BLACKROCK

March 8, 2011

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

Re: CTFC Notice of Proposed Rulemaking on Core Principles and Other Requirements for Swap Execution Facilities (RIN 3038-AD18)

Dear Mr. Stawick:

BlackRock, Inc.[1] is pleased to provide these comments on the Commodity Futures Trading Commission's (the "Commission" or the "CFTC") proposed rules (the "Proposed Rules") concerning the Core Principles and Other Requirements for Swap Execution Facilities ("SEFs"). The Proposed Rules provide requirements, guidance, and acceptable practices, for the registration and operation of SEFs, a new type of regulated trade execution facility, which will provide the ability to list, trade and execute standardized cleared and other swap transactions. The Proposed Rules implement the regulatory obligations that each SEF must meet in order to comply with Section 5h of the Commodity Exchange Act ("CEA"), both initially upon registration and on an ongoing basis. The Commission requested comment on all aspects of the Proposed Rules, guidance and acceptable practices.

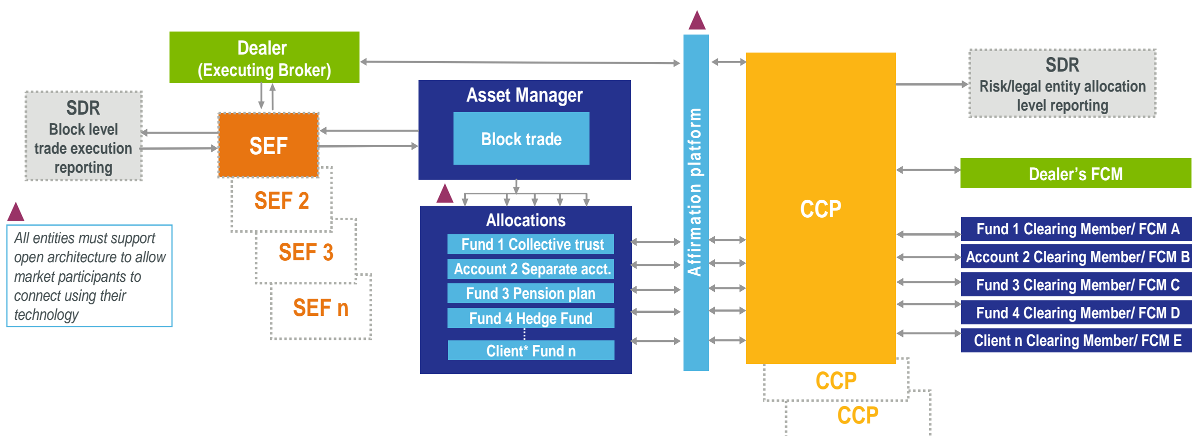
BlackRock fully supports the objectives of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") to establish a comprehensive regulatory framework that would reduce risk, increase transparency for both price and liquidity, and promote market integrity. We recognize that promoting trade executions on SEFs was one of the goals of the Dodd-Frank Act. As an asset manager representing many different types of clients, investment vehicles, and separate accounts (collectively "Funds and Accounts"), we offer these comments to help the CFTC write final rules that will facilitate the development of a successful SEF marketplace to the benefit of all market participants including investors in our Funds and Accounts.

As we present our comments to the Commission, we believe it is important to set the context of the SEFs within the current bilateral over-the-counter ("OTC") market, as SEFs are a material change to the current market structure and could potentially undermine

[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.

the success of cleared derivatives as they migrate from the OTC bilateral market. The current OTC market provides investment managers like BlackRock with a deep and liquid market that we confidently use to execute swaps for our clients. This confidence comes from transparency of prices linked to dependable liquidity offered to us from a range of liquidity providers. We are concerned that the Commission is focusing primarily on price transparency, with less focus on liquidity transparency, also known as depth of market. The OTC market is an institutional market for market participants who meet a certain standard. Many of the draft SEF rules attempt to promote retail market conventions with the objective of price transparency, something the OTC market currently offers to asset managers like BlackRock. However, the Proposed Rules come at the cost of impairing liquidity, which will drive up the costs of swaps and make swaps a less attractive investment product. Liquidity comes from confidence of execution, thus we encourage the Commission to be less prescriptive and to allow flexibility in trade execution when introducing SEFs, understanding it will take time to gain confidence and will only do so with a phased approach, allowing new market conventions to form, consistent with the spirit of the Dodd-Frank Act.

