



January 18, 2011

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Proposed Regulation SBSR – Reporting and Dissemination of Security-based Swap Information (File Number S7-34-10)

Dear Ms. Murphy:

Better Markets, Inc.¹ appreciates the opportunity to comment on the above-captioned proposed rules (“Proposed Rules”) of the Securities and Exchange Commission (“Commission”). The Proposed Rules establish requirements for reporting, collecting, and disseminating information about security-based swap (“SBS”) 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 financial institutions and their commercial clients took on enormous risks subject to little, if any, transparency, knowledge, or scrutiny from regulators or other market participants. As a result, a central purpose of the Dodd-Frank Act is to bring transparency to the large and complex derivatives 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 composites of simpler transactions that can be disaggregated and disclosed separately. Market participants must not be permitted to

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.

continue the shadow market through “bespoke” or “customized” transactions that in reality can be reported and disseminated to increase transparency.

- 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 represent a 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.
- 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) shorten the delay applicable to the release of block trade information;
- (3) adopt a more appropriate methodology for calculating the size thresholds applicable to block trades;
- (4) require reporting of additional information on certain types of SBS;
- (5) shorten the time limits within which data must be reported to the SBS data repositories (“SDRs”); and
- (6) provide guidance to parties who must allocate the responsibility for reporting SBS transactions.

Above all, the Commission must set a uniform standard for data collection and dissemination. Without setting a standard and insisting on it, then a critical component of the entire infrastructure is effectively being outsourced and, worse, left to chance. Only a clear, specific, and uniform regulatory mandate will avoid potential 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 must be avoided.

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: 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 very little guidance regarding the dissemination of data to the public, and none regarding the distribution of data to regulators. Rule 902(a) simply provides that an SDR must “publicly disseminate a transaction report . . . immediately upon receipt of information about the Swap” The timing standard (“immediately”) is certainly appropriate, but the rule is silent on the critical issues of data format and aggregation.

In the Federal Register Release (“Release”) accompanying the Proposed Rules, the Commission acknowledges the potential value in “dictat[ing] the exact format and mode of providing required SBS transactions to the public,” observing that it would promote consistency. Release at 75227. The Release explains, however, that in the Commission’s view, such an approach “could inhibit innovation and the development of best practices.” *Id.*

We strongly disagree. 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. For this to occur, 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.

The Proposed Rules also fail to incorporate critically important aggregation requirements. In the Release, the Commission recognizes the importance of minimizing the number of collection points for SBS data, so that participants can obtain a “comprehensive view of the market” without having to collect data feeds from multiples “venues.” Release at 75227. In light of these concerns, the Commission invited comment on the possibility of establishing “central processors” that would collect data from multiple SDRs and provide a consolidated data feed.

Id. The Commission should establish such a system, which will provide all market participants, members of the public, and regulators with a central source for SBS data collected by all SDRs.

The reasons offered by the Commission for rejecting this approach are unconvincing. The Release states that a central processor of information might “take more time to implement.” This is not a satisfactory justification for the fragmented approach to data dissemination adopted in the Proposed Rules. 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.

The Release also suggests that an aggregator “may not be required given the present SBS market structure.” We disagree with this observation as well. 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 CFTC 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 and competing priorities, we understand the appeal of a passive approach. However, we believe emphatically that a core regulatory mission under the Dodd-Frank Act is to ensure the dissemination of SBS transaction data in a form that is useful in the actual, functioning marketplace.

Format for Data Reported to SDRs.

The Proposed Rules also must be clarified to ensure that formats used for reporting data to the SDRs are uniform. The Release correctly observes that use of a uniform electronic reporting format is “essential.” Release at 75222. It goes on to state that Proposed Rules 901(h) and 907(a)(2) “together mandate the use of a uniform reporting format for SBS information reported to a particular registered SDR.” *Id.* As written, however, those two rules appear to allow SDRs to specify multiple formats and connectivity requirements for the submission of data. Clarification on this point is important to ensure that the Commission’s intent is accurately reflected in the rules.

Reporting of Block Trade Data.

