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Chairman and  
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OFFICE OF THE  
SECRETARIAT

February 17, 2011

David A. Stawick  
Secretary of the Commission  
Commodity Futures Trading Commission  
Three Lafayette Centre, 1155 21<sup>st</sup> Street, NW.  
Washington, D.C. 20581

## COMMENT

Re: RIN Number 3038-AD08  
Real-Time Public Reporting of Swap Transaction Data

Dear Mr. Stawick;

The Financial Industry Regulatory Authority ("FINRA")<sup>1</sup> staff submits this letter in response to the Commodity Futures Trading Commission's ("Commission") request for comment on the Commission's proposed rules to implement a new framework for the real-time public reporting of swap transaction and pricing data for all swap transactions and to address the appropriate minimum size and time delay relating to block trades on swaps and large notional swap transactions.<sup>2</sup> FINRA strongly supports a trade reporting and dissemination structure for swap information. FINRA believes that such a structure and the information it provides, to both market participants and regulators, is vital to maintaining market integrity and investor protection. However, FINRA urges the Commission to consider further mandating the consolidation of swap information at the time the Commission determines that such data will be disseminated publicly.

FINRA's comments reflect FINRA's experience with the Trade Reporting and Compliance Engine ("TRACE"). FINRA's TRACE rules require the reporting of corporate and agency debt securities transactions in real-time, and provide for the immediate dissemination of such information to the market. TRACE has significantly increased transparency in these sectors of the bond markets and

<sup>1</sup> As the largest non-governmental regulator for all securities firms doing business with the public in the United States, FINRA oversees nearly 4,700 brokerage firms and about 167,000 branch offices and more than 635,000 registered securities representatives.

Created in July 2007 through the consolidation of NASD and the member regulation, enforcement and arbitration functions of the New York Stock Exchange, FINRA is dedicated to investor protection and market integrity through effective and efficient regulation and complimentary compliance and technology-based services. FINRA has approximately 2,800 employees and operates from Washington, DC, and New York, NY, with 15 District Offices around the country.

The comments provided in this letter are solely those of the staff of FINRA; they have not been reviewed or endorsed by the Board of Governors of FINRA. For ease of reference, this letter may refer to "we" "FINRA" or "FINRA staff" interchangeably, but these terms only refer to FINRA staff.

<sup>2</sup> See Commodity Futures Trading Commission Release, 75 FR 76140 (December 7, 2010) (Notice of Proposed Rulemaking) ("Proposing Release").

improved pricing in such markets. Since 2002 when TRACE was established,<sup>3</sup> TRACE has been successful as both a repository of data used by regulators to ensure effective and efficient oversight of the bond market, as well as a centralized location where all market participants can access valuable transaction data.

#### Proposed Reporting Requirements and Regulatory Oversight

In FINRA's view, the timely collection and review of transaction data increases market integrity, promotes investor protection and enhances market surveillance. FINRA supports the Commission's proposal that all swap transactions be subject to "real-time public reporting,"<sup>4</sup> which is defined to mean reporting "data relating to a swap transaction, including price and volume, as soon as technologically practicable after the time at which the swap transaction has been executed."<sup>5</sup> Given the relationships between various instruments available in the market place today, FINRA believes regulators must have timely access to transaction level data for all relevant securities. In our view, the Commission's proposed rules regarding swaps will help make this necessary data available and, consequently, allow for more effective market surveillance and oversight. In addition, FINRA stresses that transaction data should be reported as soon as practicable after the execution of a swap transaction. Requiring parties to do so will provide a more accurate data base and enhance transparency. While the "Commission recognizes that what is 'technologically practicable' for one party to a swap may not be the same as what is 'technologically practicable' for another party to a swap,"<sup>6</sup> FINRA believes that providing a reasonable, but not overly extended, period, for reporting is necessary and may reduce instances where counterparties may try to delay trade reporting for as long as possible (while remaining in compliance with reporting deadlines), altering the order in which transactions appear in regulatory data and are disseminated to the public.

#### Transparency

In the Proposing Release, the Commission notes that Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010,<sup>7</sup> was enacted, among other things, to "increase transparency and promote market integrity

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<sup>3</sup> In March 2010, TRACE was expanded to collect and disseminate trade data for debt issued by federal government agencies, government corporations and government sponsored enterprises (GSEs), as well as primary market transactions in new issues for both corporate and agency debt. This timely collection of corporate and, more recently, agency transaction data, has enabled FINRA to effectively surveil the market for fraudulent behavior, manipulation, excessive markups and other misconduct that violates federal securities laws and FINRA rules.