BlackRock supports the introduction of SEFs and urges the Commission to promulgate flexible SEF rules that will allow for confidence and liquidity to build in these new trading platforms. Market participants will resist trading on SEFs unless they have confidence in SEFs and SEF regulation. We support a regulatory framework consistent with the Dodd-Frank Act that will allow the SEF marketplace to evolve as the swap market transitions from the OTC market to a cleared environment. Accordingly, we urge the Commission to reconsider those aspects of the Proposed Rules that would impose impediments on the ability of market participants to execute trades on SEFs. We are particularly concerned that certain provisions of the Proposed Rules would impair liquidity and transfer this risk premium to investors in our Funds and Accounts in the form of wider bid/ask spreads and higher transaction costs. These increased costs and risks may cause investors to seek other risk transfer strategies or to transact swaps in jurisdictions with more favorable regulations and market structures, contrary to the goals established in the Dodd-Frank Act.



We also recommend that the Commission consider the role and interconnectivity of SEFs as illustrated above within the overall trade process flow in the new market structure regime. If the cost of trading or transacting on SEFs is too high due to the need to link to multiple SEFs, each with a shallow pool of liquidity in different product offerings, or the

path that leads transaction data information from the SEF to the CCPs becomes too expensive or operationally burdensome, investment strategies may be forced into other markets or products.

In the interest of investors in our Funds and Accounts, we specifically request that the CFTC: (1) allow transparency of price and liquidity in the swap markets to develop gradually rather than trying to encourage transparency though mandating execution methods; (2) allow SEFs to establish flexible trade execution options; (3) clarify the post-execution responsibilities of SEFs; (4) ensure that all market participants have a meaningful voice on SEF operating committees; and (5) harmonize SEF regulation with regulation of security-based swap execution facilities ("SBSEFs").

We will comment on the Proposed Rules in the context of the following categories: (i) pre-trade price transparency, (ii) trade execution, (iii) post-execution responsibilities, (iv) SEF governance, (v) market development and (vi) sequencing and implementation.

I. Pre-Trade Price Transparency

The Dodd-Frank Act seeks to "promote the trading of swaps on swap execution facilities and to promote pre-trade price transparency in the swaps market."[2] In BlackRock's view, one way the Commission can advance these objectives is by adopting regulations that permit SEFs to offer market participants flexible trade execution options that allow for transparency of price and availability of liquidity to co-exist without causing market disruption.

i. RFQ to a Mandatory Minimum Number of Counterparties

The current proposed rule requiring a market participant to seek a request for quote (a "RFQ") from at least five potential counterparties on a SEF may hinder competitive liquidity on the SEF and discourage market participants from executing on SEFs. From an asset management perspective, there are times when substantial risk positions have to be transferred on behalf of Funds and Accounts and the best way to execute without disrupting the market is to deal with a limited number of counterparties which, depending on liquidity in the market, may actually be a single counterparty. The Commission's requirement that a market participant broadcast its desire to execute to at least five potential counterparties could affect prices and liquidity and move the market against that investor. Liquidity providers may not have certainty of trade nor sufficient time to hedge their positions as other market participants will have knowledge of the trade. The liquidity providers will have to factor into their prices the market impact of transactions entered into by other market participants based on the expectation that those market participants now have knowledge that the winning liquidity provider may have to hedge its exposure and as such will transfer the liquidity risk premium to the investor in the form of wider bid/ask spreads. This transference of liquidity risk premium is a direct cost to investors in our Funds and Accounts as it

[2] Dodd-Frank Act § 733, New CEA § 5h(e).

will be reflected in the performance of particular strategies and in the returns BlackRock can deliver to its investors.

We recommend that the Commission not set a minimum number of counterparties from whom an RFQ must be sought but allow an investor to choose from "all" market participants on the SEF. We note that the Dodd-Frank Act requires that SEFs offer market participants *the ability* to accept bids and offers made by other market participants. It does not compel the CFTC to force this functionality on the marketplace. When considered beneficial to receiving competitive pricing for Funds and Accounts, asset managers should be given the option to choose how many counterparties to seek a RFQ from. Over time, as liquidity increases for certain types of swap transactions and confidence builds within the swap market, there will be a natural progression for RFQs to migrate to more counterparty requests and then ultimately to central order books for execution.

