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- David A. Berg
  Vice President, General Counsel and Secretary

February 7, 2011

Filed Electronically

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

Re: Real-Time Public Reporting of Swap Transaction Data; Proposed Rule, 75 Federal Register 76140 (December 7, 2010); RIN No. 3038-AD08

Dear Mr. Stawick:

The Air Transport Association of America, Inc. ("ATA") appreciates this opportunity to comment on the rules proposed by the Commodity Futures Trading Commission ("CFTC" or "Commission") relating to real-time public reporting of swap transaction data (the "Proposed Rules").[1] Section 727 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") was intended to provide for public dissemination of swap transaction and price data for the purpose of enhancing price discovery.[2] ATA supports reporting of transactions to the Commission or to a Swaps Data Repository for regulatory purposes as soon as technologically practicable. ATA also supports the effort to bring enhanced price discovery to the swap markets. However, ATA is very concerned that the Commission's proposed rules for the public dissemination of information of trade details fails to address the detrimental effects of such disclosure on transactions in illiquid markets or market segments – the markets in which ATA members transact their hedging. In such markets, the real-time reporting requirement likely will either increase the bid/ask spread to

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[1] *Real-Time Public Reporting of Swap Transaction Data*, 75 FR 76140 (Dec. 7, 2010) ("Proposing Release").

[2] Commodity Exchange Act ("CEA" or the "Act") § 2(a)(13)(B) (all references to the Act are as amended by the Dodd-Frank Act).

end-users, erode the already limited market liquidity, or both. To mitigate these ill effects, transactions in illiquid markets (described below) should be eligible for the "block-trade" delayed reporting provision, but with a delay substantially greater than 15 minutes.

ATA

ATA is the principal trade and service organization of the U.S. scheduled airline industry.[3] It is the nation's oldest and largest airline trade association and its members account for more than 90 percent of the passenger and cargo traffic carried by U.S. airlines. Since its founding in 1936, ATA has encouraged governmental policy decisions that foster a financially stable U.S. airline industry capable of meeting the nation's travel and shipping needs while withstanding the inherently cyclical nature of the air line industry.

ATA Members' Use of Swaps

As major consumers of jet fuel, the price of which is tied fundamentally to the price of crude oil, ATA members rely extensively on swaps to hedge their exposure to volatile oil and jet fuel prices. These swaps are most frequently bilateral contracts. Upon implementation of the Dodd-Frank Act, ATA's members are likely to continue transacting swaps bilaterally, in reliance upon the end-user exemption of section 2(h)(7) of the Act.

ATA members use a variety of strategies to hedge their fuel cost, depending on where fuel costs are relative to historic norms. In the most general terms, members may endeavor to lock in prices when the market is at a low point, cap their future exposure to price movements when the market is at a high point and limit their future exposure to price movements in either direction in periods of uncertainty. Some ATA members hedge using strategies that are accomplished by entering into large, customized, long-term swap contracts.[4]

In order to effect these hedging strategies, ATA members frequently transact in swap markets or market segments that are illiquid, such as jet fuel. A liquid market for standardized derivatives on jet fuel has not developed and there are a very limited number of market participants. ATA members may also hedge their commercial exposure to fuel prices by entering into transactions that are distant on the forward curve. Such market segments, even for otherwise liquid commodities such as heating oil or crude oil are relatively illiquid as well. The markets for customized, long-term contracts are similarly illiquid.

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[3] The members of the association are: ABX Air, Inc.; AirTran Airways; Alaska Airlines, Inc.; American Airlines, Inc.; ASTAR Air Cargo, Inc.; Atlas Air, Inc.; Continental Airlines, Inc.; Delta Air Lines, Inc; Evergreen International Airlines, Inc.; Federal Express Corporation; Hawaiian Airlines; JetBlue Airways Corp.; Southwest Airlines Co.; United Airlines, Inc.; UPS Airlines; and US Airways, Inc. Associate members are: Air Canada and Air Jamaica.

[4] Richard Cobbs & Alex Wolf, *Jet Fuel Hedging Strategies: Options Available for Airlines and a Survey of Industry Practices*, 2004, *available at* http://www.kellogg.northwestern.edu/research/fimrc/papers/jet_fuel.pdf.

