May 14th, 2012

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

Re: **RIN 3038-AD08: Real-Time Public Reporting of Swap Transaction Data (17 CFR Part 43)**

In Consideration of Appropriate Block Trading Thresholds with Regard to Swaps Execution and Trade Reporting

Dear Mr. Stawick:

Javelin Capital Markets ("Javelin") appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the "CFTC") on the CFTC's Notice of Proposed Rulemaking regarding Real-Time Public Reporting of Swap Transaction Data (17 CFR Part 43).

Javelin provides electronic trading execution for Interest Rate Swaps and Credit Default Swaps. In late 2011, working with several liquidity providers and the buyside, Javelin executed over $4.1 Billion of interest rate swaps trades, the vast majority of which cleared *in less than* two seconds at the CME. With the average trade of these trades at $195 million, the speed at which these trades cleared was a market first. Javelin is extremely familiar with block trade, liquidity and market structure issues as the market embraces transparency, increased liquidity and greater competition. Javelin expects to file as Swap Execution Facility ("SEF") once the Commission has promulgated rules for such entities.

Introduction

Common in most transparent markets, block trade rules exist to promote liquidity in marketplace. Such rules shield market makers, who quote block size, by delaying the reporting time in which the liquidity provider must notify the market of such a trade. Too little time and the market maker cannot trade out of its position or hedge its position. Too long a time and the liquidity provider almost has 'inside' information on a market moving trade that it can use against the market. A tension therefore exists between the market's right to immediate notification so that it can function efficiently and the market maker's goal to protect itself by hedging or trading out of a block trade.

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Block trades rules are determined by three factors. First, what is the appropriate time delay before the block trade is reported to market? Second, what is the information ultimately reported? Third, what is the correct size threshold that determines the block trade? Because the CFTC has already finalized the time delay to be 30 minutes in year one, and 15 minutes in years subsequent—this comment letter focuses on the second and third factors.

Javelin supports the current CFTC block trade proposal for reporting caps and block trade thresholds. Specifically, Javelin believes that the CFTC rule for cap size on trade information ultimately reported is appropriate and balanced for year one. As the market transitions to more transparency and competition in later years, such a cap rule will prove scalable as more data becomes available.

With regard to the 67% block trade threshold rule for interest rate swaps and credit indices, Javelin believes that such a CFTC threshold is conservative when compared to market liquidity realities where trade volume and order depth are considered. Javelin recommends that the CFTC raise such a threshold to *at least* 75% of trade notional and consider such an approach in tandem with the *market depth* and *market breadth* approach discussed in question 35 (a). Such a method considers not only trade data, but also measures available swap liquidity as a function of limit orders to set the block trade threshold. By considering such methods together, the CFTC will have a more scalable and complete approach where conservative thresholds may be set and where the market is protected from disruption and where greater transparency, competition and liquidity are ensured.[1]

In Support of Cap Rules

Javelin supports the cap size rule approach for interest rate swaps and credit indices. For year one, the CFTC rule requires that trade size, when reported, be the greater of block trade threshold (67% of trade notional) or a table with generally lesser trade amounts.[2] In subsequent years, the CFTC rule sets cap size at 75% of trade notional, while the block threshold remains at 67% of trade notional. Such a cap size rule is appropriate and is consistent with the block trade threshold. By limiting the information ultimately reported to the market with this method, the hedger or block trade liquidity provider is properly shielded from market forces that might otherwise act against it.

When the cap size rule is considered in concert with the already finalized time delay rule of 30 minutes in year one (15 minutes in subsequent years), the market maker is considerably protected from market forces that otherwise might act against it. By contrast, block trade reporting delays in other markets generally run in the minutes, certainly not the half hour range.

Block Trade Threshold: 67% of Notional Traded

Javelin supports the CFTC's Block trade threshold at 67% or notional traded and recommends it go *higher* to 75% of notional traded.

[1] Javelin supports CFTC block rules for Commodities, Equities and Foreign Exchange, but the primary focus of this comment letter is the 67% threshold rule for the IRS and Credit Index markets.

[2] See Section 43.4(1)(i) and 43.4(1)(ii)

Sixty seven percent of notional is consistent with congressional intent. In considering OTC derivatives reform, Congress argued that "the guiding principle in setting appropriate block-trade levels should be that the *vast majority* of swap transactions should be exposed to the public market through exchange [or SEF] trading... (emphasis added).[3] Javelin supports the CFTC's position that 'vast majority' equates to 67% of notional and not 50% of notional traded. The CFTC is correct to take the literal meaning of Congressional language when the alternative is considered. Simply put, 50% is not the *vast* majority; it is not even a *simple* majority. To set block thresholds at 50% would be contrary to the intent of Congress.

Congress also required that the SEF trade tape had meaning and value to market participants. Discussed below, 50% of trade notional would equate to trades dangerously close to the average trade in the marketplace. Most market participants would agree that a tape that reported trades 30 minutes in arrears where the size was shielded and the block trade was set close to the average trade size would have little utility to the sophisticated market practitioner. It would be immediately discounted as having little value or meaning.

