BARCLAYS

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

May 14, 2012

RE: Further Notice of Proposed Rulemaking CFTC RIN 3038-AD08, Procedures to Establish Appropriate Minimum Block Sizes for Large Off-Facility Swaps and Block Trades

Dear Mr. Stawick,

On behalf of Barclays Bank PLC ("Barclays"), we write to express our support for the Commodity Futures Trading Commission's (the Commission) efforts to implement the Dodd-Frank Wall Street and Consumer Protection Act ("Dodd-Frank") and to thank you for the opportunity to provide comments on the Further Notice of Proposed Rulemaking (FNPR) regarding the Procedures to Establish Appropriate Minimum Block Sizes for Large Off-Facility Swaps and Block Trades.

Our comments on the FNPR are set out as follows

1. The Purpose of block levels
2. The mechanism of risk transfer/ market structure
3. The Dodd Frank mandate in respect of block levels
4. Assumptions made in forming Barclays response
5. Methodology Issues and Recommendations
6. Calibration Issues and Recommendations

1. The purpose of block levels

Block levels serve the dual purpose of determining the minimum transaction size that may be exempt from the Swap Execution Facility's pre-trade transparency requirements and, also, the minimum size of transaction that benefits from a deferral in the requirement that transactional information be disclosed to the public as soon as technologically practicable after the time at which the relevant transaction has been executed.

The same block levels would presumptively apply to serve each of the pre trade and post trade purposes.

Pre trade block levels are set at levels so as to allow a market participant to be able to execute a trade without adversely moving the market in cases where having to disclose the size of the market participant's interest would have this effect. In such a case the transaction is customarily exempted from many of the formal pre trade requirements.

Block levels for post trade transparency are presumptively set at the same pre trade level (ie at levels that would move the market) but the time interval of the deferral in the releasing of trade data to the public ought be determined as the period that appropriately balances the benefit to the public of prompt disclosure with the time required for the dealer substantially to execute a hedge.

2. Block execution / Transfer of price execution risk from participant to intermediary

Pre-Trade

In the case where a participant executes against an anonymous order book he assumes the risk of adversely moving the market in the process of that execution. Brokers provide many execution management tools to their clients to access the market and to assist with that execution, and those tools reflect a wide range of priorities that the client may wish to adopt in managing the execution process. In such cases however, the price risk is always with the client.

Block levels allow a participant who has a large size transaction to execute to pass this price execution risk to an intermediary who makes a firm price to the participant for the whole size, thus giving the participant price certainty of execution. The intermediary is compensated for this execution risk by a bid/offer spread that is intended to compensate the intermediary for the risk that the market moves before he can execute a hedge. The intermediary thus assumes the execution risk.

Fixed Income, Commodity and most FX markets can be thought of as non-continuously traded markets. This is particularly so of derivative markets. There are essentially no crossing networks in these markets because there is seldom contra liquidity. Since even the most frequently traded interest rate swap, the ten year US $ interest rate swaps, trades on average 200 times per day, an end user needing to execute immediately must use an intermediary. Similarly an end user requiring even a minor structural variation from the norm must seek an intermediary since there will likely be no natural contra liquidity for that particular structure.

Accordingly, Swap Dealer Intermediaries currently assume the execution risk by making firm executable prices to their customers and putting their capital at risk. The "bid /offer" spread in any product represents the monetary compensation a Swap Dealer requires in order to compensate it for the amount the market is expected to move before it is able to offset the risk with another third party, and to provide the Swap Dealer with a return on the risk capital employed.

Post-Trade

For post-trade transparency it is evident that a requirement to post immediately a transaction whose size cannot be effectively hedged will likely result in a wider spread being quoted by the intermediary to protect itself from potential adverse price movements post reporting.

3. The Dodd Frank Mandate in respect of block levels

Title VII of the Dodd-Frank Act added section 2(a)(13) to the CEA to direct the Commission to promulgate rules requiring the real-time public reporting of swap transaction and pricing data, *while protecting market liquidity for block trades and large notional off-facility swaps*.