On May 16, 2011, TRACE will expand further to include transaction reporting in asset- and mortgage-backed securities. As a result, transaction-level information for trades representing 70 percent of the U.S. debt market will be available (including transactions in municipal securities reported to the Municipal Securities Rulemaking Board), further improving the transparency of the debt markets. Post-trade data will be available for all publicly traded debt securities except money market instruments, U.S. Treasury securities, and foreign sovereign debt instruments.

<sup>4</sup> See Proposing Release at 75 FR 76143.

<sup>5</sup> See Proposing Release at 75 FR 75143.

<sup>6</sup> See Proposing Release at 75 FR 76143.

<sup>7</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, 124 Stat. 1376 ("Dodd-Frank").

within the financial system.”<sup>8</sup> FINRA applauds the Commission’s timely proposal to satisfy this directive by proposing the dissemination of transaction information in swaps. The Commission states that in external meetings with market participants “although CFTC staff was often told of the adverse impact of post-trade transparency on market liquidity, staff is not aware of any empirical evidence to support this position.”<sup>9</sup> Drawing upon the experience with TRACE, a study of TRACE transaction data has shown that TRACE has effectively narrowed bid-ask spreads, which are widely agreed to be a hallmark of efficient markets.<sup>10</sup> A second study indicates that TRACE has reduced investor cost significantly (this study estimates that annual trading costs were reduced by nearly \$1 billion for the full corporate bond market).<sup>11</sup> A third study includes findings that TRACE has contributed to improved valuation precision, reducing the dispersion in valuation between different mutual funds holding the same security.<sup>12</sup> A study of the OTC derivatives market conducted by the Federal Reserve Bank of New York and published in January 2010 identifies improvement of “trade level price reporting” as an effective step to improve the OTC derivatives market, and refers to TRACE as evidence of the effectiveness of trade level price reporting and dissemination of such information as follows:

For example, TRACE, a system for disseminating essentially all transactions prices in the over-the-counter markets for corporate and municipal bonds, was established in 2002. TRACE reports transactions prices after a brief delay, providing investors some insight into the range of prices at which they are likely to be able to execute their next trades. This can improve the ability of investors, particularly those who are not dealers, to “shop around,” that is, to determine more easily whether to accept the bids and offers quoted to them, and also allows them to better monitor the quality of price execution that they have received on their past trades.<sup>13</sup>

There has been no observed loss of liquidity since the launch of TRACE or after the dissemination of last sale information was adopted as the general policy for all debt securities transactions that are currently reported to TRACE. During the roll-out of TRACE, one study indicated that the increased post-trade transparency had a neutral

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<sup>8</sup> See Proposing Release at 75 FR 76140.

<sup>9</sup> See Proposing Release at 75 FR 76166.

<sup>10</sup> See Edwards, A. K., Harris, L. E., & Piwowar, M. S., Study, Corporate Bond Market Transaction Costs and Transparency, September 21, 2004.

<sup>11</sup> See Bessembinder, H., Maxwell, W., & Venkataraman, K., Study, Market Transparency, Liquidity Externalities, and Institutional Trading Costs in Corporate Bonds, October, 2005.

<sup>12</sup> See Cici, G., Gibson, S., & Merrick, J. J., Study, Missing the Marks? Dispersion in Corporate Bond Valuations Across Mutual Funds, July 14, 2010.

<sup>13</sup> See Duffie, D., Li, A., & Lubke, T., Study, Policy Perspectives on OTC Derivative Markets Infrastructure (“OTC Derivatives Market Study”), Federal Reserve Bank of New York Staff Report No. 424, (January 2010, Revised March 2010), available at [http://www.newyorkfed.org/research/staff\\_reports/sr424.pdf](http://www.newyorkfed.org/research/staff_reports/sr424.pdf).

As previously stated, TRACE is currently a collector and disseminator of corporate and agency debt transaction data. Collection and dissemination of data in municipal securities is performed by the Municipal Securities Rulemaking Board’s (“MSRB”) Real-time Transaction Reporting System (“RTRS”).

or positive effect on liquidity for BBB-rated corporate bonds.<sup>14</sup> Given the positive effects of transparency on the corporate debt market, FINRA supports the Dodd-Frank mandate “to make swap transaction and pricing data available to the public in such form and at such times as the Commission determines appropriate to enhance price discovery,”<sup>15</sup> and approves the Commission’s proposal to carry out their duty to mandate that swap transaction information be made available to the marketplace.

