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February 7, 2011

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

Via Electronic Submission

Re: RIN 3038-AD19 – Proposed Rules: Swap Data Recordkeeping and Reporting Requirements
RIN 3038-AD08 – Proposed Rules: Real-time Public Reporting of Swap Transaction Data

Dear Mr. Stawick,

Vanguard appreciates the opportunity to provide the Commodity Futures Trading Commission (the "**Commission**") with our views on its proposals for reporting and publicly disseminating swap information, which the Commission proposed under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**").

Vanguard[1] is a Securities and Exchange Commission registered adviser with more than $1.5 trillion in assets under management. As a part of the prudent management of our mutual funds and other portfolios, we enter into derivatives contracts, including 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.

The Commission's proposed rules for swap data recordkeeping and reporting[2] ("**SDR Reporting Rules**") set forth how swap information will be reported to a registered swap data repository ("**SDR**") or to the Commission as well as which parties are obligated to make such reports. The Commission's proposed rules for real-time public reporting of swap transaction

[1] Vanguard offers more than 170 U.S. mutual funds and serves approximately 23 million shareholder accounts.

[2] See Swap Data Recordkeeping and Reporting Requirements, 75 FR 76573 (December 8, 2010) (the **"SDR Reporting Release"**).

data[3] (the "**Public Reporting Rules**" and together with the SDR Reporting Rules, the "**Swap Reporting Rules**") provide a framework for how swap transaction and pricing data will be disseminated to the public.

While we support the overall objectives of the Public Reporting Rules, we are concerned that the short time frame proposed for publicly reporting large notional swaps[4] ("**Large Notional Swaps**") and block trades[5] (collectively, "**Block Trades**") may have unintended negative consequences for the market and for our investors. We recognize the legislative mandate to introduce applicable rules for these purposes by mid-year, however it would be far more preferable for the rules to be crafted on a fully informed basis following adequate analysis and having the benefit of trade data collected after central clearing and exchange trading represent the new normal for swaps trading. If such rules are to be implemented ahead of such analysis and review, then care should be taken to construct an appropriately liberal approach which can be refined and tightened on an informed basis over time. Introducing an overly conservative approach at the outset could present serious risks to the system including higher costs and inefficiencies and, in the worse case, a serious disruption to liquidity.

From a practical perspective, we believe that if swap end-users (e.g., funds) are obligated to make reports to SDRs concerning their swap trades as currently proposed in the SDR Reporting Rules, 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**").

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

- **Block Trade thresholds should be based on a monthly assessment of the relative liquidity of the relevant product.** Block Trade sizing should be tailored to current liquidity levels appropriate to the specific trade type, underlying instrument and term of swap within a swap asset class to better ensure the reporting requirement does not negatively impact trading in the more thinly traded segments of the swaps market. Liquidity tests should be assessed on as live a basis as is reasonably practicable (e.g., monthly) to ascertain whether a particular swap trade could move the market at the time of execution.

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[3] See Real-time Public Reporting of Swap Transaction Data, 75 FR 76139 (December 7, 2010) (the "**Public Reporting Release**").

[4] Large notional swap is defined as a swap that: (1) ***is not available for trading or execution on a swap execution facility or exchange***; (2) is consistent with the appropriate size requirements for large notional swaps set forth in § 43.5 of the Public Reporting Release; and (3) is reported in accordance with the appropriate time delay requirements set forth in § 43.5(k) of the Public Reporting Release. See also § 43.2(l) of the Public Reporting Release.

[5] Block trade is defined as a swap that: (1) ***is available for trading or execution on a swap execution facility or exchange***; (2) is consistent with the minimum block trade size requirements set forth in § 43.5 of the Public Reporting Release; and (3) is reported in accordance with the rules and procedures and the appropriate time delay set forth in § 43.5(k) of the Public Reporting Release. See also § 43.2(f) of the Public Reporting Release.

