BLACKROCK

January 18, 2011

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

RE: Advanced Notice of Proposed Rulemaking-Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies; RIN 3038 AD99

Dear Mr. Stawick:

BlackRock, Inc. is pleased to respond to the Commodity Futures Trading Commission's request for comments on its Advanced Notice of Proposed Rulemaking on the the Protection of Cleared Swaps Customers, 75 Fed. Reg. 75162 (the "ANPR"). This issue has generated vigorous debate among industry participants, and we support both the issuance of the ANPR and the Commission's stated goals of maximizing customer protection and minimizing costs imposed on customers and the industry as a whole.

BlackRock is one of the world's leading asset management firms. We manage over $3.45 trillion on behalf of institutional and individual clients worldwide through a variety of equity, fixed income, cash management, alternative investment, real estate and advisory products. Our client base includes corporate, public, multi-employer pension plans, insurance companies, third-party mutual funds, endowments, foundations, charities, corporations, official institutions, banks and individuals around the world. We are proud to be a fiduciary to our clients

We believe the essence of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "DFA") is to increase the overall safety and soundness of the US financial markets. The DFA essentially creates a statutorily-mandated oligopoly for Designated Clearing Organizations ("DCOs"), replacing a market that currently has numerous counterparties negotiating their own terms, including mechanisms for the protection of posted collateral. The Commission should carefully examinethe claims of sell-side market participants, the large independent Future Commission Merchants ("FCMs") and their industry associations that established practices in the futures regime are necessary, serve well the interests of buy-side participants and protect against systemic risk. The Commission should carefully examine the risk profile of the OTC derivatives market which is different from the futures market as it determines the applicability

of the futures model to the OTC Derivatives Account Class. The Commission also should carefully examine whether FCMs and swap dealers are leveraging the DFA requirement for mandatory clearing to impose costs on buy-side participants (and to increase revenue for themselves) that are less achievable in the bilateral environment.

I. The ANPR

The ANPR seeks comments from cleared swaps customers on: (i) the benefits of each of the potential models set out in the ANPR relative to the existing futures model (the "Baseline Model") for the protection of customers and their collateral, as well as seeking similar information on any additional models that may be suggested by commenters, and (ii) the costs expected to be incurred relative to the Baseline Model and where possible identifying if these are additive to costs currently existing in the bilateral OTC derivatives market.

II. Risks and Costs

The risks and costs for each model have a component driven by DCOs, FCMs, liquidity providers (i.e., executing brokers and dealers) and buy-side customers. DCOs are in the best position to provide information on the guaranty fund and margin requirements along with any other risks and costs incurred by the DCOs for the four models. FCMs will need to provide information on additional operational costs or savings, if any, as well as fee structures for the four models. It will be important for the Commission's analysis that these costs not be co-mingled with the costs that will result from the re-engineering of practices and processes to achieve the objectives of DFA and the addition of the OTC Derivatives Account Class to the FCM model.

The liquidity providers need to provide information on any additional risks and costs associated with the four models in relation to the current OTC derivatives market. Historically, over the past 10 years the average bid/ask spread paid for the benchmark 5 year and 10 year interest rate swaps has ranged from a ¼ bp to 2 bp of notional depending on market volatility. The liquidity providers have a profitable business model where this bid/ask spread has produced profits after paying for the following costs among others: capital charges for market risk, credit risk and operational risk;operations costs and charges including "dealer-to-dealer clearing using physical segregation of collateral";legal,technology,risk management; and their front, middle and back office staff. We fail to understand why protecting customer collateral through segregation for the OTC Derivative Account class when done at an FCM is associated with high costs when the OTC derivatives market has been able to function as a profitable business with collateral segregation as part of this business model.

For buy-side customers, their model for OTC derivatives currently includes paying the bid/ask spread for swaps, daily collateral management on a fund-by-fund basis with each counterparty (executing broker,dealer) which includes receiving and posting of independent amounts and variation margin, tri-party collateral arrangements (by choice), and swap documentation and confirmations for every swap on an individual fund level. As the buy-side customer generally has its operational components in place (and has been managing the associated maintenance costs), the change in costs in the cleared environment for customers will be mostly reflected in the change in bid/ask spread by liquidity providers,and the addition of the FCM fee structure and changes in the margin requirements relative to the OTC markets imposed by DCOs.