#### Implementation and Disseminated Data

FINRA supports the Commission’s proposed timeframe for implementation and its consideration as to how and when such data should be disseminated to the public.<sup>16</sup> In the Proposing Release, the Commission states that it is fully committed to implementing Congress’ directive to require real-time public reporting of all swaps and will adopt final rules by July 15, 2011, but also notes that:

participants will need a reasonable amount of time in which to acquire or configure the necessary systems, engage and train the necessary staff and develop and implement the necessary policies and procedures to implement the proposed rules. The Commission’s proposed rules provide that appropriate minimum block sizes will be published by registered SDRs beginning in January 2012. Accordingly, it is anticipated that registered entities and registrants will have begun their compliance by that time.<sup>17</sup>

FINRA supports the Commission’s proposed time frame for implementation. However, based on its experience with TRACE, FINRA urges the Commission to consider a phased-in approach to the dissemination of swap transaction data. FINRA implemented the public dissemination of last sale transaction information for transactions reported to TRACE in phases based on liquidity, starting with the largest, most liquid, issues first and completing the implementation in January 2006.<sup>18</sup> FINRA believes that phasing in dissemination ensures a more orderly

<sup>14</sup> See Goldstein, M. A., Hotchkiss, E. S., & Sirri, E. R., Study, Transparency and Liquidity: A Controlled Experiment on Corporate Bonds, *The Review of Financial Studies* 1 v 20 n 2 (2007).

<sup>15</sup> See Dodd-Frank, Pub. L. No. 111–203, 124 Stat. 1376, 1696.

<sup>16</sup> See Proposing Release at 75 FR 76141 (“Section 2(a)(13)(E) of the CEA provides that the Commission shall prescribe rules that: (i) Ensure such information does not identify the participants; (ii) specify the criteria for determining what constitutes a large notional swap transaction (block trade) for particular markets and contracts; (iii) specify the appropriate time delay for reporting large notional swap transactions (block trades) to the public; and (iv) take into account whether public disclosure will materially reduce market liquidity.”).

<sup>17</sup> See Proposing Release at 75 FR 76142-76143.

<sup>18</sup> FINRA phased in dissemination by starting with the largest, most liquid issues and, generally, the most highly-rated issues, then began to incorporate additional bonds in phases, based generally on their credit rating, making more highly rated bonds subject to dissemination before lower-rated bonds. Phasing in dissemination was completed in January 2006. Currently, through TRACE, real-time, public dissemination of transaction and price data for all publicly traded corporate bonds occurs – including intra-day transaction data and aggregate end-of-day statistics (most active bonds, total volume, advances and declines and new highs and lows).

With the expansion to capture and disseminate agency debt in March 2010, TRACE currently captures and disseminates transaction information in over 45,000 eligible securities from 2,000 FINRA-regulated firms

transition that minimizes the likelihood of market disruptions and an unintended loss of liquidity. Additionally, phased-in dissemination provides participants, both investors and traders, adequate time to adjust to a market with real time swap transaction data. Such an approach to dissemination also provides regulators with the ability to assess the impact of transparency on the market and, if necessary, to make adjustments to both the timing of dissemination and the data that should be disseminated.

With regards to block trades and large notional swap transactions, while the Proposing Release states that any "delay does not apply to the reporting party's requirement to report to a swap market or to a swap party's requirement to report to a real-time disseminator,"<sup>19</sup> the Commission proposes that "block trade or large notional swap transaction and pricing data shall be reported to the public by the swap market (through a third-party service provider) or registered swap data repository that accepts and publicly disseminates such data within 15 minutes of the time of execution reflected in the data."<sup>20</sup> Additionally, "transactions greater than \$250 million notional amount—even the very largest of trades—will just be reported as being greater than \$250 million."<sup>21</sup>

The Commission determined the proposed time delay for standardized block trades and large notional amounts by examining how such transactions are handled in other markets. The Commission reviewed TRACE requirements, noting that: "FINRA's TRACE system for corporate and agency debt securities requires that 'transactions in TRACE-eligible securities executed on a business day at or after 8:00 a.m. Eastern Time through 6:29:59 p.m. Eastern Time must be reported within 15 minutes of the time of execution.' Given the 15 minute reporting delay, TRACE does not provide any additional time delay for those trades that are subject to disseminated volume caps."<sup>22</sup> FINRA supports the Commission's recognition that transactions of a certain size should be capped so as not to hinder liquidity. However, given FINRA's experience with TRACE, FINRA believes that liquidity can be significantly protected through dissemination caps alone and that the Commission should consider a dissemination time frame that is consistent across all swaps, regardless of the notional size of the transaction. FINRA believes such an approach will ensure that all necessary information is made available to the public as soon as possible and, as a result, will promote market integrity and investor protection.

#### Consolidation of Data

As noted above, FINRA strongly supports bringing transparency to the swap market. FINRA agrees with the Commission's proposal requiring registered entities "to publicly disseminate the swap transaction and pricing

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registered to trade eligible bonds. This data is available through all major market data vendors and on certain public websites. Currently, over 50,000 professionals use the data, and free access is available to retail investors through FINRA's website. As a result, FINRA not only recognizes the importance of transparency, but also the significance of how and when such data is disseminated to the public.

<sup>19</sup> See Proposing Release at 75 FR 76166.

