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COMMENT
CL-08312

From: Medero, Joanne <Joanne.Medero@blackrock.com>
Sent: Monday, April 26, 2010 7:06 PM
To: secretary <secretary@CFTC.gov>
Cc: Sherrod, Stephen <SSherrod@CFTC.gov>; Van Wagner, David <dvanwagner@CFTC.gov>; Heitman, Donald H. <dheitman@CFTC.gov>; Lewis, Bradford <Bradford.Lewis@blackrock.com>
Subject: Proposed Federal Speculative Position Limits for Referenced Energy Contracts
Attach: BLK_CommentCFTC4-26-10filed.pdf

Mr. Stawick--Attached please find the submission of BlackRock on the above referenced proposal.

With best regards,

Joanne Medero
Managing Director
BlackRock

Ph: 415 670 2620

<<BLK_CommentCFTC4-26-10filed.pdf>>

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BLACKROCK

Submitted via electronic delivery

April 26, 2010

David Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Federal Speculative Position Limits for Referenced Energy Contracts-Proposed Rule

BlackRock welcomes the opportunity to comment on the Commodity Futures Trading Commission's proposed rules on Federal Speculative Position Limits for Referenced Energy Contracts ("Proposed Rules").

Introduction

BlackRock is one of the world's largest asset management firms, managing approximately $3.3 trillion on behalf of institutional and individual clients worldwide through a variety of equity, fixed income, cash management, alternative investment and advisory products. Headquartered in New York City, we have offices in 24 countries and employ over 8500 people. Our clients include public and corporate pension plans, endowments, foundations, insurance companies and exchange traded fund/mutual fund investors. Our clients are both institutional and retail, but it is important to note that our institutional clients represent in turn hundreds of thousands of defined benefit and defined contribution pension participants and beneficiaries. BlackRock does not engage in proprietary trading whether in commodities, commodity derivatives or any other asset class. As a fiduciary for our clients, we have a strong interest in a regulatory regime that supports liquid, fair and orderly markets.

Our comments will focus primarily on the proposed changes to the CFTC's long established aggregation principles, and the impact of this on large, global asset managers such as BlackRock. We will also touch briefly on the role of passive/index investors in the commodity futures markets—those institutional managers that follow strategies that seek to match the return of a specified commodity index—and how the Proposed Rule would impact these strategies and futures trading in the referenced energy contracts.

Background

In order to achieve portfolio diversification, to manage the volatility risk to which investment portfolios are subject, and to improve risk-adjusted returns, institutional investors are increasingly seeking investment in asset classes that exhibit neither positive nor inverse correlation to traditional equity and fixed income assets. Investment research indicates that appropriately structured indices and baskets of physical commodities exhibit investment return characteristics that are uncorrelated with traditional portfolio asset categories. The investment officers of these institutional investors source these investments to managers with ability to match the desired return stream at the lowest possible cost. Through economies of scale, BlackRock is able to offer these investors exposure to the commodity markets at a competitive cost with best-in-class risk management. On a global basis, BlackRock manages approximately $5 billion in commodity-based strategies.[1]

One of the principal tenets of the Commodity Exchange Act is the recognition that speculative (but not excessive speculative) liquidity is critical to the successful operations of the futures markets. Further, commercial hedgers are plainly not the only legitimately interested constituency when it comes to the regulation of energy and other physical commodities. Ordinary citizens, whose current and retirement incomes are significantly affected by physical commodity prices, have an equal stake in their ability to obtain asset management services (directly or indirectly through pension plans) designed to manage the corresponding risks to which their current and retirement savings are subject.

Impact of Aggregation Proposal on Large Asset Managers and their Clients

As the Commission is aware, Federal speculative position limits (and to some extent, exchange set position accountability levels) act as a constraint on the use of regulated futures contracts as a vehicle for obtaining the investment exposures necessary to achieve targeted levels of portfolio diversification through investment in commodities. As a result, institutional investors are relegated to sub-optimal investment diversification or must turn to alternative, and potentially less efficient, instruments for obtaining targeted commodity exposures.[2]

The Commission's current proposal to eliminate independent account controller status and to require aggregation across enterprises with as little as 10% common ownership will further

[1] These strategies can be either indexed or absolute return and are offered as institutional private funds or separate accounts, and as exchange traded products ("ETPs"). Some BlackRock ETPs invest directly in physical commodities (iShares® COMEX Gold Trust and iShares® Silver Trust). BlackRock's ETPs are listed and traded on regulated securities exchanges and offer the benefits of real-time transparency and liquidity.

