MEMO# 26158

May 15, 2012

ICI Letter on CFTC's Minimum Block Trade Reproposal

[26158]

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 23-12
DERIVATIVES MARKETS ADVISORY COMMITTEE No. 17-12
INVESTMENT ADVISER MEMBERS No. 6-12
SEC RULES MEMBERS No. 36-12 RE: ICI LETTER ON CFTC'S MINIMUM BLOCK TRADE REPROPOSAL

ICI has filed a comment letter with the Commodity Futures Trading Commission ("CFTC") on its re-proposed rules specifying the procedures for determining block trade sizes. [1] The Reproposal defines the criteria for determining swap categories and the methodologies for setting appropriate minimum block sizes for each swap category. The Reproposal also includes additional measures to prevent public disclosure of the identities, business transactions, and market positions of swap market participants.

ICI's letter acknowledges the CFTC's efforts in the Reproposal to provide a more tailored approach to increase the transparency of swap transactions without damaging liquidity in the swap markets. The letter, however, expresses concern that the proposed swap categories are too broad – grouping together swaps with vastly different liquidity profiles – and that the proposed 67-percent notional amount calculation would result in too high a threshold for block trades. The letter explains that too high a threshold will impose real costs to funds and their shareholders by increasing the costs of large trades or forcing funds to break up the block trades into smaller orders. The letter is attached and briefly summarized below.

Swap Categories

For the interest rate and credit default swaps categories, the letter argues that the proposed categories appear to continue to group together swaps of a wide range of liquidities. For the FX and other commodity asset classes, the letter states that it is not possible to determine whether the CFTC has identified the most relevant criteria because no data was available for those asset classes. Given that only interest rate swaps and credit default swaps were based on any data and that the data set was extremely limited, the letter recommends that the CFTC analyze the swap data that it will receive from repositories to refine further the swap categories. The letter also disagrees with the CFTC's proposal not to treat any trades in equity swaps as block trades and urges the CFTC to propose an appropriate minimum block sizes for equity swaps. The letter argues that there are differences in liquidity in the underlying equity cash market that would call for closer study of the data on equity swap transactions.

Notional Amount Calculation

The letter recommends that the CFTC not adopt the 67-percent notional amount calculation, which would set the minimum block thresholds too high and raises the risk of damaging market liquidity severely. Instead, the letter urges the CFTC to adopt the 50-percent notional amount calculation that was suggested as an alternative approach and to phase-in this standard over a period of time for very illiquid categories of swaps. The letter states that it would be prudent to be more cautious rather than rushing to achieve benefits that may not materialize and could harm the swaps markets and market participants.

Frequency of Block Calculation and Data Set

The letter also recommends a quarterly or a semi-annual calculation of the thresholds rather than the proposed annual calculation to confirm that the minimum block sizes continue to be appropriate for each category within an asset class. The letter explains that trade volumes in the swaps market can fluctuate considerably within a short period of time and, therefore, more frequent calculations are necessary to track liquidity. Moreover, because swaps are not traded with a high degree of frequency, the letter also encourages the CFTC to look at a one year set of data and one quarter set of data for the calculation of minimum block sizes rather than the proposed three-year window of data to ensure more accurate results.

"Cap Size" Determinations

Finally, the letter argues that the 75-percent notional amount calculation would be too high for determining the "cap size" – the maximum limit of the principal, notional amount of a swap that would be publicly disseminated – and would reveal the identities, business transactions, and market positions of market participants engaging in large transactions. The letter recommends that the CFTC adopt a 67-percent notional amount calculation for determining cap size.

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Attachment

endnotes

[1] For a summary of the Reproposal, see ICI Memorandum No. 25940 (Feb. 28, 2012), available at http://www.ici.org/my_ici/memorandum/memo25940.

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