

May 14, 2012

ICAP North America Inc.
Harborside Financial Center
1100 Plaza Five, 12th Floor
Jersey City, New Jersey
07311-4996
Tel: +1 212 406 1100
www.icap.com

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

Re: Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades (RIN 3038-AD08)

Dear Mr. Stawick:

ICAP North America Inc., on behalf of its U.S.-based operating subsidiaries and overseas affiliates (collectively, "ICAP")¹ appreciates the opportunity to provide comments to the Commodity Futures Trading Commission ("CFTC" or "Commission") on the proposed rules related to the procedures to establish appropriate minimum block sizes for large notional off-facility swaps and block trades (the "Proposed Rule"),² pursuant to section 727 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").³

We believe the Proposed Rule does not properly address the statutory mandate to which it is responsive and needs to be reworked. Our recommendations are:

- First, the Commission needs to determine what constitutes a "market moving" transaction for particular swap contracts when setting the block trade level;
- Second, the Commission should base the initial block sizes on the experience and expertise of market participants who understand what size trade can move the market. ICAP

¹ ICAP is the world's leading voice and electronic interdealer broker and the source of global market information and commentary for professionals in the international financial markets. ICAP is active in the wholesale markets in interest rates, credit, commodities, foreign exchange and equity derivatives. ICAP has an average daily transaction volume in excess of \$1.5 trillion, more than 60% of which is electronic. ICAP plc was added to the FTSE 100 Index on 30 June 2006.

² See Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades, 77 Fed. Reg. 15,460 (March 15, 2012).

³ ICAP Energy, a division of ICAP specializing in commodities brokerage, has filed a separate comment letter addressed to specific issues associated with the application of the Proposed Rule to the electricity and natural gas markets.

recommends, for example, that the Commission set a block level of \$100 million for the 10 year USD IRS, with additional recommendations set forth below for some of the other more liquid contracts; and

- Third, if the Commission decides to retain its “time bucket” approach, it should utilize a 50% or lower notional threshold, and base such thresholds on data reflecting specific swap contract tenors which are liquid rather than “buckets” mixed with swaps with varying tenors with widely different liquidity characteristics.

1. The Dodd Frank Act requires the CFTC to identify what constitutes a “market moving” transaction when establishing block trade levels

A. Block Trade Legislative History and Statutory Provisions

As the legislative history of Title VII and the “block trade” provision make clear, Congress was well aware of the existence of “block trades” in both the securities and futures markets.⁴ Congress identified block trades as those which involve “a very large number of shares or dollar amount of a particular security or commodity and which transactions could move the market price.” Congress provided the CFTC with specific statutory authority to set the appropriate block trade levels and reporting delays for swaps and security based swaps. Congress expected the Commission to distinguish between different types of swaps based on “the commodity involved, size of the market, term of the contract and liquidity in that contract and related contracts.”

Pursuant to Section 2(a)(13)(E)⁵ of the Commodity Exchange Act, as added by Title VII of the Dodd Frank Act, the Commission is required to prescribe regulations specifying “the

⁴ 156 Cong. Rec. S5921 (daily ed. July 15, 2010) (Statement of Sen. Blanche Lincoln) (“Block trades, which are transactions involving a very large number of shares or dollar amount of a particular security or commodity and which transactions could move the market price for the security or contract, are very common in the securities and futures markets. Block trades, which are normally arranged privately, off exchange, are subject to certain minimum size requirements and time delayed reporting. Under the conference report, the regulators are given authority to establish what constitutes a “block trade” or “large notional” swap transaction for particular contracts and commodities as well as The committee expects the regulators to distinguish between different types of swaps based on the commodity involved, size of the market, term of the contract and liquidity in that contract and related contracts, i.e.; for instance the size/dollar amount of what constitutes a block trade in 10-year interest rate swap, 2-year dollar/euro swap, 5-year CDS, 3-year gold swap, or a 1-year unleaded gasoline swap are all going to be different. While we expect the regulators to distinguish between particular contracts and markets, the guiding principal in setting appropriate block-trade levels should be that the vast majority of swap transactions should be exposed to the public market through exchange trading. With respect to delays in public reporting of block trades, we expect the regulators to keep the reporting delays as short as possible.”).