We also urge the Commission to reconsider its decision to embargo the notional value of each block trade for an extended period. Proposed Rule 902(b) provides that the notional value of each block trade must be withheld from the marketplace for up to 26 hours, depending on when the block trade was executed. 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 Release acknowledges that there is no authoritative study validating the notion that market liquidity would be adversely affected if block trade data were fully disclosed. Ironically, under the Proposed Rules, the price for a block trade is to be disclosed even though, as acknowledged by the Release, the price is virtually useless to the market: it includes an unspecified liquidity premium (*i.e.*, the dealer's fee for intermediation). Price is useful only as a possible tool for market participants to infer the size of the notional quantity (by using market prices to infer a premium and then estimating the quantity that might be associated with that premium).

Other practical considerations suggest that the reporting delay is far too long. In reality, dealers will be able to hedge block trades effectively and without significant price distortion in much shorter periods than those specified in the Proposed Rules. The approach taken by the Commodity Futures Trading Commission ("CFTC") in its own block trade proposal supports this view: they would require only a 15-minute delay on release of block trade data.

In addition, an extended delay in block trade disclosure is actually less important in the SBS market than it might be in other contexts. Security-based swaps generally address longer-term risks. Short-term risk hedging of the underlying security, to cover a period in which the SBS market can absorb the block trade, is often available to the dealer and the customer.

The Proposed Rules recognize that the concept of delayed reporting of a block trade is simply not appropriate for an equity total return swap, which is a synthetic substitute for a position in the underlying equity. *See* Proposed Rule 907(b)(2). A party can always hedge the underlying security pending completion of the synthetic equivalent transaction. However, the same rationale applies broadly to SBS. The swap and the underlying security do not have to be financially interchangeable in all respects for the dealer or customer to hedge the price risk of a block trade reasonably effectively. Large and liquid markets exist to enable timely and efficient hedging of SBS by hedging the underlying security over short periods of time. In nonsecurity-based swap markets, parties routinely hedge with nearest listed equivalent contracts and, under the CFTC's proposed rules, they are to be reported as the swap and the nearest listed equivalent in the aggregate. In cases where a hedge cannot easily be found, this is likely to be a function of conditions endogenous to the market in which the hedging takes place, rather than any liquidity

impact caused by the reporting of a block trade.

Given those market conditions, a 15-minute delay in reporting notional value would be more than ample. Indeed, a trader who took considerably longer than 15 minutes to hedge an open SBS position would raise serious questions as to the original motivation for entering into the swap. This is particularly pertinent for desks subject to Volcker Rule prohibitions on proprietary trading activities, but also applies to any institution incorporating sound risk management practices.

Setting Block Trade Thresholds.

The Proposed Rules should be amended to provide clearly that the Commission, rather than the SDRs, will establish block trade thresholds. Both the Release and the Proposed Rules indicate that SDRs will be responsible for calculating and publicizing block trade thresholds in accordance with criteria specified by the Commission. Release at 75228; Proposed Rule 907(b). On the other hand, the Release states that the *Commission* “intends to propose specific block trade thresholds simultaneous with the adoption of Regulation SBSR” Release at 75228.

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

The formula for setting the thresholds should also be improved. The Proposed Rules appear to favor a test based on a distribution of historic transaction sizes. Under this view, block trade size thresholds would be established at a size greater than some percentage (*e.g.*, 95%) of historically large transaction sizes.

This methodology can, however, yield inappropriate results. For example, if all transactions were historically about the same size, the threshold might be unnecessarily low even in a liquid and frequently traded market. An alternative approach is one based on the larger of the mean, median, and mode transaction size in the data base, multiplied by a factor (for example, a factor of 5 is appropriate for a market in which swap sizes are consistent). We propose that the Commission adopt a formula that sets the threshold for a block trade as the higher of the results of these two tests.

More Information About SBS Transactions That Do Not Reflect the Market.

Proposed Rule 901(c)(11) requires parties to report, where applicable, an “indication that the transaction does not accurately reflect the market.” The rule should also require disclosure of the specific reasons *why* an SBS does not accurately reflect the market. Without this information, neither market participants nor regulators can fully understand the significance of the SBS prices that are being reported, and the price discovery function intended under Dodd-Frank will be impaired.