Another unintended consequence of the minimum RFQ to five counterparties may be that asset managers may be forced to break trades into smaller slices so as to decrease the risk of market moving activity to the detriment of its clients and the market as a whole. This slicing of trades also transfers liquidity risk and uncertainty of trade execution from the liquidity provider to the investor. Apart from impacting the pricing, slicing will lead to an increase in transaction costs and operational risk.

II. Trade Execution

BlackRock believes that, consistent with the CFTC's principles-based approach to regulation, SEFs should be designed to offer flexible trade execution options. For the purpose of orderly trade execution, without causing market disruption, the CFTC should balance the goal of transparency using both the elements of price and liquidity.

The Commission should also continue to promote an all-to-all marketplace and discourage any structural impediments to the framework or the infrastructure supporting the framework that would impede this. A primary example is a SEF should not be allowed to specify in its rules that one side of a transaction must be a particular market participant.

i. Execution Methods

The current OTC bilateral swap markets are deep, liquid and generally offer pre-trade price transparency that allows for orderly hedging of risk, which in turn supports the availability of liquidity.

We support the CFTC's proposal to allow SEFs to offer market participants flexible methods of execution that are designed to take into account available liquidity and pre-trade price transparency so the transaction can be absorbed into the overall market with no market disruption. This flexibility of execution methods should encourage some swap products to gravitate naturally towards central limit order books as confidence builds within the SEF and availability of liquidity begins to concentrate and appear on the central limit order book. SEFs should have the

flexibility to offer both required and permitted transactions through central limit order books and RFQ platforms. The parameters that differentiate the central order book, the RFQ and non-SEF trade execution (block trade) should take into account liquidity of a particular swap and may differ from one swap to another.

ii. Block Trades

An asset manager transacts for many different investors linked to an investment strategy. In order to minimize the transaction cost for its investors, the manager may execute these trades as a block. Block trading is a very important and efficient mechanism of trade execution used by asset managers. The block size set for block trading should take into account market disruption and liquidity of the tradable instruments by factoring in open interest and average size of trade and should be set at a level that makes trade execution at a block level an option for institutional investors and not only liquidity providers.[3] We reiterate our position in our earlier comment letter[4] and we suggest that the CFTC consider setting the block size initially at the 75th percentile rather than the 95th percentile, as the Commission has proposed.

If the block size is set too large, making block trading an unavailable option to asset managers, these transactions would need to be executed in smaller pieces so as not to disrupt the market while the overall trade is being executed so as not to harm the interest of our clients. The slicing of trade execution increases the liquidity risk to the investor. It will also increase transaction costs and operational risks. Over time, as market transitions and the confidence in the new market structure builds, the minimum block size could be adjusted to continue to achieve the goals of the Dodd-Frank Act. The flexible trade execution options would allow for certain swap transactions to migrate naturally, as appropriate, from block trades to RFQ and then to central limit order book as liquidity begins to build and appear at the various SEF trade execution venues.

We ask the Commission to clarify that a SEF-eligible swap that trades as a block off the SEF platform but under the SEF's block trade rules is allowed to use the SEF for purposes of processing.[5] This would allow for consistent post trade operational flows to exist for all trades executed on a particular SEF-eligible swap regardless of size of trade execution. It would also reduce the cost and operational risk for clients as they will not need to maintain two separate post trade processes based on trade size. Another advantage is that it would allow the SEF to have more insight into the actual tradable amount for a particular swap. As a SEF-eligible swap builds confidence and as such liquidity begins to appear, allowing the SEF to process the block trades will make the transition from block to RFQ and central limit order book simpler and easier for clients, as only the trade execution option will need to be adapted but all operational flows will already be in place.

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[3] *See* BlackRock Comment Letter dated February 22, 2011 entitled "Core Principles and Other Requirements for Designated Contract Markets; Proposed Rule; 75 Fed. Reg. 80,572; RIN 3038-AD09."

[4] *See* BlackRock Comment Letter dated February 7, 2011 entitled "Real-Time Reporting of Swap Transaction Data; RIN 3038-AD08; 75 FR 76140."