<sup>20</sup> See Proposing Release at 75 FR 76176.

<sup>21</sup> See Proposing Release at 75 FR 76182.

<sup>22</sup> See Proposing Release at 75 FR 76166. "Disseminated volume caps" refers to disseminating TRACE transaction level data in real-time, capping those transactions which meet FINRA's designated thresholds to ensure that liquidity for the largest trades are not reduced because of transparency (size is capped at \$5 million for corporate investment grade and agency debt securities, and \$1 million for high yield debt securities).

data.”<sup>23</sup> More specifically, the Commission states that “with respect to all off- facility swaps, the Commission’s proposal requires that reporting parties send swap transaction and pricing data to registered SDRs to publicly disseminate such data in real-time. With respect to swaps that are executed on a swap market, the Commission’s proposal requires that swap markets publicly disseminate swap transaction and pricing data either through a registered SDR or a third-party service provider.”<sup>24</sup> However, if multiple SDRs do emerge, FINRA urges the Commission to consider further mandating the consolidation of disseminated swap data to the public.

FINRA recognizes the Commission’s attempt to minimize fragmentation of market data when considering dissemination options for swap information. For example, the Proposing Release states that when “considering different schemes of real-time public reporting requirements, the Commission also considered a “first touch” method of reporting whereby the swap dealer, MSP or swap market where a swap transaction occurred would have been required to real-time report the transaction by posting the transaction on its Internet Web site or through other electronic means. The Commission chose not to pursue a “first touch” method because it would likely lead to greater fragmentation of market data, increased search costs for market participants and potential concerns with the quality of the data that would be publicly disseminated.”<sup>25</sup> However, the Commission states that it “estimates that there will be approximately 15 registered SDRs,”<sup>26</sup> and also notes that “neither the CEA nor the Dodd-Frank Act grants the Commission explicit statutory authority to establish a real-time reporting consolidator.”<sup>27</sup> FINRA believes any further steps taken by the Commission to mandate the consolidation of public swap transaction data will only help to ensure uniformity and, as a result, help to promote market integrity and investor protection. In addition, FINRA believes that the central consolidator must have the regulatory authority to compel all participants, including SDRs, to submit the data to help ensure that there is one, comprehensive, and accurate source for this data.

#### Aggregate View of Marketplace

Finally, FINRA favors the Commission’s proposal because, based on FINRA’s experience with TRACE, FINRA believes that the collection and review of transaction level data is necessary to obtain an accurate view of and insight into the swap market. TRACE has revealed facts and figures about a marketplace where previously no aggregate view was available. After FINRA obtained and reviewed TRACE data, many long-held assumptions regarding the OTC bond market proved inaccurate or incomplete. For example, dealer participation is less concentrated than was anticipated; retail investors are much more active than was commonly thought; and, a broader range of securities trade more actively than most industry participants predicted. FINRA also makes such aggregate market information available to market participants and the public in the FINRA TRACE Fact Book.<sup>28</sup>

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<sup>23</sup> See Proposing Release at 75 FR 76142.

<sup>24</sup> See Proposing Release at 75 FR 76142.

<sup>25</sup> See Proposing Release at 75 FR 76142, note 20.

<sup>26</sup> See Proposing Release at 75 FR 76169.

<sup>27</sup> See Proposing Release at 75 FR 76149.

<sup>28</sup> The FINRA TRACE Fact Book, which is published annually, is available at FINRA’s website [www.FINRA.org](http://www.FINRA.org). In 2009, FINRA also began to include quarterly updates to its TRACE Fact Book.

Similarly, we believe the Commission's proposal will provide significant insight into the scope and dynamics of the swaps marketplace. Obtaining data, especially transaction level information, about the market will ultimately provide for a broader and more complete risk assessment, a regulatory frame work based on accurate information and improved market surveillance. FINRA believes that transparency can be most efficiently achieved through a single consolidator of data.

In Summary

In its almost nine years of existence, TRACE has provided the marketplace and regulators with invaluable insight into the corporate bond, and more recently, the agency debt markets (except asset-backed securities). It has provided investors with crucial price information, making real-time data available to over 50,000 market professionals, and has provided regulators with essential information for oversight and surveillance which helps to ensure the market integrity necessary for investor protection. Today, few in the market place would act before consulting the transaction information available from TRACE.

Given FINRA's experience with TRACE as a vehicle for the collection and dissemination of transaction data, along with the benefits that these functions have afforded the OTC marketplace and its investors, FINRA is fully in favor of enhancing regulatory surveillance and market transparency and, therefore, strongly supports a trade reporting and dissemination structure for swap information.

Sincerely,

A handwritten signature in cursive script, appearing to read "Richard G. Ketchum".

Richard G. Ketchum  
Chairman and CEO