BETTER MARKETS
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May 14, 2012

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

Re: Proposed Rules – Procedures To Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades (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" or "CFTC"). The Proposed Rules implement a methodology for establishing minimum sizes for block trades ("Block Trades") in accordance with the real-time public reporting of swap transaction and pricing data for all swap transactions mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

INTRODUCTION AND SUMMARY OF COMMENTS

The Dodd-Frank Act sets a clear mandate of bringing transparency, accountability, and oversight to the large and complex derivatives market that was at the core of the shadow market of the pre-crisis world. Timely reporting of all derivatives transactions is an essential component of this new regime, bringing a previously fragmented market onto common-access platforms where bids and offers, execution prices, and trading volumes are visible market-wide. This will enable all market participants to make informed decisions, to reduce unnecessary risks, and to generate more efficient allocation of resources across the U.S. economy.

Given the vast profits being made by the dominant market participants, it is no surprise that the Block Trade provisions of the real-time reporting rules have generated fierce discussion. What is at stake is no less than the very survival of the nascent derivatives regime that Congress sought to create in Title VII of the Dodd-Frank Act. If a significant portion of derivatives trades are classed as "Block Trades," and thereby

[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.

rendered invisible from the real-time record, the entire Swap Execution Facility model is undermined and threatened: transactions will continue to be bilaterally negotiated off-exchange, complete with all the concomitant risks, inefficient pricing, and potential for abuse that this entails. While this will benefit a few large, powerful, and vocal industry members, it will harm the majority of market participants, as well as the U.S. economy and broader public interest.

The Commission has already determined that Block Trades will be subject to delayed reporting, in some cases up to several hours. Given that this is so, it is essential that the Commission now set Block Trade thresholds that are appropriately high. Otherwise, invisible trades will come to dominate the market place, causing a return to the pre-Dodd Frank climate that facilitated and even encouraged widespread abuses and excessive risk taking.

While the basic approach of the Proposed Rules is logical, it must be tightened in several key respects. Specifically:

- Swap categories must not be made so specific that they cause some swaps to be subject to excessively low Block Trade thresholds, thereby diminishing transparency and encouraging arbitrage to avoid reporting requirements.

- Economically related contracts must be broadly construed so that the thresholds for commodity swaps are maintained at an appropriately high level.

- Data-based tests used in establishing Block Trade thresholds must reflect the clearly expressed intent of Congress, namely that the **vast majority** of trades be reported in real time. The 67% notional value calculation should be a low bar. Under no circumstances should it be lowered to 50%, and indeed the Commission must consider gradually raising it to 95% over time.

- Ultimately, a better test than the notional value test is one based in market breadth and depth. Once the necessary data is available (a year's worth), the Commission must consider transitioning to such a test, which is directly responsive to available liquidity, the premise of the Block Trade concept.

In addition, the Commission should be guided by several key principles as it finalizes its consideration of the costs and benefits of the Proposed Rules. Specifically, it should expressly address in its consideration of costs and benefits these core points:

- Congress's ultimate objective in the Dodd-Frank Act was to prevent another crisis and the massive costs it would inflict;

- The Proposed Rules are an integral component of the reforms that Congress decided were necessary to achieve this objective; and

- The costs of compliance and reduced profit margins that industry may have to absorb from requiring real-time reporting, with limited exceptions for

> Block Trades, pale in comparison with the benefits of preventing another crisis.

SUMMARY OF PREVIOUSLY SUBMITTED COMMENTS ON BLOCK TRADES

In a previous letter to the Commission dated February 7, 2011 ("Real-Time Reporting Letter")[2], Better Markets underscored the importance of adequately defining Block Trades so as to avoid undermining the statutory mandate for pre- and post-trade transparency in the derivatives markets:

> 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.[3]

The letter made two main sets of recommendations: (1) that time delays for reporting Block Trades should be minimal, and (2) that the proposed methodology of using a combined distribution test and multiple test for determining the minimum size threshold Block Trades should be adopted, but with certain key improvements.

