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February 7, 2011

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

*Re: Real-Time Reporting of Swap Transaction Data (RIN 3038-AD08)*

Dear Mr. Stawick:

The Investment Company Institute<sup>1</sup> is submitting this letter in response to the Commodity Futures Trading Commission's ("Commission") proposal regarding reporting and dissemination of swap information pursuant to Section 727 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").<sup>2</sup> The proposal would require, upon execution, reporting of transaction, volume, and pricing terms of a swap to a registered swap data repository ("SDR"). The SDR then would be required to make certain of the swap data publicly available in real time.

As participants in the swaps markets, funds have a strong interest in ensuring the integrity and quality of these markets. Market transparency is a key element to achieving those goals. Accordingly, we support the concept of requiring reporting and public dissemination of certain swap transaction data. We are concerned, however, that the proposed block trade provisions do not account for the unique characteristics of the swaps market.<sup>3</sup> We recommend that the Commission (1) define a block

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<sup>1</sup> ICI is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding and otherwise advance the interest of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$12.68 trillion and serve almost 90 million shareholders.

<sup>2</sup> Commodity Futures Trading Commission Release, *Real-Time Reporting of Swap Transaction Data*, 75 FR 76139 (December 10, 2010), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010-29994a.pdf>.

<sup>3</sup> In this letter we refer to "block trades" to include block trades and large notional transactions as discussed in the proposal.

trade by evaluating the market for a particular swap category to determine what might be an illiquid size and (2) change the reporting time frame to the later of 24 hours after trade execution or the opening of trading the following day. As discussed below, we also recommend a number of modifications to the proposed reporting obligations to reflect market practices and the status of technological developments in the swaps market.

## **I. Block Trades**

Block trades enable funds, on behalf of their shareholders, to transact in large amounts off an exchange with minimal disruption to the swaps market. After a block trade has been executed, one or more of the counterparties, will seek to reduce risk by hedging its exposure, usually by transacting on an exchange. Knowledge of a block trade therefore signals to other market participants that there is the potential for subsequent trading activity. This signaling can negatively affect the market and fund shareholders by significantly skewing pricing if the market does not have sufficient time to digest the block order. In addition, opportunistic market participants may piece together information about a fund's holdings or trading strategy, leading to front running of a fund's trades which also adversely impacts the price of the swap and the underlying security to the detriment of fund shareholders.

For example, in a block transaction a dealer must have adequate time to lay-off the trade before the dissemination of key information about the swap trade. This time will vary depending on the type of swap and the current market for that swap. If the market learns of the block trade prematurely, market participants may be able to execute trades in anticipation of the dealer's subsequent trading activity and thereby raise the price of such activity. If this happens, the dealer could charge a higher price to the fund executing the block to compensate for its loss of flexibility to hedge the trade in the market. Essentially, the dealer does not want to lose money on the trades so it charges (passes-on) the cost to the fund. This higher price also could negatively impact market efficiencies and liquidity if the fund breaks up its block into small orders instead of paying the higher price.

Flexible and anonymous block trading is essential to the swaps market's comparative lack of depth and liquidity. First, swaps are not as liquid or traded as frequently as futures; the mantra holds true that liquidity begets liquidity. Without block trading in the swaps market, market participants will not execute larger size transactions, further impeding the development of more liquidity in these markets. Second, the signaling problem discussed above is more severe for swaps than futures or other securities because the highly distinctive terms of even "standardized" swaps reveal larger amounts of information about the positions and trading strategies of the counterparties to a trade, and can often be used to infer the identity of at least one of the counterparties to the trade. Third, swaps are commonly used by market participants to hedge their exposures in the futures market because of the extremely limited block trading in that market. Fourth, the swaps market currently does not lend itself to consolidated limit order book-type markets, where trading is anonymous.

A. Thresholds for Qualifying as a Block Trade

The proposal includes a two-test model to determine the minimum block trade threshold, with the larger result from the tests being the applicable threshold. The “distribution test” would provide that 5 percent of swaps in a category would be block trades, based on transaction sizes over the prior calendar year. The “multiple test” would provide that a block trade is one that is larger than the largest of five times the mean, median and mode of transactions in the category of swaps over the prior calendar year. Under the proposed thresholds, many transactions that should be treated as block trades would not qualify as such.<sup>4</sup>

We believe the best way to identify the appropriate thresholds for block trades in the swaps market is to account for the liquidity in each unique category of swaps. The risks, trading and liquidity associated with a particular swap differ for each individual swap category within an asset class based on type, term and underlying security.<sup>5</sup> The Commission should reflect these granular and significant differences by creating narrow buckets to which the threshold formulas would apply. These thresholds should be calculated regularly (*e.g.*, quarterly) to ensure that they are appropriately tracking liquidity in the swap categories.

