



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 Association of Institutional INVESTORS¹ (the “Association”) appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (“CFTC” or “Commission”) on the proposed rules related to the procedures used 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”).³ The Association continues to support the Commission’s efforts to regulate the derivatives market and to implement the transparency and oversight goals at the core of the Dodd-Frank Act.

I. Overview of the Association’s Concerns

As previously noted in our letter to the Commission dated June 2, 2011, the Association would like to ensure that the Commission sets the appropriate block size thresholds so that disclosure of trades does not negatively impact liquidity formation or make it excessively burdensome for market makers

¹ The Association of Institutional INVESTORS is an association of some of the oldest, largest, and most trusted investment advisers in the United States. Our clients are primarily institutional investment entities that serve the interests of individual investors through public and private pension plans, foundations, and registered investment companies. Collectively, our member firms manage ERISA pension, 401(k), mutual fund, and personal investments on behalf of more than 100 million American workers and retirees. Our clients rely on us to prudently manage participants’ retirements, savings, and investments. This reliance is built, in part, upon the fiduciary duty owed to these organizations and individuals. We recognize the significance of this role, and our comments are intended to reflect not just the concerns of the Association, but also the concerns of the companies, labor unions, municipalities, families, and individuals we ultimately serve.

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

³ See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, 124 Stat. 1376 (2010).

to offlay risk.⁴ We understand that, in promulgating regulations under Section 2(a)(13) of the Commodity Exchange Act (“CEA”), Section 2(a)(13)(E)(iv) directs the Commission to take into account whether public disclosure of swap transaction and pricing data will “materially reduce market liquidity.”⁵ However, despite noting, “many commenters argued that the potential effects of the large notional off-facility swap and block trade provisions would adversely affect market liquidity,” we believe the CFTC’s revised test under the Proposed Rules does not adequately consider these concerns and fails to appropriately modify the block trading threshold. We recognize that the CFTC must find an appropriate balance between setting the block levels too high, inadvertently impairing liquidity in favor of transparency, and setting the block trade levels too low, providing insufficient increases in transparency in the marketplace.⁶ While recognizing this is a difficult task, we believe that if the CFTC utilizes the 67 percent notional calculation required under the Proposed Rules, the CFTC will sacrifice liquidity for certain swap products and alter the proper functioning of the marketplace in the name of transparency.

In setting the block trading thresholds, the Association urges the Commission to consider the potential effects of not allowing certain trades to be considered block trades. If a trade has the ability to move the market, it must be considered eligible to be a block trade. Additionally, if publication of a trade’s details will cause “front running,” resulting in the inability of a party to the trade to hedge its position without experiencing significant price increases, the trade should be considered eligible to be a block trade. The Association is concerned that, if the block trading thresholds do not account for these situations, significant market inefficiencies will result that will negatively affect institutional investors. Further, as block trades are inherently large and specialized, it provides the market with very little benefit to require such trades to be reported in real time, as they do not serve as a good price indicator to other market participants. As noted by the New York Federal Reserve, “exceptionally low trading frequency, customized contract terms, and high degree of trade dispersion may limit the impact on price formation from the reporting of these trades.”⁷

These same potential effects suggest that certain swap transactions that trade sufficiently infrequently should receive block treatment at any size. The Association urges the Commission to consider permitting block treatment for any swap transaction that trades less than five times a day. Based on the criteria noted above, these infrequent trades are more likely to move the market, and

⁴ CFTC Public Comments, <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id44580&SearchText=investors> (contains the comment letter addressing comments to the CFTC Rule on Real-Time Public Reporting of Swap Transaction Data (75 Fed. Reg. 76,139 (Dec. 7, 2010) (“Initial Proposal”)) and other CFTC proposed rules).

⁵ Commodity Exchange Act, § 2(a)(13)(E)(iv).

⁶ See Statement by Commissioner Bart Chilton, Open Meeting of the Commodity Futures Trading Commission, available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/chiltonstatement022312> (stating, “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> (adding, “[t]his 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.”).

