



May 14, 2012

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:

The Wholesale Market Brokers' Association, Americas¹ ("WMBAA" or "Association") 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 ("Proposed Rules"),² pursuant to section 727 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

In addition to the comments provided in its May 1, 2012 letter, the WMBAA herein addresses (i) the impact of block trades on liquidity formation, (ii) the appropriate notional amount calculation; (iii) the value of timely, accurate transaction data in calculating block trades; (iv) harmonizing rules between SEFs and designated contract markets ("DCMs"); and (v) the relationship between block trades and modes of trade execution. The WMBAA encourages the CFTC to reconsider the initial block trade thresholds proposed, and implement more conservative initial block trade thresholds. By starting the new delayed dissemination regulatory regime with lower block trade thresholds – either by implementing a different approach such as the one suggested in this letter, using a 50 percent notional amount calculation or otherwise – and by relying on more timely and complete data required to be reported to swap data repositories ("SDRs"), the CFTC can ensure that these rules promote competitive and efficient markets and do not impair market liquidity.

¹ The WMBAA is an independent industry body representing the largest inter-dealer brokers (IDBs) operating in the North American wholesale markets across a broad range of financial products. The five founding members of the group are: BGC Partners; GFI Group; ICAP; Tradition; and Tullett Prebon. The WMBAA seeks to work with Congress, regulators and key public policymakers on future regulation and oversight of OTC markets and their participants. By working with regulators to make OTC markets more efficient, robust and transparent, the WMBAA sees a major opportunity to assist in the monitoring and consequent reduction of systemic risk in the country's capital markets. For more information, please see www.wmbaa.com.

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) [hereinafter Proposed Rules].

Block Trade Level Thresholds

Balancing Liquidity vs. Transparency

The WMBAA is mindful that there is a delicate balancing required with respect to implementing the block trading rule, the SEF rule, and the reporting rules in concert with respect to certain goals of Section 5h(e) of the Commodity Exchange Act. As multiple Commissioners observed, setting the block trade level too low will not promote swaps trading, and setting the block levels too high will unreasonably and wrongly impair liquidity in the name of transparency.³

Appropriate Notional Amount Calculation

The Commission proposes to use a 67 percent notional amount calculation to determine initial and post-initial appropriate minimum block sizes for swaps in the interest rate and credit asset classes.

The stated purpose of the 67 percent notional amount calculation is to ensure that within a swap category, approximately two-thirds of the sum total of all notional amounts are reported on a real-time basis, thereby assuring that the market has a timely view of a substantial portion of swap transaction and pricing data. Further, the Commission believes that the proposed 67 percent methodology would minimize the potential impact of real-time public reporting on liquidity risk.

The 67 percent notional amount will result in only six percent of interest rate and credit swaps qualifying as block trades.⁴ The WMBAA agrees that such a high threshold “ignores Congress’ mandate that we take into account the impact of public disclosure on liquidity” and “effectively sacrific[es] liquidity at the altar of transparency.”⁵

³ See Statement by Commissioner Bart Chilton, Open Meeting of the Commodity Futures Trading Commission, available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/chiltonstatement022312> (“if we go too far in, for example, setting block levels too low, we will possibly not promote SEF swaps trading. On the other hand, if we set the block level too high, then we risk impairing the ability of participants to effectively utilize the markets at all. In other words, certain large trades simply wouldn’t happen, because dealers would not be able to efficiently lay off their risk”); see also comments by Commissioner Jill Sommers, Open Meeting of the Commodity Futures Trading Commission, available at <http://cftc.gov/PressRoom/SpeechesTestimony/sommersstatement022312> (“This requires a balancing act—if the block threshold is set too low, there will be reduced transparency in the market. If the block threshold is set too high, there will be reduced liquidity in the market.”).

⁴ See comments by Carl Kennedy, Office of General Counsel, Open Meeting of the Commodity Futures Trading Commission, available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/dsubmission/dsubmission4_022312-trans.pdf MR (“We considered a number of alternatives before presenting the recommended approach. In fact, some of our alternatives would go lower than 50 percent and some would go higher, as high as 95 percent of number of trades within a particular swap category. We ultimately settle on 76 [sic] percent and we were going back and forth between 50 and 67 percent, but we ultimately decided on 67 percent because we think that it still would capture the vast majority of transactions that would be subject to real-time reporting and we would still balance liquidity.”).

⁵ See comments by Commissioner Jill Sommers, Open Meeting of the Commodity Futures Trading Commission, available at <http://cftc.gov/PressRoom/SpeechesTestimony/sommersstatement022312>.