[2] OTC derivatives and structured notes may be more costly than futures contracts, introduce tracking error and present individual counterparty risk. Even if regulated futures contracts on the relevant commodities are accessible in non-US venues, it may also be inefficient from a margining and operational perspective to establish multiple trading accounts for the same strategy. However, as a global firm we are also well positioned to react to US regulatory changes in order to continue to provide strategies that meet our clients' needs.

exacerbate the impact of the proposed position limits, impose considerable implementation costs, and likely not achieve the objective of the Commission to reduce price volatility in these contracts. In fact, if the combination of position limits, new aggregation rules and the so-called "crowding out provision" were adopted as proposed, we believe that this would result in reduced liquidity in these contracts making them more susceptible to sudden price movements and also undercutting their effectiveness for commercial hedgers.

Independent Account Controllers. Disaggregation based on the independence of control over trading decisions has been a long-standing policy of the Commission, premised on a recognition that accounts that are under separate management need not be, and should not be, aggregated because they have no combined effect on the market. Asset managers may utilize both passive and active trading programs, which by their very nature are based on different investment decisions and time horizons. Asset managers also participate in 'fund of funds' structures in order to provide their investors access to diversified independently managed investment strategies. As the Commission has recognized for most of its 40 year existence, there is no reason to aggregate these independent positions because different investment approaches provide (and require) different types of market liquidity.

The Commission now proposes to prohibit previously eligible entities from disaggregating positions in the specified energy contracts, notwithstanding the independence of trading control. For asset managers that have relied on Regulation 150.3 and guidance provided thereunder in the establishment and continued conduct of their commodity futures related strategies, this change could be extremely disruptive to the strategies an asset manager provides to its clients.[3] Among other thing, this new aggregation rule may cause asset managers to reduce their trading in the US energy futures markets, and/or shift their activities to other instruments or other venues. It may cause some asset managers to close funds to new investors or to even close down some strategies completely. This all will then result in reduced volume and liquidity for US futures exchanges.

The elimination of independent account controllers for the specified energy contracts –but not agricultural contracts--also will present significant operational challenges for asset managers to design a system that can comply, real-time, with two different aggregation regimes.[4] Further this will need to be coordinated across business units or legal entities that have specifically designed their operations to comply with Regulation 150.3 and not share information.

If the Commission is concerned that the conditions for reliance on the disaggregation rules are not being met by a particular set of affiliated entities, it has inspection and enforcement tools at its disposal to remedy the matter. It should not eliminate a long-standing regime without further

[3] BlackRock is an 'eligible entity' under Regulation 150.3 which complies with the processes and procedures for affiliated independent account controllers.

[4] The proposal also creates a dual regulatory regime, with the Commission setting position limits in the referenced energy contracts and the exchanges continuing to administer position accountability—each with different aggregation rules. This will add to the compliance burden, create potential for confusion, and contribute to errors.

empirical evidence that the 'concentration' that might exist poses a threat to the efficiency and effectiveness of the markets in the referenced energy contracts.

Controlled Entities. The proposal also would require market participants to aggregate positions globally on all entities in which they have a 10% equity interest.[5] There is no exception for asset managers who are passive investors in a potentially large number of companies—located in the US and elsewhere-- that may be engaged in trading the reference energy contracts, as commercial hedgers or otherwise. Instead, the proposal would require these "commonly controlled" enterprises to aggregate their positions, regardless of whether there is any true control being exercised. The proposal would have the perverse effect of requiring otherwise independent trading operations of otherwise independently managed companies to communicate with each other as to their trading positions and intentions, raising the potential for trading in concert, which is presumably the sort of behavior the Commission seeks to preclude by the proposed rules.

Requiring an asset manager to share proprietary trading information with entities in which it holds a 10% equity interest (25% for pools) and allocate limited position volumes across these entities raises concerns about the ability of the asset manager to comply with its fiduciary duties to its clients. It also raises concerns about the ability of an asset manager to maintain the confidentiality of its trading strategies. There is a risk that an asset manager's trading strategies could be copied, destroying the value of the intellectual property employed, along with the managers ability to generate returns for its clients. Additionally, for firms that are global and have global investments, the operational aspects of compliance with such a process are exceedingly complex and will be difficult to implement in a real-time system for US trading hours.