⁵ (E) RULEMAKING REQUIRED — With respect to the rule providing for the public availability of transaction and pricing data for swaps described in clauses (i) and (ii) of subparagraph (C), the rule promulgated by the Commission shall contain provisions—

- (i) to ensure such information does not identify the participants;
- (ii) to specify the criteria for determining what constitutes a large notional swap transaction (block trade) for particular markets and contracts;

criteria for determining what constitutes a large notional swap transaction (block trade) for particular markets and contracts” and “the appropriate time delay for reporting large notional swap transactions to the public.”⁶ The Commission must take into account whether public disclosure of swap transaction and pricing data will “materially reduce market liquidity.”⁷

B. The Commission has used a methodology that does not identify what a “market moving” swap transaction size is or the effect of its proposed block sizes on market liquidity

The Commission has not followed Congressional intent to identify what constitutes a “market moving” transaction size for certain swap contracts. The Commission has not sought to determine at what dollar level a particular swap contract or transaction would have a “market moving” impact, nor has the Commission proposed criteria for making this determination. The Commission also has not made a determination that the block levels it is proposing would not materially reduce market liquidity, as Congress directed it to do.⁸

Rather, the Commission has gathered and analyzed certain historical swaps data and then applied a 67 percent notional amount test to “buckets” of swaps which fall into a particular “swap category.” CFTC staff indicated that the 67 percent notional amount calculation was relied upon because it resulted in 94 percent of interest rate and credit swaps not qualifying as block trades, and thus subject to real-time public reporting requirements.

The Commission appears to base its chosen methodology almost entirely on its interpretation of a single sentence in the legislative history regarding the block trade rule:

“In considering the benefits and effects of enhanced market transparency, the Commission notes that ‘the guiding principle in setting appropriate block trade levels [is that] the vast majority of swap transactions should be exposed to the public market through exchange trading.’”

(iii) to specify the appropriate time delay for reporting large notional swap transactions (block trades) to the public; and

(iv) that take into account whether the public disclosure will materially reduce market liquidity.

⁶ See *id.* § 2(a)(13)(E)(ii) and (iii).

⁷ *Id.* at § 2(a)(13)(E)(iv).

⁸ The Commission appears to shift the burden of making this determination to commenters: “As noted above, CEA Section 2(a)(13)(E)(iv) directs the Commission to take into account whether the public disclosure of swap transaction and pricing data ‘will materially reduce market liquidity.’ If market participants reach the conclusion that the Commission has set appropriate minimum block sizes for a swap category in a way that will materially reduce market liquidity, then those participants are encouraged to submit data in support of their conclusion.” Proposed Rule, 77 Fed. Reg. 15,480. We respectfully suggest that it is the Commission’s obligation to make that determination, not utilize an alternative methodology and invite challenge.

ICAP respectfully believes that the Commission is misconstruing the statute, viewed in light of the legislative history, in three important outcome-determining respects.

First, the Commission does not cite to or otherwise consider the earlier portion of this legislative history which actually sets forth what Congress thought a block trade was – “Block trades, which are transactions involving a very large number of shares or dollar amount of a particular security or commodity and which transactions could move the market price for the security or contract, are very common in the securities and futures markets” (emphasis added).⁹ Indeed, we are unaware of a block trade concept in any other marketplace which bases block size on a results-oriented preferred dispersion of blocks and non-blocks, or that calculates block size in the manner the Commission proposes.

