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RE: RIN: 3038-AD08, Notice of Proposed Rulemaking on Real-time Public Reporting of Swap Transaction Data; File No. S7-34-10, Proposed Regulation SBSR–Reporting and Dissemination of Security-Based Swap Information

Goldman, Sachs & Co. ("Goldman Sachs")[1] appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the "CFTC") and the Securities and Exchange Commission (the "SEC" and, together with the CFTC, the "Commissions") regarding reporting of swap transaction data in response to the CFTC's proposed rules on Real-Time Public Reporting of Swap Transaction Data[2] (the "CFTC proposal") and the SEC's proposed

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Through its affiliates, GS Group is a primary dealer in U.S. Treasury securities, and a dealer in swaps. Because of our extensive trading of, and operational support for, swaps, Goldman Sachs has a strong interest in providing the Commission with comments and recommendations about the most effective and efficient ways to implement the swap transaction data reporting requirements of the Dodd-Frank Act.

[2] Real Time Public Reporting of Swap Transaction Data, 75 Fed. Reg. 76,140 (December 7, 2010).

Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information[3] (the "SEC proposal" and, together with the CFTC proposal, the "proposals").

Background

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") promotes greater transparency and price discovery in the swaps markets through various provisions, including section 727 and the new section 13(m)(1)(C) of the Securities Exchange Act of 1934, which require the Commissions to adopt rules mandating the real-time reporting of swaps and security-based swaps (collectively referred to as "swaps"). At the same time, the Dodd-Frank Act recognizes the importance of promoting liquidity and customer choice in the swaps markets by directing or permitting the Commissions to adjust the terms of public dissemination requirements for "block trade" swaps that involve transfers of risks that are larger than those commonly transacted in the market.[4]

The Dodd-Frank Act provides a framework under which parties (such as asset managers and end users) that seek to transfer significant risks have the ability to obtain firm, executable prices from dealers who are able to assess and price the risks associated with managing the exposures that they assume in entering transactions with such counterparties. In the current market structure, a dealer provides prices to a potential counterparty based on the exposures that it would assume upon trade execution but generally without having to factor in the market impact of transactions entered into by unrelated third parties who trade based on the expectation that the dealer will have to hedge such exposures. If, however, counterparty trades are disclosed before the time the dealer expects to complete its hedging, the pricing that the dealer provides its counterparty would be adjusted to reflect the risk of this additional market impact. As a consequence, disclosure of counterparty transactions will increase the cost of the liquidity provided by dealers—potentially by a substantial amount—which will impair the ability of customers to choose risk transfer methodology.[5]

The block exemptions[6] contemplated by the Dodd-Frank Act and the proposals provide the lever to balance the benefits of transparency with the interests of market participants in

[3] Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, 75 Fed. Reg. 75,208 (December 2, 2010).

[4] Commodity Exchange Act § 2a(13)(E); Securities Exchange Act § 13(m)(1)(E).

[5] In this regard, we share the concerns expressed in the SEC proposal regarding the negative effects on liquidity, the ability to implement hedge programs and similar considerations that result from the dissemination of information regarding private transactions. SEC proposal, at 75,225–30.

[6] In this letter we refer to block trades to include block trades and large notional transactions as defined in the proposals. *See* CFTC proposal § 43.2(f), at 76,171; CFTC proposal § 43.2(l), at 76,171; SEC proposal § 242.900, at 75,283.

having the confidence and ability to transfer significant risks at a known price. Given the importance of block exemptions for this objective, we encourage the Commissions to give careful consideration to the size of transactions that qualify for exemption treatment.

Goldman Sachs appreciates the effort and consideration that the staffs of the Commissions have dedicated to developing the proposals. For the reasons set forth below, we respectfully recommend that the Commissions modify the proposals in the following ways:

- **Define specific categories to reflect market differences within an asset class:** We encourage the Commissions to define swap categories with sufficient specificity to ensure that instruments having common risk and liquidity profiles are grouped together in a manner that accurately reflects transactions having the same essential characteristics. This will also ensure that block exemption levels are appropriately sized so as not to be over- or under-inclusive;

- **Refine block thresholds to more accurately capture trades that would have a market impact:** We believe that block trade thresholds should be set so that they capture those transactions whose disclosure will impact liquidity or be larger than the observable "social size" of transactions commonly executed within each swap category. We also believe that these thresholds should be determined based on an analysis of existing OTC transaction data; and

- **Establish a tiered approach to the treatment for block trades:** We recommend that the rules adopt a tiered approach with respect to the timing and scope of information requirements applicable to the dissemination of information regarding block trades, so that information regarding smaller or less impactful block trades is disseminated sooner than information regarding larger or more impactful block trades. This would comport with the approach recommended by European regulators.

Further, we would suggest that the SEC reconsider the exclusion of certain equity swaps from the block trade regime.