ATA member airlines will enter into the vast majority of such transactions with counterparties that are likely to be deemed "swap dealers" under the Dodd-Frank Act and forthcoming Commission regulations. These swap dealers, after entering into a transaction with an ATA member will in many cases seek to lay off the risk of the transaction by entering into one or more transactions with others, including other swap dealers. Because the markets or market segments in which the airlines transact are thinly traded, the dealer may be required to resort to a number of strategies, including entering into multiple transactions with a variety of counterparties, to lay off its risk without signaling its demand and thereby impacting the price. If it cannot do so, the risk of the transaction to the dealer will increase, causing the dealer to widen its quoted bid/ask spread or become less active in the market (and reduce liquidity), or possibly both. In either case, the airlines are harmed because their ability to execute their *bona fide* hedging strategies will be diminished or possibly eliminated entirely.

The Commission's Proposed Rules on Real-Time Reporting of Block Trades and Large Notional Swaps

Pursuant to Section 2(a)(13) of the Act, the Commission must require real-time public reporting for all swaps, regardless of whether they are required to be cleared or whether they are in fact cleared. In drafting the Dodd-Frank Act, however, Congress recognized that the hedging utility of swaps transactions could be diminished by requiring real-time reporting of some information and in certain situations. Thus, the Commission is required implement the reporting requirement in a manner that does not disclose the business transactions and market positions of any persons.[5] Congress further mandated that in undertaking its rulemaking, the Commission shall "take into account whether the public disclosure will materially reduce market liquidity."[6]

Definitions of Block Trade and Large Notional Swap

The Commission has proposed rules that would allow for some delay in reporting "block trades" in swaps, as well as "large notional swaps," each as defined in the proposed rules. A "block trade" would be defined as a swap transaction involving a swap that (1) can be traded on a swap market; (2) occurs off the market's trading system pursuant to the market's rules; (3) meets the minimum block size requirements set by that market or swap data repository, pursuant to Commission rules; and (4) is reported in accordance with the market's rules and with the time delay mandated by proposed § 43.5(k).[7] A "large notional swap" would be a swap that (1) cannot be traded or executed on a market; (2) meets the

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5 CEA § 2(a)(13)(C)(iii), (E)(i).

6 CEA § 2(a)(13)(E)(iv).

7 Proposed § 43.2(f).

minimum size requirement set pursuant to Commission rule; and (3) is reported in accordance with the time delay mandated by proposed § 43.5(k).[8]

Minimum Block Sizes

The Commission proposes to require registered swap data repositories ("SDR") to calculate the minimum block sizes for each category of "swap instrument"[9] for which they receive data.[10] Swap markets would then refer to the minimum block size set by the SDR and set their own minimum block trade sizes at or above the minimum block size.[11] Parties to off-facility swaps would determine the category into which their swap fits and refer to the minimum block size set by an SDR for swaps in such category to determine if their transaction can qualify as a large notional swap.[12] In determining the minimum block size for each category of swap instrument, SDRs would be required to compare the results of a "distribution test" and a "market test."[13] The distribution test would require an SDR to compile the notional or principal amounts of all transactions in a given category of swap instrument over a given period of time and determine the amount below which 95% of transactions fell during the period.[14] The market test would be calculated by identifying the greatest of the mode, median, or mean transaction size for a category of swap instrument over a particular period of time (the "social size") and multiplying that figure by five. The minimum block size would be the greater of the result of the distribution test and the result of the market test.

Time Delay in Real-Time Reporting

The proposed rules provide that swap markets and SDRs must publicly disseminate data for standardized block trades and large notional swaps within 15 minutes of execution.[15] SDRs would be required to disseminate data for customized large notional swaps (*i.e.*, those large notional swaps that are not subject to mandatory clearing but are cleared or that are not cleared but are reported to an SDR or to the Commission) within such time as the

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[8] Proposed § 43.2(l).

[9] A "swap instrument" would be defined as a grouping of swaps in the same asset class with the same or similar characteristics. Proposed § 43.2(y).

[10] Proposed § 43.5(g).

[11] Proposed § 43.5(h).

[12] Proposed § 43.(j)(1).