- **Public dissemination of transaction and pricing data related to Block Trades should occur no earlier than 24 hours after trade execution.** The short proposed delay for the public dissemination of Block Trade transaction and pricing data presents the very real risk that Swap Dealers will not be able to enter into mirror trades (or "lay-off" their positions) without prior market knowledge. If the Swap Dealer knows that the market is anticipating such trading, the price for the original Block Trade will inevitably increase, leading to additional costs and inefficiencies ultimately borne by the investors in our funds. We believe that transaction and pricing data concerning Block Trades should be disseminated to the public no earlier than 24 hours after execution.

- **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 a non-U.S. Swap Dealer or MSP is a party to the trade, in certain circumstances, the proposed rules obligate the U.S. swap end-user to report swap data to an SDR. 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.

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

I. Block Trade thresholds should be based on a monthly assessment of the relative liquidity of the relevant product.

In the swaps market, a "Block Trade" has historically referred to a trade of a relatively illiquid size, either intended to establish a single large position or representing a large aggregated position executed by an asset manager for allocation across a number of 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 individual fund allocations confirmed to the Swap Dealer shortly after trade execution.

When quoting a price for the Block Trade, Swap Dealers typically charge a slight premium to the then current market price for a similar trade of a more liquid size. Once the Block Trade is executed, the Swap Dealer executes one or more liquid-sized mirror trades at such current market price to lay-off its position and to flatten its market exposure.

As the Swap Dealer's price for the Block Trade is fully dependent on its ability to lay-off its position at the then current price in the liquid market, we have serious concerns about the potential negative impact that could be caused if details related to the Block Trade are prematurely disseminated. In such situations, advance knowledge of the Swap Dealer's imminent trading is likely to move the market against the Swap Dealer. If the Swap Dealer knows that it will be forced to trade at a significant premium to the then-liquid market, it will be forced to increase the price for the Block Trade. Fund investors will ultimately have to bear either the increased price of relevant trades, or the increased costs of establishing positions using multiple trades of liquid sizes. As a worst case scenario, such potential impact could lead both swap providers and users to exit the market, resulting in fewer viable strategies to effect our clients' objectives.

To determine the minimum size for Block Trade status, the Commission has proposed two alternative approaches with the applicable minimum size to be the greater of the results from the "**Distribution**" and "**Multiple**" tests based on a one-year look back of trade sizes. The minimum Block Trade size is to be set for each "**Swap Instrument**" within an applicable "**Asset Class**"[6]

Under the Distribution test, the SDR considers the transaction sizes for each Swap Instrument during the previous calendar year. Using that data, the SDR identifies the notional size equal to the 95th percentile of trade sizes executed in such period (the "**Distribution Threshold**"). Under the Multiple test, the SDR calculates the mode, mean and median transaction sizes for each Swap Instrument during the previous calendar year. The SDR selects the highest of such mode, mean and median and multiplies it by a factor of 5 to identify the notional size under such test (the "**Multiple Threshold**" and together with the Distribution Threshold, the **"Thresholds"**). For each Swap Instrument, the applicable minimum Block Trade size is the greater of the Thresholds derived from the tests.

In evaluating the proposed tests, we are mindful that they are based, in part, on tests which have been successfully used for years in futures market. Nevertheless, the swaps market is significantly different from the futures market, and the potential impact of mandated trading restrictions is unclear. While, overall, the swaps market is much more diverse than the futures market, apart from a limited number of products and trades, trading volumes can be relatively shallow. Volumes for some Asset Classes, or categories of Swap Instruments within an Asset Class, may be so low that a trade of almost any size could risk moving the market if reported prematurely. Liquidity can also be quite volatile with trade volumes for some Swap Instruments fluctuating considerably month to month. For this reason, a test based on a one-year look-back may establish Block Trade thresholds that are too high for the then current volume and lead to market movement upon the reporting of even more modestly sized trades.

In light of the significant downside risks, we believe it is important for the Commission to tread carefully as it enters this phase of the rulemaking. Indeed, we believe it to be far better to adopt a more liberal approach until the market has adequate time to digest the changes and clarify areas for further tightening.