"Appropriate" Block Trade Time Delays

The Real-Time Reporting Letter argued that time delays for Block Trades should be set at zero. In principle, any delay in dissemination of data for block and large notional trades greatly reduces transparency for the rest of the market. Reduced transparency represents a huge cost to the marketplace, and makes it by default much less efficient. Therefore, any such reporting delay must be justified by some corresponding benefits that outweigh its costs. Congress mandated that an "appropriate" time delay should be allowed, thereby including the possibility that such a delay should be zero.[4] In the absence of any evidence that delayed reporting generates liquidity benefits, therefore, there is no justification for a reporting delay.

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2 *Available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27631&SearchText=better%20markets (incorporated by reference as if fully set forth herein).

3 Real-Time Reporting Letter, at 2.

4 Section 2(a)(13)(E)(iii) of the Commodity Exchange Act ("CEA"), as amended by the Dodd-Frank Act, mandates that the CFTC must determine "the appropriate time delay for reporting large notional swap transactions (block trades) to the public." Further, section (iii) stipulates that in determining the appropriate delay, the Commission must consider whether public disclosure of block trades "materially reduces market liquidity." Thus, it is clear that if immediate public disclosure of Block Trades does not materially reduce market liquidity, then the appropriate time delay for reporting transaction data is zero.

In its initial Real-Time Reporting Proposed Rule,[5] the Commission acknowledged 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.

Nevertheless, the Commission ultimately adopted a phased-in series of time delays ranging from 15 minutes to several hours.[6] Therefore, since any transaction qualifying as a Block Trade will be invisible to the marketplace for a significant length of time, it is essential that thresholds are set at an appropriate level to ensure only genuine Block Trades are classified as such. In determining what should count as "genuine" here, it must be remembered that the motivating principle behind the idea of a Block Trade reporting delay was to create adequate time for hedging large exposures that would otherwise leave the counterparties vulnerable to predatory trading. Therefore, Block Trade thresholds should reflect liquidity in the relevant swaps market, as well as the underlying market, since these are the factors that determine the size of transaction that can easily be hedged.

Setting Block Trade Thresholds

The Real-Time Reporting Proposed Rule established sensible methodological approaches to calculating thresholds: the distribution test and the multiple test.[7] However, the Real-Time Reporting Letter identified that two important factors were not sufficiently addressed: the trade data set which is required to be used in the tests and the periods for recalculation.

First, the letter argued that 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 letter urged that calculations be refreshed quite often to ensure they accurately reflect evolving market conditions.

DISCUSSION OF PROPOSED RULES

During the final stages of the Dodd-Frank legislative process, Sen. Blanche Lincoln (D-AR), then Chairman of the Senate U.S. Senate Committee on Agriculture, Nutrition and Forestry, made it precisely clear that the Block Trade provision was not meant to significantly diminish the principle of transparency:

> While we expect the regulators to distinguish between particular contracts and markets, the guiding principal in setting appropriate block-trade levels should be that the **vast majority** of swap transactions should be exposed to the public market through exchange

5 CFTC Notice of Proposed Rulemaking, 75 Fed. Reg. 76140 ("Real-Time Reporting Proposed Rule"), December 7, 2010.

6 CFTC Final Rule, 77 Fed. Reg. 1247-8 (the "Real-Time Reporting Final Rule"), January 9, 2012, Section 4.5.

7 Real-Time Reporting Proposed Rule, Section 4.5(g).

> trading. With respect to delays in public reporting of block trades, we expect the regulators to keep the reporting delays as short as possible.[8] (Emphasis added)

Thus, it is clear that Congress intended the Commission to avoid setting Block Trade thresholds so low that anything beyond a **tiny minority** of transactions count as Block Trades. This must be held as a guiding principle throughout.

To this end, our comments below focus on three key parameters, the exact specifications of which will determine to a large degree whether the rules ultimately adopted by the Commission will fulfill its Congressional mandate or not. These parameters are **Swap Categories, Economically Related Contracts, and Data-Based Tests.**

Swap Categories

As with the time-delay provisions of the Real-Time Reporting Final Rule, the Proposed Rules suggest a phased-in approach.[9] During the initial phase, certain enumerated "swap categories," for which the Commission feels it has sufficient data, or which are economically related to futures contracts for which there are sufficient data, will be subject to minimum size thresholds for Block Trades. Other classes of swaps will be subject to a universal time delay until the Commission feels it has sufficient data to determine Block Trade thresholds.[10] Equity-based swaps will not be permitted any Block Trade delays.[11]

As stated in the Real-Time Reporting Letter, if reporting of Block Trades is to be delayed at all, then the length of the delay and the size of the transactions for which the delay will be allowed must be rooted in market realities and tailored to different markets.