[13] Proposed § 43.5(g)(1).

[14] Proposed § 43.5(g)(1)(i).

[15] Proposed § 43.5(k)(2).

Commission may prescribe.[16] The Commission indicated that the time delay for reporting of customized large notional swaps may vary based on whether the swap's "underlying asset is a financial or a physical commodity, asset class, and/or other factors."[17] In requesting comment on the proposed time delays, the Commission indicated that a longer time delay might be appropriate for large notional swaps on physical commodities because of the hedging strategies associated with such swaps, but did not propose a specific rule.[18]

ATA Comments on the Proposed Rules

As an initial matter, we note that the Commission has long recognized the need for flexibility in execution requirements in the context of large blocks, noting that "block trading is intended to provide greater efficiency and economy in the execution of large orders than otherwise may be achievable."[19] More recently, the Commission provided a summary of the benefits of off-market block trading:

> Block trades are allowed to be transacted off the centralized market for two reasons. First, prices attendant to the execution of large transactions on the centralized market may diverge from prevailing market prices that reflect supply and demand of the commodity. This is because the centralized market may not provide sufficient liquidity to execute large transactions without a significant risk premium, so that the prices of such trades tend to reflect, to a significant degree, the cost of executing the trade. Accordingly, reporting these prices as conventional market trades would be misleading to the public. Second, block trading facilitates hedging by providing a means for commercial firms to transact large orders without the need for significant price concessions and resulting price uncertainty for parties to the transaction that would occur if transacted on the centralized market.[20]

These observations with respect to large-sized blocks are equally valid in the execution of smaller transactions on illiquid markets or market segments and support a policy of delaying reporting end-user hedge transactions in these markets or market segments. The proposed 15 minute delay for reporting of block trades, however, is insufficient in many

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[16] Proposed § 43.5(k)(3).

[17] Proposing Release at 76167.

[18] *Id.*

[19] CFTC Press Release, *Commission Approves Cantor Financial Futures Exchange Block Trading Proposal* (Feb. 14, 2000).

[20] *Execution of Transactions: Regulation 1.38 and Guidance on Core Principle 9*, 73 Fed. Reg. 54,097 (Sept. 18, 2008).

markets in physical commodity swaps, including in particular, jet fuel, and in the market segments for longer dated tenors of physical contracts, including heating oil and crude oil.

The proposed rules will reduce liquidity in these already illiquid markets

In proposing a 15 minute delay in disseminating prices of block trades, the Commission relied upon a review of real-time reporting regimes in effect at a number of other markets, including the rules for FINRA's TRACE reporting facility (for corporate and agency bonds), the New York Stock Exchange, the London Stock Exchange, the CME Group, and NYSE Liffe.[21] However, these markets do not provide a reasonable comparison to the markets for jet fuel swaps and for swaps with a long-dated tenor for heating oil and crude oil. These swap markets and market segments are far less liquid than the markets cited in support of the 15 minute delay. By way of illustration, in contrast to the more than 1 million transactions per day in CME U.S. 10-year Treasury notes, [22] one recent study examined the volumes of customized and standardized interest rate swaps traded by the G-14 dealers, worldwide, in all currencies and maturities, and found that there are only approximately 3,600 trades of such products per day.[23] In U.S. dollar interest rate swaps, the most actively traded interest rate swap, there were an average of only 1,200 transactions per day.[24] The trading volumes for jet fuel swaps are substantially lower than that. Accordingly, the experience of the cited markets is of limited application when determining the appropriate delay in reporting of transactions in illiquid over-the-counter swaps markets.

It is likely, however, that swap dealers will be less willing to act as counterparties to airlines seeking to hedge their risk through block trades if the dealer knows that it must publicly disseminate information about the trade within 15 minutes of execution. Dealers will know that premature disclosure of these transactions will signal the demand to the market, which will in turn push up the dealer's cost of covering its risk. This is classic behavior in an illiquid market. Accordingly, permitting only a 15 minute delay in reporting blocks as proposed to be defined will have the perverse effect of further reducing liquidity in these already illiquid markets or market segments, such as those for the products frequently used by our members to hedge fuel costs. This is a result squarely at odds with the mandate of Section

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[21] Proposing Release at 76166.