Although we question in general the application of aggregation rules at an equity ownership of 10% (without a showing of some other significant indicia of operating control), if the Commission were to proceed with such an approach, we respectfully suggest that asset managers that are solely passive investors in equity interests in operating companies be excluded from such aggregation policies. [6]

Commodity Index Strategies

Investments in commodity index strategies are made in order to provide portfolio diversification in an asset class whose returns are generally not correlated or negatively correlated with traditional asset classes such as equities and bonds. Commodity index products have a variety of forms, including private funds, separate accounts and ETPs. Many are benchmarked to well-

[5] The aggregation test for commodity pools would be 25% .

[6] A useful model may be the Securities and Exchange Commission's rules and interpretations under Section 13(d) of the Securities Exchange Act of 1934.

diversified and transparent commodity indices, and most are based on passive, long-only, fully collateralized commodity futures positions. Most institutional investors in commodity index strategies are long term investors in these strategies. An argument can be made that commodity index investors are not speculators but in fact are hedging against the impact of inflation on their current and future buying power.

Economist and academics, international agencies and US governmental entities, including the Commission itself, have studied the role of index investors in the futures markets and have been unable to find empirical evidence to support a causal connection between commodity index investing and the value of commodity futures. The studies have correctly concluded that fundamental supply and demand is the underlying cause of oil price volatility, not speculators. Commodity index investors also provide liquidity to the futures markets, and their predominantly long positions facilitate the shorting activity of commercial hedgers. The proposed position limits, coupled with the proposed changes in aggregation rules has the potential of reducing the participation of these investors in the US futures markets, and reducing liquidity in the referenced energy contracts.[7] Rather than enhancing the efficacy of the markets for commercial hedgers, the Commission's proposals could have the opposite effect.

BlackRock's commodity index strategies are conducted consistent with the operation of a fair and orderly market. The orderly approach and longer term objectives of our strategies are directed toward achieving optimal outcomes for, and acting in the best interests of, our clients, many of whom are themselves charged with the management of retirement savings and the investment assets of hundreds of thousands of beneficiaries.

As an alternative to imposing position limits on passive commodity index investors, the Commission could instead utilize its regulatory tools to require reports and to examine these activities. Further, the exchanges also have numerous mechanisms to assure orderly markets through the application of position accountability and other rules.

Conclusion

BlackRock supports the efforts of the Commission to assure that the US futures markets remain fair and orderly and provide effective price discovery for all market participants. It supports the Commission's use of all surveillance tools at its current disposal, and the need for the Commission to receive new surveillance and other powers as the markets evolve. However, we believe the proposal to set Federal position limits on the referenced energy commodities will not achieve the goal of decreased price volatility. BlackRock also believes the elimination of the independent account controller provisions will be very disruptive to the investment strategies

[7] As noted above, in order to achieve portfolio diversification, investors will seek alternative sources of commodity index exposure, which are likely less efficient and pose a different set of risks than US exchange- traded futures.

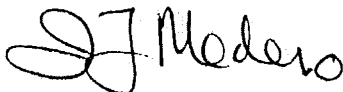
managed for its clients, will add significant compliance costs and also will not achieve the goal of decreased price volatility. We believe that the proposals, taken as a whole, will likely result in decreased liquidity in these contracts, and cause investors to seek alternative solutions to achieve their desired diversification, including non-US venues and alternative instruments to the detriment of US futures exchanges and the US financial markets in general.

We also share and support the views of other commentators that the CFTC's statutory authority to impose Federal limits is predicated on its finding that such limits are "necessary to prevent" the burdens of excessive speculation (CEA §4a(a)), and that the CFTC has failed in the Proposing Release to make such a finding. Further, we also agree with other commentators that the CFTC lacks a statutory basis to adopt regulations designed to restrict the 'concentration' of positions. As other have commented on these matters, we will not repeat those comments here.

We note that regulatory reform legislation now pending before the US Congress may substantially change the Commission's powers, including the ability to establish position limits over OTC commodity derivatives. We urge the Commission to postpone action on this proposal until this legislation is enacted, and the full scope of the agency's authority has been finally determined.

We appreciate the opportunity to comment on the proposal. If you have any questions or would like further information, please do not hesitate to contact us.

Sincerely,



Joanne T. Medero
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