Swap Categories

A fundamental step in establishing a transaction reporting regime is appropriately defining the transaction types and categories within that regime. The Dodd-Frank Act requires the Commissions to categorize trades for a number of purposes, including for determining whether they should be subject to mandatory clearing and execution requirements and for defining block trade thresholds. In light of the diverse range of product types in the swaps markets with different characteristics and risk profiles, it is particularly important to define categories with a relatively high level of specificity so as to ensure categories are not over- or under-inclusive. At the same time, we agree with the proposals that the Commissions should establish swap category definitions in a clear and easily understood manner.[7]

We would propose that each asset class be divided into categories for purposes of the proposed block trade exemption rules based on the distinguishing characteristics most relevant to pricing and liquidity within that asset class. For example, in the context of the interest rate asset class, such parameters might include (i) whether swaps are cleared or uncleared, (ii) outright vs. spread, (iii) fixed/floating vs. floating/floating, (iv) floating rate indices and (v) tenor. We note that it will be appropriate for the relevant characteristics used to differ between asset classes (the taxonomy for categorizing credit swaps may differ from that used for commodities swaps, for example). We believe this should preserve an adequate level of simplicity for customers while sufficiently focusing the categories.

Block Trade Requirements

Block Size Thresholds

Goldman Sachs supports the approach reflected in the proposals that seeks to establish block exemptions based on whether a particular transaction would be likely to impact liquidity[8] or be larger than the trade size that is customarily transacted in the market (referred to as "social size").[9] We believe that these measures will necessarily differ by asset class and product type within a particular asset class and encourage the Commissions to adopt rules that take these differences into account.

The CFTC proposes a two-part test that would set the minimum block size at the greater resulting number of each of a distribution test and a multiple test.[10] The distribution test surveys the notional or principal transaction sizes in a particular swap category during a given time period and establishes the block level at a specified percentage of trades so surveyed.[11] The proposed multiple test, which calculates the "social size" of a particular type of swap based on the highest of its mean, median and mode transaction sizes and then applies a block multiplier, is intended to account for illiquid markets in which too few transactions are executed to provide a meaningful distribution of transaction amounts.[12] As constructs, we generally support the

[7] See, *inter alia*, SEC proposal, at 75,213.

[8] SEC proposal, at 75,228.

[9] CFTC proposal, at 76,162.

[10] CFTC proposal § 43.5(g)(1), at 76,174.

[11] CFTC proposal § 43.5(g)(1)(i), at 76,174.

[12] CFTC proposal § 43.5(g)(1)(ii), at 76,174.

distribution and multiple tests proposed by the CFTC.[13] However, we encourage the CFTC to modify the multiple test by eliminating the mean prong. Defining the social size of a swap category with reference to the mean of transaction sizes would make the calculation susceptible to skewing in circumstances where there are a small numbers of extreme outlier trades. Further, in order to avoid misleading or arbitrary results, we would recommend that trade sizes be rounded in accordance with the proposed rounding convention before being used for purposes of the mode test.[14]

In order for these constructs to be appropriate mechanisms to achieve the aims of Dodd-Frank, the variables in them (*i.e.,* the applicable percentage in the case of the distribution test and the applicable multiplier in the case of the multiple test) must be based upon a review and analysis of a statistically significant data set for each applicable swap category. While it is true that information at a sufficient level of detail necessary to inform this analysis is available only on a limited basis, we believe that the Commissions could obtain an appropriate data set by requesting large dealers to provide such information on a confidential basis and augment this by a survey of other market participants as was suggested by the CFTC under Reg 1.38 in 2008.[15] We at Goldman Sachs have analyzed our own trading portfolios by category type, applying both the distribution and multiple test, and found the results to be quite interesting.

Timing of Dissemination Requirements; Recommended Tiered Approach

The CFTC proposal provides for a 15-minute delay in the public dissemination of information regarding block trades which applies to all information regarding the trade (including both price and size).[16] The SEC proposal requires the immediate public dissemination of trade details other than the specific trade size (which is required to be disseminated from 8 to 26 hours after execution depending on at what time during the day the execution occurs).[17] In its proposal the SEC indicated that it took this approach in order to promote the public interest of price discovery without subjecting block trade counterparties to undue risk of a significant

[13] We note that the SEC Division of Risk, Strategy and Financial Innovation released a memorandum in which they analyze alternative approaches to the setting of block exemption thresholds, including setting thresholds by using a percentage of trading volume in the relevant instrument during a specified period. Based on our preliminary review, we believe that this may also be a useful approach assuming that it employs properly defined product definitions and is based on percentage tests that are appropriately sized to achieve the objectives of the proposals. Division of Risk, Strategy and Financial Innovation Memorandum entitled "Security-Based Swap Block Trade Definition Analysis", January 13, 2011.

[14] CFTC proposal § 43.4(i), at 76,174.