[22] Pat Sjoberg and Susan Hinko, *It's Transparency but not as we know it*, TriOptima AB (Jan. 21, 2011), http://www.trioptima.com/resource-center/insights/It's-transparency,-but-not-as-we-know-it.html. In October, 2010, 22.9 million futures contracts on 10-year Treasury notes traded on the CME (an average of over 1 million contracts per day).

[23] *Id*.

[24] *Id*. If the analysis is narrowed further, to transactions in 10-year dollar interest rate swaps capable of being standardized, there were only 208 transactions per day in June, 2010.

727, which requires the Commission to take into account whether public disclosure will materially reduce market liquidity.[25]

Even if liquidity is not reduced as a result of the proposed rules, the cost of hedging for airlines and other end-users is likely to increase significantly through wider dealer bid/ask spreads, [26] substantially increasing the hedging cost to the airlines. These increased hedging costs will unavoidably be passed on to the American consumer in the form of higher air travel or shipping costs, a result that is clearly contrary to the public interest, or airlines simply will be forced to abandon their hedging strategies.

A Longer Time Delay Should Apply

In proposing a reporting delay of greater than 15 minutes for customized large notional swaps, the Commission recognized that a single approach cannot apply equally to all markets and types of transactions. ATA concurs with this conclusion and believes that a delay of more than 15 minutes is also appropriate for many, if not all, transactions in illiquid markets or market segments.

ATA respectfully suggests that the Commission address the issue of premature public dissemination of transaction information in illiquid markets by requiring that such information be publicly disseminated the earlier of the swap dealer substantially covering its exposure from the transaction or 24 hours from the time of execution.[27] The Commission could define illiquid markets subject to this provision by reference to particular commodities, such as jet fuel, or by a formula relating to the average number of transactions per day. Market segments would be defined by distance on the forward curve. We believe that many swap contracts in physical commodities that are longer than nine months forward should be eligible for this delay in public dissemination. For illiquid markets, this would be a more meaningful measure than the proposed distribution and market tests for determining block size.[28] Such a rule would recognize that in these illiquid markets it may take time for the swap dealer to lay off the risk it has taken; however, once having done so, the transaction must be publicly

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[25] CEA § 2(a)(13)(E)(iv) (requiring the Commission to take into account whether public disclosure of block trades will result in a decrease in market liquidity).

[26] *See, e.g.*, Katy Byrne, *Derivative Rules Seen Lifting Cost of Swaps*, WALL. ST. J., November 22, 2010 at C5 ("On large trades, if the dealer cannot liquidate that risk in the shortest amount of time, the dealer has to charge a wider bid/offer spread to take the risk…The cost is borne by either the original client or by the dealer -- the beneficiary would be a third party.") (quoting Athanassios Diplas, head of systemic risk management for global credit trading at Deutsche Bank).)

[27] Although we believe that 24 hours will allow broker/dealers sufficient time to lay off most risk it may not be enough time for all commodities in all market environments.

[28] More study is needed to determine the tenor of trades that require 24 hours or more in order for swap dealers to have adequate time to lay off the risk of their transactions. For example, a trade 3 to 6 months out on the curve in crude oil or heating oil may be less liquid simply because of the uncertainty of geo-political events.

disclosed. A 24 hour maximum delay would ensure that price discovery would not be hindered.[29]

Such a test would also comport with the Commission's past guidance on what trades are "large" enough to be considered block trades:

> [B]lock trades should be limited to large orders, where "large" is the number at which there is a reasonable expectation that the order could not be filled in its entirety at a single price, but would need to be broken up and executed at different prices if transacted in the centralized marketplace. As such, the proposed guidance notes that minimum block trade sizes should be larger than the size at which a single buy or sell order is customarily able to be filled in its entirety at a single price (though not necessarily with a single counterparty) in that contract's centralized market, and exchanges should determine a fixed minimum number of contracts needed to meet this threshold.[30]

The Commission Should Gather Data Before Implementing Rules for Dissemination of Block Trade and Large Notional Swap Data

The proposed rules for reporting of block trades and large notional swaps, if implemented as proposed, are likely to have a profoundly adverse effect on the market for swaps for jet fuel and in heating oil and crude oil in the tenors in which many airlines trade. The Commission should have a full understanding of the volumes traded in these markets before it implements a final rule for these contracts/tenors. After the SDRs commence operations, the Commission will have available to it ample data to enable it to make a well-informed analysis of whether the rules, as currently proposed, would result in a substantial reduction of liquidity or increase in costs.