⁷ Staff Report No. 557, Federal Reserve Bank of New York, An Analysis of OTC Interest Rate Derivatives Transactions: Implications for Public Reporting, p. 21 (Mar. 2012).

public disclosure of price is more likely to lead to front-running, which allows market participants to anticipate a forthcoming hedge and profit off of such knowledge. Further, as these infrequent trades limit the impact on price formation from trade reporting, it does not significantly benefit the market to require such trades to be reported on a real time basis.

The Association commends the Commission for determining that an initial period is necessary to ensure that the proper data is available to set appropriate block trading sizes, but we worry that the thresholds the CFTC is setting during the initial period are far too high. We believe the CFTC should consider either removing block trading thresholds during the initial period or lowering the thresholds well below the levels set in the Proposed Rules to appropriately transition the market and avoid unnecessarily harming liquidity.⁸ As the Association advocated in its comment letter last June, we believe it would be proper to collect market data for one year prior to implementing any rulemakings related to block trades, including the real-time reporting requirements.⁹ Under the Proposed Rules, the block trading size thresholds will cause market inefficiencies, particularly when considering the market liquidity in certain asset classes. This will, in turn, increase costs to the American workers and retirees. By initially implementing lower block trade thresholds or removing the thresholds until complete data has been reported to the swap data repositories (“SDRs”), the CFTC will ensure that the Proposed Rules do not impede competitiveness and unnecessarily impair market liquidity.¹⁰

II. Block Trade Thresholds

Sections 2(a)(13)(E)(ii) and (iii) of the CEA require the Commission to prescribe regulations specifying “the criteria for determining what constitutes a large notional swap transaction for particular markets and contracts” and “the appropriate time delay for reporting large notional swap transactions to the public.”¹¹ Under the Proposed Rules, the Commission groups swaps into five

⁸ For an example of a market transparency system that was implemented slowly and carefully to ensure transparency goals were tempered by market liquidity needs, we urge the Commission to consider implementation of FINRA’s Trade Reporting and Compliance Engine (TRACE). TRACE was phased in over three years for the U.S. corporate, municipal, and agency bond markets. More Information on TRACE may be found at: <http://www.finra.org/Industry/Compliance/MarketTransparency/TRACE/CorporateBondData/>.

⁹ Association of Institutional INVESTORS, Comment Letter (June 2, 2011), *available at* <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=44580&SearchText=investors>.

¹⁰ Although the Association believes each of the asset classes would benefit from lower initial block trading thresholds or the removal of any threshold during the initial period, we are particularly concerned about the FX asset class and certain specialty swaps, where the Commission is attempting to set block trading thresholds without data. In particular, the Association urges the Commission to consider removing the block trading threshold during the initial period for the FX asset class and swaptions. We also urge the Commission to remove any block trading threshold for certain swaps not addressed by the proposal, including transactions that have an exchange for risk (“EFR”) component, which allows for simultaneous exchange of risk in a futures position for a corresponding or similar over-the-counter swap position, and “packaged trades,” or trades that recoupon existing positions into one analytically equivalent position. These swaps would particularly benefit from data collection prior to setting any block trading thresholds, as data would allow the Commission and the market to properly evaluate the market prior to determining where to set the block trading threshold.

¹¹ *See id.* at §§ 2(a)(13)(E)(ii) and (iii).

swap asset classes: interest rates, credit, equity, FX, and other commodities. Each asset class is then broken down further into separate swap categories for the purpose of determining appropriate minimum block sizes for such categories.

The Proposed Rules state that the Commission believes these asset classes and swap categories result in swaps grouped together by common risk and liquidity profiles.¹² The Association disagrees. We believe that the Commission's proposed categories often group liquid swap products together with products that are traded infrequently and fails to adequately account for the differences between various products. We are also concerned that the Commission's proposed notional amount calculation results in the reporting of too many transactions in real-time, ultimately hurting market liquidity and making it excessively burdensome for the market to adequately offlay risk.

