ISDA Safe, Efficient Markets

17 CFR Part 43

July 7, 2023

Vince McGonagle
Division of Market Oversight
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Request for a Delay to the Compliance Date for New Block Thresholds and Cap Sizes

Dear Mr. McGonagle:

The International Swaps and Derivatives Association, Inc. (**"ISDA"**),[1] on behalf of its members, is writing to request that the Division of Market Oversight (**"DMO"**) of the U.S. Commodity Futures Trading Commission (**"CFTC" or "Commission"**) issue time-limited no-action relief that would delay the effective date of new block thresholds and cap sizes from December 4, 2023 to December 4, 2024.[2]

For the past ten years, since the initial publication of the block thresholds, we have stated that incorrectly set block sizes will adversely impact the ability of virtually every market participant, including end-users, such as insurance companies, pension funds and mutual funds, to efficiently execute large-sized swap transactions—unnecessarily impeding their

[1] Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1000 member institutions from 79 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org.
[2] On April 19, 2023, the Commission published the Revised Post-Initial Appropriate Minimum Block Sizes and Post-Initial Cap Sizes for Publicly Reportable Swap Transactions on the CFTC's website where they declared the effective date of the new thresholds and sizes to be December 4, 2023, *available at* https://www.cftc.gov/PressRoom/PressReleases/8691-23. *See also* Commission Regulation § 43.6(g)(6).

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ability to hedge risk through swaps. Toward this end, we are very concerned with the CFTC's recalibrated block thresholds and cap sizes that, in certain cases, result in drastic increases to both block and cap sizes, particularly in contracts that are also subject to the trade execution requirement. Such increases require careful deliberation as inappropriately sized block thresholds will negatively affect market liquidity, significantly raise trading costs for buy-side market participants and end-users, as well as increase burdens on client-trading workflows.[3]

Critically, these increased thresholds come at a time when the US swap markets is undergoing significant market structure adjustments, including the transition away from LIBOR and implementation of UPI reporting, as described in more detail below, that demand immediate attention and considerable resources. ISDA therefore requests an extension of time to comply with the increased thresholds and cap sizes in order to ensure an orderly and uninterrupted market transition to the new block trade thresholds and cap sizes.

I. Discussion

ISDA seeks additional time to comply with the new block thresholds and cap sizes for two (2) main reasons, which are explained in more detail below:

(1) Drastic Changes to Block Thresholds Will Add Pressure to Already Taxing Regulatory Changes. The swaps market is currently inundated with forthcoming regulatory and market infrastructure changes in trading and reporting, and additional time for compliance will enable market participants to prioritize ensuring a smooth transition towards trading under the new block thresholds and cap sizes.

(2) Additional Time is Necessary to Allow the CFTC Advisory Committees to Offer Insights on the New Block Trading Thresholds and Cap Sizes. CFTC Advisory Committees have recently agreed to take on discussion and analysis of the potential impacts of drastic increases in block thresholds and cap sizes on the US swaps market. A delay in implementation would allow the Committees to develop thought leadership and potential solutions to any negative impacts on market liquidity.

[3] These impacts are likely to be exacerbated by recently observed volatility in the markets.

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Drastic Changes to Block Thresholds Will Add Pressure to Already Taxing Regulatory Changes.

There are a number of forthcoming regulatory changes that will have a profound effect on the derivatives market infrastructure in the coming months.

First and most importantly, the cessation of LIBOR occurred on June 30, 2023. While a significant number of market participants adhered to the ISDA Fallback Protocol and thus had the necessary agreements in place to transition their LIBOR swaps to the fallback rate, operationalizing the fallback rate will occur during the weeks and/or months following the cessation. This is because the fallback rates apply as payments on the relevant transaction come due.[4] Thus, systems readiness and the appropriate implementation and integration of fallback rates will continue to be tested for a substantial period of time following the cessation.

Similarly, while adoption of SOFR as the reference rate for new transactions has been hugely successful, SOFR is a fundamentally different rate than LIBOR and has therefore required significant operational changes, some of which are still ongoing. In addition, meaningful trading in SOFR only began in 2021 and the market is still learning about how this rate will trade and respond to different market dynamics.

Second, to further complicate an already complex transition, certain SOFR and SONIA swaps are expected to become subject to the trade execution requirement in early August of 2023 (**"MAT Compliance Date"**). In other words, SONIA and SOFR swaps will, for the first time, be required to be traded on a SEF via a request-for-quote to three (**"RFQ-to-3"**). This will be a significant adjustment for market participants as these swaps are not (and have not been) trading RFQ-to-3 today in the US or even globally. As with fallback rates, in the weeks and months following the MAT Compliance Date, market participants will need to expend significant resources towards assessing systems and technological readiness, adjusting to the new trading protocols, and mitigating any SEF connectivity issues or other trading disruptions.

