

Global Markets Advisory Committee – Global Market Structure Subcommittee

- **Challenge:** The new post-initial block¹ and cap sizes published by the Commission on April 19, 2023 under the CFTC’s Real-Time Public Reporting Requirements (Part 43), for which compliance is required starting July 1, 2024, reflect in many cases a significant increase of the sizes compared to the block and cap sizes currently in place under the CFTC’s Part 43 Rule. Appropriately calibrated block and cap sizes are vital to the proper functioning of the U.S. derivatives markets, including price discovery and transparency, whereas inappropriately set block and/or cap sizes may negatively affect market liquidity and significantly raise trading and hedging costs for buy-side market participants and end-users.

The GMAC Subcommittee appreciates and fully supports the 7-months extension of the compliance date for the post-initial block and cap sizes from December 4, 2023 to July 1, 2024 recently granted by the CFTC Division of Market Oversight (DMO) through its no-action letter dated as of October 18, 2023 (CFTC Staff Letter 23-15). Such extension, however, appears to only contemplate the time necessary to address certain operational and technological issues.

The GMAC Subcommittee does not believe the Commission has adequately addressed the true challenges and concerns with the post-initial block and cap sizes across all asset classes, tenors and currencies which is predicated on whether the data sets used to determine the new post-initial block and cap sizes were accurate. While the industry cannot replicate the calculations and analysis performed by CFTC staff, the GMAC Subcommittee does not believe the new increases in certain transactions properly strikes the right balance between transparency and liquidity, and we believe they will likely result in reduced liquidity, potential information leakage, wider bid-offers and increased transaction/hedging costs.

The GMAC Subcommittee agrees with the observations from Commissioners Mersinger and Pham in their Joint Statement released in connection with CFTC Staff Letter 23-15 that more time is needed during which a data driven analysis should be undertaken to arrive at proper functioning post-initial block and cap sizes based on more recent data reported under the amended and improved CFTC trade reporting rules.

- **Recommendations:** The GMAC Subcommittee recommends that:
 1. the compliance date for the post-initial block and caps sizes is extended for all asset classes to at least December 4, 2024; and
 2. during the extension period, the Commission engages with the industry in discussions and analysis to ensure that the post-initial block and cap sizes are appropriately tailored. Such discussions and analysis should include:
 - (i) how the CFTC collected and analyzed the notional amount data obtained from each swap data repository (“SDR”) to determine the baseline data set to serve as the proper basis to

¹ For ease of reference, this Recommendation uses the term “block” equivalent to what is referred to under the CFTC’s Part 43 Rule as “appropriate minimum block”.

perform the 67% notional amount calculations (for blocks) and 75% notional amount calculations (for caps) to arrive at the post-initial block and caps sizes per swap category in each asset class as required under Part 43;

- (ii) **development of objective criteria for tailoring applicable block and cap sizes (also during times of market stress or volatility) with a view on their impact on the market (such review should include available market data e.g. from swap execution facilities (SEFs) and/or DCOs informative on the topic) and on how the CFTC's real time public reporting requirement under Part 43 applying to trades below and above the block and cap sizes compares to post-trade transparency requirements in other jurisdictions; and**
- (iii) **making adjustments to the published post-initial block and cap sizes and underlying calculations and methodologies, as necessary, before compliance with post-initial block and cap sizes is required under the CFTC rules.**

The new post-initial block and cap sizes reflect in many cases drastic increases (in multiple cases around 10 times higher) compared to sizes currently in place. More importantly, some outputs look anomalous and raise a host of questions and concerns as to whether the data set used by the CFTC properly accounted for certain types of activity, particularly such transactions that should be excluded for purposes of the block and cap size determinations. Unfortunately, since the industry does not have transparency into the data set used by the Commission when setting the new sizes, the industry is not in a position to replicate the new sizes and is unable to explain why the new sizes are substantially higher than expected in certain swap categories.

For example:

- *How did the Commission arrive at a cap size of \$510 million for iTraxx Senior Financial when (i) more liquid index CDS products have a much lower cap sizes (for CDXIG the cap size is \$300 million and for iTraxx Europe it is \$386 million) and (ii) the cap size for iTraxx Senior Financial is expected to be more in the range of the cap size for CDXHY (\$100 million) or iTraxx Cross Over (\$104 million)?*
- *How did the Commission arrive at a block size of \$2.643 billion for gold when the current block size - assuming a price of \$2000 per troy ounce - is around \$5 million? This looks like a tremendous increase in the block size (about 500 times) which market participants are unable to replicate due to their lack of access to overall market data.*
- *Did the Commission exclude notional amounts on roll dates for products other than non-option index CDS (e.g. for FX)?*
- *How did the Commission treat forward starting trades (e.g. in Rates where the relevant swap categories are distinguished inter alia by tenors)?*
- *How did the Commission treat amendments to existing trades, novations, offsetting trades or error correction messages or transactions (in all asset classes) when collecting the notional amount data to perform the required notional amount calculations?*