The Commission must establish thresholds that allow larger participants, whose hedging policy might be dictated by regulatory compliance (*e.g.* banks or government sponsored enterprises), to trade without increasing market volatility. Execution over a swap execution facility ("SEF") or designated contract market ("DCM") alone brings transparency to the marketplace. However, unless this transparency is appropriately implemented, it can also bring market volatility, which will affect larger participants more than their smaller counterparts. Larger market participants must transfer risk when rebalancing portfolios after trades to stay within regulatory compliance. Broker-dealers play a vital role in the marketplace and for larger market participants, reducing this otherwise necessary risk transfer by acting as a trade intermediary.

The broker-dealer network absorbs the risk on its own balance sheet in exchange for a fee, called the "bid/ask spread." The commitment of the broker-dealer's balance sheet serves as a buffer to absorb risk temporarily while the broker-dealer redistributes the risk to other participants. This, in turn, allows the market participants to both meet their regulatory requirements and focus on their core business. The bid/ask spread earned by the broker-dealer allows the broker-dealer to cover the costs of unintended market movements while redistributing the risk. All else being equal, the more liquidity that exists (*i.e.* the more trading volume) within a market, the smaller the bid/ask spread because liquid markets allow the risk redistribution to take place quickly and minimize unintended market movement.

Currently, large trading blocks are not constrained by the consideration of market size. Broker-dealers have the ability to work through various channels to redistribute risk within twenty to thirty minutes. Part of the willingness on the part of a broker-dealer to commit balance sheet is dependent on the broker-dealer's ability to disguise the redistribution among other market flows. A large client cannot disguise a large trade through an exchange, but he can find a broker-dealer who is willing to spread that risk through his network over a period of time, and thus find the liquidity required to complete a large trade.

If the thresholds are not set correctly, such large trades will be inappropriately forced on to SEFs or DCMs. If an asset manager elects to break-up the large trade into smaller pieces to execute it electronically in a quieter fashion, the requirement that each trade must be shown to five dealers will

¹² See Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades, 77 Fed. Reg. at 15,467, fn. 95.

also place the asset manager in a position where he must show one large trade to five dealers, or show a series of smaller trades to five dealers each. In both cases, there will be an increased operational costs and risks as well as increased possibility of market volatility or moving the market.

The Association's specific concerns with the Commission's proposal are detailed below.

A. Interest Rate and Credit Asset Classes

1. Appropriate Notional Amount Calculation

Under the Proposed Rules, the Commission uses 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.¹³ This calculation ensures that within a swap category, approximately two-thirds of the sum total of all notional amounts is reported on a real-time basis, thus ascertaining that market participants have a timely view of a substantial portion of swap transactions and pricing data to determine competitive pricing for swaps within a relevant swap category.¹⁴

During the Open Meeting discussing the Proposed Rules, staff revealed that the Proposed Rules originally relied upon a 50 percent notional amount, but the Commission opted to change to a 67 percent notional amount calculation the evening prior to the Open Meeting. The Commission staff explained 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.¹⁵ According to the Commission, this enhanced price transparency would "encourage market participants to provide liquidity, particularly when transaction prices move away from the competitive price."¹⁶ The Commission also argues that this enhanced price transparency would improve market integrity and price discovery, while reducing information asymmetries "enjoyed by market makers in predominately opaque swap markets."¹⁷ The Proposed Rules request public comment on whether it should use a 50 percent notional amount calculation methodology (or other percentage) for determining the appropriate minimum block sizes for such asset classes.

¹³ See Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades, 77 Fed. Reg. at 15,517.

¹⁴ *Id.* at 15,480.

¹⁵ See Comments by Carl Kennedy, 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. ("KENNEDY: 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.").

¹⁶ See Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades, 77 Fed. Reg. at 15,480.