[15] The release recommends that designated contract markets interview experienced floor brokers and traders as part of their determination of appropriate block sizes. Execution of Transactions: Regulation 1.38 and Guidance on Core Principle 9, 73 Fed. Reg., 54097-54106 (Sept. 18, 2008), at 54,100.

[16] CFTC proposal § 43.5(k)(2), at 76,176.

[17] SEC proposal § 242.902(b), at 75,285.

change in the price necessary to hedge the market risk created by entering into the block trade.[18] However, we strongly believe the disclosure of the simple fact that a block trade occurred would likely have substantially the same market impact whether or not the particular size of the trade is disclosed. As such, we do not believe that the approach outlined in the SEC proposal will achieve the Commission's goal of protecting liquidity.

In order to achieve maximum transparency with the smallest impact to liquidity and customer choice, we recommend that the Commissions adopt a hybrid between the CFTC and SEC proposals that would be based on the particular size of the transaction in the context of its particular category. Specifically, we recommend the creation of two tiers of transactions. The smaller tier, or "Block Level 1," would apply to transactions above "social size," the disclosure of which would be meaningful to market liquidity. The larger tier, or "Block Level 2," would apply to transactions the disclosure of which would be substantially impactful to market liquidity. The significance of the block level designations would be two-fold: (i) the block levels would be the basis for the timing of the public of dissemination of information regarding the trade and (ii) the block levels would be the basis for trade size "bands" that are used for dissemination purposes.

Under the bands, a trade whose size is greater than Block Level 1 but less than Block Level 2 would be reflected as "above Block Level 1" and trades whose size is greater than Block Level 2 would be reflected as "above Block Level 2." This approach is consistent with the rounding convention reflected in the CFTC proposal and is a means of providing transparency while protecting the trading positions and strategies of market participants.[19] With regard to the timing of disclosures, information regarding Block Level 1 trades would be publicly disseminated up to 15 minutes after execution (at which time all information regarding the trade, including the size band, would be disseminated). Information regarding Block Level 2 trades would be publicly disseminated within the time-frames specified in the SEC proposal based on when trade execution occurs (at which time all information regarding the trade, including the size band, would be disseminated). This tiered structure would allow the Commissions to provide market participants with trade transparency yet ensure liquidity for varying levels of large trades. In addition, it is similar to the approach recommended by the Committee of European Securities Regulators in 2010[20] and, as such, will support international harmonization of regulation, another key Dodd-Frank objective.

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[18] SEC proposal at 75,232.

[19] In this respect, our proposal is similar to the rounding convention outlined in the CFTC proposal. CFTC proposal § 43.4(i), at 76,164.

[20] The Committee of European Securities Regulators, now under the auspices of the European Securities and Markets Authority, recognizes that it must balance the potential for adverse market impact on liquidity if market participants are not provided enough time to unwind block trades before making them public and supporting liquidity in normal market conditions. It accordingly provides a deferred publication framework based on market liquidity. Committee of European Securities Regulators. *CESR Technical Advice to the European Commission in the Context of the MiFID Review - Non-Equity Markets Transparency* (July 2010).

Trades Excluded from the SEC Block Trade Proposal

Total Return Swaps

The SEC proposal contemplates excluding total return equity swaps and similar transactions from eligibility for block exemption treatment on the grounds that these transactions may be designed as a substitute for positions in the underlying securities which would be required to be publicly reported. We respectfully urge the SEC not to exclude these transactions from block exemption eligibility so long as they are hedged in related underlying securities for which there is a public reporting requirement. It is typically the case currently that when a dealer takes the short side of an equity total return swap it purchases a hedge either in the listed stock or listed futures markets – both public, transparent markets. Similarly, when taking the long side of such a transaction the dealer will short, typically in the public, transparent markets. Not to afford total return equity swaps and similar transactions the possibility of block exemption treatment that is available to all other swaps (including, notably, total return swaps on broad based equity indices that fall under the jurisdiction of the CFTC) will reduce the availability of a type of transaction that is relied upon by many market participants as a means of efficiently transferring risks. We believe that no transparency is lost by a block exemption provided the hedge is transacted in a public, real-time reported market. Additionally, a hedge-based block exemption for equity total return swaps and similar transactions would be consistent with how other over-the-counter equity derivatives are currently regulated by the SEC.[21]

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[21] We note that there is precedent for the recognition of hedging activities as providing a basis for eligibility for exemptive treatment under relevant rules. In particular, FINRA Rule 2360(b)(3)(A)(vii)b "Delta Hedging Exemption for Members and Non-member Affiliates" and CBOE Rule 4.11 Delta Hedging Exemption from Equity Options Position Limits provide a position limit exemption for equity options provided the trades are delta hedged under a "permitted pricing model."

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We would be pleased to discuss any of the comments or recommendations in this letter with the Commissions' staff in further detail.

Sincerely,

R. Martin Chavez
Managing Director
Goldman, Sachs & Co.