III. The Models

The four models are each discussed in turn:

(a) Full Physical Segregation. This model assumes that each customer's cleared OTC derivatives account, and all property collateralizing that account is kept separately at the FCM, DCO and at each depository. The benefit of this approach, which would mimic the treatment of customer collateral in the bilateral OTC derivatives world, would be to provide, in the event of an insolvency of a carrying FCM, a known and clear path to the transfer of positions (accompanied by the necessary margin) of non-defaulting customers in a timely manner. The current OTC bilateral derivatives model includes the cost of customer protection segregated accounts through the ability to choose to have a tri-party custodial arrangement. We estimate tri-party custodial arrangement costs for the buy-side participant to be approximately 1.1 basis points of the market value of account assets per year per account, which includes a profit margin for the custodial bank. This tri-party arrangement cost will be replaced by the cost of full physical segregation.

A potential proxy for the cost of full physical segregation is the current LCH Clearnet model, which is a dealer-to-dealer model where each account is legally and physically separated for its dealer accounts. As mentioned above, the cost associated with the protection received due to the legally and physically separate collateral accounts for the dealers is embedded in the current bid/ask spread paid by their customers.

Elimination of customers from the mutualization of loss among customers of an FCM could result in the need to increase the margin that might otherwise be required for cleared OTC derivatives. An alternative would be to increase the amount of the DCO guaranty fund. In fact, the protection of customers and clearing members could be achieved through either lever, and some DCOs may choose to use a combination of both. A combination would likely reduce the amount of the increase in initial margin to the individual customer from that in a pure "defaulter pay" model and likely increase clearing fees for all market participants to pay for the increase in the size of the guaranty fund.

A drawback of full physical segregation is that it may increase operational complexity for some market participants, although we believe this can be handled through automated processes, much as routine computational and other back office and custodial operations are managed today. We note that for buy-side customers much of the operational complexity in this model already exists as part of their OTC derivatives operations today. The additional costs would be the increase in fee structures or margin requirements imposed by the FCMs and DCOs.

(b) Legal Segregation With Commingling. As described in the ANPR, this model would have the collateral of all cleared OTC derivatives customers of an FCM clearing member operationally managed on an omnibus basis but attributed to each customer based on the

collateral requirements, as set by the DCO, attributable to each customer's swaps. In the event of an FCM bankruptcy, the DCO would treat each customer's swaps positions and related margin individually based upon the positions reported and margins posted as of the day previous to the default.

As in full physical segregation, this approach removes the non-defaulting customers of an FCM from the mutualization of loss caused by a defaulting customer of the FCM. As such, the same interplay between the potential for increases in margin and increases to the DCO guaranty fund exists, as discussed above. We believe the advantage of legal segregation with operational commingling over full physical segregation would be a reduction in both initial start-up costs and maintenance costs due to a substantial decrease in the re-tooling required due to operational complexity.

(c) Moving Customers to the Back of the DCO Waterfall. This model would require that DCO capital resources and DCO guaranty funds be applied (and expended) prior to the use of the non-defaulting FCM's customers collateral. Enhanced customer protection would result from the low probability that a default event would be so severe that the other funds in front of the non-defaulting customer collateral pool would be insufficient. The advantage of this approach would be minimal changes to the current FCM model and the DCO default waterfall concept. It would also keep the customer collateral as part of the overall DCO default management waterfall and part of the mutualization. The disadvantage is that this model does not eliminate the "fellow customer risk" as do the physical and legal segregation models. Portability of non-deafulting customers to another FCM would also be delayed when compared to the physical and legal segregation model, although similar to the Baseline Model. There should be minimum change in operational complexities for this model. As we believe DCOs and clearing members will seek to pass the costs of this change back to customers, the potential additional costs to customers could come from an increase in margin requirements or fees to fund an increase in the guaranty fund if required.

