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By Comments Online process at: <http://comments.cftc.gov>

February 7, 2011

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

Re: Notice of Proposed Rulemaking: Real-Time Public Reporting of Swap Transaction Data;
RIN 3038-AD08

Dear Secretary Stawick:

Freddie Mac is pleased to submit these comments in response to the Notice of Proposed Rulemaking regarding the real-time public dissemination of information relating to cleared and uncleared swaps, published by the Commodity Futures Trading Commission (the "Commission") on December 7, 2010 (the "Proposal")¹ pursuant to Section 727 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

Freddie Mac was chartered by Congress in 1970 with a public mission to stabilize the nation's residential mortgage markets and expand opportunities for homeownership and affordable rental housing. Our statutory mission is to provide liquidity, stability and affordability to the U.S. housing market. Freddie Mac uses swaps to hedge large-scale commercial risks on an ongoing basis. Freddie Mac currently operates under the direction of the Federal Housing Finance Agency as our Conservator.

Summary

Freddie Mac supports the goal of increasing transparency in the swaps market in order to enhance price discovery, reduce risk and promote market integrity. However, we are concerned that the manner of public disclosure for large notional swaps under the Proposal² will materially reduce market liquidity³ and may have additional negative unintended consequences for the swaps market and market participants like Freddie Mac. We urge the Commission to exercise caution in establishing size parameters for identifying large notional swaps or "block trades" and

¹ 75 Fed. Reg. 75162.

² While proposed § 43.2(f) and (l) define "block trades" and "large notional swaps" separately to distinguish between trades executed or crossed on a designated contract market or swap execution facility from those executed in the over-the-counter ("OTC") market, the terms are used interchangeably for purposes of this letter as we believe the rules relating to size and report timing parameters should be the same regardless of the transaction forum.

³ In promulgating rules for real-time reporting of swap transaction date, the CFTC is required to take into account whether the public disclosure will materially reduce market liquidity. See § 2(a)(13)(E)(iv) of the Commodity Exchange Act ("CEA"), added by § 727 of the Dodd-Frank Act.

establishing timing requirements for public reporting. For the reasons described below, we believe the Commission should initially provide a time delay for public dissemination of block trades of at least 24 hours. Additionally, the metrics for determining the size of "block trades" initially should be low and should not be overly complex.

Discussion

To avoid adverse market impacts, Freddie Mac believes that implementation of real-time reporting obligations for swap transactions requires care, as comprehensive market data for swaps is not currently available. In the absence of adequate data about the liquidity and depth of swaps markets, we submit that it is not currently possible to precisely gauge the ability of those markets to absorb large positions in the context of real-time reporting. Therefore, we believe that the Commission should take an incremental approach to the reporting of block trades. Initial rules adopted by the Commission should establish size thresholds and reporting requirements that are designed to ensure that market participants with a need to trade in large size, such as Freddie Mac, may do so without exposure to undue market risks. As the Commission collects data about the liquidity of the swaps markets and the effects of the Commission's reporting rules, it may be appropriate to revisit the initial parameters for block trade reporting in order to further increase transparency.

The danger of aggressive requirements for the dissemination of public information of large notional swaps is that such requirements, if not properly implemented, will raise the cost of executing block trades and decrease market liquidity. This danger arises when public dissemination of information about a block transaction occurs before a liquidity provider can hedge the risk of facilitating the block trade. Premature disclosure may permit other market participants to "front-run" the liquidity provider or use knowledge of its need to offset risk to extract higher prices. In such circumstances, dealers can be expected to charge hedging parties increased risk premiums to facilitate block transactions by widening their bid-offer spreads and/or exit the market in whole or part. This, in turn, would reduce liquidity and create a variety of related market inefficiencies.⁴ Indeed, premature publication of large notional swap trading could impair, rather than enhance, price discovery in the swaps market, as reported prices would be more reflective of risk premiums for block positions than economic fundamentals. Freddie Mac, which hedges interest rate risk in large interest rate swap transactions on an ongoing basis, would be particularly susceptible to any reduced liquidity and increased costs of execution.

