Vanguard®

P.O. Box 2600
Valley Forge, PA 19482-2600

(610) 669-1000
www.vanguard.com

May 22, 2020

Submitted electronically to
https://comments.cftc.gov

Mr. Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Amendments to the Real-Time Public Reporting Requirements (RIN 3038-AE60)

Dear Mr. Kirkpatrick:

Vanguard[1] appreciates the opportunity to provide our comments to the Commodity Futures Trading Commission (the "**Commission**") on its recent proposal to amend the rules governing the real-time reporting framework for swaps (the "**Proposal**").[2]

Vanguard has been fully supportive of global derivatives regulatory reform and advocated for approaches that bring more transparency, efficiency, and fair competition to the swaps market throughout the Commission's rulemaking process.[3] With this in mind, Vanguard agrees with and supports the Commission's efforts to address certain aspects of the current Swap Execution Facility (the "**SEF**") regulations (the "**Current SEF Rules**")[4] in order to enhance liquidity, price transparency, and price discovery within the swaps market.

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[1] Vanguard is one of the world's leading investment management companies, offering a diverse selection of low-cost investment products, with aggregate assets of approximately $5 trillion.

[2] *Amendments to Real-Time Public Reporting Requirements*, 85 Fed. Reg. 21516 (April 17, 2020), *available at* https://www.cftc.gov/sites/default/files/2020/04/2020-04405a.pdf.

[3] *See generally Letter from Greg Davis, Managing Director and Chief Investment Officer, and Joseph Brennan, Managing Director and Chief Risk Officer, Vanguard, to Mr. Christopher Kirkpatrick, Secretary, Commission*, dated March 2, 2020, *available at* https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=62373&SearchText=vanguard.

[4] *Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades*, 78 Fed. Reg. 32866 (May 31, 2013), *available at* http://www.gpo.gov/fdsys/pkg/FR-2013-05-31/pdf/2013-12133.pdf.

The Proposal seeks to revise the Current SEF Rules in certain key areas, including: (i) changing the definition of "block trade", (ii) updating the swap categories for block treatment, (iii) updating the block thresholds and cap sizes, and (iv) increasing the delay for the public dissemination of block transactions.[5]

While Vanguard supports the Commission's proposals regarding the "block trade" definition and swap categories for block treatment, we have reservations with respect to the proposals to increase both the block thresholds and the length of the delay for public reporting of blocks. Specifically, Vanguard is concerned that the Commission's proposals are not accompanied by supporting data demonstrating that the appropriate balance has been struck between the Commission's policy goals of market transparency and market liquidity for SEFs.[6]

Absent the presentation of data supporting the Commission's proposals, it is challenging to provide an informed, objective view on the merits. Commenting is also compromised as the Commission is seeking a simultaneous change in both the block sizes and the reporting delay as a change in one necessarily impacts the other. Although it may not be unreasonable to conclude that an increase in the block size would justify an increase in the reporting delay, no data has been provided to support change to either or both of the size or delay.

And while in the past Vanguard has expressed a preference for a longer delay in the public reporting for blocks, absent the demonstration that the data supports such changes in furtherance of the Commission's stated goals, we find it premature to comment on these specific proposals. Our comments instead seek to offer ideas for the Commission to consider as to the data we believe is relevant in assessing the merit of any potential change to block size and/or reporting delay.

Summary of Vanguard's Comments:

- Any change to existing block thresholds must be supported by data which demonstrates a meaningful change in market liquidity with respect to the trading of blocks which can be mitigated by a limited adjustment of block sizes to preserve liquidity without sacrificing price transparency.

- Any change to existing reporting delays for blocks must be supported by data which demonstrates a meaningful change in market liquidity with respect to the trading of products used to hedge block trades which can be mitigated by the adjustment of the reporting delays to preserve liquidity without sacrificing price transparency.

[5] *Proposal* at 21516.

[6] *Core Principles and Other Requirements for Swaps Execution Facilities*, 78 Fed. Reg. 33476 (June 3, 2013), *available at* https://www.govinfo.gov/content/pkg/FR-2013-06-04/pdf/2013-12242.pdf.

I. Background

Vanguard funds enter into derivatives contracts, including swaps and futures, to achieve a number of benefits for our investors, such as hedging portfolio risk, lowering transaction costs, managing cash, and achieving more favorable execution compared with traditional investments.

Swap price transparency and discoverability provided by the Current SEF Rules requiring RFQ to three or central limit order book ("CLOB") protocols, together with immediate public reporting, benefits Vanguard investors as it promotes competition among swap providers and thereby lowers trading costs. Swap liquidity is also provided by the Current SEF Rules allowing block trade sizes to be traded RFQ to one with delayed reporting, which enable swap providers to quote for block trades knowing they can more easily execute hedges related to the blocks.