Swap Maturity	***Screen Size (MM)***	***Average Trade Size****	***50% Notional***	***67% Notional***	***50% DVO1***	***67% DV01***	***Blackrock DV01***
2yr	200	344	460	750	82,110	133,875	300,000
3yr	150	221	240	380	66,912	105,944	300,000
5yr	100	126	240	380	117,288	185,706	300,000
7yr	75	113	170	290	111,945	190,965	300,000
10yr	50	85	170	290	148,801	253,837	300,000
30yr	25	52	120	210	193,320	338,310	300,000

** LCH Data from 1/25/2012*

*** page 6. Blackrock Letter re Block Size. 2/7/11*

Figure 1. Block Trade Thresholds on DVO1(MM)

The CFTC Block threshold of 67% is consistent with the cleared swap market today. It might actually be low when considered relative to *average* trade size. See above *Figure 1* for LCH data for cleared two year swaps. The average two year trade is $344MM. The 67% threshold would set the two year swap block threshold at $750MM or just over *2.20 times* the average trade. In comparison, the 50% threshold of $460MM would set the threshold only *slightly higher* than the average or 1.33 times the average trade of $344MM.

By definition a block trade is a trade whose size is so large that it cannot readily be absorbed by the current liquidity in the market place. Javelin submits that a two year swap trade of $460MM, as the 50% block would suggest, is only slightly higher than the average two year trade of $344MM. It is a size that does not move the market today, but instead is routinely absorbed by the available liquidity at the current market price. Given that the market maker has at least 15 minutes in which to hedge it's block

[3] S5922 (Congressional Record, July 15, 2010).

trade position, $460MM would have to equal all available liquidity in that period for the market maker to be harmed. The same is true for swaps of longer tenors listed above. Thus, when considered against average trade size in the cleared market, 50% of trade notional is not a high enough threshold to set block trade.

On Risk Adjusted or DV01 (MM) basis the 50% threshold also appears too low. See Figure 1. Consider the DV01 (MM) of the 50% threshold two year amount, or $460MM notional. It is $82,110 per basis point, which means for every basis point move of yield, the value of the swap moves $82,110 or $178 per million. In fact, consider the approximate DVO1 (MM)'s across all tenors for the suggested block sizes of the 50% threshold: 2 year ($82,000), 3 year ($66,000), 5yr ($117,000), 7yr ($111,000), 10yr ($148,000) and 30 year ($193,000). At no point does the maximum value of the risk ever *exceed* $200,000 per basis point for the 50% block trade threshold sizes.

The 67% suggested block thresholds fair better, but could also be improved upon to reflect true market moving trades on a risk adjusted basis. See figure 1 for 67% block trade thresholds, at no time do the block sizes related to 67% increase above $340,000 per basis point of risk.

It is generally accepted today that block trades, those that are market moving by definition trade well in excess of $500,000 of risk. This notion is supported by the Blackrock, one of the world's leading asset management firms.

In a letter to the CFTC dated 2/7/11, Blackrock argued that block trade thresholds should be set conservatively, so as not to cause "our dealer counterparties/ liquidity providers to widen spreads significantly, transferring the liquidity risk premium to the investor."[4] To that end Blackrock suggested setting the Block trade threshold at a conservative $300,000 per basis point risk for interest rate swaps.

The CFTC should be conservative as it sets thresholds, but such a low threshold should reflect market reality. Such a block trade threshold should be at least $300,000 per basis risk for interest rate swaps and credit indices.

Question 35 (a): Market Depth and Breadth

But is there another way to determine the correct threshold? And what can rule makers reasonably rely on in terms of 1) data availability and 2) calculation method that is both intuitive and scalable to the marketplace?

Javelin supports the *Market Depth* and *Market Breadth* method discussed in Question 35 (a). Javelin supports such a method in tandem with a 75% block trade threshold of notional traded. Unlike the proposed method, the market depth approach considers liquidity as a function of limit *orders* in the market at time of trade, not just trades. It also scales well.

Consider the following. If, in a purely liquid market, no block trade rule is required, because there would always be a *bid* to absorb any sell and always an *offer* to absorb any buy at the current market price,

[4] Page 3. (Blackrock Submission to CFTC: Re RIN 3038-AD08; 75 FR 76140, 2/7/11).

then the block trade threshold should be set where the *sum* of all bids or sum of all offers fail to absorb the trade.

Market Depth
With the market depth method, it follows that the block trade threshold is *equal* to the sum of available bids in the market place at the current price for the seller, or the sum of all the available offers in the marketplace for the buyer.

For example, if there are bids on five SEFs that equal $750MM for 10 year swaps at the current price, then the block trade should equal $750MM. A block trade threshold set above $750MM and there are not enough bids to absorb the sell, and a block trade threshold set below $750MM and there is more than enough liquidity to absorb the sell.

