



October 20, 2010

Securities & Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Commodities Futures Trading Commission  
3 Lafayette Centre, 1151 21<sup>st</sup> Street, NW  
Washington, DC 20581

**File No. 4-611**

**Re: Regulatory rule writing regarding Sec 727 and Sec 763 entitled "Public reporting of Swap Transaction Data" and with specific regard to Block Trade exemptions.**

Dear Chairman Gensler and Chairwoman Shapiro:

Javelin Capital Markets, an electronic trading venue of OTC derivatives, appreciates the opportunity to comment on the SEC's and CFTC's rulemaking process with respect to the *Dodd Frank Act* requirement for public reporting of swaps and security-based swap transaction data as specified in Sec 727 and Sec 763.

Javelin Capital Markets provides an electronic trading venue for Interest Rate Swaps and Credit Default Swaps. We are very familiar with the \$400 Trillion IRS and \$30 Trillion CDS markets and the technology which is currently available for trading, clearing and reporting of these contracts. Javelin will most likely become a Swap Execution Facility and/or a Security-based Swap Execution Facility once the Commissions have promulgated rules for such entities. We know and understand where the liquidity is in the different maturities of the IRS and CDS markets. Our recommendations below on what constitutes a "round lot" and what should be considered to be a "block trade" in a particular IRS or CDS contract maturity is based on our market experience.

Specifically, the CFTC and SEC should be mindful to enforce the Act's requirement that all swap and security-based swap transactions shall be reported real time, with real-time being that which is technologically practicable. Congress specifically addressed large notional or block trades in swaps and security-based swaps and the type of public reporting which is expected. Block trades in swaps and security-based swaps are provided with some limited time delay in public reporting. There are at least 2 important determinations which the CFTC and SEC need to make related to block trades. First, what size transaction qualifies as a block trade? There is some legislative history from Chairman Lincoln on this issue which the Commissions should follow. Such a block trade exemption should be considered on simple objective metrics that can be drawn from current market practice and the experience from other similar markets. Second, how long should the block trade reporting delay be? Again, there is legislative history from Chairman Lincoln on this issue which the Commissions should follow. In any event, the time delay for block trades should be as short as possible and in no event more than 10 minutes.

#### Dodd Frank Act: Public Reporting of Swap Transaction Data

Section 727 and Section 763 entitled "Public reporting of Swap Transaction Data" is clear. It requires that all swaps and security-based swaps, must be reported to the public "as soon as technologically practicable" for the purposes of market transparency, with an exemption for block trades.

#### Majority of Trades Should be Real Time

Congress knew that there are large notional and/or "block trades" in the swaps market, just like there are block trades in both the securities and futures markets. Congress made it clear that the Commissions should define block trades as trades which are very large and which would move the market. Further, Congress was aware of the fact that what constitutes a block trade will vary based on the asset class, the contract maturity and other factors.

The vast majority of interest rate and credit default swap trades that occur today are standard size trades and not block trades. In addition, the technology has long existed that such trades can be reported on a real time basis as these trades occur. Real time transaction reporting should be measured in milliseconds because that is what is "technologically practicable." Trading firms today routinely meet real time trade requirements (in milliseconds) in other markets such as the securities and futures markets.

Trading counterparties and Swap Execution Facilities (SEF's) should therefore be required *to post all non block trades immediately* where instrument, price, size and time of trade are disclosed. Given today's advances in technology, only such a real time reporting requirement is truly compliant with the Act and meet the public's need for greater price discovery and transparency.

#### Same Reporting Requirement for all SEF's

Regulators should have one trade reporting requirement for all SEF's regardless of SEF execution method. It has been suggested that voice/hybrid execution systems should be allowed a longer or slower trade reporting time window over their electronic competitors.

Firstly, such a bifurcated requirement could result in conflicting sets of data which would result in an inaccurate trade tape confusing the market and regulator alike. It would clearly make price discovery more difficult. Such confusion could become more accentuated in times of market crisis and volatility just as the market needs transparency most.

Secondly, such a bifurcation might also create a 'race to the slowest' among SEF's as certain market participants, seeking to shroud their trading, favor slower reporting SEF's with their business over more efficient and transparent counterparts. Thus, the regulators should specify that all counterparties, regardless of execution method should conform to one universal trade time reporting standard.