- *In the preamble to the recent amendments to the Part 43 Rule, the Commission agrees that certain multi-party swap portfolio risk reduction exercises can serve the same purpose as portfolio compression exercises and for that reason do not fall within the definition of “publicly reportable swap transaction” under the Part 43 Rule and are not required to be reported under Part 43. How are such trades properly excluded from the Part 43 data which the CFTC reviews for the block and cap size determination?*
- *Here are some stylized examples (illustrating some of the questions above) where we are curious how each of these trades were treated in determining the appropriate data set. Consider that each of these transactions would mechanically go through the same exact trading venue with no indication whether it is an outright trade, a riskless transaction, collapse, roll or curve trade:*
 - *Rec 1bln SOFR 4% 9/15/23 – 9/15/33 vs Pay 1bln SOFR 4.375% 12/15/23 – 12/15/33 (3m swap roll)*
 - *Rec 1bln SOFR 3.25% 3/15/23 – 3/15/33 vs Pay 950mm SOFR 4% 9/15/23 – 9/15/33 (6m swap roll)*
 - *Rec 1bln SOFR 3.75% 9/15/22 – 9/15/32 vs PAY 900mm SOFR 4.375% 12/15/23-12/15/33 (1y swap roll)*
 - *Rec 120mm SOFR 1.5% 9/15/21 – 9/15/31 + Rec 480mm SOFR 1.75 3/15/22 – 3/15/32 + Rec 500mm SOFR 1.5% 9/15/21 – 9/15/33 vs Pay 120mm SOFR 4% 9/15/23 – 9/15/31 + PAY 480mm SOFR 4.25% 12/15/23 – 12/15/32 + Pay 500mm SOFR 4.375% 12/15/23 – 12/15/33 (multiple leg swap collapse, aged 10y into 8y + aged 10 into 9y + aged 12y into 10y but economically “neutral”)*
 - *Rec 150mm SOFR 4.375 12/15/23 – 12/15/33 vs Pay 300mm SOFR 4.5% 12/15/23 – 12/15/28 (5s10s curve trade)*
 - *Rec 200mm SOFR 4.375 12/15/23 – 12/15/33 (outright 10y swap).*
- *Has the CFTC extended its review to include one year’s worth of relevant SDR data to arrive at the post-initial block and cap sizes for risk free rates products?*

It is important that a more fulsome analysis of relevant trade data be conducted to ensure the quality of the data set upon which the block and cap sizes are based. This analysis needs to be undertaken on a cross-section of relevant trade data which cannot be replicated by industry participants alone based on their own data (necessarily leading to skewed results) but requires the cooperation of the Commission who alone has access to the overall market data via the SDRs.

Further Background:

- Block and cap sizes serve a vital role under the CFTC rules. For swaps reaching the block size, (i) public dissemination of swap transaction and pricing data by the SDR as required under Part 43 is delayed and (ii) if the swap product is subject to the Commission’s mandatory trade executing requirement (i.e. a Made Available to Trade (“MAT”) Product) the requirement to enter into the trade via a SEF Order Book or RFQ-to-3 does not apply and RFQ-to-1 execution is permitted. If a swap reaches the cap size, the public dissemination of swap transaction and pricing data for the swap by the SDR does not include the full notional amount but just the cap size/capped notional. Special treatment of trades reaching the block and cap sizes reflect the CFTC’s acknowledgment that for larger notional trades there is more risk of information leakage and a need for time to enter into offsetting hedges.
- Block and cap sizes are set by the Commission under Part 43. The current block and cap sizes (referred to under the rule as the “initial appropriate minimum block and cap sizes”) were set by the CFTC in 2013 via amendments to the original Part 43 Rule (“Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades”) which also required the

Commission to determine at a later date - based on a methodology set forth in the Part 43 Rule - post-initial block and cap sizes. For the Credit and Rates asset class, the initial block sizes were based on a 50% notional amount calculation.