¹⁷ *Id.*

The Association disagrees with the Commission's analysis that the 67 percent notional amount calculation will "encourage market participants to provide liquidity." Rather, we argue that this high threshold will restrict liquidity because providing such extensive trade information and price disclosure immediately to the marketplace about large institutional trades will signal to other market participants that a hedge will soon follow. If it becomes more difficult to hedge such large positions, the provision of liquidity will be restricted, not encouraged. Therefore, the Association agrees with Commissioner Sommers' argument that this high threshold, "ignores Congress' mandate that [the Commission] take into account the impact of public disclosure on liquidity" and "effectively sacrific[es] liquidity at the altar of transparency."¹⁸

The Association suggests that the Commission set the block trading thresholds during the initial period conservatively low, and then once enough data is collected, reconsider what the appropriate threshold for each asset class should be. At this point, without market data, it is difficult to determine appropriate thresholds. Although we suggest the Commission should not use the notional amount calculation until additional data is collected, if the Commission were to later require notional amount calculations, we believe that the 50 percent notional amount calculation would be a substantial improvement over the 67 percent notional amount calculation.¹⁹ The 50 percent notional amount calculation would only require 86 percent of trades to be reported in real-time, rather than 94 percent, as would be the case under the 67 percent notional amount calculation.²⁰ Should the Commission continue with a test that essentially mirrors the result under the test proposed in the Initial Proposal, the Association respectfully suggests that the Commission has not fully considered the numerous comments submitted to the Initial Proposal noting liquidity concerns with block trading thresholds that would capture 95 percent of trades.

After the initial period, we also hope that the Commission will remain open to all alternatives for the actual block trading thresholds: data may show that even a 50 percent notional amount calculation will not work for the marketplace. Once the initial period has passed and the Commission has collected enough data to better understand each product, the Commission will be better able to determine what calculation would set the thresholds at an appropriate level.

2. Reliance on Recent Transaction Data to Establish Block Trade Thresholds

In order to determine the swap categories 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 and August

¹⁸ See Comments by Commissioner Jill Sommers, Open Meeting of the Commodity Futures Trading Commission (Feb. 23, 2012), available at <http://cftc.gov/PressRoom/SpeechesTestimony/sommersstatement022312>.

¹⁹ However, the Association notes that as stated above, even a 50 percent notional amount calculation would be inappropriate for truly illiquid swaps that trade less than five times per day.

²⁰ See Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades, 77 Fed. Reg. at 15,481.

2010, while the Warehouse Trust Company LLC provided the credit default swaps (“CDS”) data set covering transactions from May to July 2010.²¹

The Association commends the CFTC for reviewing non-public swap data in developing the block trade thresholds included in the Proposed Rules for interest rate and credit asset classes. However, while we believe the Commission is moving in the right direction by relying on market data, we do not believe the Commission’s collection and analysis efforts to date provide a sufficient basis on which to implement initial block trading thresholds. The Association agrees with Commissioner Sommers that the Proposed Rules are “relying on stale data, and far too little of it.”²²

The Commission’s data came from a pre-Dodd-Frank Act world, before major market changes, such as central clearing and mandatory trade execution, were implemented. This data is no longer reflective of the market the Association’s members operate in, nor is it reflective of the market that will result once the Commission’s regulations are implemented in full. As Commissioner O’Malia described it, relying on this pre-Dodd-Frank Act era data to determine thresholds for the five asset classes is “an apples-to-oranges comparison”²³ that is at best unhelpful in determining block trading sizes, and at worst could cause the thresholds to be set inappropriately high, negatively impacting the ability of our investors to operate in these markets.

Until the Commission has received sufficient, timely, and accurate swap transaction data for cleared and uncleared swaps, the Association urges the Commission not to rely on minimal and outdated data to set block trading thresholds, but rather simply set the block trading thresholds low. Current data that will soon be collected by SDRs will assist the CFTC in determining the appropriate threshold for each asset class’s block trading size, balancing the Proposed Rule’s transparency goals with the liquidity considerations required under the Dodd-Frank Act. As there is only a short amount of time from the potential release of a final rulemaking implementing the Proposed Rules until the Commission would be able to actually rely on 2012 transaction data, lower thresholds would serve the singular purpose of transitioning the market closer to the transparency goals without disrupting the core liquidity functions of the marketplace.