#### Block Trading Exemptions: What should the Time Delay be?

The Act correctly recognizes that for large or 'block' trades a certain tension exists between the market need for information and the need for market participants quoting large trade size to have sufficient time to trade out of that position. The notion is simple, such a trader should be encouraged to do larger trades, thus adding liquidity to the market, but should be temporarily shielded from reporting the trade so that they are not unfairly put at risk.

Regulators should be mindful that a block trading exemption should never be a method through which market participants under report or fail to report a trade completely. The same information: instrument, price, size and time of trade should still be disclosed, albeit with a time delay to the market.

In no circumstance should the Commissions adopt the TRACE approach of merely reporting in block trade situations that a transaction above a certain dollar size has been done. The statute requires reporting on price and volume. Congress was aware of the TRACE system but chose real time price reporting. The Commissions should not adopt the lower transparency standard of TRACE.

Some have argued that such a time delay should be measured in days, weeks and even months. We strongly believe that such a time delay should be objectively measured in minutes, if not milliseconds. It should moreover vary upon the instrument type and its typical liquidity. Regulators should also look to time delay examples in other markets such as euro/dollar swaps and oil swaps.

Block Trading Exemptions: How big is a Block Trade?

Only very few trades in any market are block trades. We believe that any block trade size threshold should be based upon an *objective but consistent measure*—and importantly should be many multiples larger than a standard ‘round lot’ trade size in any given market.

A straight forward ‘multiples’ approach could be simply 10 or 20 times the standard trade size. Such is the case with the similarly traded US Treasury futures market where the CBOT has adopted a simple notional threshold of 5,000 contracts or 500MM cash equivalent for the following contracts: 2 year, 3 year, 5 year & 10 year. For 30 year contracts, the CBOT specifies a lower 3,000 contracts or 300MM cash equivalent as the block trade threshold.

Interestingly enough for the contract that is arguably the closest to resemble an interest rate swap—the 2 year Eurodollar bundle the threshold is 1,000 contracts.

A second approach is to set the block trade threshold as a function of risk per basis point or ‘DVO1’ for a particular swap. For example a block trade could mean all trades with a DVO1 greater than \$500,000. Thus the block trade size notional is larger for a two years swap (smaller risk and DVO1) but smaller for a 30 year interest rate swap (larger risk and DVO1).

Current market practice in IRS today recognizes such a DVO1 approach for standard size trades. For block trade thresholds for interest rate swaps, we believe that the approach should be consistent with market practice and should be a DVO1 approach.

Furthermore, the DVO1 for the block trade threshold should be consistent, for now, across all maturities and should match the DVO1 of the block trade threshold of the 2yr Eurodollar bundle; \$200,000.

For credit default swaps where multiple credit curves exist, it should be simply 10x the market’s standard size trade. Please see below table for suggested block size considerations.

**Markets & Suggested Block Trade Size (Multiples & DVO1 Approach)**

<b>IR Swap</b>	<b>Standard Size</b>	<b>Block Size (10x)</b>	<b>Block Size (20x)</b>	<b>Block Size (DVO1 @ 200T)</b>
IRS 2YR	200	2,000	4,000	1,111
IRS 3YR	150	1,500	3,000	714
IRS 5YR	100	1,000	2,000	411
IRS 7YR	75	750	1,500	308
IRS 10YR	50	500	1,000	235
IRS 30YR	20	200	400	148

<b>Credit Swap</b>	<b>Standard Size</b>	<b>Block Size (10x)</b>	<b>Block Size (20x)</b>
CDS 5YR (IG)	5	50	100
CDS 5YR (HY)	2	20	40
Index IG	50	500	1,000
Index HY	10	100	200

**Conclusion**

The Dodd Frank Act calls for the real time reporting of swaps and security-based swaps. With one qualified exemption ('block trades'), this means all eligible interest rate and credit default swaps trades that trade in standard size lots. For block trades, certain objective standards drawing from current market practice can be set whereby the tension between market place and those who trade in it can be balanced such that greater price transparency is not only encouraged but assured.

Thank you for the opportunity to comment during this period. We welcome any further discussion with you, other regulators, the government or any other market participants regarding these crucial issues.