The Commission could achieve this goal by adopting a phased approach to implementing the real-time reporting rules for block trades and large notional swaps, beginning with swaps subject to mandatory clearing that are listed on a swap execution facility or designated contract market. These are the swaps that are most similar to the futures contracts that are subject to the current block trade rules. While we appreciate the Commission's proposal to delay implementation of its proposed rules until January 2012, we suggest that this implementation date should apply only to actively traded, liquid swaps that are listed on trading facilities and cleared. Implementation of the rules for other products should be deferred until the Commission can gather sufficient data with respect to less liquid, niche products or to transactions in less liquid tenors.

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[29] To reiterate, the delay proposed relates only to public dissemination. We do not propose to delay reporting to the Commission in the first instance.

[30] *Execution of Transactions: Regulation 1.38 and Guidance on Core Principle 9*, 73 Fed. Reg. 54,097 (Sept. 18, 2008).

An Appropriate Delay Before Dissemination Will Mitigate the Damage Resulting from Lack of Anonymity of Swap Participants

As the noted in the Proposing Release, Congress directed the Commission, in enacting real-time reporting rules, to preserve the anonymity of the parties to a swap.[31] Proposed rule 43.4(e)(2) provides that the transaction and pricing information reported to a real-time disseminator must be general enough to maintain the anonymity of the parties to a swap but specific enough to provide for a meaningful understanding of the economics of the swap. Given the structure of the swap market in jet fuel and heating oil and crude oil in the longer-dated tenors, it will almost certainly be possible for participants in that market to surmise the identity of the end user entering into a swap from the publication of data for the transaction. This is an additional reason to provide for delayed dissemination of such data. Providing for an adequate delay for reporting of transactions would to some extent mitigate any damage that will result from public dissemination of this information.

Conclusion

ATA strongly supports reporting of swap transaction data that is essential to facilitate regulators' monitoring for and assessment of systemic risk. We support rules that will help the Commission gather information necessary to prevent market manipulation and price distortion. We also believe that public reporting will help to increase price transparency, which over time may lead to more efficient markets and better pricing for commercial end-users while simultaneously promoting the orderly functioning of the U.S. energy markets.

Real-time reporting of block trades and large notional swaps in illiquid markets is not, however, necessary to achieve these goals. Instead of providing pricing benefits to commercial end-users, real-time reporting in many circumstances will hurt those very entities who are seeking to manage their risk, particularly risk that is distant on the forward curve. Instead of tightening bid-ask spreads, increasing market efficiency, and providing better prices for end-users, the proposed rules have the potential to increase the cost of hedging by draining liquidity from these already illiquid markets. Real-time reporting will limit end-users' access to risk management tools, and increase risk premium costs for those products that remain available. The inevitable results of such cost increases are increased costs to the public of air travel and shipping.

ATA appreciates the opportunity to comment on the Proposed Rules and commends the Commission on its efforts to implement the provisions of the Dodd-Frank Act. We also urge the Commission to modify the final rules to provide for a delay in the public dissemination of information relating to transactions in illiquid markets or market segments to the earlier of the swap dealer's substantially covering its risk of the transaction or 24 hours.

We would be happy to discuss our comments at greater length with the staff. Please feel free to contact Mr. David Berg, Vice President and General Counsel, Air Transport

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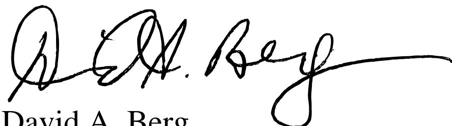
[31] Proposing Release at 76150; CEA §§ 2(a)(13)(C)(iii), (E)(i).

Association of America, Inc., at 202-626-4234 or Paul M. Architzel of Wilmer Cutler Pickering Hale and Dorr LLP, outside counsel to ATA, at (202) 663-6240, if you have any questions regarding our comments.

Respectfully Submitted,



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