To this end, the concept of a "swap category" is useful, in that it allows greater granularity than the far broader notion of "asset class." As such, the CFTC is able to differentiate between different categories of swap according to various characteristics such as tenor and underlying currency for interest rate swaps, tenor and spread for credit swaps, etc.

However, it is important that the Commission bear in mind the overarching framework within which the Block Trade provision exists. Reporting delays are permitted only as a **minority event**, in cases where they are absolutely necessary to avoid disrupting markets. Excessive granularity can actually undermine this feature, rather than promote it, by unintentionally creating arbitrary categories for which lower thresholds are created than are warranted.

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8 Congressional Record, July 15, 2010 S5921, *available at* https://www.sullcrom.com/files/upload/Senate%20floor%20debate%20on%20Dodd-Frank%20Conference%20Rpt.pdf.

9 77 Fed. Reg. 15466-7.

10 *Id.*

11 Proposed Rules § 43.6(d).

For example, suppose the Commission created separate categories for agricultural commodity swaps transacted between two dealers as opposed to those transacted between a dealer and an end-user. This division would artificially reduce the total notional value level used to calculate the Block Trade threshold for the dealer to end-user transactions. This would generate a lower threshold than would otherwise be the case, causing many transactions to be subject to delayed reporting, unnecessarily reducing transparency. To prevent arbitrarily low thresholds of this sort, the same analysis must be applied to the various criteria that the Commission **is** considering for use in determining what counts as a category of swaps.

Up to a point, then, subdividing swaps into swap categories ensures that thresholds are well-calibrated. Beyond that point, however, further granularity simply leads to an over-reliance on data that is extremely specific and time-bound. It **causes some swaps to be subject to far lower Block Trade thresholds than are appropriate,** and creates many arbitrage opportunities to avoid real-time reporting requirements by re-structuring products so that they fit into a category with a lower Block Trade threshold.

Thus, for instance, the Commission should reject the idea of having separate credit swap categories for individual credit default swap ("CDS") indexes. This is too granular. On the other hand, a division of CDS into single-name vs. index is appropriate, as is the sub-division of indexes into Sovereign, Corporate, Municipal, MBS, and Other. These are categories that the market already understands and uses. Further sub-division, rather than improving sensitivity to liquidity conditions, would simply dilute the notional value amounts used to calculate thresholds, and would therefore be excessive. Simply put, swap categories should reflect the categories market participants use when hedging. Granularity beyond this point has a detrimental effect.

Economically Related Contracts

Commodities are different from other "asset" classes. While financial assets are used to channel investments and cash flows, commodities are the basic raw materials of the economy, necessities without which businesses and households cannot survive. Therefore, it is particularly important that these markets be regulated in a way that promotes transparency and reliable price discovery.

The Proposed Rules employ the concept of economically related contracts to determine swap categories for commodities. While this is entirely appropriate, it is crucial that the criterion for economic relatedness be expanded beyond the proposed overly-narrow definition which uses needless fine-line distinctions such as delivery location and specific commodity.[12] It is a ubiquitous practice in commodity markets to lay off risks in one grade or delivery point of a commodity with swaps in a different grade or location plus a basis swap.

In fact, one point of having listed commodity futures contracts is to provide a benchmark contract for a wide dispersion of commodity grades and delivery points.

[12] 77 Fed. Reg. 15476-7.

Therefore, grades and delivery points are not grounds by which it is necessary to distinguish separate categories of commodities swaps.

Moreover, as Ke Tang and Wei Xiong at Princeton have pointed out, commodity prices are increasingly correlated.[13] Today, it is not uncommon to see different commodities within a broader class being used interchangeably as hedging devices (such as refined products and oil within the energy complex) by market participants, including large swap dealers and hedgers. Therefore, the Commission should stick to the listed futures industry practice of simply dividing commodities into agricultural, soft, precious and base metals, and energy categories with no further sub-categorization.