3. Swap Categories

Based on its review of such transaction records, the Commission proposes to define swap categories for: (1) interest rate swaps based on combinations of tenor and underlying currency; and (2) CDS based on combinations of tenor and conventional spreads. The Association does not believe the Commission’s proposed swap categories are sufficiently granular to account for the liquidity differences between different swap products that would be grouped together under the Proposed Rules.

²¹ *Id.* at 15,468.

²² Statement of Commissioner Jill E. Sommers, Open Meeting of the Commodity Futures Trading Commission (Feb. 23, 2012), available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/sommersstatement022312>.

²³ Statement of Commissioner Scott D. O’Malia, Open Meeting of the Commodity Futures Trading Commission (Feb. 23, 2012), available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/omaliastatement022312b>.

Different currency interest rate swaps should not be grouped together in the same swap category. USD and EUR single-currency fixed versus benchmark LIBOR interest rate swaps trade very differently from JPY and GBP interest rate swaps; the USD and EUR swaps are significantly more liquid. Grouping these four currencies together does not account for significant differences in trading volume and frequency between these currencies. Instead, the Association urges the Commission to consider each currency separately in determining block trading thresholds.

Additionally, while we support the use of tenor as a factor in determining interest rate swap block sizes, we urge the Commission to consider narrower tenor categories that better reflect the marketplace. In particular, we would support tenor categories divided as follows: 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 >30 years.

With regard to CDS products, the Association believes that each individual CDS index series should be grouped separately. Trading is highest for a CDS index series during the first six months, until a new version of the index series is released. The CFTC's groupings will result in grouping on the run (or the most liquid) with off the run (or the least liquid). In other words, by grouping together more than one CDS index series, the Commission will be automatically grouping together products with distinctly different levels of trading. The Association also supports narrowing the tenor categories for CDS products to better reflect the market.

Further, the Association suggests that the Commission reconsider using tranche levels in determining block trading sizes for CDS products. While we understand that separating CDS products based on tranche levels may produce more swap categories, we do not agree that this would impose unnecessary complexity on market participants. Rather, because we believe this is a logical way to separate out different CDS products, we suggest that the market would embrace and support the Commission's determination that granular swap categories for these products are necessary.

B. Equity Asset Class

1. Treatment of Swaps within the Equity Asset Class

Under the Proposed Rules, all swaps in the equity asset class would not qualify for treatment as a block trade or large notional off-facility swap (*i.e.*, these swaps would not be subject to a time delay under part 43). The Commission is proposing this approach based on: (1) the existence of a highly liquid underlying cash market; (2) the absence of time delays for reporting block trades in the underlying equity cash market; (3) the small relative size of the equity index swaps market relative to the futures, options and cash equity index markets; and (4) 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.

The Association disagrees with the Commission's proposal that all swaps in the equity asset class should not qualify for treatment as a block trade or large notional off-facility swap. Despite the underlying cash market, there is still a need for a block trading threshold to ensure liquidity remains within this marketplace. To better understand the potential harm that could be caused by disallowing block trades within the equity asset class, consider the London Stock Exchange's

(“LSE”) “big bang” market restructuring. In 1986, as part of sweeping reforms to the rules governing equity trading in London, the LSE introduced a trade reporting regime that required almost all trades to be reported within five minutes. Almost immediately, it was apparent that real-time information dissemination concerning large trades within the equities market negatively affected the market. This requirement provided other market participants with access to information about the trades, and also disclosed the potential offsetting positions or hedges that the market maker would take, raising the costs of hedging such positions and limiting those who were willing to play the market making role for investors. Market makers that would still make markets would then pass these costs back to asset managers and their customers, as the hedge prices are typically factored into the total price for the transaction.