In striving to meet its policy goals, the Commission must optimally calibrate block sizes and reporting delays so as to balance the competing goals of transparency and liquidity in the SEF-traded swaps market.

II. Vanguard believes that any change to existing block thresholds must be supported by data which demonstrates a meaningful change in market liquidity with respect to the trading of blocks which can be mitigated by a limited adjustment of block sizes to preserve liquidity without sacrificing price transparency.

When the Current SEF Rules were finalized in 2013, the Commission sought to implement a two-period, phased-in approach (initial and post-initial) for determining block sizes.[7] With respect to the initial phase, the Commission adopted a 50-percent notional amount calculation (meaning the larger 50 percent of swaps (by notional amount) would not be subject to RFQ to three and immediate reporting).[8] As for the post-initial phase, which has yet to be implemented, the Commission's intentions were to increase the notional amount calculation from 50-percent to 67-percent.[9]

The Proposal now seeks to implement the 67-percent calculation contemplated in the Current SEF Rules. As noted above, no data is provided by the Commission to confirm that a change in the block size is now justified, or, if justified, what percentage change is justified.

Increasing the block size would increase transparency by reducing the number of trades that qualify for delayed reporting as blocks. However, it is clear that with respect to many, if not most, product types the magnitude of the proposed increase in block size would have an adverse

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[7] *Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades* at 32870.

[8] *Id.* at 32942.

[9] *Id.* at 32870.

impact on liquidity with respect to existing block trades which would no longer benefit from RFQ to one and delayed reporting.

For example, the increase in block sizes would render trades which currently enjoy the block protections to being forced into competition using RFQ to three with immediate reporting. The competitive bidding and immediate reporting would negatively impact liquidity as swap providers would undoubtedly struggle to execute hedges without market foresight. Absent data demonstrating otherwise, through enhancing transparency, it is possible the Commission has inadvertently sacrificed liquidity in raising block size thresholds.

We recommend that before any change to existing block sizes is considered, the Commission should obtain and analyze the data to ensure the policy goals of transparency and liquidity are reasonably balanced. For this purpose, we recommend as a starting point that the Commission assess the following data points for each block category, comparing the present data to historical data available for a previous assessment period of at least a year:

- Data for the top 5, top 10 and top 15 swap market makers:
  - Average bid/offer width
  - Average size quoted
  - Cumulative size quoted
  - Average percent of two-way markets
  - Average RFQ response time
- Data for all market makers
  - Average spread between winning quote and cover (width between winning price and next best price)
  - Percent of no-quotes (percent of trades where a broker did not respond to an RFQ)

We further recommend that in assessing the data, and considering any change to the existing block sizes, the Commission aims for the smallest change required to maintain block trade liquidity so as not to unreasonably sacrifice overall swap market transparency.

To be clear, our message is not that block trading is inappropriate, or that the Commission’s proposed changes are a mistake. Rather, Vanguard strongly recommends that before moving forward with any proposed change to block trade sizes, the Commission must analyze the data to support the most modest change necessary to preserve liquidity while avoiding an unreasonable sacrifice to transparency.

III. Vanguard believes that any change to existing reporting delays for blocks must be supported by data which demonstrates a meaningful change in market liquidity with respect to the trading of products used to hedge block trades which can be mitigated by the adjustment of the reporting delays to preserve liquidity without sacrificing price transparency.

Pursuant to the Current SEF Rules, swaps currently eligible for block treatment are categorized into different asset categories where the Commission utilizes a specific methodology to establish block thresholds within those categories.[10] Once established, varied time delays for the public reporting of these block trades are applied based on different factors established by the Commission, including whether the swaps are executed on a public trading platform or subject to mandatory clearing.[11] These delays range from 15 minutes for block trades executed on a public platform to 48 hours for large, less liquid block trades that are executed off a public platform.[12]

The Current SEF Rules regarding block trades and attendant reporting delays were intended to preserve liquidity for large-size trades while at the same time limiting the unreasonable sacrifice to transparency occasioned by the limited reporting delay. Reporting delays on block trades preserve liquidity by enabling swap providers adequate time to hedge the risk associated with the block trade and avoid the "winner's curse" as other market participants learn about the block trade, and drive up the costs of hedging for the winning bidder.

The Commission is proposing to subject qualifying block trades to a blanket 48-hour delay as a "conservative measure" to account for the ability of market participants to hedge positions and to provide consideration of the deadlines imposed by "other authorities."[13] No data is provided to support this proposed increase in the delay for the reporting of block trades.