Thus, for example, on the NYMEX, Brent Financial, WTI Crude, Henry Hub Nat Gas, Gulf Coast Gasoline, Gulf Coast ULS Diesel, and New York Harbor ULS Diesel all have identical Block Trade thresholds. Heating Oil and Gasoline are the only energy contracts with a different threshold.[14] Equally, Cocoa, Coffee, Sugar, and Cotton, as soft commodities, all share a common threshold.[15] On the COMEX, the precious metals, Gold and Silver, share a threshold, while Copper, as a base metal, has a separate one. On the CBOT all agricultural commodities share a common Block Trade threshold of zero.[16]

Thus, it is clear that different commodities within a complex generally have identical Block Trade thresholds within the listed futures market. *A fortiori*, this should hold in the swaps world, where hybrid contracts based on a number of commodities are common, and where there is even greater fungibility between commodities within a complex.

Data-Based Tests

To generate Block Trade thresholds during the second phase of the two-phase implementation, the Commission has generally settled upon a 67% notional amount calculation method.[17] However, input is requested as to whether the Commission should consider a 50% notional amount calculation method for certain more thinly traded asset classes.[18] Further, the Commission requests comment on the costs and benefits that would accrue from such an arrangement to market participants and registered entities.

On a fundamental level, the move to a 50% notional value calculation method is unjustified. Given that the underlying principle behind the Block Trade provisions is that the **vast majority** of trades **should be reported**, there is simply no statutory justification for a 50% calculation that would cause **at most only half** of all notional value to be reported in real time, and possibly even less if a trimmed data set is used. Such a low threshold would cause many clearly standard-sized trades to fall within the Block Trade

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13 Ke Tang and Wei Xiong, "Index Investment and Financialization of Commodities" Princeton 2010, *available at* http://www.princeton.edu/~wxiong/papers/commodity.pdf.
14 *Available at* http://www.cmegroup.com/clearing/trading-practices/NYMEX-COMEXblock-trade.html.
15 *Id.*
16 *Available at* http://www.cmegroup.com/clearing/trading-practices/CBOTblock-trade.html.
17 77 Fed. Reg. 15481.
18 *Id.*

category.[19] As the data presented below confirms, for interest rate swaps, a 50% threshold would cause transactions to be classed as Block Trades even though they could comfortably be laid off **instantaneously** in the open marketplace. Further, the data demonstrates that **even a 67% threshold is in the lowest acceptable range** for a Block Trade threshold. This analysis therefore supports that of BlackRock in their letter of February 2011, in which they recommended an initial 75% threshold that could gradually be scaled up to 95%.[20]

Moreover, data presented by the Swaps and Derivatives Marketing Association ("SDMA") in February of this year in connection with the Real Time Reporting Rule demonstrates clearly that for USD interest rate swaps, the 50% threshold would classify transactions as Block Trades despite the fact they too could be fully hedged **instantaneously** with just two transactions.[21] The data shows that even a 67% threshold is low because it also would capture trades that could be fully hedged **instantaneously** in just three transactions.

For example, in the 5yr < x ≤ 10yr Super-Major IR band presented in the table at 77 Fed. Reg. 15481, the 50% threshold yields a Block Trade minimum size of $170 million, and the 67% threshold yields a minimum size of $290 million. The SDMA tracked liquidity provided by six dealers over a period of six trading days. At no point during the period did these dealers collectively provide less than $525 million on both sides of the market for 7 year maturities, or less than $375 million on both sides for 10 year maturities. Throughout the period, a $170 swap of either tenor could have been hedged in at most three transactions by hitting quotes already held out to the market. Similarly, there was no point at which a swap of $290 million could not have been hedged in at most four transactions. Transactions that can so readily be hedged simply cannot be classed as Block Trades under any reasonable definition. Therefore, a higher notional value threshold must be used.

The Commission also considers highly liquid swaps with large underlying cash markets, and proposes gradually increasing the 67% calculation in steps until it reaches 95%. Comment is sought as to which asset classes other than equities might benefit from such an approach.[22] First, there is no reason for the Commission to weaken its position on equity-based swaps. There exists a clear consensus among the vast majority market participants, and plenty of actual trade data evidence that no Block Trade delay is required for this asset class. However, the Commission must consider gradually raising the 67% calculation to a 95% level for **all** other asset classes and swap categories over time. The point is more transparency for all market participants. This is a key reform element in reducing bid offer spreads and increasing market efficiency in previously opaque markets.