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[6] The definitions of each of "**Asset Class**" and "**Swap Instrument**" are specified at § 43.2 of the Public Reporting Release. "**Asset Class**" is defined to mean the "broad category of goods, services or commodities underlying a swap" (See § 43.2(e) of the Public Reporting Release), which we view to correlate to the "major swap categories" defined by the Commission with respect to the rules applicable to "major swap participant". To the extent that the drafting needs to be tightened, we would prefer to see these definitions harmonized to facilitate ease of tracking by market participants. "**Swap Instrument**" is defined to mean "a grouping of swaps in the same asset class with the same or similar characteristics" (See § 43.2(y) of the Public Reporting Release), which we view to mean that within the "Asset Class" of "rate swaps", a "Swap Instrument" would be transactions having a similar underlying and maturity (e.g., a 5 year, fixed, floating, USD3 month LIBOR interest rate swap). Note that we had some confusion with the use of the term "category" of Swap Instrument appearing in the draft rules. We believe the use of "category" is to distinguish between different types of "Swap Instruments" within a particular "Asset Class". Again, a clarification of this definition is advisable and we will so construe these terms for the purposes of this comment.

We have concerns with the proposed approach applying the greater of the "Distribution" and "Multiple" tests and have been considering a test strictly based on relative liquidity for a particular Swap Instrument with a Block Trade threshold adjusting up or down depending on the trade volume for such Swap Instrument over the previous calendar month. While the Commission has expressed concern about the burden for SDRs in making such frequent calculations, we are more concerned that liquidity tests should be assessed on as live a basis as is reasonably practicable to produce a size which could move the market at the time of execution.

While we have not performed a detailed analysis of a proposed alternative approach, the following example may be useful in illustrating our thinking. We start from a relatively standardized, liquid trade in an Asset Class for which the most conservative assessment of Block Trade size may be appropriate. For example, in the Asset Class related to rate swaps, the SDR could identify the most liquid Swap Instrument for the relevant period, such as the 5 year, fixed/floating, 3 month USD LIBOR BBA interest rate swap, to establish the benchmark volume level (the "**Benchmark Trade Liquidity**") for that Asset Class. The Block Trade size for other Swap Instruments within that Asset Class could be based on a comparison of the volume for such Swap Instrument to that of the benchmark for the Asset Class with a lower Block Trade size threshold applied on a graduated scale as follows:

- At or above the Benchmark Trade Liquidity: Block Trade size at the 80th percentile of trades done over the previous calendar month;
- 75% to 99% of Benchmark Trade Liquidity: Block Trade size at the 70th percentile of trades done over the previous calendar month;
- 50% to 74% of Benchmark Trade Liquidity: Block Trade size at the 60th percentile of trades done over the previous calendar month;
- 25% to 49% of the Benchmark Trade Liquidity: Block Trade size at the 50th percentile of trades done over the previous calendar month; and
- Below 24% of the Benchmark Trade Liquidity: all trades are considered block trades for reporting purposes.

Each Asset Class would have its own Benchmark Trade Liquidity for purposes of deriving Swap Instrument Block Trade sizes within such Asset Class. Given the unknown impact these rules will have on the swaps market, and the serious downside risk on pricing, costs and liquidity, we believe it prudent to set the initial threshold for even the most liquid trades at the 80th percentile until we have a better sense as to how the market reacts to the new normal of clearing and exchange trading.

In assessing the "Multiple" test, we feel the example in support of the test cited by the Commission at footnote 89 of the Public Reporting Release actually illustrates its flaws. We think it likely that $275 million is far too large a block trade threshold for a historical trade concentration of between $50 and $60 million (5 times the median of $55 million). Even if the multiplier is 2 times the highest of the mean, mode or median, we are not comfortable with the final test based on the greater of the Distribution and Multiple tests. It is for these reasons that we ask the Commission to consider a single test based on a monthly assessment of trade liquidity for each Swap Instrument within a respective Asset Class.

II. Public dissemination of transaction and pricing data related to Block Trades should occur no earlier than 24 hours after trade execution.

Section 2(a)(13)(E) of the Commodity Exchange Act requires that in establishing rules to provide the public with information about cleared swap transaction data, the Commission must, among other things, (a) "specify the appropriate time delay for reporting [Block Trades] to the public," and (b) "take into account whether public disclosure will materially reduce market liquidity." The Public Reporting Rules provide that transaction and pricing data for Block Trades that are subject to the mandatory clearing requirement be reported to the public fifteen (15) minutes after the time of execution. The Commission has also asked for comment on the appropriate public reporting delay for Large Notional Swaps not subject to the mandatory clearing requirement.

