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From: Cameron, Tim [tcameron@sifma.org]
Sent: Tuesday, January 18, 2011 6:00 PM
To: 'rule-comments@sec.gov'
Cc: RealTimeReporting
Subject: SBSR Letter
Attachments: AMG.Comment.Letter.Reg.SBSR.pdf

Subject: Comments on Proposed Regulation SBSR, File Number S7-34-10

Attached please find a comment letter on certain issues related proposed Regulation SBSR.

Please feel free to contact me with any questions or comments.

Sincerely,

Tim

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January 18, 2011

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Comments on Proposed Regulation SBSR (File Number S7-34-10)

Dear Ms. Murphy:

The Asset Management Group (the "**AMG**") of the Securities Industry and Financial Markets Association ("**SIFMA**") appreciates the opportunity to provide the Securities and Exchange Commission (the "**Commission**") with our comments regarding certain aspects of proposed Regulation SBSR under the Securities Exchange Act of 1934 (the "**Exchange Act**").

The AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, state and local government pension funds, universities, 401(k) or similar types of retirement funds, and private funds such as hedge funds and private equity funds. In their role as asset managers, AMG member firms, on behalf of their clients, may engage in transactions, including transactions for hedging and risk management purposes, that will be classified as "security-based swaps" ("**SBS**") under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**").

As discussed in more detail below, the AMG believes that: (a) where an SBS is entered into between an end user and either a security-based swap dealer ("**SBS Dealer**") or a major SBS participant ("**MSP**"), all SBS reporting obligations should fall upon the SBS Dealer or MSP, whether or not it is a U.S. person; (b) the delay in the public dissemination of block trade information provided for in Regulation SBSR should be uniform and should apply to all trade data, not just the notional size of the trade; and (c) the ownership threshold for

"control" used to determine affiliation for reporting purposes is too low and should be raised from 25% to at least a majority.

The reporting party should always be the SBS Dealer or MSP, whether or not it is a U.S. Person.

Proposed Regulation SBSR provides that, with respect to each SBS, the "reporting party" must report certain information about the SBS to a registered security-based swap data repository ("**SDR**") or, if no SDR will accept the information, to the Commission. In the case of uncleared SBSs, Exchange Act Section 13A allocates this reporting obligation first to the counterparty, if any, that is an SBS Dealer, then to any MSP counterparty and, finally, if both counterparties are end users (*i.e.*, neither counterparty is an SBS Dealer or MSP counterparty), between the end users as they determine.[1] This statutory allocation does not depend on whether a counterparty is a U.S. person.

Proposed Rule 901(a), however, provides that where one counterparty is a U.S. person and the other is not, the U.S. person must act as the "reporting party" regardless of whether it or the other counterparty is an SBS Dealer or MSP. The Commission's rationale for this provision is that "where only one counterparty is a U.S. person, assigning the reporting duty to the counterparty that is a U.S. person would help to assure compliance with the reporting requirements of proposed regulation SBSR."[2] The AMG believes that, due to their commercial interests, technological know-how and business relationships, SBS Dealers and MSPs that are not U.S. persons are equally likely to comply with reporting obligations as those who are U.S. persons. When a foreign SBS Dealer or MSP elects to enter the U.S. market in order to trade with a U.S. counterparty, or where a U.S. SBS Dealer or MSP trades swaps in the United States through a foreign branch or affiliate, the foreign SBS Dealer or MSP should be required to bear the same regulatory reporting responsibilities that are incumbent upon U.S. SBS Dealers and MSPs. In addition, SBS Dealers and MSPs will be best positioned to develop at the lowest cost the technological infrastructure or relationships with third party service providers[3] necessary to meet the reporting obligation.

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[1] Dodd-Frank does not otherwise specify which counterparty should be the reporting party.

[2] Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, 75 Fed. Reg. 75,208, 75,211 (proposed December 2, 2010) (amending 17 CFR Pts. 240 and 242) (the "**Release**").

[3] The Release states that "proposed Rule 901(a) would not prevent a reporting party to an SBS from entering into an agreement with a third party to report the transaction on behalf of the reporting party." Release at 75,211. There is no explicit mention of this in the proposed rules themselves.

Moreover, the proposed preference for a U.S. person to act as reporting party will unnecessarily prejudice end users who, for valid business purposes, prefer to transact with non-U.S. SBS Dealers or MSPs and create competitive inequalities among U.S. and foreign SBS Dealers and MSPs. The AMG believes that an end user should not incur higher transaction costs or potential legal liabilities depending on the location of its counterparty. While a non-U.S. SBS Dealer or MSP might contractually agree to fulfill the U.S. end user's reporting requirement,[4] under the proposed rule the end user nonetheless would retain the regulatory obligation to report.