Second, while it acknowledges that it has the statutory obligation to take into account whether public disclosure will materially reduce market liquidity, the Commission has not determined that its proposed methodology satisfies this required consideration. Instead, the Commission asserts that its 67% methodology would minimize the impact of real time reporting on liquidity, but offers no data or analysis to support its assertion.¹⁰

Third, the Commission’s proposed approach is inconsistent with the language in the legislative history “[that] the vast majority of swap transactions should be exposed to the public market through exchange trading.” This statement suggests block trade levels should result in the vast majority of “swap transactions” not being considered blocks, yet the Commission’s methodology is designed to ensure that the vast majority of “swap notional value” trades on a non-block basis. It is unclear why a “notional value” consideration rather than number of transactions would be the logical approach to achieve the objective expressed in this legislative history, and the difference in outcome could be stark as shown by the example below:

Sample Transaction Data

18 trades of \$5 million each
1 trade of \$200 million
1 trade of \$500 million

Under the Commission’s time-bucket and 67% threshold approach, block trade size would be set at \$500 million in the interest of a substantial majority of “notional value” trading as non-blocks. Yet, if one considers the phrase “vast majority of swap transactions” 90% of swap transactions (18/20) – a vast majority under any standard -- would still be non-blocks if block trade size was instead set at \$200 million. Accordingly, we do not believe the

⁹In discussing the meaning of block trade in the futures markets, the Commission notes in the Proposed Rules that “block sizes are set near or at the point where a trader would be able to offset the risk of an equally large transaction without bearing liquidity risk.” Proposed Rule, 77 Fed. Reg. 15,485, footnote 224.

¹⁰ Proposed Rule, 77 Fed. Reg. 15,480.

Commission has applied the legislative history in accordance with either its plain meaning or its purpose.

2. Block trade sizes should be established based on the expertise of market participants experienced with swaps trading

A. Stock and futures exchanges have historically been permitted to establish appropriate block level sizes because of their expertise in their own markets, and the Commission should allow that same approach for swaps

While we appreciate that the Commission has made a genuine and extensive effort to collect and carefully analyze available data on historic swap market transactional activity, we respectfully suggest that the Commission should utilize the same approach it has utilized for the futures markets, which have served as its reference point in a number of swap rulemaking areas and in the Proposed Rule specifically. We believe this for a number of reasons.

First, a block is the trade size that would move the market, and we do not believe there is a natural expected dispersion of trades one would expect to move the market, let alone a meaningful way to divine that level from reviewing historical transaction data. While common patterns may emerge in high volume, liquid markets with large numbers of participants, even the most liquid swap transactions do not yet possess those characteristics. Moreover, the characteristics of market activity are likely to change dramatically as derivatives regulation takes effect and new trading patterns emerge. Accordingly, we do not believe it is prudent to base block size on a limited set of historical transaction data that will not be reflective of the eventual market place, and that in any event is not amenable to an analysis that could determine the size of a market moving trade.

Second, the Commission has long recognized the benefits of permitting futures exchanges to set their own block sizes based on their expertise in their own markets.¹¹ The Commission reiterates this view in the Proposed Rule in utilizing as a reference point block sizes determinations made by futures exchanges for economically related futures contracts:

“...[T]his approach during the initial period would draw upon the experience of DCMs in considering the potential impacts on liquidity risk that enhanced transparency may cause in connection with futures contract execution.”¹²

¹¹ See Commission Advisory on Alternative Execution, or Block Trading, Procedures for the Futures Industry: “[Under the Commission’s approach], each contract market would have the ability to develop procedures that reflect the particular characteristics and needs of its individual markets and market participants.” 64 Federal Register 31,195 (June 10, 1999).

¹² Proposed Rule, 77 Fed. Reg. 15,485.

The Commission also indicates that the exchange's view is worthy of consideration because "DCMs historically have had the appropriate incentive to balance [the potential impact on liquidity risk that enhanced transparency may cause] because they benefit from liquidity generally (i.e., commissions from transaction volume in block and non-block trades provides DCMs with their primary source of revenue.)"¹³

ICAP respectfully suggests that its own business model is marked by the exact same incentives and that its expertise merits comparable consideration in identifying appropriate block levels.¹⁴ ICAP is the largest interdealer broker in the world with approximately 5,000 employees operating in 30 countries. We broker financial transactions of approximately \$1.5 trillion a day, and are one of the largest, if not the largest, broker in OTC IRS, CDS and FX transactions.