Please see attached *Congressional Record* for Sen. Lincoln comments from 7/15/2010 re Block Trading intentions.

Sincerely,

James Cawley  
 CEO  
 Javelin Capital Markets  
 Founder Swap & Derivatives Market Association.  
 (646) 588-2003  
 Jamie.cawley@javelincm.com

block trade in 10-year interest rate swap, 2-year dollar/euro swap, 5-year CDS, 3-year gold swap, or a 1-year unleaded gasoline swap are all going to be different. 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 trading. With respect to delays in public reporting of block trades, we expect the regulators to keep the reporting delays as short as possible.

I firmly believe that taking the Senate bill language improved the final conference report by strengthening the regulators enforcement authority dramatically. The Senate Agriculture Committee looked at existing enforcement authority and tried to give the CFTC the authority which it needs to police both the futures and swaps markets. As I mentioned above, we provided the CFTC with anti-fraud and anti-manipulation authority equal to that of the SEC with respect to non narrow-based security index futures and swaps so as to equalize the SEC and CFTC enforcement authority in this area. The CFTC requested, and received, enforcement authority with respect to insider trading, restitution authority, and disruptive trading practices. In addition, we added in anti-manipulation authority from my good friend Senator Cantwell. Senator Cantwell and I were concerned with swaps participants knowingly and intentionally avoiding the mandatory clearing requirement. We were able to reach an agreement with the other committees of jurisdiction by providing additional enforcement authority that I believe will address the root problem. Further, I would be remiss in not mentioning that we provided specific enforcement authority under Section 9 for the CFTC to bring actions against persons who purposely evade the mandatory clearing requirement. This provision is supposed to work together with the anti-evasion provision in the clearing section. Another important provision is one related to fraud and an episode earlier this year involving Greece and the use of cross currency swaps. We gave new authority to the CFTC to go after persons who enter into a swap knowing that its counterparty intends to use the swap for purposes of defrauding a third party. This authority, which is meant to expand the CFTC's existing aiding and abetting authority, should permit the CFTC to bring actions against swap dealers and others who assist their counterparties in perpetrating frauds on third parties. All in all, the CFTC's enforcement authority was expanded to meet known problems and fill existing holes. It should give them the tools which are necessary to police this market.

A significant issue which was fixed during conference was clarifying that in most situations community banks aren't swap dealers or major swap participants. The definition of swap dealer was adjusted in a couple of respects so that a community bank which is hedging its interest rate risk on its loan portfolio would not be viewed as a Swap Dealer. In addition, we made it clear that a bank that originates a loan with a customer and offers a swap in connection with that loan shouldn't be viewed as a swap dealer. It was never the intention of the Senate Agriculture Committee to catch community banks in either situation. We worked very hard to make sure that this understanding came through in revised statutory language which was worked out during conference. There were some concerns expressed about banks being caught up as being highly leveraged financial entities under prong (iii) of the major swap participant definition. This

concern was addressed by adding language clarifying that if the financial entity had a capital requirement set by a federal banking regulator that it wouldn't be included in the definition under that prong. This particular prong of the major swap participant provision was intended to catch entities like the hedge fund LTCM and AIG's financial products subsidiary, not community banks. We also clarified in Section 716 that banks which are major swap participants are not subject to the federal assistance bans. These changes and clarifications should ensure that community banks, when acting as banks, are not caught by the swap dealer or major swap participant definitions.

Section 716 and the ban on federal assistance to swap entities is an incredibly important provision. It was agreed by the administration, and accepted by the conference, that under the revised Section 716, insured depository institutions would be forced to "push out" the riskiest swap activities into a separate affiliate. The swap dealer activities which would have to be pushed out included: swaps on equities, energy, agriculture, metal other than silver and gold, non investment grade debt, uncleared credit default swaps and other swaps that are not bank permissible investments. We were assured by the administration that all of the types of swaps enumerated above are not bank permissible and will be subject to the push out. Further, it is our understanding that no regulatory action, interpretation or guidance will be issued or taken which might turn such swaps into bank permissible investments or activities.

It should also be noted that a mini-Volcker rule was incorporated into Section 716 during the conference. Banks, their affiliates and their bank holding companies would be prohibited from engaging in proprietary trading in derivatives. This provision would prohibit banks and bank holding companies, or any affiliate, from proprietary trading in swaps as well as other derivatives. This was an important expansion and linking of the Lincoln Rule in Section 716 with the Volcker Rule in Section 619 of Dodd-Frank.