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19 *See* SDMA letter to the Comission dated February 2, 2012, "In Consideration of Appropriate Block Trading Thresholds with Regards to Swaps Execution and Trade Reporting" and appended data sets, *available at* http://thesdma.org/pdf/120202_SDMA%20Block%20Trade%20Threshold%20Letter.pdf. Compare with the data given at 77 Fed. Reg. 15481.

20 Black Rock, letter to the Commission dated February 7, 2011, "Re: Real-Time Reporting of Swap Transaction Data," *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27603&SearchText=blackrock.

21 SDMA Op. Cit., Exhibit A and Exhibit B.

22 77 Fed. Reg. 15484.

Whichever threshold is ultimately used as the low bar, whether 67% or 75%, the Commission should reconsider its proposal to use a trimmed data set as the baseline for the calculation. The rationale given for using a logarithmic base to filter out extremely large transactions from the data set is as follows:

> The Commission is proposing to use a trimmed data set since it believes that removing the largest transactions, but not the smallest transactions, may provide a better data set for establishing the appropriate minimum block size, given that the smallest transactions may reflect liquidity available to offset large transactions. Moreover, in the context of setting a block trade level (or large notional off-facility swap level), a method to determine relatively large swap transactions should be distinguished from a method to determine extraordinarily large transactions; the latter may skew measures of the central tendency of transaction size (i.e., transactions of usual size) away from a more representative value of the center.

Therefore, trimming the data set increases the power of these statistical measures.[23]

However, this rationale does not reflect the basic reason for Block Trade reporting delays, which is to exempt from the general Dodd-Frank transparency requirements just a few large-in-size transactions, on the grounds that due to their size they would take time to hedge. Thus, excluding the largest transactions (i.e. the very candidates for Block Trade treatment) from the basic data set upon which the Block Trade threshold is to be calculated may create artificially low and misleading thresholds that class normal trades as Block Trades.

Without access to the nonpublic data on which the Commission based its table of calculated notional value thresholds,[24] it is impossible to determine how much of a difference the data trimming makes. In making its final determination, however, the Commission **must** compare the thresholds generated with a trimmed data set against those generated with the unfiltered data and it must disclose that information (even if it does not otherwise disclose the nonpublic data on which it based the calculations). To do otherwise may inadvertently undermine its own ability to comply with the statutory requirement that the vast majority of transactions be reported in real time.

The Commission must also publish an analysis of **what percentage of trades** would be classed as Block Trades under the various alternative thresholds, rather than simply relying **on percentage of notional value**.

Market Breadth and Depth

The Commission seeks input as to whether a test based on market breadth and depth should be considered as an alternative to the notional value test when setting Block

[23] 77 Fed. Reg. 15480.
[24] 77 Fed. Reg. 15481-2.

Trade minimum size thresholds (question 35a). Given that the whole purpose of a Block Trade reporting delay is to ensure there is sufficient liquidity to hedge large trades, such a test would strike right to the heart of the matter. However, these tests must not be skewed by using too narrow a data set which might be unduly affected by seasonality and other temporary variability in liquidity. Thus, the Commission should strongly consider transitioning to this type of test once at least one year's worth of data has been collected.

Consideration of Costs and Benefits

The proposing release ("Release")[25] includes an extensive discussion of the costs and benefits associated with the Proposed Rules. As the Commission receives further comments on this analysis, and as it finalizes its consideration of costs and benefits, it should be guided by three critically important principles discussed below that should govern the application of Section 15(a) of the CEA and the implementation of the Dodd-Frank Act. The Release reflects some of these concepts, and the Commission should adhere to the approach it has taken in those instances. In some respects, however, these guiding principles should be discussed at greater length as the Commission finalizes the Proposed Rules.

1. *The Commission has a limited duty simply to consider costs and benefits under Section 15(a), and it need not quantify or compare those factors.*

Section 15(a) of the CEA imposes a limited obligation on the CFTC simply to consider the costs and benefits of its rules in light of five public interest factors. [26] Congress's careful choice of words in Section 15(a), and the case law construing similar provisions, make clear that the CFTC has broad discretion in discharging this duty. In fact, the Supreme Court has long recognized that when statutorily mandated considerations are not "mechanical or self-defining standards," they "imply wide areas of judgment and therefore of discretion" as an agency fulfills its statutory duty.[27]

In fact, the CFTC has no obligation to quantify costs or benefits, weigh them against each other, or find that a rule will confer a net benefit before promulgating it. The rationale for this flexible obligation in the law is clear: requiring the CFTC to conduct a resource intensive, time consuming, and inevitably imprecise cost benefit analysis as a precondition

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25 Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades, 77 Fed. Reg. 15460 (Mar. 15, 2012) (to be codified at 17 C. F. R. Part 43).