As noted in the Release, specific circumstances that might distort a reported price include late reporting or reporting of a transaction that was not the product of an arms length negotiation. Release at 75214-15. The Proposed Rules should require disclosure of these and any other circumstances that prevent the transaction from accurately reflecting the market. The Release notes the Commission's expectation that SDR policies and procedures will require the use of "indicators" to convey details about transactions that do not accurately reflect the market. Release at 72515. Such disclosure should not be left to the discretion of the SDRs, but should instead be required by the rules.

More Information About Customized SBS.

To close a major gap in the reporting structure, the Proposed Rules must also require additional information about the pricing of customized SBS. Where SBS are so customized that the price cannot be calculated from the reported information, Proposed Rule 901(c)(12) requires parties simply to provide "an indication to that effect." That is inadequate. In such cases, the reporting party must be required to provide whatever additional information is necessary to enable a price calculation. Only this requirement will satisfy the fundamental aim of price discovery.

While such information should be reportable in real time, if in fact such additional information cannot be provided in "real time," then it must at least be reported under the more flexible time frames applicable to the data collected for regulatory purposes.

This enhancement to the Proposed Rules is particularly important with respect to SBS comprised of two swaps grafted together. Such composite SBS can be used to avoid reporting requirements. Even worse, they can be used to obfuscate the real financial implications of a transaction. Accordingly, if an SBS can be disaggregated into two or more transactions, and at least one of those disaggregated transactions can be reported in a format so that price can be calculated, then the rules should require that the SBS be disaggregated and reported in that form. The fact is, aside from obscuring information, there is no reason not to report an SBS in disaggregated form.

The Proposed Rules also represent a critically important opportunity to shed light on the nature of "customized" swaps. Since the inception of the debate over disclosure and clearing in connection with financial regulation, the concept of the "customized" or "bespoke" transactions has figured prominently, yet these terms remain poorly understood in real world terms. The Proposed Rules should clearly define the meaning of SBS that are so customized that price is not ascertainable.

More Information About Collateral.

The Proposed Rules should also be more explicit in requiring reports of information about collateral or margin associated with SBS transactions for use by regulators. That information will be indispensable for risk assessment and other purposes. In the Release, the Commission expresses its belief that such information would be captured under Proposed Rule 901(d)(v), which requires reports of the "data elements necessary for a person to determine the market

value of the transaction.” See Release, footnote 62. The rule should eliminate any doubt on the point and should expressly require the reporting of information regarding collateral or margin.

Typically counterparties enter collateral agreements 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.

Time Limits for Reporting Data.

The time limits for reporting data under the Proposed Rules must be shortened. The value of SBS transaction data to all constituents—market participants and regulators alike—depends on the fastest possible reporting. The Proposed Rules are too generous in this respect. Rule 901(c) requires that data for public dissemination must be reported to an SDR in “real time,” yet Rule 900 defines “real time” to mean “as soon as technologically practicable, but in no event later than 15 minutes after the time of execution.”

First and foremost, the rules must make clear that any delay period—whether 15 minutes or some preferably shorter time—may be invoked **only** where necessitated by human involvement in the reporting process. The rule should specify that, for transactions not matched electronically, once trade data is in the participant’s data capture system, transmission to the appropriate SDR via an ftp site or other mechanism must be automated and instantaneous. For transactions matched electronically, the matching engine must instantaneously and automatically initiate transmission to an SDR of all data subject to public dissemination.

Second, the permitted delay of 15 minutes is unjustifiably long and must be reduced. We

recognize that imposing an outer boundary on the reporting deadline offers some advantages. It helps ensure that market participants will not abuse the open-ended standard embodied in the “technologically practicable” test. But it also presents drawbacks. It delays the reporting—and therefore the dissemination—of data for too long, given the nature of the trading environments and the need for real-time information. In terms of broader impact, it also undermines any effort to steer the industry toward a fully electronic reporting regime. In short, the 15-minute window should be eliminated entirely or replaced with a substantially shorter time frame of less than 5 minutes.