Section 716's effective date is 2 years from the effective date of the title, with the possibility of a 1 year extension by the appropriate Federal banking agency. It should be noted that the appropriate federal banking agencies should be looking at the affected banks and evaluating the appropriate length of time which a bank should receive in connection with its "push out." Under the revised Section 716, banks do not have a "right" to 24 month phase-in for the push out of the impermissible swap activities. The appropriate federal banking agencies should be evaluating the particular banks and their circumstances under the statutory factors to determine the appropriate time frame for the push out.

The Senate Agriculture Committee bill revised and updated several of the CEA definitions related to intermediaries such as floor trader, floor broker, introducing broker, futures commission merchant, commodity trading advisor, and commodity pool operator as well as adding a statutory definition of the term commodity pool. We note that the definition of futures commission merchant is amended to include persons that are registered as FCMS. This makes clear that such persons must comply with the regulatory standards, including the capital and customer funds protections that apply to FCMS. The Senate Agriculture Committee wanted to ensure that all the intermediary and other definitions were current and reflected the activities and financial instruments which CFTC registered and regulated entities would be advising on, trading or holding, especially in light of Congress add-

ing swaps to the financial instruments over which the CFTC has jurisdiction. We note that in addition to swaps, we added other financial instruments such as security futures products, leverage contracts, retail foreign exchange contracts and retail commodity transactions which the CFTC has jurisdiction over and which would require registration where appropriate.

With respect to commodity trading advisors, CTAs, commodity pool operators, CPOs, and commodity pools, we wanted to provide clarity regarding the activities and jurisdiction over these entities. Under Section 749 we have provided additional clarity regarding what it means to be "primarily engaged" in the business of being a commodity trading advisor and being a commodity pool. To the extent an entity is "primarily engaged" in advising on swaps, such as interest rate swaps, foreign exchange swaps or broad-based security index swaps, then it would be required to register as a commodity trading advisor with the CFTC. On the other hand, to the extent an entity is primarily engaged in advising on security-based swaps it would be required register as an investment adviser with the SEC or the states. We would note that under existing law the CEA and the Investment Advisers Act have mirror provisions which exempts from dual registration and regulation SEC registered IAs and CFTC registered CTAs as long as they only provide very limited advice related to futures and securities, respectively. This policy is continued and expanded to the extent it now covers advice related to swaps and security-based swaps.

With respect to commodity pools, the SEC has long recognized that commodity pools are not investment companies which are subject to registration or regulation under the Investment Company Act of 1940. Alpha Delta Fund No Action Letter (pub avail. May 4, 1976); Peavey Commodity Futures Fund I, II and III No action letter (pub avail. June 2, 1983); Managed Futures Association No Action Letter (Pub Avail. July 15, 1996). To be an "investment company" under Section 3(a) of the Investment Company Act an entity has to be primarily engaged in the business of investing, reinvesting, or trading securities. In the matter of the Tonopah Mining Company of Nevada, 26 S.E.C. 426 (July 22, 1947) and SEC v. National Presto Industries, Inc., 486 F.3d 305 (7th Cir. 2007). Commodity pools are primarily engaged in the business of investing, reinvesting or trading in commodity interests, not securities. For this reason, commodity pools are not investment companies and are not utilizing an exemption under the Investment Company Act. A recent and well know example of commodity pools which the SEC has recognized as not being investment companies, and not being required to register under the Investment Company Act, comes in the commodity based exchange traded funds (ETF) world. While recent ETFs based on gold, silver, oil, natural gas and other commodities have registered their securities under the 1933 and 1934 Acts and listed them on national securities exchanges for trading, these funds, which are commodity pools which are operated by CFTC registered commodity pool operators, are not registered as investment companies under the Investment Company Act of 1940. See the Investment Company Institute 2010 Fact Book, Chapter 3. We have clarified that commodity interests include not only contracts of sale of a commodity for future delivery and options on such contracts but would also include swaps, security futures products, leverage contracts, retail foreign exchange contracts, retail commodity transactions, physical commodities and any funds held in a margin account for trading such instruments. I am pleased that