



February 7, 2011

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street NW
Washington, DC 20581

Re: Proposed Rules – Real-Time Reporting of Swap Transaction Data
(RIN 3038-AD08)

Dear Mr. Stawick:

Better Markets, Inc.¹ appreciates the opportunity to comment on the above-captioned proposed rules (“Proposed Rules”) of the Commodity Futures Trading Commission (“Commission”). The Proposed Rules implement a new framework for the real-time public reporting of swap transaction and pricing data for all swap transactions, in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”).

Introduction and Summary of Comments

At the core of the financial crisis was a shadow market where inter-connected financial institutions and their commercial clients took on enormous risks subject to little, if any, transparency, knowledge or oversight by regulators or other market participants. If those institutions and their clients suffered the trillion dollar losses from such unseen reckless financial activities, then it would be of little public concern. But, as is too well known, the American public got stuck with the bill for that irresponsible conduct and they’ll be paying that bill for many, many years to come.

To prevent that from ever happening again, a central purpose of the Dodd-Frank Act is to bring transparency, accountability and oversight to the large and complex derivatives market that was at the core of the shadow market. To fulfill this purpose, implementing regulations must clear several hurdles:

- Information on all transactions must be available to market participants, regulators, and the public as a whole; the reporting responsibility must extend to transactions which appear to be complex, but which are actually just a bundle of simpler

¹ Better Markets, Inc. is a nonprofit organization that promotes the public interest in the capital and commodity markets, including in particular the rulemaking process associated with the Dodd-Frank Act.

transactions that can be disaggregated and disclosed separately. Market participants must not be permitted to continue the shadow market through so-called “bespoke” or “customized” transactions that, in reality, can very easily be reported and disseminated.

- The data collected must be made available in a form that is meaningful to market participants as well as regulators. Dissemination of this mass of data is not merely a hurdle required by the Dodd-Frank Act to be overcome mechanically. It must be accomplished in the context of a fast-moving and defined marketplace. Making the data available is not enough; the form of the data and its mode of delivery must result in transparency and price discovery *within the practical realities of the trading environment*.
- Block trades, which present a difficult trade-off between transparency and market liquidity, must be addressed by limiting delays in disclosure to periods absolutely necessary, given the real market requirements for these transactions, and limiting availability of the delays to legitimately large transactions. Furthermore, the procedures to accommodate block trades must address the distinctions between prices for block trades and prices for other transactions in the market. Price reporting must take this basic difference into account.
- Rules setting requirements for rapid reporting, completeness of data and other elements of real-time reporting must focus on the actual functions of trading firms and individual traders, so that standards are neither unrealistically onerous nor so broadly drafted that evasion is invited.

The Proposed Rules go a long way toward satisfying these criteria, but for the reporting regime to be effective, the Proposed Rules must also:

1. require the dissemination of aggregated data in a format and mode that are more useful to both market participants and regulators;
2. require the price data point for block trades to reflect market price, exclusive of a charge for the risk of market illiquidity;
3. eliminate or shorten the delay applicable to dissemination of block trade information;
4. specify the data sets used in applying the required methodology for calculating the size thresholds applicable to block trades;
5. require reporting of additional information on certain types of swaps; and
6. clarify the time limits within which data must be reported to the swap data repositories (“SDRs”).

Above all, the Commission **must** set a uniform standard for data collection and dissemination. If the CFTC does not set a standard and insist on it, then a critical component

of the entire infrastructure will be effectively outsourced and, much worse, left to chance. Only a clear, specific, and uniform regulatory mandate will avoid likely information anarchy, one that could result in an information Tower of Babel: lots of quantity but very little quality in terms of usability in today's marketplace. This will defeat the key components of reform as well as a central purpose of the Dodd-Frank Act. That must be avoided, which means that the CFTC must set a uniform standard for data collection and dissemination.

The Proposed Rules also raise a different type of issue, related to matters addressed in other rulemakings such as core principles, conflicts of interest and registration standards. They include fairness standards for volume discounts provided by SDRs. The central concept of the service provided by SDRs is inconsistent with the use of volume discounts. SDRs must have a role of a utility or common carrier. Volume discounts must be forbidden rather than simply be structured to be fairly available.

Discussion of Proposed Rules

Dissemination of Data

The Proposed Rules must be amended to ensure that the data collected by the individual SDRs are aggregated and disseminated in a form that is genuinely useful to traders and regulators alike. Only then can it serve its intended purposes under the Dodd-Frank Act: fair and transparent markets, price discovery and regulatory oversight. This is undoubtedly true wherever multiple SDRs collect data relating to a single asset class, and it is also true across asset classes.