- In February 2020 - as part of more general proposed amendments to the CFTC's trade reporting rules in Parts 43, 45 and 49, the CFTC made available to the public proposed post-initial block and cap sizes applying to a more refined set of swap categories (introduced via the proposed amendments to the trade reporting rules). The proposed post-initial block and cap sizes were calculated as per the respective 67% and 75% notional amount calculation methodology set forth in the Part 43 Rule (from 2013) and was based on 2018-2019 data. The general market reaction – expressed via comment letters and other industry advocacy – was that these proposed increases appeared extremely high and miscalculated and would likely negatively impact market liquidity and increase costs.
- When the CFTC finalized the amendments to its trade reporting rules in September 2020, the Commission stated in the adopting release on the post-initial block and cap sizes, inter alia, that based on comments received, it would remove index CDS roll dates from the data set to determine post-initial block and cap sizes for index CDS (non-option) trades. The Commission further decided that the compliance date for the post-initial block and cap size be a full year later than the compliance date for the other amendments to the trade reporting rules. This time period was not only meant to help market participants to adjust to the post-initial block and cap sizes, but also to give the Commission extra time to recalculate the new post-initial block and cap sizes (by using data reportable under the amended reporting rules), ensure that the new levels are appropriately calibrated and take action, as necessary, so that the new sizes are appropriately tailored before compliance with the new post-initial block and cap sizes is required. During the Commission meeting adopting the rule changes a vital exchange occurred among the Commissioners which clearly indicated the intent of the Commission to engage in further discussions and analysis with the public to ensure that the final post-initial block and cap sizes are correctly set even if that requires further changes to the calculations.

By way of example: Then Commissioner Stump requested to *“convene a roundtable hearing or similar forum with potentially impacted market participants...well before the implementation deadline. It is my view that this should be done through a formal comment period. If that's not to happen, then I wish to arrange an informal comment opportunity to more appropriately discuss these matters”*.² Then Chairman Tarbert responded: *“I'm more than happy to support such a public discussion on the topic of calculating block thresholds both as they apply to real-time reporting, as well as any impact on execution methods. As a responsible regulator, we must adjust the data information. If we see data information and market dynamics evolving, then I think we act accordingly. ... I certainly commit to supporting changes to our block trade calculations in the event that further public discussions, data, and anything else show that changes are needed.”*³ The public statement on the Part 43 Rule amendment adopting release of then Commissioner Berkowitz includes: *“I also support evaluation and refinement of the block reporting rules, if appropriate, based upon market data and analysis. Market participants can ... provide their views to the Commission on whether further, specific adjustments to the block sizes and/or reporting delay periods may be appropriate for certain instrument classes. This implementation period is also sufficient for the Commission to consider those comments and make*

² See p. 160 of Transcript: <https://www.cftc.gov/sites/default/files/2020/12/1607532690/openmeetingtranscript091720.pdf>.

³ See p. 161 et seq. of Transcript: <https://www.cftc.gov/sites/default/files/2020/12/1607532690/openmeetingtranscript091720.pdf>.

any adjustments as may be warranted. The Commission should consider any such new information in a transparent, inclusive, and deliberative manner.”⁴ (emphasis added)

- Despite the support of these Commissioners for the CFTC to engage in further public discussions and solicit additional feedback, on April 19, 2023, the Commission published on its website (i.e. without any further public industry discussions) revised post-initial block and cap size calculated based on data from December 1, 2021 to November 30, 2022 (i.e. data reported before the amended trade reporting rules went into effect in December 2022 deviating from what was laid out by the Commission to use data reported after the amended trade reporting rules went into effect).

Conclusions:

- Market participants are not in a position to replicate the revised post-initial block and cap sizes because each market participant only has data for its own positions and SDR Part 43 data is made publicly available only with capped notionals.
- As a matter of good public policy and transparency, the CFTC should share with the industry how the CFTC arrived at the revised post-initial block and cap sizes and engage with the industry to establish the proper data points and analysis and develop objective criteria to set the block and cap sizes. This would enable the industry to provide comprehensive feedback to the Commission and facilitate the discussion and analysis of the potential impacts of the block and cap sizes on the U.S. swaps market to ensure that they are appropriately calibrated.
- Furthermore, an impact analysis should be conducted by the CFTC to ensure that the post trade transparency requirements under the CFTC’s real time public reporting rule in Part 43 as it applies to trades below and above applicable block and cap sizes compares to post-trade transparency requirements in other jurisdictions to avoid opportunities for regulatory arbitrage.
- We believe an extension to at least December 4, 2024 for the compliance date of the post-initial block and cap sizes is necessary to undertake this more detailed and comprehensive analysis and review and to engage with CFTC staff on substantive discussions - as the Commission envisioned when it finalized amendments to its trade reporting rules - to ensure that appropriate calculations and calibrations of the post-initial block and cap sizes will enable and support proper functioning of the U.S. derivatives markets.
- If the post-initial block and cap sizes are not appropriately calibrated to balance between transparency and liquidity, this could lead to swap dealers widening bid-offers due to potential information leakage before they can hedge their exposures, especially on large MAT swaps required to be done on an RFQ-to-3 basis, or, decline to provide liquidity in larger notional trades below the post-initial block sizes. As a result, many buy-side managers and end-users may need to break up larger notional trades into smaller clips and trade more often (thus generating more transaction costs and less trading efficiency) or trade alternative, less optimal products for a particular trading or hedging strategy.

⁴ <https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement091720>.