Similar concerns apply to Proposed Rule 901(d)(2), which specifies that information intended for distribution to regulators need only be reported “promptly,” with outside deadlines ranging from 15 minutes to 24 hours, depending on how the SBS was executed and confirmed. This standard is also without justification. The technology necessary to comply with much shorter deadlines exists and is widely available and used throughout the industry. Market participants should be held to that higher standard, which they use routinely for their own business and internal reporting.

The timing requirements for the submission of “life cycle events” and corrections should also be strengthened. Under Proposed Rules 901(e) and 905, both types of data must be submitted “promptly.” A stronger and more specific standard should govern those data submissions.

Time-Stamping in Smaller Increments.

The Commission should also shorten the time-stamping increments. Proposed Rule 901(f) requires time stamping to the nearest second. Especially in markets for which there are multiple swap execution facilities (“SEFs”) and markets in which automated, algorithmic trading occurs, the sequencing of trade data for transparency and price discovery, as well as surveillance and enforcement purposes, will require much smaller increments of time-stamping.

The use of such shorter time frames is technologically feasible, affordable, and already in place. Time-stamping increments should be as small as technologically practicable, but in any event not longer than fractions of milliseconds.

The Duty to Report.

The Proposed Rules must provide guidance to parties who must allocate between themselves the duty to report SBS transaction data. Under Proposed Rule 901(a), the obligation to report SBS transaction data hinges on the nature of the counterparty. For example, where one counterparty is an SBS swap dealer (“Dealer”) and the other counterparty is a major SBS swap participant (“Major Swap Participant”), the Dealer must report the transaction. Proposed Rule 901(a) further stipulates that under certain circumstances—such as where neither party is a Dealer or Major Swap Participant—the counterparties to the SBS “shall select” the reporting party.

These provisions raise two concerns. First, it is not clear that parties to an SBS transaction will always be able to ascertain the identity of their counterparties. Without such knowledge, they

Ms. Elizabeth Murphy
Page 10

may not be able to determine who bears the obligation to report the transaction. Second, the Proposed Rules provide no guidance to parties who must allocate the duty to report between themselves.

As a practical matter, the counterparties in most SBS will be matched electronically *via* a SEF, an exchange, or a broker. In each of these cases, the intermediary will very likely perform the tasks of identifying the party obligated to report and actually reporting the relevant data to an SDR on behalf of the obligated counterparty.

However, not all SBS will fit this paradigm, and the rules must provide some guidance to parties who assign the duty either to themselves or to their counterparty. Factors could include a party's role in the transaction, access to the data that must be reported, and technological capability. To provide no guidance, and merely leave it up to the parties, is to invite problems where there should be none.

Conclusion

Fast, complete, and easily accessible data flow is critically important to price transparency, efficiency, and regulatory oversight in the SBS markets. 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

Stephen W. Hall
Securities Specialist

Better Markets, Inc.
Suite 307
1225 Eye Street, N.W.
Washington, D.C. 20005
(202) 481-8224

dkelleher@bettermarkets.com
wturbeville@bettermarkets.com
shall@bettermarkets.com

www.bettermarkets.com

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Ms. Elizabeth Murphy

Page 10

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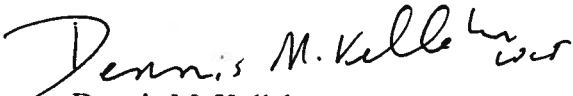
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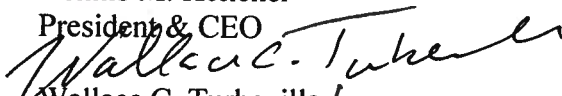
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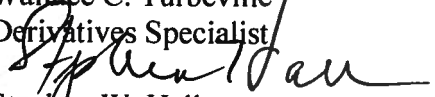
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Better Markets, Inc.
Suite 307
1225 Eye Street, N.W.
Washington, D.C. 20005
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wturbeville@bettermarkets.com
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www.bettermarkets.com