Accordingly, the AMG believes that the reporting party should always be the counterparty that is an SBS Dealer or MSP, whether or not it is a U.S. Person.

The delay in public dissemination of block trade information should be uniform and should apply to all trade data, not just notional size.

The AMG commends the Commission for recognizing the need for sufficient time delays for block trade reporting. However, the AMG believes that a 24-hour delay for all block trades would be more appropriate than a regime in which trades executed at the end of the trading day have a different delay than trades executed at the beginning of the trading day, as under the Commission's proposed 8- to 26-hour delay, depending on the time of execution of the trade. Specifically, a delay for block trades executed at the end of a trading day until the start of the following business day does not leave market participants sufficient trading time to hedge their positions. A uniform period of sufficient time, such as 24 hours, would decrease the likelihood of strategic timing of trade execution as a means of optimizing reporting delays.

In addition, the AMG believes that, consistent with the methodology proposed by the CFTC,[5] the Commission should delay reporting of all block trade information, rather than just notional size. Otherwise, the immediate signaling to the market that a block trade has occurred will potentially harm end users (including the pensioners, mutual fund shareholders and endowments that are

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[4] *See* footnote 3. The AMG believes that the Commission does not mean the use of the term "third party" to mean that one counterparty cannot contract with the other counterparty to do the required reporting; for example, the AMG believes that the Commission would allow a non-U.S. person Swap Dealer to report to an SDR on behalf of its U.S. person end user counterparty, even though that end user counterparty will retain the reporting obligation as it would when contracting with a different reporting service. The AMG would appreciate clarification of this point in the final Regulation SBSR.

[5] Real-Time Public Reporting of Swap Transaction Data, 75 Fed. Reg. 76,140 (proposed December 7, 2010) (amending 17 CFR Pt. 43) (the "**CFTC Proposed Rule**").

advised by and invest money in funds advised by AMG members) by reducing market liquidity and increasing bid-ask spreads.

As the Commission acknowledges in the Release, dealer counterparties that agent swaps for "natural long" customers hedge the risk of the block by entering into additional transactions, and opportunistic traders aware of a block trade before the dealer has a chance to hedge will "front-run" the dealer in the hedge market. This "winner's curse" increases the cost to dealers of entering into the block as well as the risk that they will be unable to hedge the block. Since dealers participate in these markets to provide a service to end users and make a profit off that service, these costs may, in turn, be passed on to end users through wider bid-ask spreads.

In the Release, the Commission states its belief that Regulation SBSR's proposed block trade reporting rule "promotes the public's interest in price discovery without subjecting the block trade counterparties to undue risk of a significant change in the price necessary to hedge the market risk created by entering into the block trade."[6] The AMG disagrees with the Commission's dual propositions. First, block trades are generally entered into at off-market prices to compensate for the additional risk borne by the liquidity provider and the service it performs in entering into large transactions rather than requiring the "natural long" to face the price effects of a series of on-market transactions. Therefore, the disseminated block trade price information would distort, rather than enhance, price discovery. Second, the AMG believes that the mere signaling of the occurrence of a block trade in a specific instrument, even without the exact notional size, would cause a significant reduction in swap market liquidity. While opportunistic traders would not know the exact size of the block trade, knowledge of the block threshold and the underlying instrument will allow them to front-run at least part of the hedge transaction and will result in at least a partial "winner's curse" situation.[7]

Thus, any effective solution to the "winner's curse" problem caused by the immediate dissemination of block trade information must provide the dealer sufficient time to hedge before enough information is disseminated to the public

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[6] Release at 75,232.

[7] The Commission could set the block threshold low enough that knowledge that a "block trade" has occurred does not give the market sufficient information to know that a large hedging trade is about to occur or makes the amount of the hedge that the trader can front-run trivial. As the Commission has chosen not to provide proposed block threshold sizes at this point, the AMG is unable to comment on their efficacy for this purpose. We note that the suggestion put forward in the Release by the Commission to report the block trade in real time with a "randomized" notional amount would provide incorrect data to the marketplace about the size of executed transactions.