The WMBAA believes that the reliance on percentages of notional amount of a trade size is misguided. Congress made clear that the block trade concept was related to “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.”⁶ It does not indicate that the Commission should develop and implement a mathematical formula to carry out this function, and certainly not a nine-step process that is unnecessarily complicated and can be carried out in a less burdensome method. Rather, the Commission should authorize SEFs to analyze ongoing swaps market trading activity and trade data to determine uniform thresholds that distinguish transactions that move markets from those that do not move markets. The Commission should maintain authority to supervise and routinely review such threshold setting by SEFs. Such an approach would be consistent with the CFTC’s oversight of DCMs.

With respect to the reliance on a percentage of notional trade sizes, the Commission seems to have arbitrarily selected a threshold of 67 percent, which could have easily been 50 percent or 85 percent. We are not aware of any cost benefit analysis considered by the Commission on the impact of the 67% notional amount calculation on liquidity in the U.S. swaps markets. While the WMBAA does not believe selecting an appropriate threshold is simple, as evidenced by the evolution of block trade levels in futures markets,⁷ the Commission in this instance has drawn a line in the sand that is not responsive to its legislative mandate. Rather, in developing appropriate block trade thresholds, the Commission should (i) consider the unique liquidity factors of a certain product and (ii) rely on current, accurate transaction data (discussed below), determine what minimum transaction size, if publicly disseminated without delay, will materially reduce market liquidity.

If the Commission is determined to rely upon the Proposed Rules’ formula, the WMBAA believes, based on its member firms’ decades of experience fostering swaps market liquidity, that a 50 percent notional amount calculation would be a more appropriate level for across-the-board calculations to ensure that market liquidity is not significantly eroded. The Proposed Rules allow for an increase in block trade thresholds during the post-initial period. The WMBAA would suggest that the Commission begin with a conservatively low block trade threshold and, if determined to be encompass too many transactions in a particular asset class, the number can be increased after the initial period.

Further, the WMBAA disagrees with the Commission’s approach using one notional amount calculation for all swaps. Rather, the WMBAA believes it more appropriate to establish a regime that would “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.”⁸

⁶ 156 Cong. Rec. S5921 (daily ed. July 15, 2010) (Statement of Sen. Blanche Lincoln).

⁷ See comments by Commissioner Jill Sommers, Open Meeting of the Commodity Futures Trading Commission, available at <http://cftc.gov/PressRoom/SpeechesTestimony/sommersstatement022312> (“I believe it is worth noting that we have been grappling with the concept of appropriate block size and market transparency in the futures markets for years. In July 2004 we proposed guidance on, among other things, DCM block trading rules. We re-proposed again in 2008, and again in 2010.”).

⁸ 156 Cong. Rec. S5921 (daily ed. July 15, 2010) (Statement of Sen. Blanche Lincoln).

Reliance on Recent Transaction Data to Establish Block Trade Thresholds

In developing block trade thresholds for interest rate and credit asset classes, the Commission reviewed non-public swap data from third-party service providers. Specifically, MarkitSERV provided interest rate swap data covering transactions from its platform between June to August 2010, while the Warehouse Trust Company LLC provided the credit default swaps (CDS) data set covering transactions from May to July 2010.

The WMBAA wholeheartedly endorses the use of transaction data to establish appropriate block trade thresholds. To that end, the WMBAA is supportive of the Commission's decision to make data-driven policy determinations.

However, in this instance, the Commission risks destroying liquidity formation across multiple products in OTC markets based on an ill-founded reliance on three months' worth of transaction data from nearly two years ago. The WMBAA agrees with Commissioner Sommers' assessment that the Proposed Rules are "relying on stale data, and far too little of it."

As the Commission is aware, OTC markets have changed and developed over the last two years, in part due to the passage and beginning stages of implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act. The CFTC is using data based on an OTC marketplace, not a marketplace that requires central clearing and mandatory trade execution through SEFs and DCMs. Crucially, the WMBAA believes that average trade sizes will drop considerably under the new requirements, where competitive SEFs will generate liquidity for market participants. As Commissioner Scott O'Malia described it, the use of these small pools of data to construct across-the-board thresholds in five asset classes is "an apples-to-oranges comparison" that will lead to inappropriate block trade thresholds that will jeopardize the efficient operation of these markets.

The WMBAA encourages the Commission to implement lower block trade thresholds while the post-trade reporting requirements are implemented and market participants begin providing swap data repositories with timely, accurate swap transaction data for cleared and uncleared swaps. As Chairman Gensler has indicated, the Commission will soon have access to large amounts of reliable market data. The CFTC should scrutinize that data to find the proper point at which to set the minimum block sizes. Given the minimal time frame between the release of the Proposed Rules and when the Commission will begin to receive more current data, the WMBAA believes that the Commission should rely on 2012 transaction data reported to a swap data repository rather than on incomplete market data from two years ago.