In addition, the thresholds must be low enough to encourage the use of block trades. As discussed above, setting the thresholds too high could cause significant market disruption and harm to fund shareholders by eliminating the use of block trades in these markets and the associated benefits provided by such trades. We note that the appropriate thresholds may result in a small number of trades qualifying as block trades for certain swap categories but the size of these trades may be significant. Further, we believe that the Commission should err on the side of caution by setting the thresholds low initially to collect data to enable it to evaluate the thresholds and the appropriate delays for data dissemination.<sup>6</sup>

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<sup>4</sup> We are concerned, for example, that the proposed distribution test reflects the liquidity and homogeneity of the futures market, not the swaps markets, and is therefore set too high to be meaningful for swaps trading.

<sup>5</sup> The categories that we are recommending the Commission use to identify block trades would likely differ from the swap categories used by the Commission for other purposes (*e.g.*, identifying major swap participants).

<sup>6</sup> In light of the many unanswered questions regarding the appropriate thresholds and reporting delays for swap block trades, we believe that the Commission should consider phasing-in its reporting rules to minimize market disruption and harm to investors.

## B. Delayed Reporting

The proposal would provide that the reporting party for a block trade would report the transaction data in real time but the real-time disseminator would not publicly disseminate the data before the expiration of 15 minutes. We firmly agree with the Commission's assessment regarding the need to delay real-time reporting regarding the size of a block trade. We believe, however, that 15 minutes is not an adequate time frame to allow the market to absorb the impact of a block trade and could result in higher costs for block trades which, ultimately, would be felt by fund shareholders.<sup>7</sup> We recommend instead that reporting for block trades be delayed until the later of 24 hours following execution of the trade and the opening of the next following trading day.

Swaps are not as liquid or traded as frequently as futures or equities so time frames for dissemination of block transaction data in other markets is of limited value. In some cases, it may take a day or more for large or illiquid transactions to be off-set in the swaps market. Moreover, whether a swap is illiquid may depend on the time of day and the term. Longer delays are unquestionably needed for swaps to avoid front running by opportunistic market participants looking to trade ahead of the hedging (or risk-offsetting) transaction.

In fact, we believe that the appropriate time for dissemination of block trade data is best determined by evaluating the type of swap and the factors considered in establishing a "block trade." The Commission, however, does not yet have the information to make these determinations. A 24-hour reporting time frame generally should be adequate to account for off-setting a trade regardless of the type of swap. Once the Commission gains a better understanding of the appropriate thresholds for a "block trade" and the time it takes the market to absorb a block trade in the various categories of swaps, we think our 24-hour recommendation could be revisited.

## II. Reporting Obligations

We have several recommendations that would ensure that the proposal accounts for current operational capabilities and market practices of swaps market participants.

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<sup>7</sup> In the Release, the Commission states that it is not aware of any empirical evidence to support the claim of impaired liquidity given greater transparency or how block trades on swaps are affected by a post-trade transparency regime. We firmly believe that fund shareholders, as well as the market, may be negatively affected by premature disclosure of transaction data about a swap block trade. In post-transaction analysis of block trades, our members report being able to see that the market tracked their movements. In addition, we note that the Securities and Exchange Commission ("SEC") has expressed concerns that market knowledge of large swap transactions may signal to other market participants that there is the potential for subsequent trading activity; dissemination of information regarding block transactions therefore should be suppressed to provide time for subsequent transactions to be absorbed by the market. See SEC Release No. 34-63346, 75 FR 75208 (December 2, 2010), available at <http://www.sec.gov/rules/proposed/2010/34-63346fr.pdf>.

A. Reporting Time

The proposal would require real-time reporting by an SDR, swap execution facility, designated contract market and the parties to a swap, including swap dealers and major swap participants, as soon as technologically practicable after execution of a swap transaction. “As soon as technologically practicable” would mean as soon as possible, taking into consideration the prevalence, implementation and use of technology by comparable market participants. The Release notes that this definition may have different interpretations for different parties to a swap and it states that reporting parties should remain current with changes in technology and regularly update their technology infrastructure to decrease the time of transmission of swap transaction data to real-time disseminators. We strongly support the Commission’s recognition that parties to swap transactions will have different technological capabilities. We believe the Commission’s interpretation of “technologically practicable” appropriately recognizes these variances and the limitations of existing communications and data infrastructure.