As set out in the pre-amble of the FNPR, the benefits of enhanced market transparency and the effects such transparency would have on market liquidity[1] were documented as a primary concern to the Commission.

4. Assumptions made in forming Barclays response

Since the same block levels established for the purpose of the post trade reporting regime set out in Part 43 will surely be used also to determine whether or not a transaction, that otherwise must trade on a SEF (or DCM), is of a size would exempt it from having to do so, any comment on the quantification of such block levels requires us to know the pre trade transparency and order interaction protocols under which SEFs will be required to operate. The Commission published an NPR setting out proposals for these requirements on January 7, 2011 (Core Principles and Other Requirements for Swap Execution Facilities[2]) but no final rule has yet been published. Not yet knowing the pre trade transparency requirements for SEFs must necessarily qualify our comments.

5. Methodology recommendations

Barclays commends the Commission for addressing in this FNPR a number of the concerns raised in relation to the initial proposed rule as to the construct and framework of a block regime.

We appreciate in particular the efforts to introduce more nuanced categories for which individual block levels may be appropriately calibrated, but have concerns that the current proposal in the FNPR is still not optimally aligned with the way the markets view liquidity profiles across products and maturity bands.

---

[1] 77 FR 15466
[2] 76 FR 1214

We set out below our recommendations for further enhancing the framework/methodology for the construction of the post trade reporting regime to which discrete block levels might apply.

5.1 Methodology Recommendations applicable to all Asset Classes

We respectfully request the Commission consider the following general recommendations to the proposed methodology/framework set out in the FNPR;

a) Off SEF transactions

Barclays believes that all product / transaction types that are not "made available to trade" and mandated to transact on SEFs (or DCMs) should be reported as blocks for the purpose of post-trade reporting with appropriately calibrated delays. By definition these are not price forming contracts and are used by counterparties/end users that need to hedge a specific risk. We believe that there is very limited value to the public in the immediate reporting of any transaction in this category but that the risk of adversely impacting liquidity, if having to do so, is entirely unknown. Some products may justify longer than standard delays. Accordingly we urge caution in this.

b) Swaps that are "available to trade" but subsequently trade infrequently

We recommend an approach that recognizes that a product that has been "made available to trade" may subsequently become illiquid. Barclays proposes that, for all swap categories, when there are no more than three transactions per business trading day in the instrument these swap categories be treated as blocks for the purpose of post trade reporting. Failure to treat illiquid transactions as such may result in market makers being reluctant to quote prices and reduce end users ability to obtain quotes.[3] An alternative would be to remove these trades from the "available to trade" category, such that, under our proposed framework, such trades would benefit from a deferral in post trade reporting.

c) Treatment of Options

The current FNPR proposes that Options, for all asset categories, are treated as bullet swaps for block threshold level and associated post-trade reporting purposes.

Based on our own transactional data, we believe that this treatment is inappropriate as there is a far from perfect correlation between options and their underlying swaps in terms of average notional trade sizes and trade volume. In addition, using the bullet swap block size block size level is inappropriate since options have multiple risk factors that need to be considered when determining block sizes. Including the tenor of the option and of the underlying into which the option is exercised. These factors include;

---

[3] Staff Report No. 557, Federal Reserve Bank of New York, An Analysis of OTC Interest Rate Derivatives Transactions: Implications for Public Reporting, March 2012, at 21.

- Delta – hedging the DV01 of the option
- Gamma – non-linear price changes with rate
- Vega – the size of the volatility position
- Strike/ Skew – price dependent on strike or skew of the option

Barclays believes that, ideally, a multi-dimensional treatment of block sizes for options is needed in order to provide the scalars necessary to set block sizes that reflect the fundamentals of option contracts and products. As it appears that no CCP is likely to be ready to clear options in the near future, we recommend that all options are treated as blocks until such time as the Commission has conducted sufficient quantitative analysis to determine the appropriate sensitivity factors and their associated block threshold levels.