26 Better Markets has set forth a comprehensive analysis regarding the limited scope of Section 15(a) in the *amicus curiae* brief it filed in support of the Commission in *ISDA v. CFTC,* Civil Action No. 11-cv-2146 (RLW) ("*Amicus* Brief"). In that case, representatives of industry are challenging, *inter alia*, the Commission's consideration of costs and benefits in connection with the position limits rule. In addition, Better Markets has written to the Office of Management and Budget ("OMB") opposing Commissioner Scott O'Malia's request that OMB review the cost benefit analysis performed by the Commission in connection with several recently finalized rules. Letter from Better Markets to Jeffrey Zients, Acting Director of OMB (Feb. 29, 2012) ("Letter to OMB"). In the Letter to OMB, Better Markets makes clear that various executive orders and OMB guidelines requiring cost benefit analysis are inapplicable to the Commission's rulemaking. Both the *Amicus* Brief and the OMB Letter are incorporated by reference as if fully set forth herein.

27 *Sec'y of Agric. v. Cent. Roig Ref. Co.*, 338 U. S. 604, 611 (1950).

to rulemaking would significantly impair the agency's ability to implement Congress's regulatory objectives.

2. *The Commission should be guided by the public interest as it considers the economic impact of its rules, not by concerns over the costs of regulation imposed on industry.*

The nature of the five factors that the CFTC is to consider under Section 15(a) reflects Congress's primary concern with the need to fashion regulations that serve the public interest and accomplish the agency's mission, not with a need to spare industry the costs of regulation. Without exception, each factor relates to a public benefit that arises from a robustly regulated marketplace, including preventing abuse, promoting competition, enhancing transparency, and limiting systemic risk.[28] None of the listed factors mentions any industry-focused concerns, such as compliance costs or the feasibility of conforming to rule requirements. Removing any doubt, the fifth and final factor in Section 15(a) requires the CFTC to consider generally "any **other** public interest considerations."[29]

3. *For any rule promulgated in accordance with the Dodd-Frank Act, the ultimate "public interest consideration" is implementing the reforms that Congress enacted to prevent another financial crisis.*

As the CFTC considers the costs and benefits of rules implementing the Dodd-Frank Act, it should give proper weight to Congress's overriding objective: to institute a comprehensive set of reforms, including a swaps reporting regime, to prevent another financial collapse and economic crisis, including trillions of dollars in financial losses and incalculable human suffering. Therefore, as the CFTC assesses the costs and benefits of the Proposed Rules under Section 15(a), it should continue to consider, above all, the benefits of the entire collection of reforms embodied in Title VII and the Dodd-Frank Act, of which the Proposed Rules are a single, integral part.

Congress's resolve to prevent another financial crisis clearly overrides cost concerns under the Dodd-Frank Act. Congress passed the Dodd-Frank Act knowing full well that it would impose significant costs on industry, yet it determined those costs were not only justified but necessary to stabilize our financial system and avoid another financial crisis. Those costs include the elimination of extremely profitable lines of business as well as significant and ongoing compliance costs. A leading example is the establishment of the new, comprehensive regulatory regime for swaps. It will require the financial industry to incur significant costs arising from new personnel and technology, ongoing compliance, margin and collateral, and reduced revenues and profits.

Congress fully understood these costs and consequences. It knew that every one of its regulatory reforms would impose costs, in some cases totaling billions of dollars. The Dodd-Frank Act reflects Congress's unflinching determination to increase the financial

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[28] 7 U. S. C. § 19(a)(2).
[29] 7 U. S. C. § 19(a)(2)(E) (emphasis added).

industry's costs across the board and very substantially—or, more accurately, to shift those costs back to industry from a society that has paid the bill for industry's unregulated excesses. In short, Congress conducted its own cost benefit analysis and concluded that the enormous collective benefits of the law far exceeded the costs and lost profits that industry would have to absorb.