[5] *See* Proposed Rule 37.9(a)(v) (defining "Permitted Transactions") and Proposed Rules at 1218-1219 and n. 37.

iii. Fifteen Second Rule

BlackRock does not believe that the core principles outlined by the Dodd-Frank Act in Proposed Rule 37.9(b)(3) for SEFs justify the imposition of a 15 second hold quote requirement. Requiring market participants to hold a customer's quote for 15 seconds introduces uncertainty of trade execution and market movement risk that will be priced into the bid/ask spread given to the customer. Although there is the possibility that another market participant may provide an improved price, it is unlikely to be in the customer's best interest given the potential reduction in liquidity this rule may create. Competitive pricing should be driven by market forces.

Swap markets can experience periods of sporadic liquidity. Buy-side customers rely on swap dealers to mitigate illiquidity events and provide deep and liquid markets. One potential negative effect of the timing delay would be that a dealer who places both the customer’s sale order of a non-block size and the dealer’s buy order into a SEF for execution will not know until the expiration of fifteen seconds whether it will have completed both sides of the trade or whether another market participant will have taken one side. Therefore, at the time of receiving the customer order a dealer would have no way of knowing whether it will ultimately serve as its customer’s principal counterparty or merely as its executing agent. This may lead to unwillingness on the part of dealers to provide liquidity to the swap markets, with detrimental results for buy-side customers and end users. The proposed fifteen-second timing delay in the context of the swap markets may not necessarily be well-suited for investor pricing. In the context of an all-to-all marketplace this rule may potentially cause impediments.

III. Post-Execution Responsibilities

i. Trade and Risk Reporting

We believe that trade and risk reporting at time of execution should be done by the SEFs directly to a Swap Data Repository (“SDR”). SEFs have the necessary information, such as the economic terms at time of trade execution. The fewer entities reporting to the SDR enhances data integrity as the transaction data is reported. If data is transferred too many times before it is reported to the SDR, it can compromise the integrity of the transaction information as the risk of data errors occurring increases with each “hand-off.” A SEF entity is also preferred as a reporting party to any one market participant or a market participant hierarchal reporting structure as this will help preserve the intent of an all-to-all market structure as proposed by the Dodd-Frank Act.

We share the Commission's belief that SEFs must be execution facilities, and entities that merely process swaps do not meet the Dodd-Frank Act's definition for SEFs. We also recognize, however, that SEFs will be providers of transaction data to entities involved in post-trade processing. We ask the CFTC for transaction-level data required by a SEF to be limited to information required for block-level trade execution and not to burden the SEF with post-trade operational data collection

and maintenance. For example, a SEF is not a party to the clearing of a trade but rather only to the execution of the trade. If certainty of clearing is required at time of trade execution, this should be achieved through documentation between the market participant and its clearing member and should not be part of the SEF validation checks.

A SEF should be required to report the transaction size of trades executed on the SEF. However, it would be too burdensome and costly for a SEF to monitor and report aggregate transaction positions executed by a counterparty. This is partially because the SEF only has a view into transactions executed on the SEF and has no view on transactions executed by a counterparty on other trading venues or SEFs.

ii. Market Surveillance

The Proposed Rules would require SEFs, as part of their self-regulatory function, to collect and evaluate data on individual market participants' market activity on an ongoing basis in order to detect and prevent manipulation and price distortion. SEFs are not in a position to comply with the rule as proposed and this rule may restrict the development of SEFs. This is because SEFs will not possess information about trades that are executed on other venues or about other positions that a market participant holds. Nor should SEFs be expected to collect or evaluate data for transactions that occur off the facility. The CFTC should avoid imposing unnecessary regulatory burdens on SEFs or forcing market participants to provide SEFs with information about all trades that are executed elsewhere.[6] Such a result would be operationally burdensome and costly and is not mandated by the Dodd-Frank Act.

iii. Central Counterparty Clearing House ("CCP") Connectivity

BlackRock requests that the CFTC affirm that a SEF must ensure market participants connectivity to affirmation platforms that connect to all CCPs that clear for the asset classes offered on the SEF. Specifically, we believe the CFTC should clarify its statement that "for swaps cleared by a DCO [derivatives clearing organization], a SEF must ensure that it has the capacity to route transactions to the DCO."[7] We believe the proper interpretation of this language is that if a DCO offers a swap for clearing, each SEF that lists that swap for execution must ensure that market participants will have the capability to route transactions in an efficient manner to that DCO.