Not all equity swaps trade alike, and less frequently traded equity swaps would be particularly affected by the Commission’s proposal to disqualify the entire equity asset class from treatment as a block trade or large notional off-facility swap. Investors and the market as a whole would be best served by a harmonization of the CFTC’s Proposed Rules with the Securities and Exchange Commission’s (“SEC”) approach for large equity trades. For example, under the SEC’s Proposed Rule titled, “Regulation of Non-Public Trading Interest,” the SEC proposes exemptions to the equities market transparency requirements for large transactions of \$200,000 or more.²⁴ In the proposal, the SEC notes that it “is sensitive to the need of investors executing large size trades to control the information flow concerning their transactions.”²⁵ The SEC adds that it, “preliminarily believes that the exception for large size trades strikes the appropriate balance between the need of investors executing large size trades to minimize significant information leakage and the right of the investing public to have this identifying post-trade information.”²⁶ The Association believes this approach better reflects and recognizes the need of large investors to control the public display of their trading interest.

2. Swap Categories

The Commission also proposes a single swap category for swaps in the equity asset class, given the nature of the underlying cash market. As noted above, the Association disagrees with grouping all equities swaps together, because not all equity swaps have the same or even similar liquidity characteristics. Rather, the Association urges the Commission to consider the liquidity of the underlying index. Equity swaps on some indexes, such as international indexes, do not trade as often as equity swaps on the S&P 500. Assuming the Commission reconsiders the need for block trading thresholds within the equity asset class, as the Association strongly suggests, it does not make logical sense for these swaps to be grouped together under a block trading threshold calculation.

The Association believes a high block trading threshold that utilizes similar block trade criteria to the criteria that applies to other asset classes for the equities asset class will work far better for the

²⁴ See Regulation of Non-Public Trading Interest, 74 Fed. Reg. 61,208, 61,238 (Nov. 23, 2009).

²⁵ *Id.* at 61,219.

²⁶ *Id.*

market than simply disqualifying all equities swaps from treatment as block trades or large notional off-facility swaps. Certain equities are traded frequently, and the Association agrees that the Commission may justifiably set the block trading threshold higher for certain equity swaps than for swaps in other asset classes, assuming a rational block trading threshold is in place. Despite any potential differences in the equity asset class, dealers must still be able to execute institutional investors' large trades without taking on unmanageable levels of risk. If not, regardless of the existence of a highly liquid underlying cash market, liquidity may still be impaired for our clients and the market for large customized contracts will be far more inefficient.

III. Block Trade Implementation Procedures

A. Commission Determination of Block Trade Sizes

Under the Proposed Rules, the Commission would determine the appropriate minimum block size for any swap listed on a SEF or DCM, and for large notional off-facility swaps. The Commission notes, however, that the Proposed Rules do not prohibit SEFs or DCMs from establishing block sizes for swaps at higher levels than the appropriate minimum block sizes determined by the Commission.

The Association does not believe SEFs or DCMs should have the ability to set block sizes for swaps at higher levels than the appropriate minimum block sizes determined by the Commission. When executing block trades, asset managers' ultimate exposure rests with the clearing agent, not the SEF or DCM. The SEF or DCM is merely acting as a trade intermediary or pass through agent facilitating the trade. SEFs, in particular, have interests that may not always be aligned with the buy-side firm trading on behalf of client accounts. Further, SEFs may not be properly incentivized to ensure that market disruption remains at a minimal level. Given the CFTC's current efforts to set block trading thresholds at appropriate levels, there does not appear to be any reason for SEFs or DCMs to have the ability to set block sizes for swaps at higher levels than the appropriate minimum block sizes determined by the Commission.

B. Publication and Timing of Post-Initial Appropriate Minimum Block Sizes

According to the Proposed Rules, the Commission would publish the post-initial appropriate minimum block sizes on its website and such sizes would become effective two months after the publication date. The Commission will use a three-year rolling window (beginning with a minimum of one year and adding one year of data for each calculation until a total of three years of data is accumulated) of swap transaction and pricing data corresponding to each relevant swap category recalculated no less than once each calendar year.²⁷ The Commission would publish updated post-initial appropriate minimum block sizes at least every calendar year.

