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FIA
Principal Traders Group

June 13, 2012

VIA ELECTRONIC SUBMISSION (http://comments.cftc.gov)

Mr. David Stanwick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW.
Washington, DC 20581

Re: Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades; RIN 3038-AD08

Dear Mr. Stanwick:

The Futures Industry Association Principal Traders Group ("FIA PTG") appreciates the opportunity to comment on the most recent notice of proposed rules regarding "Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades" (the "Proposal").[1]

The FIA PTG, a division of the Futures Industry Association, is composed of 33 firms that trade their own capital in the exchange-traded markets. We engage in manual, automated and hybrid methods of trading and are active in a variety of asset classes, such as equities, foreign exchange, commodities and fixed income. Members of the FIA PTG are a critical source of liquidity in the exchange-traded markets, allowing those who use these markets to manage their business risks to enter and exit the markets efficiently.

This letter will focus on the Proposal's block trade thresholds. The members of the FIA PTG have extensive experience with block thresholds by virtue of our involvement in exchange-traded markets.

[1] 77 FR 15460 (March 15, 2012)

General Comments

We commend the Commission's efforts in putting forth the Proposal. It thoughtfully addresses a complicated subject, and we agree that there is a place for certain large transactions to take place away from the central, competitive market. If thresholds are set properly, block trades are liquidity enhancing, allowing for orderly trading of very large orders. However, when the thresholds are too high or too low, liquidity is harmed. When block thresholds are too high, end users are unable to readily source liquidity for large transactions.

When block thresholds are too low, liquidity in the central market is negatively impacted. As we have seen repeatedly in the listed markets, when a block threshold is too low, many liquidity providers who transact a block trade merely liquidate the resulting position via the central market prior to public dissemination of the trade. This "toxic" or "informed" order flow into the central market diminishes incentives to provide liquidity. Ultimately, this type of encroachment into the central market reduces liquidity and transparency, widens bid-ask spreads and increases costs to end users. We also note that if block trade thresholds are too low, the practice of "payment for order flow" is incentivized. This practice is wrought with conflicts of interest and non-transparent costs to end users.[2]

Furthermore, we believe that the adoption of a sound block trade threshold in a timely manner is important to realize the full benefits of the reporting requirements of "Real-Time Public Reporting of Swap Transaction Data."[3] Transparency is a critical component to implementing Title VII of the Dodd-Frank Act.

Specific Questions from the Proposal

- Question 33 – In light of our experience in trading interest rate products, including Eurodollar and Treasury futures and options, we believe that a 50% test for interest rate swaps would be significantly too low. Interest rate products are far too liquid to warrant a 50% test. We also note that the notional volume of related interest rate futures is not even considered in the Proposal.
- Question 35a – We are supporters of a well designed market depth and breadth approach for all asset classes and instruments, one which appropriately considers liquidity beyond the best bid and offer. This is the only way to determine what size trades the Central Limit Order Book "CLOB" can handle efficiently and what size trades should be allowed to transact off market. A market depth and breadth approach measures actual liquidity, the ultimate test of what transactions can be handled in the CLOB. Many of our members expect to provide significant liquidity in cleared swaps, and the full impact of such liquidity can only be measured through a market breadth and depth approach.

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[2] The British Financial Services Authority recently issued a report on this topic entitled Guidance on the practice of 'Payment for Order Flow' (http://www.fsa.gov.uk/static/pubs/guidance/fg12-13.pdf (May 2012).
[3] 77 FR 1182 (January 9, 2012).

- Question 52 – The 67% test for Other Commodity Classes does not address the varying liquidity in these instruments. Similar to the Proposal's methodology for interest rate swaps, there should be some sort of grouping based on the "tenure" of the swap. For example, a natural gas swap with a term of 6 months has considerably different liquidity and risk than a 10-year natural gas swap.
- Question 56 – We believe that the Proposal's approach for swaps with optionality ("swaptions") is too simplistic. To start, the thresholds for swaptions should not be based on the thresholds for the underlying swaps. Primarily, this approach does not recognize the potential differences in liquidity between the swap and an underlying swaption. For example, the liquidity in a 6-month swaption on a 1-year interest rate swap 6 months forward is significantly greater than the liquidity in a 6-month swaption on a 1-year interest rate swap 10 years forward. Lastly, the Proposal does not address how to handle combinations of options. Would a swap which represents a straddle have its notional value multiplied by two to determine if it is block eligible?

Conclusion

We support a well designed market depth and breadth approach to determine block trade thresholds for swaps. Such an approach is superior to a straight percentage test in that it is a better measure of trades that can efficiently be handled in the open market.

If you would like to discuss this letter, please contact Joanna Mallers at jmallers@futuresindustry.org.

Respectfully,

Walt L. Lukken

Walt Lukken
President

cc: The Hon Gary Gensler, Chairman
The Hon. Jill E. Sommers, Commissioner
The Hon. Bart Chilton, Commissioner
The Hon. Scott D. O'Malia, Commissioner
The Hon. Mark P. Wetjen, Commissioner