Our business model is to help clients find liquidity and generate a commission as a result of a completed trade, and as we operate in the interdealer space, we are commonly assisting clients in executing large trades in a favorable manner. Put differently, one of the key values we add for our clients as a broker is understanding what size trade may move the market, such that disclosure of full size would harm liquidity. Our incentive as a broker is to provide as much information about trading interest to as many market participants as quickly as possible consistent with not hurting liquidity. We see firsthand what size trade market participants feel they can prudently execute if broadly disclosed, as well as the impact on market liquidity when trades of a certain size are completed. It is this exact balance that the Commission is tasked with identifying.

B. Recommended block trade sizes for particular IRS, CDS and FX tenor instruments

The swap market for different products has developed to a point to find a balance of a minimum notional amount that maximizes liquidity and minimizes market exposure and is used in securities and derivatives OTC markets. The table in Appendix A sets forth our specific recommendations related to the swap contracts which have significant trading liquidity today and what we believe to be the appropriate initial block trade levels for such contract by tenor.

Interest Rate Swaps –

It is our view that in the USD IRS sector, that the "on the run" IRS swap contracts are the 2, 5, 10 and 30 year contracts. Each one of these "tenors" is a liquid trading point. We recommend that the CFTC adopt an initial block trade level of \$100 million for 10 year USD

¹³ Id., at footnote 223.

¹⁴ While the Commission notes that DCMs have historically been required to set block trade sizes in accordance with Core Principles, the commercial incentives to identify a proper block size are exactly the same for an interdealer broker. Moreover, we expect to register and operate as a SEF once the rules go into effect, such that our determinations would be similarly subject to a Core Principle and Commission oversight.

IRS. The corresponding initial block trade levels would be \$400 million for the 2 year USD IRS, \$200 million for the 5 year USD IRS and \$40 million for the 30 year USD IRS.

Credit Default Swap Indexes –

It is our view that in the USD CDS Index sector, that the “on the run” CDS Index swap contracts are the 5 year IG CDS Index and the 5 year HY CDS Index contracts. Each one of these “tenors” is a liquid trading point. We recommend that the CFTC adopt an initial block trade level of \$150 million for the 5year IG CDS Index contract and \$50 million for the HY CDS Index contract.

Foreign Exchange –

We understand that certain FX Instruments will be treated as swaps under Title VII. In particular, non deliverable forwards, FX options, forward rate agreements and cross currency swaps would be considered swaps and subject to all requirements under Title VII.

We are providing comments solely with respect to FX NDFs at this time. It is our view that in the NDF FX sector the “on the run” NDF FX contracts are the 1 month contract. We recommend an initial block level of \$10 million in the 1 month contract on a variety of FX NDF contracts as specified in Appendix A.

C. Recommended block trade sizes for all other swap instruments

For all swap instruments which are not identified above and on Appendix A, we recommend that the Commission permit SEFs to set the block levels for such instruments. As noted above, DCMs currently set and adjust block trade levels for futures contracts listed and traded on their markets, and we believe that SEFs will be subject to a comparable Core Principle and have comparable incentives that merit crediting their recommendation, which the Commission will of course have oversight of.¹⁵

3. If the Commission retains its proposed approach, we believe a number of important changes to that approach should be made

As noted above, ICAP respectfully recommends that the Commission not utilize its proposed “time-bucket” methodology and instead rely on those with the pertinent market expertise to determine market moving trade size, and whether non-block treatment of particular size transactions would reduce liquidity. If the Commission chooses to retain the approach

¹⁵ We would also note that we are not aware of any Commission effort to remove the discretion of futures exchanges to set block sizes for their listed futures contracts, and consistent with the Commission’s frequently stated concern about creating “regulatory arbitrage” among different markets, we do not believe there is a basis for permitting DCMs a level of discretion to set futures block sizes that would not be permitted for a SEF setting swap block trade sizes under its Core Principles in accordance with CFTC criteria.

outlined in the Proposed Rule, we believe a number of important changes should be made to that approach.