In proposing a 15-minute time delay for the public reporting of block-size swap transactions, the Commission states that it considered reporting requirements in the securities and futures markets.⁵ However, the structure of the swaps market, which is almost wholly institutional, is significantly different from the securities and futures markets. As an initial matter, there are generally fewer participants and a greater variety of products in the swaps markets. As a result, trading tends to be more concentrated in the swaps markets and the distribution of trade sizes may be very different from trading in the futures and securities markets. It is therefore unclear

⁴ For example, end-users might become unwilling to hedge their risks should the costs of doing so become prohibitive. As a result, risk would be misallocated in the economy.

⁵ 75 Fed. Reg. 76166.

to what extent those markets serve as a useful proxy for trading activity in the swaps market or whether reporting rules that work for those markets are appropriate for swaps.

Moreover, structural differences between the futures and swaps markets, particularly with respect to interest rates products, may make assumptions based on futures trading activity questionable for swaps trading. While the futures market may be “liquid” in the sense of providing continuous markets, the size of transactions that one can execute in the futures market pales in comparison to the size possible in the swaps market. Indeed, use of the block exemption for trading interest rate futures may be unnecessary in many cases precisely because OTC interest rate swaps provide a parallel market that is highly preferred by swap users such as Freddie Mac for the bulk transfer of risk. The facility of the interest rate swaps market for transferring risk in large notional amounts is, in our view, one of the hallmarks of that market and a primary reason that it has become such a useful risk management tool. Compromising the ability to effect the bulk transfer of risk in the swaps market could significantly raise the cost of hedging risk, reducing liquidity and potentially deterring market participants from hedging at all. Therefore, we believe that a prudent approach to rulemaking for reporting of block positions would not be based on assumptions about what works in structurally dissimilar markets, but rather an assessment of what is needed to provide reasonable assurance that information about large trades that may have significant market impacts is not published before liquidity providers can adequately offset their risk positions.

Freddie Mac routinely executes interest rates swap transactions in extremely large notional sizes in order to hedge its interest rate risk in connection with mortgage transactions. In our experience, these swap transactions frequently have the potential to move prices significantly. In almost every case, 15 minutes would not be enough time for Freddie Mac’s dealer counterparties to hedge the risk of facilitating these transactions. Indeed, we believe it could take a matter of hours, not minutes, to hedge effectively many of these transactions. In light of our experience, we believe a more prudent starting point for public reporting of swap transaction data for large notional trades would be to require a delay of at least 24 hours. Any shorter delay would potentially benefit predatory market participants at the expense of end users like Freddie Mac that must hedge large commercial transactions.⁶

We are also concerned that the Commission’s dual-test approach for determining whether a transaction qualifies for treatment as a block trade may establish levels for reporting large notional transactions that are far too high and far too complex. While we support the Commission’s efforts to create objective tests that relate thresholds to the volume and distribution of trades in the market place, the 95% threshold used for the “distribution” test and the multiplier used for the “social size” test, as well as the proposed rule to model “social size” on the highest of the mean, median or mode in a market, are unduly complex and, effectively, no more than guesses as to the point at which trades could have a significant market impact. We urge the Commission to lower these thresholds to be more inclusive and simplify these tests to be more straightforward.

⁶ Additionally, as the Commission obtains more data about the liquidity of the swaps market and potentially reduces reporting delays, we suggest that public reporting rules be tailored, by product, to provide for appropriate delays based on the relative notional size for particular markets.

Conclusion

Freddie Mac supports the goals of the Dodd-Frank Act, and the proposed Commission regulations thereunder, to increase market transparency in the swaps markets. We also acknowledge that the impact that public dissemination of large notional trade information will have on the swaps market currently is unclear. However, the Commission should bear in mind the potential negative consequences of its rules. While the Commission's statutory mandate under the Dodd-Frank Act is to adopt rules that enhance price discovery,⁷ it is also expressly required to take into account whether public disclosure will materially reduce market liquidity. Failing to do so could cause significant market disruptions and inefficiencies. Accordingly, we believe that the appropriate regulatory approach in these circumstances should be incremental.

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Freddie Mac appreciates the opportunity to provide our views in response to the Proposal. Please contact me if you have any questions or would like further information.

Sincerely,



Lisa M. Ledbetter

⁷ Section 2a(13)(B) of the CEA, added by § 727 of the Dodd-Frank Act.