

BLACKROCK

March 7, 2011

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

Re: Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding the Mitigation of Conflicts of Interest 17 CFR Parts 1, 37, 38, 39, and 40 (RIN 3038-AD01)

Dear Mr. Stawick:

BlackRock, Inc.¹ submits these comments on the Commodity Futures Trading Commission's (the "Commission") Notice of Proposed Rulemaking entitled "Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest." 76 Fed. Reg. 722 (January 6, 2011) (the "Proposed Rule"). In the Proposed Rule, the Commission has proposed certain substantive requirements to address the governance requirements for and mitigation of conflicts of interest in the operation of derivatives clearing organizations ("DCOs"), designated contract markets ("DCMs"), and swap execution facilities ("SEFs" collectively with DCOs and DCMs, the "enumerated entities"). Such substantive requirements address, among other things, reporting, transparency in decision making, and limitations on use or disclosure of non-public information.

The Proposed Rule is intended to complement the Commission's proposed rules of October 18, 2010 entitled "Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest" (the "Conflicts of Interest Release").²

BlackRock supports the Commission's goal to have rules that may achieve better governance of and a mitigation of conflicts of interest within the enumerated entities. As the voice of and a

¹ BlackRock is one of the world's leading asset management firms. We manage over \$3.54 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.

² See 39.13(g)(1), 75 Fed. Reg. at 63,750

fiduciary for our clients, BlackRock has a vested interest in strong governance and mitigating conflicts of interest that arise in the operation of such the market participants. We believe that strong governance requirements and effectively mitigating such conflicts will serve our clients' interests as well as the interests of the U.S. financial system. We welcome the opportunity to express our view that requiring fair representation on the operating committees that have responsibility for the day-to-day affairs of these enumerated entities, such as the risk management committees ("RMCs") of DCOs³, is critical to achieving the Commission's goals.

I. The buy-side must have a meaningful voice in DCO operations.

In response to the Conflicts of Interest Release, BlackRock submitted a comment letter dated November 15, 2010 (the "November Letter"), the essence of which was that buy-side participants, like customers of clearing members, need meaningful representation on the committees that make the critical determinations on the core functions of the organization that impact all of its participants. Such representation is more important than fair representation on the Board of Directors because the operating committees, such as RMCs, will have significant influence over the day-to-day affairs of DCOs.⁴

We believe certain aspects of the Proposed Rule would mitigate conflicts of interest less effectively than the rules proposed in the Conflicts of Interest Release. Specifically, the Commission would replace the customer representation requirement for the RMC with Proposed Rule 39.26(b), which imposes a requirement that DCO Boards of Directors be composed of at least 10% customer representatives. The Commission suggests that the buy-side may prefer customer representation on the Board of Directors because the Board of Directors would have the opportunity to review and adjust actions of the RMC.⁵ The Commission further states that it is not inclined to require customer representation on both the RMC and the DCO Board of Directors, as the former reports to the latter. Put differently, the Commission appears to believe that Board representation for the buy-side would be preferable to RMC representation because customer directors would have the opportunity to (i) review recommendations and actions of the RMC, (ii) request the rationale behind such recommendations and actions, and (iii) vote to reject such recommendations and to supersede such actions.

i. Board representation alone will not give the buy-side a meaningful voice in DCO operations.

We, on behalf of our clients, respectfully disagree with the Commission's conclusion. BlackRock believes that Proposed Rule 39.25(b) does not go far enough in providing the buy-side appropriate representation through the Board of Directors. Proposed Rule 39.25(b) requires a DCO to submit a report to the Commission detailing five items of information including the rationale for rejecting

³ The focus of this letter is on RMCs of DCOs. However, the same principles should apply to Boards and governance oversight committees of DCMs and SEFs. In particular, BlackRock believes the buy-side should be represented on the committees that make membership and product determinations for registered entities.

⁴ Prior to the submission of the November Letter, at the CFTC-SEC Public Roundtable on Governance and Conflicts of Interest in the Clearing and Listing of Swaps, BlackRock observed that "as the [sole] fiduciary on this panel, we talk about membership, we talk about ownership, we believe that very strong governance with the participation of the users of these venues is critically important." See Comments from Richard Prager, Managing Director, Global Head of Fixed Income Trading, BlackRock, Roundtable Transcript, 131:20-132:3 (Aug. 20, 2010).

⁵ See 76 Fed. Reg. at 729.

the recommendation in the event that the DCO Board of Directors rejects a recommendation or supersedes an action of the RMC. Notwithstanding this rule, DCOs are not likely to structure their internal operations so that all decisions of RMCs are reviewed by the Board of Directors. Many decisions made by the RMC will likely not be reviewed or will be reviewed in a cursory way after some delay.