First, if the Commission intends to rely on historical market data, we recommend that it not do so without data that is more current and demonstrated to be representative of the market. In IRS and CDS, the data used for proposing the initial block levels is from 2010 and covers only 90 days of swaps trading information. We note that the SEC utilized 12 months of data in its recent report regarding CDS.¹⁶ In addition, the data is solely from transactions involving G-14 participants as opposed to all market participants and it may be the case that the transaction sizes are larger than they would be if the sample included other, smaller, market participants. Accordingly, we do not believe that the Commission has a basis to conclude that the data is representative of true volume and size activity. While we recognize the difficulty of obtaining comprehensive data given the historically unregulated nature of the market, the determination of block size will have dramatic implications for the market and liquidity under the Commission's rules, and it should not be based on insufficient data.

Second, we believe the threshold level utilized by the Commission should not be 67% and should at most be 50% (which we understand the Commission was considering as late as the night before the rules were proposed). As noted earlier, we believe that the 67% notional threshold test is inappropriate because it focuses on notional amounts rather than what constitutes a "market moving" transaction. However, if the Commission is going to proceed with this approach we believe it must drop the threshold significantly in order for the result to be more consistent with what the market currently perceives to be block size.

Third, we believe the Commission's proposal is mistaken in its use of "swap categories" and "buckets" of time frames as opposed to using the standard liquid tenors of swaps contracts. As noted in the legislative history cited earlier, Congress expected block trade levels to be set by swap contract and **by specific tenor** - not buckets¹⁷. Senator Lincoln specifically identified 5 even year swap contract tenors in the discussion of what was expected for block trades: 1,2,3,5 and 10 year tenors. This is logical in that both futures and swaps contracts are normally quoted and traded in even year tenors at the liquid trading points for that market. Further, it shows that Congress was aware of the fact that there were certain liquid trading points on the curve for swap contracts and these were even year tenors. In contrast, the Commission has proposed 8 separate "time buckets" for IRS. One "time bucket" covers a 5 year period while another covers a 20 year period. While we recognize the Commission believes it will be simpler for the market to administer fewer block trade sizes organized by category, we believe the grouping of liquid and illiquid swap contract tenors into broad "time buckets" is

¹⁶ Staff Analysis of Market Data Related to Credit Default Swap Transactions (March 15, 2012), SEC Division of Risk.

¹⁷ "The committee expects the regulators to distinguish between different types of swaps based on the commodity involved, size of the market, term of the contract and liquidity in that contract and related contracts, i.e; for instance the size/dollar amount of what constitutes a block trade in 10-year interest rate swap, 2-year dollar/euro swap, 5-year CDS, 3-year gold swap, or a 1-year unleaded gasoline swap are all going to be different." Senator Lincoln Statement, Congressional Record July 15, 2010.

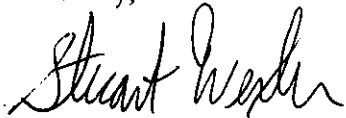
May 14 2012
Mr. David A. Stawick, Secretary
RIN 3038-AD08
Page 9 of 10

inconsistent with Congressional intent and inadvisably attempts to generate a common threshold level from materially dissimilar components.

Conclusion

ICAP thanks the Commission for the opportunity to comment on the Proposed Rule. Please feel free to contact the undersigned with any questions you may have on our comments.

Sincerely,



Stuart Wexler
Americas General Counsel

cc: Honorable Gary Gensler, Chairman
Honorable Mark Wetjen, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Scott O'Malia, Commissioner

APPENDIX A

Instrument	Recommended Block Trade Size (\$ Millions)
2 Year Interest Rate Swap	450
5 Year Interest Rate Swap	200
10 Year Interest Rate Swap	100
30 Year Interest Rate Swap	40
5 Year CDS Investment Grade Index	200
5 year CDS High Yield Index	100
1 Month CNY NDF	10
1 Month KRW NDF	10
1 Month IDR NDF	10
1 month INR NDF	10
1 Month MYR NDF	10
1 Month PHP NDF	10
1 Month TWD NDF	10
1 Month BRL NDF	10
1 Month ARS NDF	10
1 Month CLP NDF	10
1 Month COP NDF	10
1 Month PEN NDF	10