Indeed, we concur with the Commission’s assessment that cost, access to the latest technology and other factors may prevent some market participants from obtaining the fastest, most efficient technology. We believe that custom and market practice will eventually define the time period that is a reasonable interpretation of “technologically practicable,” driven by more swaps becoming exchange traded and centrally cleared. We also believe that the Commission’s approach provides flexibility to market participants for unintended or uncontrollable delays as the swaps marketplace adapts to the Dodd-Frank Act rulemaking. Consequently, we do not believe that the Commission should establish maximum times frames in which reporting parties must report to a registered SDR.

B. Reporting Party

The proposal would require the parties to a swap to report swap transaction data to the appropriate registered entity. The reporting requirement would be satisfied if a swap is executed on a swap market. For off-facility swaps, the proposal includes a hierarchy for identifying the reporting party to a swap transaction. In the Release, the Commission justifies the hierarchy on the basis of its belief that swap dealers and MSPs are more likely to have the infrastructure and resources available to report information quickly. While we agree with the Commission’s assessment that swap dealers and MSPs are more likely to have the ability to report swap data than end-users, we believe that there is a large difference in the capabilities of swap dealers from other users.

Outside of the dealers, there is little automation with respect to counterparty swap transaction data. Most swaps counterparties agree to the terms of timing contractually, and the transaction data is manually entered into electronic recording systems typically by the close of the next business day. Generally, dealers are the only market participants that currently have the infrastructure and

standardization to report the requisite data. Upgrades to their systems to accommodate the proposed reporting requirements would be minimal.<sup>8</sup> Funds, in comparison, would need to expend significant time and resources to build out their systems to accommodate the proposed data collection and reporting requirements. We therefore recommend that, generally, swap dealers be obligated to report off-facility swap data.

We also recommend that the Commission permit the parties to an off-facility swap transaction to determine who will assume the reporting obligation. This determination could be memorialized in the transaction contract between the counterparties. Importantly, as long as the reporting party was identified to the SDR, the Commission would have a responsible party to contact regarding any questions about the reported swap transaction.

In response to the Commission's request for comment regarding reporting of off-facility swap transactions involving non-U.S. parties, we recommend, for the reasons discussed above, that swap dealers have the reporting obligation regardless of whether or not they are a U.S. person and regardless of whether they are registered in the United States, assuming there are jurisdictional ties to the United States warranting reporting of the swap (*e.g.*, trading with a U.S. counterparty).<sup>9</sup>

### C. Dissemination of Data to Real-Time Disseminator

The proposal would permit a market participant to satisfy its reporting obligation by executing a swap on swap market. The swap market would be required to publicly disseminate the swap transaction data either through a SDR or third-party service provider. The proposal would prohibit a swap market or any reporting party to a swap from disclosing the swap transaction data before the real-time disseminator has publicly disseminated such data. We strongly support this proposed restriction. Otherwise, the potential would exist for a market participant to disseminate swap data in its possession before it is available to the public, potentially creating unfair advantages for the recipients of such data.<sup>10</sup>

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<sup>8</sup> See SEC Release No. 34-63346, 75 FR 75208 (December 2, 2010) ("Regulation SBSR"), at footnote 57, available at <http://www.sec.gov/rules/proposed/2010/34-63346fr.pdf>.

<sup>9</sup> We note that the Commission has proposed in another swap reporting proposal that a U.S. person would have to report certain swap data if the other party to the swap transaction is not a U.S. person. See Commodity Futures Trading Commission Release, *Swap Data Recordkeeping and Reporting Requirements*, 75 FR 76574 (December 8, 2010) ("Swap Data Release"), available at <https://www.cftc.gov/ucm/groups/public/20therif/documents/ifdocs/federalregister112210.pdf>. As with the recommendation above, we believe that the dealer should have the obligation to report whether or not they are a U.S. person, assuming there are jurisdictional ties to the United States warranting reporting of the swap.

<sup>10</sup> Given the extra step necessary for the distribution of swap data to the public, we recommend that the Commission consider latency issues related to any market or market participant distributing this information prior to a SDR distributing it to the public. In the context of the equity markets and the consolidated data tape, for example, many ICI members believe

#### D. Unique Identifiers

Citing several other Commission releases, the proposal states that unique product identifiers may develop for individual swap products. It provides that, if developed, a unique product identifier may be used in lieu of certain data fields in the required transaction reporting data template. We support this provision but are concerned about the larger issue of consistent taxonomies in the financial market for participants and financial instruments.