The Proposed Rules provide insufficient guidance regarding the dissemination of data to the public, and none regarding the distribution of data to regulators. The Proposed Rules provide as follows:

Swap transaction information shall be reported to a real-time disseminator so that the real-time disseminator can publically disseminate swap transaction and pricing data in real time in accordance with this part, including in the manner and format requirements described in Appendix A to this part 43 and this section.²

The Proposed Rules appropriately address in detail various issues relating to timing and content in relation to the data that is to be transmitted to a real-time disseminator. Upon receipt by a disseminator, it is clear that dissemination is to occur in real-time. However, the Proposed Rules are much less detailed and clear regarding the actual dissemination of the data to the public.

Public dissemination and publically disseminate means to publish and make available swap transaction and pricing data in a non-discriminatory manner, through the Internet or other

² Proposed Rules, Section 43.4.

electronic data feed that is widely published and in machine-readable electronic format.³

Registered swap data repositories shall publicly disseminate swap transaction and pricing data in such a format that may be downloaded, saved and/or analyzed.⁴

This approach is far too passive and will not result in achieving the purpose of the law. The optimal approach is to require a single data format that would maximize fast, efficient, and cost-effective access to the information by the greatest number of users. To achieve price discovery in any meaningful sense of the term, the data must be disseminated by delivery to market participants in a format that individual traders will actually use in their daily activities.

Requiring only an ability to download permits a system which severely limits the usefulness of the data for price discovery, ***the very standard which the Dodd-Frank Act employs in articulating the Commission's authority regarding dissemination.***⁵ Instead, the data must be made available to traders in a format they understand and in a mode that:

- allows them to view it in near-real time;
- fits onto the limited space on their trading screens; and
- allows multiple markets to be viewed simultaneously, including security based and non-security based swap markets that are related.

The success of companies like Bloomberg is instructive: *how* the data is delivered is at least as important as *how much* data is available.

Moreover, the Proposed Rules also fail to incorporate critically important aggregation requirements. In two roundtables regarding real-time dissemination of data, the need for aggregation of across-trading venues and products has been made by numerous participants, and has been a consensus judgment of the participants.⁶ This is no wonder given the way markets and traders operate. Yet, the Proposed Rules are silent on this critical issue.

It may be that the Commission is concerned that a central processor of information might take more time to implement. However, this is not a satisfactory or sufficient justification for the fragmented approach to data dissemination adopted in the Proposed Rules.

³ Proposed Rules, Section 43.2(r).

⁴ Proposed Rules, Section 43.3(e).

⁵ Commodity Exchange Act, Section (2)(a)(13)(B).

⁶ CFTC Public Roundtable, September 14, 2010, Swap Data, Swap Data Reporting and Real Time Reporting; CFTC Roundtable, January 28, 2011, Swap Data Recordkeeping and Reporting.

If establishment of a central aggregator takes more time than a system that does not meet the requirements of the Dodd-Frank Act, it must be required nonetheless. Data from multiple SDR sources must be integrated so that it makes sense as a whole. Often, individual traders will need to review and analyze data from several markets and across multiple asset classes. Without this functionality, any regime for data collection and dissemination cannot achieve the goals of transparency and regulatory oversight envisioned under the Dodd-Frank Act.

The ideal approach would be collaboration by the SEC and the Commission to create (or facilitate and direct the creation of) a single, central system that performs these data dissemination functions. This may emerge if private sector entities step forward to organize and transmit the trade data as a business line. But a passive role by the regulators leaves the ultimate attainment of real-time trade data dissemination to chance.

In a world of restricted resources, competing priorities, and exaggerated claims of burden, the appeal of a passive approach is obvious. However, it simply cannot be denied that a core regulatory mission under the Dodd-Frank Act is to ensure the dissemination of swap transaction and pricing data in a form that is useful in the actual, functioning marketplace.

The Commission expresses concern about its authority to establish a “real-time reporting consolidator” and requests comments on methodologies.⁷ Given that such a “consolidator” is the lynchpin of so much of what is required in the Dodd-Frank Act and so essential to the success of the Act, there can be little genuine doubt that the Commission has ample authority to establish a “real-time reporting consolidator.”

However, as important, the Commission must recognize and understand that the ultimate consolidator is the Commission itself. All data will be made available to it.

The Commission should consider engaging the services of an entity that could aggregate and consolidate the data received and create a format and dissemination system that is truly useful. In exchange for fees paid by data recipients, which are reasonable and approved by the Commission, this entity could make the data available in this consolidated form to market participants in a format designed to serve the purpose of price discovery. This would not displace the potential for specialized data disseminators as contemplated by the Commission.⁸ However, it might result in a superior system of dissemination for a broad range of market participants interested in multiple markets.

If the Commission does not take such action in connection with the Proposed Rules, then the Commission should seek public input on this option and give it serious consideration and deliberation.

