exchange Act of 1934 defines a swap data repository as "any person that collects and maintains information or records with respect to transactions or positions in, or the terms and conditions of, security-based swaps entered into by third parties for the purpose of providing a centralized recordkeeping facility for security based swaps."

[6] Proposing Release at 15.

requirement. In addition, for swaps transacted through a Swap Utility, such entity should be the person required to report the swap to the SDR.[7] Each of these reporting regimes will facilitate economies in the marketplace as fewer entities will be required to build out costly systems to support reporting to SDRs.

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In closing, we thank the Commission for the opportunity to comment on Regulation SBSR and appreciate the Commission's consideration of Vanguard's views. If you have any questions about Vanguard's comments or would like additional information, please contact William Thum, Principal, at (610) 503-9823 or Michael Drayo, Associate Counsel at (610) 669-4294.

Sincerely,

/s/ Gus Sauter

Managing Director
and Chief Investment Officer
Vanguard

/s/ John Hollyer

Principal and Head of Risk Management
and Strategy Analysis
Vanguard

cc: Securities and Exchange Commission
The Honorable Mary L. Shapiro
The Honorable Kathleen L. Casey
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[7] Swap Utilities may even be SDRs.