In addition to this proposal on real-time reporting of swap transaction data, the Commission has issued proposed recordkeeping and reporting rules that would require the assignment of unique identifiers to certain pieces of information in a swap transaction, including the swap, the counterparties, and the underlying products referenced in a swap.<sup>11</sup> The Commission explains that, ideally, these unique identifiers would be determined by an international “voluntary consensus standards board” as defined by the Office of Management and Budget Circular No. A-19 Revised. The Commission would prescribe, however, its own method for creation of a unique identifier if the Commission was unable to identify an acceptable system prior to the implementation of the proposed rules.

We are very concerned by the possibility that multiple unique identifiers could be assigned by different regulators to the same financial entity, unnecessarily creating compliance burdens, operational difficulties, and opportunities for confusion. We strongly recommend that regulators coordinate their efforts to establish unique identifiers.

For example, both the SEC and the Department of the Treasury have outstanding proposals that would require the creation and assignment of a unique identifier or, in the case of the Treasury, a “Legal Entity Identifier” to certain financial entities.<sup>12</sup> It is critical for these and other regulators to work

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that the SEC should consider eliminating the two-tiered distribution of consolidated quote and tape information to ensure fairness in the distribution of market data. See Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, dated April 21, 2010.

<sup>11</sup> See Swap Data Release, *supra* note 9.

<sup>12</sup> The SEC’s proposed Regulation SBSR regarding real-time reporting of security-based swap transaction data includes a provision for the use of unique identification codes for swap counterparties. See Regulation SBSR, *supra* note 8. The Office of Financial Research within the Department of the Treasury has issued a statement of policy regarding its preference to adopt a universal standard for identifying parties to financial contracts. See Office of Financial Research; Statement on Legal Entity Identification for Financial Contracts, 75 FR 74146 (November 30, 2010), available at <http://edocket.access.gpo.gov/2010/pdf/2010-30018.pdf>. See also, Letter from The Clearing House Association, EDM Council, Financial Services Roundtable, Futures Industry Association, Investment Company Institute, International Swaps and Derivatives Association, Managed Funds Association, and Securities Industry and Financial Markets Association,

together and issue a single, universal standard to identify financial entities. The creation of different identification mechanisms for different regulatory purposes not only unduly burdens affected financial entities but also creates operational difficulties as multiple and larger control systems are needed to track the various identification mechanisms created in response to regulatory mandates. Finally, the existence of multiple unique identifiers for a single financial entity has the potential to create confusion among regulators and other users of the unique identifiers, particularly as the regulators attempt to coordinate their efforts to monitor and manage systemic risk in the U.S. financial system.<sup>13</sup>

### III. Consistency with SEC Reporting Requirements

The Commission seeks comment on whether the proposal should be consistent with the SEC's proposal requiring real-time reporting of security-based swap transaction data and what, if any, problems arise from different approaches. We believe that the principles guiding the regulatory approaches and the underlying rules should be the same with respect to real-time reporting. The approach to reporting should be uniform and consistent, reflecting the unique characteristics of the swaps market even though application of the final rules to the individual swaps within the agencies' jurisdictions should differ in recognition of the liquidity for those products. Duplicative requirements are burdensome and inconsistent requirements are operationally and systemically problematic. At a minimum, we recommend that the agencies coordinate their proposals with respect to reporting parties, reporting time frames, data to be reported, the approach to establishing block trade thresholds, and the time frames and data requirements for reporting block trades. Such coordination would be in keeping with the Dodd-Frank Act mandates and would help to minimize excessive and unnecessary regulatory burdens caused by the different regulatory requirements.

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If you have any questions on our comment letter, please feel free to contact me directly at (202) 326-5815, Heather Traeger at (202) 326-5920, or Ari Burstein at (202) 371-5408.

Sincerely,

/s/ Karrie McMillan

Karrie McMillan  
General Counsel

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to Office of Financial Research, Department of the Treasury, dated January 31, 2010.

<sup>13</sup> Significantly, in the fund context, it would be most appropriate to apply a unique identifier to each fund/portfolio/series – *i.e.*, an identifier should not be applied at the trust level when a trust contains multiple funds.



Mr. David A. Stawick

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cc: Honorable Gary Gensler, Chairman  
Honorable Michael Dunn, Commissioner  
Honorable Jill E. Sommers, Commissioner  
Honorable Bart Chilton, Commissioner  
Honorable Scott D. O' Malia, Commissioner