In fact, the Commission's proposal recognizes the value of timely data, providing that block trade thresholds may be revised on an annual basis. Using the Commission's designated intervals, the 2010 swap data relied on in the Proposed Rules would have already been superseded twice by more contemporary transaction data reflective of current market conditions. The CFTC should strongly consider relying more directly on the trade execution platforms given their direct involvement in

⁹ Statement of Commissioner Scott D. O'Malia, Open Meeting of the Commodity Futures Trading Commission, available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/omaliastatement022312b>.

fostering liquidity. The CFTC should authorize SEFs, with CFTC supervision, to analyze ongoing swaps market trading activity and trade data to determine uniform thresholds that distinguish transactions that move markets from those that do not move markets.

Potential for Arbitrage between DCMs and SEFs

The WMBAA strongly encourages regulators to implement rules that are harmonized to the greatest extent possible, between jurisdictions, among domestic regulators, and for similarly-situated regulated entities. For that reason, the WMBAA urges the Commission to compare the Proposed Rules with that which has been proposed (and recently adopted) for DCMs. Under the Commission's Part 38 rules, DCMs that permit block trade transactions on futures contracts may fashion their own rules to limit block trades to "large transactions," and formulate and impose their own minimum size requirements for block trades, subject to certification or approval by the Commission.

The Commission, in the Proposed Rules, appears to be mindful of potential opportunities for regulatory arbitrage.¹⁰ Further, the Commission recognizes the economic equivalence between certain swaps and futures product and has discussed the possibility for regulatory burdens to provide incentive for regulatory arbitrage.¹¹ For these reasons, the CFTC should work to ensure that block trade regimes for swaps executed on SEFs and DCMs are as consistent as possible, and do not provide motivation, commercial or regulatory, to execute block trades on one type of trading platform over another. To do so would be antithetical to the competitive framework envisioned by Congress in the Dodd-Frank Act.

Relationship between Block Trades and Trade Execution

It is important to recognize at the outset that the block trade classification was expressly intended by Congress to only relate to post-trade reporting. Congress created a unique delayed trade dissemination regime for block trades, recognizing that delayed dissemination of certain large transactions would be necessary to ensure competitive and efficient markets.¹²

¹⁰ Proposed Rules at 15746 ("the Commission's goal to protect the price discovery function of the underlying equity cash market and futures market by ensuring that the Commission does not create an incentive to engage in regulatory arbitrage among the cash, swaps, and futures markets.")

¹¹ See Core Principles and Other Requirements for Designated Contact Markets, 75 Fed. Reg. 80572, 80588 ("The DCMs accept these trades as futures contracts by converting them, through their block trade or exchange-for-swaps (or other exchange of derivatives for a related position) rules, to economically equivalent futures contracts in order for them to be cleared by their derivatives clearing organization.")

¹² 156 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 an appropriate time delay in reporting such transaction to the public. 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

Pursuant to the CEA, the Commission is required to prescribe regulations specifying “the 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.”¹³ The Commission must take into account whether public disclosure of swap transaction and pricing data will “materially reduce market liquidity.”¹⁴ The Commission’s regulations must also provide for the protection of the identities of counterparties to mandatorily-cleared swaps, swaps excepted from the mandatory clearing requirement, and voluntarily-cleared swaps.¹⁵ Similarly, its regulations must maintain the anonymity of business transactions and market positions of the counterparties to an uncleared swap.¹⁶

As discussed in its letter dated May 1, 2012, the WMBAA strongly urges that the Commission to review the interplay between the Proposed Rules and the proposed rules related to the core principles and other requirements for swap execution facilities (“SEF Proposal”).¹⁷ Considering the combined impact of these proposals, the Commission risks artificially restricting the permitted methods of swaps execution, in direct conflict with the SEF definition as set forth in Section 1a(50) of the Commodity Exchange Act.¹⁸

As the Commission proceeds with these rules, it must heed Commissioner Bart Chilton’s warning to “be extremely cognizant that all of these swaps rules are an interdependent set. It is a grave error to look at each rule as free-standing—they are not. These swaps regulations—the SEF rule, the block trade rule, the reporting rules, for example—all have to work together, have to be perfectly balanced, in order for the markets to function and for consumers to be protected.”¹⁹

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.”)

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

¹⁴ *Id.* at § 2(a)(13)(E)(iv).

¹⁵ *Id.* at § 2(a)(13)(E)(i).

¹⁶ *Id.* at § 2(a)(13)(C)(iii).