⁷ Release, page 76149.

⁸ Release, page 76152.

Price Data Point

The Proposed Rule requires that price be an element of the data which is reported.¹⁰ The price associated with either a block or large notional swap transaction is based on market price plus a value paid for the risk associated with market price change during the period the position is hedged or disposed of.

The market price and this charge based on market liquidity and volatility should be separately reported. This will add materially to price transparency. Market participants wishing to enter into block or large notional transactions should be able to obtain the information necessary to discover the pricing of this service.

Reporting of Block Trade Data

The Commission should also reconsider its decision to embargo the notional value of each block trade. While the Dodd-Frank Act requires the Commission to promulgate a rule specifying an appropriate time delay for publicly reporting block trades, **no compelling economic justification currently exists** for delaying the immediate public dissemination of any data regarding block trades. Thus, any delay in the dissemination of block trade data should be the minimum duration needed to accomplish the claimed purpose of a delay. This duration is certainly far shorter than the time frames set forth in the Proposed Rules.

A block trade allows a customer to sell or acquire a large swap position at a negotiated price through a dealer who intermediates between the customer and the market. The customer pays a premium over current prices for this intermediation. The customer could sell or acquire the swap position in increments over time, but wishes to have the entire position priced at once.

Those who favor the block trade rule argue that if all data relating to a block trade is shared with the market in real time, then other market participants, recognizing the dealer's urgent need to hedge, would extract value from the dealer in the form of a higher price. Under these conditions, it is claimed, the dealer would be less willing to accommodate the customer by executing the block trade and market liquidity would suffer.

The fact is that delay in dissemination of data for block and large notional trades reduces transparency for the rest of the market. The Release¹¹ acknowledges that there is no authoritative study validating the notion that market liquidity would be adversely affected if block trade data were fully disclosed. As a result, any information embargo should be eliminated. While this could result in cost to the customer wishing to execute the block trade because he or she is exposed for a period of time to market price movements, this is actually an equitable result.

However, if a delay is permitted in spite of there being no basis for it, then the period of the embargo must be directly related to the market in which the block or large notional trade is

¹⁰ Proposed Rules, Appendix A, Table A-1.

¹¹ CFTC Notice of Proposed Rulemaking, 75 FR 76140 (the "Release").

being executed. This would have to be directly related to the liquidity of the particular market. The Commission acknowledges that the nature of the underlying asset is a major factor. For financial swaps based on equity, currency, interest rates and credit, 15 minutes is much too long a period for an embargo. In many of these markets, high frequency trading powers transaction strategies that can be implemented in tiny fractions of a second. Hedging strategies will most likely be in place well before the block or large notional swap is executed. Taking these market realities into account, the embargo should not exceed one minute for financial swaps.

Setting Block Trade Thresholds

The Proposed Rules establish sensible methodological approaches to calculating thresholds, the distribution test and the multiple test.¹² However, two important factors are not sufficiently addressed: the trade data set which is required to be used in the tests and the periods for recalculation.

First, the tests must be based on at least one year of trade data. This will eliminate seasonality issues related to certain asset classes (energy and agriculture, in particular), while still requiring that current market behavior be measured.

Second, the calculations must be refreshed quite often. The algorithms are relatively simple. The only constraint is that the market should have some stability relating to the thresholds. Weekly recalculations of thresholds are appropriate, going into effect at the commencement of business on the first business day of each week.

The Proposed Rules should be amended to provide clearly that the Commission, rather than the SDRs, swap execution facilities (“SEFs”) and designated contract markets (“DCMs”) will establish block trade and large notional swap thresholds. Both the Release and the Proposed Rules indicate that SDRs, SEFs and DCMs will be responsible for calculating and publicizing block trade thresholds and administering trading in accordance with criteria specified by the Commission.¹³

However, the market structure envisioned by the Dodd-Frank Act permits multiple SDRs, SEFs and DCMs. The calculation of thresholds required by the Proposed Rules requires applications of relatively straightforward algorithms to wide ranges of market data, conceivably across these entities. While the idea of delegating the duty to registered entities is superficially appealing, the need to establish structures which contemplate multiple SDRs, for example, creates complications which outweigh the benefit of delegation.

This confusion must be resolved to ensure that either the Commission or an aggregator, rather than a multiplicity of SDRs, SEFs and DCMs, will establish the thresholds for block trades. Only this approach will promote consistency and ensure that the business interests of the SDR, SEF or DCM in no way influence the selection of threshold levels.

¹² Proposed Rules, Section 4.5(g).

¹³ Release at page 76160-1; Proposed Rule Section 43.5.