The Association supports the Commission's proposal that it would publish the appropriate post-initial block trading sizes on its website. As the Association is proposing that the Commission

²⁷ See Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades, 77 Fed. Reg. at 15,516.

divide each asset class into additional swap categories, continual publishing on a website would provide the public with adequate means to confirm the appropriate block trading size.

However, the Association encourages the Commission to consider updating the block trading sizes on a more frequent basis than the proposed once per calendar year. Unlike the futures market, trade volumes for some swap categories significantly fluctuate from month-to-month. The evolving nature of the market requires that the Commission review the liquidity of various products on a more frequent basis to capture changes that result in different swaps trading in larger sizes. We recommend that the Commission consider reevaluating block trading thresholds quarterly, or at a minimum, semi-annually.

Additionally, the Association suggests that the Commission consider using a shorter time span of data for determining block trading sizes. The Proposed Rules' provisions that employ a three-year rolling window of data will not accurately reflect the marketplace, which for many swaps products changes rapidly and drastically. For example, as noted above, a new series of CDS indexes is typically selected every six months, changing the liquidity of CDS products. The Association believes it would be more prudent for the Commission to base block trading thresholds on a shorter time frame, using newer data. Therefore, the Commission should only use the highest of the three year, one year, or one quarter data collected in the determinations.

IV. Anonymity Protections for the Public Dissemination of Swap Transaction and Pricing Data

The Proposed Rule also includes provisions to protect the identities of counterparties and to maintain the anonymity of business transactions and market positions in connection with the dissemination of publicly reportable swap transactions. In particular, the Commission proposes to establish "cap sizes" for notional and principal amounts that would mask the total size of a swap transaction if it equals or exceeds the appropriate minimum block size for a given swap category. For example, if a block size for a category of interest rate swaps was \$1 billion, the cap size was \$1.5 billion, and the notional value of the transaction was \$2 billion, then the swap would be publicly reported with a delay and with a notional value of \$1.5+ billion.

Under the Proposed Rules, the Commission would establish both initial and post-initial cap sizes for each swap category within the five asset classes. During the initial period, the cap size would be the greater of the interim cap size set forth in existing CFTC regulations or the appropriate minimum block size for the respective swap category. For the post-initial period, the Commission proposes to use a 75 percent notional amount calculation methodology to determine the appropriate post-initial cap sizes for all swap categories.

The Association believes that protecting the identity of swap market participants is essential to reducing the trading costs for our investors. We agree with the Commission that the publication of detailed information about large trades may alert the market to the possibility that the original liquidity provider will be reentering the market to offset that transaction. As other market participants will then have the ability to exact a premium from the liquidity provider, it is possible that liquidity providers will be deterred from becoming counterparties to such large transactions if the transaction and pricing data is publicly disseminated.

However, we do not agree with the Commission that it is appropriate to set the cap sizes higher than the block trading threshold. Using a 75 percent notional amount calculation methodology to determine the appropriate post-initial cap sizes for all swap categories is far too high, negating the benefits of masking the total size of a swap transaction. To this end, the Association would support setting the post-initial cap size for each swap category at the same level as the block size threshold. Further, during the initial period, the Association believes the cap size should be set at a level equal to the lower of the initial block size (as amended by the Association's recommendations) or the interim cap size provided in Section 43.4(h)(1). Presumably, if the Commission considers the Association's liquidity concerns with the initial block sizes under the Proposed Rules and lowers the block trading thresholds during the initial period, such lowered block sizes would also serve as the cap sizes during the initial period.

V. Conclusion

The Association recognizes the challenges the CFTC faces in striking the difficult balance required by this rulemaking and appreciates the Commission's consideration of our concerns. Please feel free to contact me with any questions you may have on our comments at jgidman@loomissayles.com or (617) 748-1748.

On behalf of the Association of Institutional INVESTORS,



John R. Gidman
Association President

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