In addition, options should be broken down in a more granular basis as each type of option category presents different liquidity profiles. It may be appropriate to introduce a regime for caps, floors and generic swap options but defer until later a regime for more complex options and correlation products when the impact of such requirements on liquidity is more fully understood.

d) Treatment of forward starting swaps

The market needs clarity as to how to treat forwards for the purposes of post trade reporting and whether the transaction is of sufficient size so as to be exempt from having to trade on a SEF. The FNPR gives no guidance on this point.

Although Barclays recognizes that the price volatility of a forward swap may of course, materially greater than the bullet swap to the maturity of the forward, for the sake of simplicity we suggest that for forward starting swaps, in all asset classes, the final maturity of the forward starting swap should be set as the length of the underlying swap i.e. a 5 year swap starting 5 years forward be afforded the same block level assigned to a ten year swap.

e) Cap Size set

Where there is a requirement that a type of swap must exclusively trade on a SEF (or DCM) a block size must be attributed to that category to establish when an exemption from this requirement is to apply. For the purpose of post trade reporting caps should be set at the same levels these block levels. Any transaction type that has a block size attached to it should be subject to a cap of the same size in the post trade reporting regime. The variable is in the time interval of the deferral, which may perhaps differ by product type.

Where a transaction is not required to trade on a SEF (or DCM) we recommend that presumptively all such swap products receive the benefit of an appropriate delay in the post trade reporting regime, regardless of the transaction size. These are not truly price forming contracts. However, in the public

reporting of these trades the actual size of the transaction should be masked if the trade is very large to provide the intermediary with additional protection so as to be able to price the transaction to the end user in the knowledge of, and reflecting that, this additional "cap" protection exists. We agree with the Commission that such an approach has merit.

We note however that the cap levels currently proposed have been in our view set at such high levels as to be essentially inapplicable in practice to some product types. As we read the proposal the suggested $250mm cap size for FX forwards, for example, it applies to all NDFs – including as illustration, NDFs in US dollar/Chilean peso, where the average trade size is approximately $10mm.

With respect to the post initial period we recommend that cap sizes be introduced at more nuanced levels that reflect the differences between products's traded volumes.

f) Anonymity Methodology

Congress has sought to ''ensure that the public reporting of swap transaction and pricing data [would] not disclose the names or identities of the parties to [swap] transactions".

Section 2(a)(13)(E)(i) of the CEA directs the Commission to protect the identities of counterparties to swaps that are a) subject to the mandatory clearing requirement, b) excepted from the mandatory clearing requirement pursuant to the end user exemption and, c) voluntarily cleared swaps. Similarly Section 2(a)(13)(C)(iii) of the CEA requires the Commission to prescribe rules that maintain the anonymity of business transactions and market positions of the counterparties to an uncleared swap.

In particular, these sections of the statute provide that ''[the] description must be general enough to provide anonymity but specific enough to provide for a meaningful understanding of the economic characteristics of the swap.''

We accept that this is a very difficult balance to strike but our opinion is that in striving to achieve this balance, the proposals in the FNPR do not adequately protect anonymity, even when cap sizes are used to mask oversize transactions. This is especially so in the case of thinly traded asset categories or classes or those in which there are very few major players, most notably, in the Commodity asset class.

Barclays recommends the Commission use wider geographic regions when publicly disseminating data for commodity swaps with very specific underlying assets and/ or delivery points (e.g., natural gas or oil). Such a precedent is already in place in the oil markets where the US is broken down into five regions (e.g. PAD1, PAD2 etc) in order to preserve anonymity.

The need to protect anonymity is not, however, limited to the commodities markets. It is surely the case that an issuer of debt, who wishes to transact a swap relating to the specific terms of that debt issuance, will easily be identified as the true counterparty in a swap whose reported details match the terms of

the issue and are reported moments after its issuance. Some appropriate process needs to be adopted that exempts these related trades from needing to be reported to the public.

5.2 Methodological Recommendations applicable to individual Asset Classes

We urge the Commission to consider the following changes to the proposed methodologies in the FNPR which are applicable to individual asset classes.

a) Interest Rate Markets

i. Tenor buckets need to be modified more accurately to reflect market maturity profiles

Barclays supports the use of tenor bandings for categorizing interest rate swaps. We believe however that the breakdown of these maturity buckets in the FNPR would benefit from some minor adjustment.