More Information about Collateral and Security

The Proposed Rules must establish a requirement for information related to un-cleared swaps. The SDRs must be required to establish libraries for Master Swap Agreements and related Credit Support Annexes. These documents govern the terms and conditions related to swap transactions between counterparties and are essential to understanding risk relationships, including collateral and margin. That information will be indispensable for risk assessment and other purposes.

Typically, counterparties enter Master Swap Agreements and Credit Support Annexes covering all swaps between them. Risk is calculated on an aggregate basis and funding thresholds are established based on aggregate risk. Although the Commission will have the authority to obtain copies of the agreements embodying these arrangements, that process will be cumbersome and time-consuming. Unless the parties are affirmatively required to report the core data elements reflecting collateral arrangements, oversight of the markets will be impaired. Accordingly, the Proposed Rules should require the reporting of **at least** the following information:

- the parties;
- the thresholds for forbearance of posted collateral applicable to each party;
- the “triggers” applicable to each party that require immediate funding (termination of forbearance); and
- the methodology for measuring counterparty credit risk.

A record of posting triggers and a monitoring regime that detects events (most often credit rating downgrades) that trigger immediate posting obligations, is essential to prepare for potential market disruptions. History has shown repeatedly that entities involved in trading most often fail as a result of massive required collateral postings resulting from triggers. Even if the practice cannot be eliminated under the Dodd-Frank Act, it can be monitored, but to be monitored it must be reported.

When each swap is entered into, the data sent to the SDR should include a cross reference to the library site where the documents can be found or a statement that no filing in the library has been made.

Time Limits for Reporting Data

The Proposed Rules approach the time for reporting data based on the standard “as soon as technologically practicable.”¹⁴ The Commission correctly observes the following:

[T]his term may have different interpretations for different parties to a swap.... Cost, access to the latest technology and other factors may

¹⁴ Proposed Rule, Section 43.2(d).

prevent some of the fastest, most efficient technology from being available to all market participants.¹⁵

While this is undoubtedly true, in virtually all cases technological practicability relates to the processes between the moment a swap is affirmed and executed and the time that the data is introduced into the electronic records of the market participant. These processes fall into a limited number of categories. But, once the data is recorded in an electronic system, the transmission **must** be instantaneous.

The Commission should provide examples of processes used by market participants prior to recordation of data in an electronic system and describe time frames that are acceptable. The Proposed Rule must then make clear that, once the data is recorded in such an electronic system, transmission must be instantaneous.

The Release raises the question of whether there should be a maximum time frame allowed during which reporting parties must report to an SDR notwithstanding the standard “as soon as technologically practicable.”¹⁶ The answer has to be “yes.” Failing to do so has the unfortunate result of imposing standards related to electronic systems which operate at time differentials measured in fractions of seconds, but remaining silent with respect to less automated steps in the processes of certain market participants. Therefore, a standard of “as soon as technologically practicable, but in no event longer than 5 minutes” is appropriate.

Volume Discounts

The Proposed Rules include a provision which is more closely related to issues raised in other rulemakings, such as those dealing with core principles, conflicts of interest and registration standards. The Proposed Rules prohibit SDRs from paying data volume discounts to reporting entities and swap markets unless such discounts are available to all reporting entities and swap markets.¹⁷ Fairness is a sound standard and this rule achieves it.

However, there is no justification for volume discounts for any swap markets or reporting entities. It is clear from all of the information developed at the roundtables associated with real-time data issues that the conduit for information flows is best thought of as either a non-profit or regulated utility-type enterprise. This business should be in the nature of a common carrier. Volume discounts, or special discounts of any kind, suggest a highly competitive, profit-oriented approach to this function. This is neither desirable nor appropriate and will undermine several key benefits of reform.

For example, volume discounts are obvious mechanisms for establishing relationships between SDRs and oligopolies of large dealers. It is antithetical to the market structures envisioned by the Dodd-Frank Act. ***No volume discounts can be permitted within the context of Dodd-Frank if its purposes are to be achieved.***

¹⁵ Release, page 76143.

¹⁶ Release, page 76146.

¹⁷ Proposed Rule, Section 43(j).

Conclusion

Fast, complete, and easily accessible data flow is critically important to price transparency, efficiency and regulatory oversight in the swap markets. These are the lynchpins of the Dodd Frank Act. The success of the many reforms embodied in that law will rise or fall on getting this right.

We commend the Commission for its Proposed Rules in this area, and we hope that our comments will assist the Commission as it finalizes its regulation.

Sincerely,



Dennis M. Kelleher
President & CEO

Wallace C. Turbeville
Derivatives Specialist

Better Markets, Inc.
Suite 1080
1825 K Street, N.W.
Washington, D.C. 20006
(202) 618-6464
dkelleher@bettermarkets.com
wturbeville@bettermarkets.com

www.bettermarkets.com