As with the Commission's proposed increase to block sizes, in the absence of compelling data, Vanguard finds it challenging to comment on the proposed 48-hour delay for the reporting of block trades. As contemplated, the protracted delay in the public dissemination of swap data, and its blanket application across all trade types and maturities, suggests the unreasonable sacrifice of transparency in the purported furtherance of liquidity. In addition, commenting is also complicated by the proposed changes to both block sizes and reporting delays as each factor has an effect on the other with respect to transparency and liquidity.

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[10] *Id.* at 32939.

[11] *Real-Time Public Reporting of Swap Transaction Data*, 77 Fed. Reg. 1182 (January 9, 2012), *available at* https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2011-33173a.pdf.

[12] *Id*. at 1264 – 1266.

[13] *Proposal* at 21556 (The Commission states that "[the] longer delay is more appropriate given the larger notional size; because the primary reason for the delay is to ensure that the dealing counterparty is able to hedge out the risk taken in the trade, a larger average trade size would imply a greater needed time for hedging."); *Id.* at 21534 ("Other authorities" refers to the European Union's transparency requirements under MiFID II that provides eligibility for large-in scale swap transaction to defer publication of the transaction for two working days.).

We recommend that before any change to the timing for the reporting of block trades is considered, the Commission should obtain and analyze the data to ensure the policy goals of transparency and liquidity are reasonably balanced. For this purpose, we recommend as a starting point that the Commission assess data including the time required to execute products to hedge the risk related to each block category.

Our own quick survey of the data related to the time to execute hedges suggests the following:

- The time required to execute offsetting hedges for large transactions differs significantly based on swap currency, tenor and size.
- For US dollar interest rate swaps, at the proposed larger block sizes and across tenors, based on the data, we estimate the time needed to execute the most appropriate offsetting hedge in the futures market ranges from 10 minutes to 35 minutes, depending on the size and tenor.
- For Euro interest rate swaps, at the proposed larger block sizes and across tenors, based on the data, we estimate the time needed to execute the most appropriate offsetting hedge in the futures market ranges from 10 minutes to 85 minutes, depending on the size and tenor.
- Although we did not survey the data for other swap currencies, we accept that for interest rate swaps in less liquid currencies, the time needed for hedging would likely be longer.

Based on our assessment, we have concluded that at least for swaps in the most liquid currencies, the Commission's proposal to increase the reporting delay for all blocks to 48 hours is completely unwarranted. As such, we believe the proposal fails to appropriately balance the Commission's goals for transparency and liquidity, and needlessly sacrifices transparency for purported liquidity benefits.

We note that, during consideration of the proposal, Commissioners Berkovitz, Behnam, and Stump expressed concern about the proposed application of a 48-hour delay without strong empirical support.[14] This, along with the data points provided above, suggests that the proposed delay is not warranted and that the Commission should use historical data to demonstrate where liquidity challenges exist in order to propose tailored delays and avoid the unreasonable sacrifice of transparency.

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[14] *Id.* at 21575 – 21576 (Commissioners Berkovitz and Behnam noted the significant discrepancy in reporting delays between the current and proposed rules. Commissioner Berkovitz stated that the need for a single 48-hour delay is not apparent and instead called for a calibrated approach in setting the timeline for delays. During the meeting, Commissioner Stump called on market participants to help inform the Commission on the appropriate timing and application of block trade delays.).

In sum, both with respect to the proposed increase in block sizes and reporting delays, Vanguard believes that the Commission should evaluate relevant data to determine what change, if any, is supported. Absent such data, and given the interrelationship between block size and reporting delays, commenting on the proposals is challenging, if not impossible. Rather than directly comment, we have tried to convey our ideas as to useful data points for the Commission to consider in this effort. And armed with data, we believe the Commission will be better able to conceive a proposal that is more likely to achieve the reasonable balance between its goals for SEF trading of transparency and liquidity.

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Vanguard appreciates the opportunity to comment on the Commission's Proposal. If you have any questions about Vanguard's comments or would like any additional information, please contact William C. Thum, Principal, at (610) 503-9823 or william_thum@vanguard.com.

Sincerely,

/s/ Gregory Davis
Managing Director
and Chief Investment Officer
Vanguard

/s/ Joseph Brennan
Managing Director
and Chief Risk Officer
Vanguard

cc: The Honorable Heath P. Tarbert
The Honorable Brian D. Quintenz
The Honorable Rostin Behnam
The Honorable Dawn DeBerry Stump
The Honorable Dan M. Berkovitz