Barclays recommends that the Commission sets tenor buckets which straddle the relevant benchmark maturity points;

- 0-3 months,
- 3-6 months,
- 6-18 months,
- 1.5-3 years,
- 3-7 years,
- 7-12 years,
- 12-20 years,
- 20-30 years, and
- greater than 30 years.

ii. Granularity of Interest Rate Swap product type

The Interest Rate Swap asset category, as it currently stands, is not sufficiently granular in differentiating between products to allow for optimal block size levels to be established. We propose the following categorization refinements in order to determine block size levels that align more closely to liquidity differences in product sets. Each of the following categories justifies a unique set of block levels -

- Each Super Major Currency
- Swaps against standard floating rate indices
- Swaps against non standard floating rate indices
- Basis swaps

- Inflation Swaps
- Swaptions
- Caps and floors
- Cross-currency Swaps
- Structured Swaps

These categories are traded significantly less frequently than benchmark floating rate indices [4]and also present an increased risk of adverse market movement resulting from the adoption of pre trade transparency requirements. Different calibrations should apply to these products.

b) Credit Markets

i. Credit spread buckets

Barclays does not believe that traded spreads should be used as the determinant of the categorization for CDS Indexes. Index Series and Index Grouping are both sufficient for the purposes of appropriately determining the category to which a particular block level applies.

If a spread regime were adopted as the determinant, swaps may potentially move daily between different threshold buckets as spreads can move substantially over short periods. This would lead to an unacceptable level of operational risk in continually readjusting, monitoring and ensuring compliance with daily shifts in block thresholds based on current market volatility.

ii. On the run versus off the run treatment of Credit Derivative Indices

The Commission has proposed using a single block level which in our view fails to reflect that the credit derivative markets differ widely in available liquidity between maturity segments. Unlike most markets in financial instruments, CDS do not necessarily become more liquid as the tenors get shorter. This is reflected in the volume patterns traded. We note

- Volume is significantly different for on-the-run versus off-the-run indexes[5]
- Volume varies significantly by CDS Index

Barclays recommends that the Commission's final rules reflect these particular characteristics by

- Categorizing each series and index separately based on widely available industry data

[4] See Federal Reserve Bank of New York, Staff Report No. 557 March 2012. An Analysis of OTC Interest Rate Derivatives Transactions: Implications for Public Reporting

[5] **http://www.dtcc.com/products/derivserv/data_table_snap0018.php**

- Setting threshold levels for blocks based on historic transaction data

iii. Tranches

We recommend that tranches of indices receive their own unique block sizes based on empirical trade data.

c) Commodities Markets

i. Denomination of Commodities

Consistent with the treatment in futures markets, we believe block levels for commodities should be expressed in terms of the number of units traded and not dollar values of transactions. Blocks should be expressed in numbers of barrels, MMBTUs etc.

ii. Maturity breakdown

Particularly in respect of commodities we believe any maturity breakdown needs to take into account the rapid reduction in liquidity that many products experience beyond the first one or two years. Any tenor bucketing and calibration needs to reflect this appropriately.

d) Equity Derivatives

Barclays strongly disagrees with the Commission's proposal to disallow block levels for all Equity Swaps and Options. The Commission's rationale for its view is based on a false premise that, because the underlying cash market is highly liquid, with no associated delay in reporting block trades, that the equity derivatives market should follow suit.

The size of the equity index derivatives and options markets is a minute fraction of their cash counterparts. We believe that disallowing block levels would have a materially negative impact on the market.

Barclays recommends that the Equity Swap asset class be treated in a similar manner to all the other asset classes, taking into account transactional volume by index and equity asset class type. For broad based indices, such as S&P 500, block levels should be set at the same level as for the Futures market.

In addition we urge that the Commission should coordinate closely with the Securities and Exchange Commission ("SEC") in order to ensure that the potential for regulatory arbitrage is minimized. The Commission should also follow this approach when the SEC seeks to set threshold levels for single name Credit Default Swaps (CDS).

e) FX

We recommend that Euro and US Dollar denominated transactions justify a category distinct from less liquid currencies.