for opportunistic traders to know, or to reasonably guess, how hedging will occur. The AMG believes that while in many cases the 8- to 26-hour delay proposed by the Commission may be sufficient, a 24-hour delay would better ensure that block liquidity providers are able to offset their risk regardless of the time during the trading day at which the block is executed. As an additional means to prevent the "winner's curse" problem, the Commission should provide that, when notional size is ultimately publicly reported (*i.e.*, after a delay in the case of block trades and otherwise in real-time), it must be done pursuant to a rounding convention that, among other things, expresses any notional size greater than specified thresholds as simply larger than that threshold size. This methodology would be consistent with the CFTC's proposed provision that all swaps with a notional size greater than 250 million be reported as "250+."[8]

While the Commission has not yet proposed block trade size thresholds, the AMG wishes to emphasize that "one size does not fit all" as far as what constitutes a block trade.[9] The Commission's block trade size thresholds should take into account the differences inherent in various SBS products and how they are traded, including differences in typical trade sizes, liquidity and time needed for hedging.

In addition, the AMG disagrees with the Commission's exclusion of equity total return swaps and other SBS designed to offer risks and returns proportional to the underlying equity security from block trade reporting delays. Real-time dissemination of block trade information for such SBS could cause the same "winner's curse" problem as for other SBS, widening bid-ask spreads for end users wishing to enter into such trades. Furthermore, allowing block trade reporting delays for such SBS will not harm transparency in the underlying instrument. Market participants who enter into total return swaps and similar SBS enter into corresponding trades in the equity and futures markets, either before or after entering into the SBS. These equity and futures markets are transparent and require real-time post-trade reporting, thereby disseminating to the market important information about the price of the underlying without also disseminating the private information about individual market participants' stakes that would be uncovered through real-time reporting of the SBS.

Finally, the AMG believes that, due to the close relationship between swap and SBS markets, and between U.S. markets and international markets, the Commission and the CFTC should seek to harmonize their real-time reporting

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[8] *See* CFTC Proposed Rule at 76,174 (proposed rule 43.4(i)).

[9] The AMG intends to address the CFTC's proposed thresholds, and other elements of the CFTC's real-time trade reporting proposal, in a separate letter to the CFTC and will provide a copy to the Commission.

regimes with each other and with those of comparable international regulators, taking into account the importance of block trade information delays discussed above. Doing so will decrease the likelihood of regulatory arbitrage that could arise if, for example, a market participant is incentivized to choose to enter into credit default swaps on 100 individual securities rather than on an index of those 100 securities—solely to come under the Commission's reporting regime rather than the CFTC's.

The threshold for "control" for purposes of reporting under Regulation SBSR should be raised from 25% ownership to no less than majority ownership.

Proposed rule 906(b) would require participants in registered SDRs to report identifying information about their ultimate parent and any affiliate that is a participant in the SDR, as well as to update the information if changes occur. The AMG believes that the proposed 25% ownership threshold for "control" for purposes of determining who is a parent or affiliate is too low.[10] Obtaining the required information from companies with which an SBS market participant has less than majority-ownership relationship would be overly burdensome, and in some cases, not practicable. In addition, the AMG believes that at least a majority ownership threshold for "control" would better serve the Commission's expressed purpose for requiring reporting about ultimate parents and affiliates, namely that "[t]he Commission … preliminarily believes that, to be able to effectively report on participant positions to assist the Commission and other regulators in monitoring systemic risk, a registered SDR should be able to identify all SBS positions within the same ownership group."[11] As a result, the AMG suggests that the definition of "control" be changed to presume control based on no less than a majority ownership, rather than 25% ownership.

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[10] More specifically, directly or indirectly having the right to vote 25 percent or more of a class of voting securities, or having the power to sell or direct the sale of 25 percent or more of a class of voting securities, creates a presumption of control, which is the "possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." However, owning less than a majority of the voting securities of a company does not entitle one to unilaterally direct the management of the company. The other classes of presumed control including acting as a director, general partner or officer exercising executive responsibility (or having similar status or functions) or, in the case of a partnership, having the right to receive, upon dissolution, or having contributed, 25 percent or more of the capital.

[11] Release at 75,222.

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The AMG thanks the Commission for the opportunity to comment on proposed Regulation SBSR. Should you have any question, please do not hesitate to call the undersigned at 212-313-1389.

Sincerely,

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Managing Director, Asset Management Group
Securities Industry and Financial Markets Association

cc: Chairman Mary L. Schapiro, SEC
Commissioner Luis A. Aguilar, SEC
Commissioner Kathleen L. Casey, SEC
Commissioner Troy A. Paredes, SEC
Commissioner Elisse B. Walter, SEC
Chairman Gary Gensler, CFTC
Commissioner Bart Chilton, CFTC
Commissioner Michael Dunn, CFTC
Commissioner Scott D. O'Malia, CFTC
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