On top of all this, market participants are facing several impending regulatory reporting compliance dates that require significant internal builds and adjustments to their reporting infrastructure. Beginning on January 29, 2024, market participants will be required to use unique product identifiers (**"UPIs"**) for reporting and recordkeeping purposes for swaps in the credit, equity, foreign exchange, and interest rate asset classes. In preparation for that deadline, market participants are currently dedicating significant resources to individually determine how to access and what level of access they would need to (and be in a position to obtain from) the only UPI service provider that has been approved the Financial Stability Board—Derivatives Service Bureau (**"DSB"**). There are different levels of access required depending on a number of factors, including type of market

[4] For example, if a particular swap has quarterly payments, the payment in September for a June reset date will be based on LIBOR, and a payment based on the fallback rate will not be due until December (for the September reset date)—six months after the cessation.

participant (e.g., sell side or buy side), expected volume of use, and adaptability of existing systems (i.e., whether a market participant has used DSB in the past or relied on ISIN). Thus, onboarding to DSB is more nuanced and complicated than initially anticipated.

To convolute matters even further, DSB has recently stated that the "library" of UPI codes or reference data will not be available for market consumption until October. Market participants cannot proceed with their technological builds until they have that data available; this means that market participants have a very short window, between October and January, to build UPI into their reporting systems and test its capability. Additionally, market participants are also in the process of adjusting their reporting systems, and in certain cases, creating new technological builds in order to comply with the changes to the reporting rules in the EU and Japan which are both set to be effective in April 2024.[5] Separately, we understand that DTCC may not be ready to implement the new block thresholds and cap sizes until after the UPI implementation date.

In short, on a number of different fronts, the industry is undertaking massive changes to the way it trades and the way it operates. In the case of the LIBOR cessation in particular, market participants faced an unprecedented transition—and while significant effort has been expended to ensure systems preparedness, market participants cannot be sure of the amount of additional work and effort that will be required in the coming months as the market continues to make necessary adjustments while trading under new reference rates. For both reporting and trading, market participants will need to take an "all hands on deck" approach in order to facilitate trading in new rates and ensure compliance with reporting rules across multiple jurisdictions. Adding compliance with the increased block thresholds to an already challenging regulatory compliance agenda risks adverse outcomes, including inadequate managing of work streams.

For these reasons, we believe that additional time to comply with the block thresholds and cap sizes is necessary to ensure that market participants have the required resources and bandwidth to ensure a smooth transition towards trading under the new requirements. Moreover, providing additional time would be particularly judicious, given the fact that firms have traded under the current threshold levels for the past decade and, to our knowledge, there have been no transparency or liquidity issues associated with the current block trading levels.

Additional Time is Necessary to Allow the CFTC Advisory Committees to Offer Insights on the New Block Trading Thresholds and Cap Sizes.

CFTC Advisory Committees, including the Market Risk Advisory Committee and the Global Markets Advisory Committee, have recently agreed to facilitate discussion and conduct analysis on the potential impacts that the new block thresholds and cap sizes would have on the US swaps market. ISDA welcomes this discussion as the industry remains concerned with the way in which block thresholds (and cap sizes) are calculated

[5] EMIR is going live on April 29, 2024, with JFSA rules going live on April 1, 2024.

and applies to various swap categories.[6] It is particularly important for the Committees to assess the impact of higher thresholds in light of recent market volatility, as well as the need to promote the wholesale adoption of SOFR swaps. Also, the Committees can help play an important role in conducting a thorough cost-benefit analysis on the impact such thresholds would have on market participants that, today, initiate block trades on behalf of their clients, or respond to the liquidity needs of other participants, including end-users.

Collaboration among various types of market participants, including swap dealers, asset managers, end users and infrastructure providers through the work of the Advisory Committees will provide the Commission with diverse perspectives on the issues related to block thresholds. The Committees may also offer expert advice and recommendations that may lead to potential solutions on how to mitigate the adverse consequences to market functioning and liquidity if block thresholds and cap sizes are too high or otherwise not properly calibrated.

[6] Treating swaps with various degrees of liquidity equivalently by applying the uniform 67% Calculation is likely to widen bid/offer spreads and reduce liquidity, and will force large-sized transactions to be printed with their full size. Our concerns related to the methodology to determine block sizes (i.e., the 67% Calculation) equally apply to the 75% Calculation for determining cap sizes. The 75% Calculation for determining cap sizes takes the same arbitrary approach to determining what amounts should be capped for public dissemination purposes. As we have stated in the past, we do not believe that the added market transparency from reporting transaction sizes between the 67% notional threshold for block sizes and the proposed 75% notional threshold for cap sizes will outweigh the harm to liquidity from this additional disclosure. If anything, the proposed high cap thresholds will result in exposing the full size of large-sized transactions that fall below the proposed block thresholds, thereby limiting firms' ability to appropriately hedge such transactions.

II. Request for Relief

For the reasons stated above, we ask DMO staff to delay the effective date of new block thresholds and cap sizes from December 4, 2023 to December 4, 2024. A one-year delay would provide market participants sufficient time to operationalize and ensure a smooth market transition towards the new thresholds and cap sizes, as well as develop and implement potential solutions to any adverse market consequences.

Thank you for your consideration of these concerns. Please do not hesitate to contact me, or Nikki Cone (Associate General Counsel, ncone@isda.org) should you have any questions.

Sincerely,

Bella Rozenberg

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Certification Pursuant to Commission Regulation 140.99(c)(3)

As required by Commission Regulation 140.99(c)(3), I hereby (i) certify that the material facts set forth in the attached letter dated July 7, 2023 are true and complete to the best of my knowledge; and (ii) undertake to advise the Commission, prior to the issuance of a response thereto, if any material representation contained therein ceases to be true and complete.

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