¹⁷ *See* Core Principles and Other Requirements for Swap Execution Facilities, 76 Fed. Reg. 1,214 (January 7, 2011).

¹⁸ *See* CEA Section 1a(50) (“a trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that (A) facilitates the execution of swaps between persons; and (B) is not a designated contract market.”).

¹⁹ *See* Statement by Commissioner Bart Chilton, Open Meeting of the Commodity Futures Trading Commission, available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/chiltonstatement022312>; *see also* comments by Commissioner Mark Wetjen, Open Meeting of the Commodity Futures Trading Commission, available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfs submission/dfs submission4_022312-trans.pdf (“the Commission’s final block rules must address the interaction of the related SEF reporting and execution method rules.”).

Further, the WMBAA is strongly opposed to any change to the SEF regime which permits block trades, regardless of whether the contract is subject to the mandatory clearing requirement and “made available to trade,” to be exempt from SEF execution and transacted “off facility.”²⁰ In the preamble to the Proposed Rules, footnote 87 explains that

The Commission’s proposed SEF rulemaking, would require pre-trade transparency for swap transactions that: (1) are subject to the mandatory clearing requirement; (2) involves a swap that a SEF makes available to trade; and (3) are not block trades. . . This Further Proposal also would require SEFs to utilize the Commission’s rules for block trades (i.e., the subject matter of this Further Proposal) in determining the trading procedures that apply to swap transactions. Therefore, swap transactions exceeding an appropriate minimum block size would therefore be exempt from the mandatory trading requirements. (emphasis added)

The WMBAA is unaware of any authority in the CEA, or otherwise, that exempts block trades from SEF trading. Such an approach would be inconsistent with the statute, result in less trades being negotiated on regulated intermediaries, reduce the amount of pre-trade price transparency available to market participants, ultimately diminishing the number of swaps sufficiently liquid to be required to mandatorily cleared. This approach, and the negative consequences of it (which would only be amplified when applied to transactions of size), are inconsistent with the goals and plain meaning of Section 5h(e) of the CEA.

If the Commission exempts block trades from SEF execution, that would be inconsistent with the statute’s goals “to promote the trading of swaps on swap execution facilities and to promote pre-trade price transparency in the swaps market”²¹ and encourage market participants to transact in block trades so as to evade any pre-trade price transparency requirements and, instead, transact bilaterally through this Commission-created loophole. The CFTC must remain mindful that, as a practical matter, the trades to be mandatorily executed constitute only a subset of all market activity. That is, the trade execution requirement only applies to those swaps subject to the mandatory clearing requirement and are “made available to trade.”

²⁰ See Proposed Rules, 77 Fed. Reg. 15466 (“The Commission’s proposed SEF rulemaking would require pre-trade transparency for swap transactions that: (1) are subject to the mandatory clearing requirement; (2) involves a swap that a SEF makes available to trade; and (3) are not block trades. See proposed § 37.9(a)(2)(v), 76 Fed. Reg. 1,220. The Proposed Rules would require SEFs to apply the rules for block trades in determining the trading procedures that apply to swap transactions. Swap transactions exceeding an appropriate minimum block size would, therefore, be exempt from the mandatory trading requirements.” (emphasis added)).

²¹ CEA Section 5h(e).

Cost-Benefit Analysis for SEFs

The WMBAA believes that the Commission's cost-benefit analysis of the provisions in the Proposed Rules²² is overly simplistic and does not contemplate the actual efforts a SEF will have to undertake to implement the block trade regime, including the two-step notification process, the technology upgrades, providing training to existing personnel and updating written policies and procedures, among other necessary actions to comply with the CFTC's proposed rule.

The projected costs by the CFTC in its cost-benefit analysis are far from accurate. For example, estimating that the annual compliance, maintenance, and operate support would impose an incremental, recurring burden of approximately five personnel hours at an approximate cost of \$341.60 for each SEF simply ignores the internal costs incurred with respect to compliance officers, legal oversight, and other specialized input. While it is difficult to ascertain the actual cost for compliance with the Proposed Rules until after the systems have been created, implemented, and fine-tuned, the WMBAA strongly encourages the CFTC to reconsider its cost-benefit and provide more accurate projections with the input from companies that intend to operate SEFs.

Conclusion

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

Sincerely,



Christopher Ferreri
Chairman

²² In the Proposed Rules, the Commission requested comments on the analysis and conclusions reached in the ISDA discussion paper, titled "Costs and Benefits of Mandatory Electronic Execution Requirements for Interest Rate Products," which analyzed liquidity and transaction costs in the interest futures and options markets, in addition to a review of liquidity and transaction costs in the OTC derivatives market.