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. However, a mandate to publicly disclose Block Trade transaction and pricing data, whether cleared or uncleared, too soon after execution (i.e., 15 minutes) could have the unintended consequence of materially impacting transaction pricing while not significantly enhancing market transparency compared to a more delayed reporting approach.

We are greatly concerned that the proposed fifteen (15) minute timing delay for public reporting of Block Trade transaction and pricing data will not allow Swap Dealers to enter into mirror trades (or "lay-off" their positions) ahead of market knowledge. We are concerned that once Block Trade transaction and pricing data is disclosed, 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.

As the proposed 15 minute delay does not give a Swap Dealer meaningful time to lay-off the position, the Commission should include longer delays for public reporting of Block Trade transaction and pricing data until it has time to study how such reporting affects markets. In addition, we recommend that reporting of the size of a Block Trade be limited to "in excess of the applicable Block Trade size" for the relevant trade type.

With this in mind, we recommend the Commission implement real time public reporting of Block Trade transaction and pricing data 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, Block Trade transaction and pricing data should be publicly reported at 11:15 a.m. EST on the next business day. This will give the Swap Dealer at least a full trading day to lay-off the position.

If the Commission is compelled to require a 15 minute delay from the earliest effective date of the applicable rules, we urge the Commission to apply such a short delay only with respect to the most liquid, high volume Swap Instruments identified by the relevant SDR within each Asset Class. For the balance of Swap Instruments, a mandate for a much shorter period to apply at the outset presents too great a risk to the functioning of the market. We therefore

recommend the implementation of a shorter period for the more illiquid Swap Instruments only after the Commission has had an adequate opportunity to assess the appropriate period given the actual market impact of other initiatives including clearing and exchange trading.

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

Swap counterparties have significant reporting responsibilities under the SDR Reporting Rules. For example, if a swap is not traded or executed on a swap execution facility or exchange (collectively, a "**Swap Market**") and not cleared through a clearinghouse, swap counterparties are responsible for reporting primary economic data and confirmation data (collectively "**Swap Creation Data**") to the SDR and, sometimes to the Commission (i.e., if no SDR would receive the Swap Creation Data). Even if a swap is executed on a Swap Market, a swap counterparty could be responsible for reporting primary economic data to an SDR if such data is not reported by the Swap Market. Similarly, swap counterparties could be required to report to an SDR various swap continuation data (e.g., valuations, life cycle data).

To the extent that SDR Reporting Rules require swap counterparties to report swap data, if both parties are U.S. persons and only one party is a Swap Dealer, then the Swap Dealer must report. 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.

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 to the Commission. Swap counterparties that are 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.

Smaller end-users 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. In view of the heightened costs associated with reporting, one unintended consequence of the SDR Reporting 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 concentrate trading and possibly impact pricing as the U.S.-based swap end-users would effectively have fewer entities with which to transact.

Non-U.S Swap Dealers and MSPs are more likely to have appropriate systems in place to facilitate reporting and a better approach would be to require these entities to report when transacting with U.S.-based swap end users. 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 requirement. 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.

As to the issue of harmonizing approaches to real-time reporting with respect to both swaps and security-based swaps, we believe each of the Commission and the Securities and Exchange Commission (the "**SEC**") should work toward a consistent approach reflecting the unique characteristics of the swaps market. While issues related to liquidity for each Swap Instrument for which the Commission and/or the SEC has jurisdiction should guide the application of the relevant rules, the rules themselves should be harmonized to the extent practicable to minimize the potential for excessive regulatory burdens and related costs arising from divergent approaches.

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In closing, we thank the Commission for the opportunity to comment on the Swap Reporting Rules 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: Commodity Futures Trading Commission
The Honorable Gary Gensler
The Honorable Michael Dunn
The Honorable Jill E. Sommers
The Honorable Bart Chilton
The Honorable Scott D. O'Malia