(d) Baseline Model - The Current Approach Used in US Exchange-Traded Futures. The Baseline Model presumes that the model adopted for the futures markets is to be used for cleared OTC deriviatives. This would mean the collateral of all cleared OTC derivatives customers of an FCM clearing member are held at the DCO on an omnibus basis and the DCO has recourse to all such collateral in the event of the default of that FCM due to a customer default, and that customer funds are the first resource to be used after the funds of the defaulted customer and the FCM have been depleted in the DCO waterfall.

While we are not seeking to change the model for futures, we do not see any logic in perpetuating this model as OTC derivatives move to DFA mandated clearing. However, as to the current futures model, we would like to see a form of a risk rating system governing the FCM capabilities across risk management, technology, default management, client selection and portability.

Some statements have been made that elimination of omnibus customer segregation creates a "moral hazard" in that customers will not choose their carrying FCM with the same care and due diligence. This presumes that today futures customers have access to sufficient information to make truly informed decisions which does not exist. Currently there is no requirement or incentive to notify customers in an omnibus structure if a "fellow customer" is in a "stress" or potential default situation. Instead, customers rely to a large extent on the combination of DCO oversight and capital standards set by the Commission. Only the DCO has access to certain elements of the risk profile of its clearing members—whether those risks stem from the proprietary strategies in the house account or the strategies of the FCM's customers. We note also that there are market efficiencies in having DCOs perform this due diligence function, rather than the thousands of customers each attempting to perform a detailed due diligence—the costs of which are ultimately reflected in the market as a whole.

One can argue that in the current FCM model the buffer provided by customer collateral as the first line of loss makes for a less rigorous selection of clients by the FCMs, subsidizing of margin requirements by higher credit worthy clients for lesser credit worthy clients and less rigorous oversight by the DCOs. It may also contribute to the setting of lower minimum capital requirements. Customers will continue to monitor the credit quality of their carrying FCM as they do for all entities to which they have credit risk exposure. But they would not need to be concerned about the unknown secondary risk posed by trading conducted by other customers of the FCM or the risk management of the FCM towards other FCM clients—a concern which, as noted above, cannot be managed today in the futures model.

Another concern of the omnibus structure is that it will further impair the ability for customers to derive any collateral netting benefit across account classes.

(e) Additional Models-Clearing Membership. The ANPR also asks for comments on any other potential models. There have been some suggestions that buy-side firms could manage "fellow customer risk" by becoming clearing members of DCOs. By becoming a clearing member and maintaining an omnibus customer account, the asset manager could effectively manage this risk because it would be able to control it through its choice and knowledge of its clients.

While "self-clearing" may be an option worth exploring further, no DCO currently has a viable buy-side clearing membership offering today. High capital requirements, risk management procedures that require acting as principal, mandatory bidding and forced allocation are some of the non-trivial concerns that need to be addressed by the DCOs in order for buy-side firms to become 'self-clearing' members. Moreover, this option is likely not available at all to those large public and private pension plans that manage their assets directly.

We note that DCOs in general acknowledge that allowing strong buy-side customers to become self-clearing members would help diversify the clearing membership pool.

IV. Conclusion

DFA implementation has created an unprecedented workload for the Commissioners and staff. While it may seem that proposing alternative solutions to customer protection for cleared OTC derivatives is an optional exercise for the Commmission, we see this as an imperative part of the substantial overhaul of the OTC derivatives markets mandated by the DFA.

BlackRock supports a solution that will maintain the customer collateral protections as available today in the bilateral OTC market, and that customers should have choice (whether at any particular DCO or among DCO offered models). We believe the Commission should move to propose a rule that would eliminate the Baseline Model of an omnibus customer segregation account as the sole solution for cleared OTC derivatives (along with the necessary changes to Part 190), and allow DCOs enhanced flexibility in how they will serve both financial integrity and customer protection. The introduction of the potential for DCOs in providing a choice of solutions should also serve to introduce an element of competition that will drive the costs to customers down.

If we can answer any questions or provide further information concerning this important topic, please do not hesitate to contact us.

Sincerely,

Joanne Medero
Richard Prager
Supurna VedBrat