Javelin supports the Market Depth methodology discussed in Question 35(a). First, Javelin supports the CFTC method to gather order data from all SEFs and execution platforms. It samples the order data for each instrument and does so regularly during the trading day. By summing such data from multiple venues, it appropriately captures a market 'snapshot' of available liquidity by summing the bids and offers or 'market depth' at any trading point in the day.

Second, it trims each snapshot to focus only on bids or offers at the *current* price.

Javelin recommends that such a trimming step could be improved upon to consider only *highest*, *and near* highest bids and likewise, the *lowest* and *near lowest* offers for the available liquidity data set or 'snapshot.' To capture the near highest bid and near lowest offer, called the 'adjustment value,' determine the following. First, determine the 'adjustment value' by calculating the midpoint of the *bid-offer* spread. Second, subtract the adjustment value from the *highes*t bid to determine the adjustment bid. To determine the adjustment offer, add the adjustment value to the lowest offer.

For the complete snapshot at the *current price*, capture all bids between the highest bid and the adjustment bid. Capture all offers between the lowest offer and the adjustment offer.

For example, if the bid is 10.00 and the offer is 11.00, the *bid-offer* spread is 1.00. The adjustment value is the midpoint value or 0.50. Capture all bids between 10 (the current bid) and 9.50(the adjustment bid) and likewise capture all offers between 11 (the offer) and 11.50 (the adjustment offer).

Such a trimming approach negates the steps outlined in steps 8, 9 and 10 of the approach described in question 35 (a).

Market Breadth
Such a method works for illiquid swaps in the same maturity bucket when you consider *Market Breadth*. This test recognizes that swaps are traded, hedged and risk managed on a portfolio basis by market makers. Market makers routinely hedge illiquid or bespoke swaps with their more liquid, more generic swaps. That is to say, a market maker does not hedge a $400MM block 6.40 year swaps trade with another 6.40 year swaps trade. Instead, the market maker replicates the 6.40 year swap synthetically by

using a basket of five, six year and seven year swaps. Such swaps, within the same risk bucket, are economically equivalent.

Javelin supports such a test discussed in Question 35(a) because the market depth component correctly considers standard hedging techniques employed by dealer practitioners today. Simply put, such a method considers block trade thresholds for less liquid swaps to be a function of their most likely hedging cousins—those found in the same bucket or those that are economically equivalent.

The Market Breadth test is conservative because it *only* considers additional liquidity of swaps adjacent to the focus swap for hedging. It is of course possible to use non adjacent swaps for hedging purposes to avail of their liquidity if desired or necessary. For example, you could hedge a five year swap with a two year and ten year swap. For the market breadth test, we decided against including this method because if the swap curve 'pivots' or moves in a non-parallel manner the hedge result would be suboptimal.

It is important to note, that the Market Breadth Test is conservative because it also ignores hedging or availing of liquidity using hedging tools such as US Treasuries or Euro Dollar Futures. Using Eurodollar futures, which are highly liquid, can prove to be quite an efficient hedge especially in the shorter swap maturities. But again, to be conservative, we decided against including them in the Market Breadth test.

Is such order data easy to obtain for regulators to apply such a test?

Javelin asserts that order data is straightforward to obtain from SEFs and execution venues. The CFTC has authority to request such data, and such data could be provided to the CFTC without burden on the SEF or execution platform electronically. Once the snapshot algorithm is set, and the data is provided regularly, the snapshot calculation becomes routine, easy to manage and inexpensive to administer. Thus, such a market depth and market breadth test should be deployed by the CFTC as the data becomes available from SEFs.

Who Sets the Block Trade?

Javelin asserts that the CFTC should set the block trade rules and not the SEF. The SEF landscape is as yet uncertain and regulators should be mindful to prevent a 'race to the bottom' where SEFs succumb to pressures from incumbent dealers that require them to lower thresholds to politically more acceptable levels to see business. The market would be no doubt harmed as transparency and competition would be threatened. Until such time that the competitive density of market makers migrates to a broad cross section of disparate liquidity providers, the CFTC should set the rule.

Conclusion

Javelin supports block trade thresholds based on *per cent* of trade notional, but asserts that the data supports such a threshold to be 75% not 67%. Because such a method only considers *trade* data, Javelin recommends that the CFTC take a dual approach that also considers *order* data to properly determine block trade thresholds. Javelin recommends that the CFTC adopt the *market depth* and *market breadth* approach discussed in question 35 (a). Such a method should become more meaningful and accurately reflect the market in the long run as SEF's provide more data overtime to regulators. By considering

such methods together, the CFTC will have a more scalable and complete approach where conservative thresholds may be set and where the market is protected from disruption and where greater transparency, competition and liquidity are ensured.

Thank you for your time, should you have questions, please do not hesitate to contact me.

Kind Regards,

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cc: The Hon. Gary Gensler, Commission Chairman
The Hon. Bart Chilton, Commissioner
The Hon. Mark Wetjen, Commissioner
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