In addition, we also believe that for FX an increased granularity of product types is merited. We urge the Commission to consider applying distinct block levels at least to each of the following product categories:

- Forward
- Non Deliverable Forward
- Non Deliverable Option
- Vanilla option
- Other more complex types of option

As with Commodity Markets, FX markets often demonstrate very high levels of liquidity but only in very short maturities and accordingly we invite the Commission to consider introducing several maturity buckets for maturities under a year.

6. Calibration Issues and Recommendations.

We welcome and appreciate the Commissions efforts in the FNPR to tailor the framework to reflect the differences in product and maturity spectrum.

As to the calibration of the actual block sizes that are to apply we have the following comments:

- The rationale for using the 67-percent notional amount as the basis for the calibration of minimum block size levels is not based on any assessment of the impact such a figure will have on liquidity and the corresponding cost that users of the market must bear as a consequence. We question whether this approach meets the Commission's stated goal of balancing liquidity and transparency concerns.
- This 67-percent figure (for the post initial period) has been determined as appropriate in the case of all Commodities and FX swaps without any knowledge of what the formula will likely generate as actual block levels. This seems to be an unnecessary risk to take.
- The 67-percent figure contains no analysis as to whether a single such figure is appropriate across all transaction types within an asset class – for example, forwards and options, swaps against less frequently traded indices or between two indices.
- No adequate rationale is given for the absence of any block levels applying to equity swaps under the Commission's jurisdiction.

- It is our view that the risk of unintended adverse consequences to liquidity of implementing the block sizes as currently recommended in the FNPR is high. Among possible outcomes are that end users will be obliged to transact at significant increased cost or be forced to seek imperfect hedges in sister markets.

We question in fact how much confidence can be had in these figures since the number of variables that are unknown present significant risk of unforeseen adverse consequences.

In particular, we believe that the following factors make dependence on a purely theoretical assessment unwise:

- At the same time as these pre trade and post trade transparency requirements are to be introduced, the market is incurring additional costs by virtue of mandated clearing and the implementation of uncleared margin requirements. It is impossible to predict with confidence the compounded effects these increased costs will have on the market liquidity when coupled with the simultaneous implementation of transparency requirements, and

- When assessing the appropriate time intervals for deferral of post trade reporting to the public, swaps present particular challenges to a purely theoretical assessment of the time required to hedge the associated risk because a single swap may, in fact, be composed of many categories of risk combined into a single transaction. For example, any calibration mechanism would need to recognize that differing categories of risk may be capable of being

  a) hedged in their entirety i.e. all risks are capable of being hedged within a 30 minute period, or

  b) only partially (though substantially) hedged within the permitted deferral period, or

  c) only imperfectly hedged by trading proxy hedges that are correlated to some degree with the risk assumed within the permitted deferral period , or

  d) not hedged at all with an adequately correlated hedge within the permitted deferral period.

Accordingly we believe that only by means of an empirical and phased in approach can a block regime be introduced that sufficiently mitigates the risk of unintended consequences. We recommend introducing block levels that are set at such levels that allow for empirical analysis of the transaction data and sequentially increasing block sizes until such point as the desired equilibrium between transparency and liquidity is reached.

Since the same block sizes must surely apply to both pre and post trade transparency, it is necessary to set block levels in magnitudes that in the first iteration ensure that sufficiently large volumes of transactions do in fact trade on SEFs subject to the pre trade transparency requirements to give enough of a data sample to allow for an empirical assessment of the impact on liquidity of the levels selected. In the first iteration these block levels should not be so high as to present undue risk to liquidity, given the

considerable uncertainties involved. Once established these levels would be increased as soon as there is enough data to justify so doing. This process of gradually introducing higher standards was used in the introduction of TRACE post trade reporting regime, which we think provides a useful precedent in this instance also.

We are happy to discuss with the Commission how the first iteration levels may be established or any other issues and recommendations raised in this letter.

Sincerely

Keith A. Bailey

Managing Director

Barclays

Email: keith.bailey@barclays.com