Even if each DCO were to require the Board to approve RMC actions, the buy-side's ability to act as a balancing influence at the Board of Directors level would be very limited because of the likelihood that the buy-side may be outvoted, including being outvoted procedurally if it tries to raise a RMC decision for examination by the Board of Directors.

ii. Buy-side representation on the RMC would benefit the swap markets.

The buy-side represents a considerable portion of all risk-taking in each OTC derivatives asset class. Under the current central counterparty clearing house ("CCP") structure, when a futures commission merchant defaults, client collateral funds are depleted before the CCP's default fund is tapped. As holders of vulnerable stakes in DCOs, buy-side participants have real incentives to ensure that prudent risk management practices exist and are observed. In addition, as a major group of intended users of cleared products, buy-side participants would be able to explain why a particular product would be useful and whether the risks associated with such a product could be prudently managed. Given the importance of the buy-side's position, we support the representation of buy-side views on both the Board of Directors and the RMC of a DCO. However, we would give top priority to buy-side representation on the RMC and recommend that the final rules emerging from the Proposed Rule mandate a minimum 10% customer representation on the RMC or any other committee that undertakes decisions that are material to the day-to-day affairs and the market structure of such entity.

Buy-side views are best represented at the RMC level or within other similar governing committees because the Conflict of Interest Release charges the RMC with determining products eligible for clearing, setting standards and requirements for initial and continuing clearing membership eligibility, and advising the Board of Directors on the relevant DCO's risk model and default procedures. In other words, decisions of the RMC will have profound and immediate impacts on all DCO constituencies, including customers. In light of the importance of RMC decisions, it is not only advisable, but necessary, that the buy-side's views be taken into account in making these determinations. The buy-side would bring much needed balance and expertise to the decision-making process, thus increasing the transparency of that process and mitigating the conflicts of interest inherent in it from the very outset, and creating a better prospect for such conflicts to be resolved.

Moreover, failing to provide buy-side participants with meaningful representation on a DCO's RMC could lead to unintended consequences. Currently, the over-the-counter swaps market provides many buy-side participants with a viable alternative to the FCM-based CCP model for trading derivatives. Once the Dodd-Frank Act takes effect, however, the dual clearing and exchange-trading mandates contained in Section 723 will require many, perhaps most, buy-side participants to use DCOs and DCMs or SEFs for the bulk of their derivatives trades. Without meaningful representation on the operating committees (and RMCs in particular), buy-side participants will have no real voice in the operations of the registered entities Dodd-Frank requires investors and end-users to use.

II. Strong conflict of interest rules should prevent any one group of market participant from dominating the RMC.

In addition BlackRock believes that the Proposed Rule continues to allow an overrepresentation of clearing members that are dealers on RMCs. The Proposed Rule, like the Conflicts of Interest Release, continues to provide that each DCO have a RMC with at least 35% public directors and 10% customer representatives.⁶ However, neither the Proposed Rule nor the earlier Conflicts of Interest Release sets forth limitations to prevent direct control of a RMC by that DCO's dealer clearing members. No participant class should dominate the RMC, and in particular not the class that has the greatest conflicts of interest, i.e. dealer clearing members.

We respectfully renew our suggestion that the Commission adopt a mechanism to guarantee buy-side participants and other DCO constituencies real input on operating committees, including DCO RMCs. This means the Commission should make certain that dealer clearing members cannot unilaterally change DCO policies and procedures. We believe that the Commission could adopt either of the following options, in conjunction with the proposals in the Conflicts of Interest Release, to ensure that RMC decisions reflect input from non-dealer clearing members and prevent any one participant class from dominating the RMC:

- The Commission could require that a majority of the RMC and similar operating committees consist of non-dealer representatives, including public directors, customers and, where applicable, non-dealer members of the DCO. This would provide meaningful representation to the buy-side community and would also assuage clearing member concerns that too few public directors have the expertise required to execute the duties of the RMC.
- The Commission could provide that the RMC must act by a supermajority vote. For each RMC, the supermajority required would be set at a level that would prevent dealer representatives, as a group, from making any decisions without having those decisions supported by at least some non-dealer representatives. This option would prevent dealer clearing members from making any decisions unilaterally by requiring multiple DCO constituencies to approve RMC action.

Either of these options would advance the Commission's stated objective of mitigating conflicts of interest by ensuring that all the constituencies of DCOs work together to set operating policies and procedures.

We thank the Commission for the opportunity to comment on the Proposed Rule. We believe that requiring buy-side perspectives on the operating committees of these organizations will help mitigate conflicts of interest and we urge the Commission to include a fair representation

⁶ We note that the Commission has stated that it is inclined not to require customer representation on the RMC if it adopts rules requiring such representation on the Board. In this context, a "customer" means any customer of a clearing member, including, without limitation, commodity customers, foreign futures or foreign options customers, and any customer entering into a cleared swap.

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requirement in its final rules. If you have any questions or would like further information, please contact either of us.

Sincerely,

Joanne Medero

Richard Prager