Indeed, against the backdrop of the worst financial and economic crisis since the Great Depression, it is inconceivable that Congress would enact sweeping reforms and then allow the implementation of those reforms to hinge on the outcome of a rule-by-rule cost benefit analysis that ignored the overriding purpose of the new regulatory framework—and that gave controlling weight to cost concerns from the very industry that precipitated the crisis and inflicted trillions of dollars in financial damage and human suffering across the country.

The Release reflects these principles to a degree. However, the final rule release should include a more comprehensive consideration of the benefits that the Dodd-Frank Act reforms—including a real-time reporting regime for swaps in the Proposed Rule—will provide in terms of preventing another crisis. It should also expressly consider the critical inter-relatedness of this rule to the other Title VII rules and the Dodd Frank Act more generally.

The Commission's consideration of costs and benefits set forth in the Release adheres to some of the foregoing principles. For example, it correctly does not attempt to quantify all costs and benefits of the Proposed Rules, nor does it attempt to weigh or net the two against each other. That is not required and would be improper, in effect substituting the Commission's judgment for that of the Legislative and Executive Branches. And, in general, the Release appropriately frames the benefits in qualitative terms, including references to "overarching, although presently unquantifiable, benefits to swap market participants, registered entities, and the general public."[30] The specific benefits identified in the Release include "price transparency," "price discovery," and "market liquidity."[31]

In addition, the Release appropriately makes clear that, in accordance with Section 15(a), the Commission need not and does not address costs and benefits "to the extent these new regulations reflect the statutory requirements of the Dodd-Frank Act ," as opposed to "the Commission's own determinations regarding implementation of the Dodd-Frank Act's provisions . . . . "[32]

With respect to the overriding importance of the public interest in general, and the Dodd-Frank Act reforms in particular, the preamble in the Release highlights the benefits of Title VII as a collection of reforms applicable to the swaps markets:

> Title VII of the Dodd-Frank Act amended the Commodity Exchange Act ("CEA") to establish a comprehensive, new regulatory framework for swaps and security-based swaps. This legislation was enacted to

[30] Release at 15506.
[31] Release at 15506, 15511.
[32] Release at 15503.

> reduce risk, increase transparency, and promote market integrity within the financial system . . . .

The discussion of cost benefit considerations in the Release opens with this appropriate observation, specifically emphasizing the importance of the reporting regime for swaps:

> Transaction reporting is a fundamental component of the Dodd-Frank Act's general objectives to reduce risk, increase transparency, and promote market integrity within the financial system and the swaps market in particular.[33]

In addition, the Release correctly and expressly acknowledges the relationship between the Proposed Rules and the reduced likelihood of another financial crisis:

> [T]he Commission anticipates that the proposed criteria and methodology, if adopted, would likely result in enhanced price discovery . . . . With better and more accurate data, valuation, and risk assessment information, swap market participants would likely be better able to measure risk. Improved risk measurement and management potential, in turn, may reduce the risk of another financial crisis since, presumably, it should better equip market participants to value their swap contracts and other assets during times of market instability.[34]

In the final rule release, the Commission should further develop these concepts and apply them expressly throughout its consideration of the costs and benefits of the Proposed Rules. In short, the final release should articulate and apply the following analytical framework for the consideration of all costs and benefits associated with the Proposed Rules:

- Congress's ultimate objective in the Dodd-Frank Act was to prevent another crisis and the massive costs it would inflict;
- the Proposed Rules are an integral component of the reforms that Congress decided were necessary to achieve this objective; and
- the costs of compliance and reduced profit margins that industry may have to absorb by virtue of the Proposed Rules pale in comparison with the benefits of preventing another crisis.

Finally, and in keeping with this perspective, the final rule should ensure that, notwithstanding any individual or aggregate costs to industry, Block Trade thresholds are set high enough to ensure that, with very limited exceptions, swap transactions are reported in real time, as Congress intended.

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[33] Release at 15502.
[34] Release at 15507.

CONCLUSION

Setting appropriate Block Trade thresholds is essential to the success of Title VII. Specifically, the final rule must adhere to the statutory requirement that the **vast majority** of transactions be reported in real time. We hope you find the above comments helpful in your implementation of these Rules.

Sincerely,

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