The Dodd-Frank Act and previously proposed CFTC rules contemplate that counterparties to a swap will choose where the swap will be cleared. If a SEF is not required to ensure connection of market participants with each DCO that accepts a particular swap for clearing, a SEF would be able to deprive swap

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[6] With respect to certain proposed rules, such as Proposed Subpart G — Position Limits or Accountability, the CFTC would confine a SEF's duty to monitor positions to those established on or though the SEF. We believe the CFTC should confirm that other rules requiring monitoring refer only to positions established on or through the SEF.

[7] *See* Proposed Rules at 1229. We note that the CFTC has recently reproposed the Proposed Rule (37.702) that requires SEFs to ensure connectivity to DCOs. We urge the Commission to confirm that the rule as reproposed will still require SEFs to connect to each DCO that clears a swap.

counterparties of available liquidity by providing connectivity to one DCO resulting in a form of the vertically-integrated SEF-DCO traded execution and clearing model such as is found in the futures industry. Clarifying that SEFs must offer connectivity to every DCO that clears a swap will enhance competition by preventing one DCO from establishing a monopoly for clearing a particular swap. In addition, connectivity to multiple DCOs will reduce costs to market participants who would otherwise have to participate on multiple SEFs in order to have access to the liquidity available for a different DCO clearable transaction. For example, if one SEF ensures connectivity to the CME Group ("CME") and another SEF ensures connectivity to the LCH Clearnet Group ("LCH"), then a client would need to connect to both SEFs to have access to the liquidity of the CME and LCH contracts, which may be identical from a risk standpoint.

iv. Swaps Available to Trade

The Proposed Rules require that all swaps subject to the clearing requirement and "made available for trading" by a Designated Contract Market ("DCM") or SEF be traded on a DCM or SEF (the "Execution Requirement").[8] A cleared swap may be exempt from the Execution Requirement if no SEF or DCM "makes the swap available to trade." The term "available to trade" has a significant new meaning in the context of a SEF, where it is a critical aspect of the determination that a swap must be traded on a SEF or DCM. The Commission's proposed approach to determining when a swap is "available to trade" places too much power in the hands of market participants that may be motivated by self-interest and will create confusion about which swaps are required to be traded on a SEF or DCM.

The Commission proposes that if "at least one swap execution facility has made the same or an economically equivalent swap available for trading, all swap execution facilities are required to treat the swap as made available for trading."[9] It is unclear what this means as a practical matter. The Commission should not permit SEFs to determine whether a swap has been made "available to trade." Instead, the CFTC itself should make that critical determination based on CFTC-established mandatory objective criteria including the accessibility to trade and clear the swap by all market participants. The lack of mandatory objective criteria for the determination that a swap is available to trade will create considerable uncertainty among market participants.

For this reason, we appreciate that the Commission has distinguished between listing a swap and making that swap "available to trade" in the Proposed Rules. We ask the Commission to go further, however, and explicitly curb SEF discretion for declaring a product "available to trade." Because the determination that an instrument has been made available to trade essentially removes it from the bilateral OTC swap market, a significant segment of customers and market makers without connectivity to that particular platform would effectively be precluded from entering the market in that instrument unless they rely on intermediaries or other SEFs or DCMs also offer that swap. Market participants would be required to

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[8] Section 723 of the Dodd-Frank Act which amends Section 2(h)(8) of the CEA.

[9] *See* Proposed Rule 37.10(c)(1).

seek connectivity with the platform listing a particular instrument in order to trade the instrument. As a consequence, market participants with greater resources to devote to connectivity, operations and document negotiation would likely have an advantage in gaining access to trading. The exclusion of market participants who do not have such resources would be inconsistent with the equal access requirements of the Dodd-Frank Act.

IV. SEF Governance

BlackRock, as the voice of its clients, has repeatedly urged the CFTC to require that the committees responsible for the day-to-day operating of registered entities include input from all market participants and that no one participant class should dominate these committees.[10] The Commission should require that SEFs ensure that buy-side market participants have a meaningful voice on these operating committees. We believe such representation is critical to building a robust and sustainable regulatory framework for SEFs to serve the best interests of our clients as well as the interests of the U.S. financial system.

The SEF governance rules should require SEFs to have robust procedures and processes to evaluate and approve eligibility to participate on the SEF. The CFTC also should provide clarity on the role and liability of the SEF for transactions that have trade execution breaks. In the central limit order book where parties trade anonymously, it is essential that a SEF have the right rules and processes in place to manage credit risk exposure of market participants allowed to participate on the SEF and for trade execution break resolution. In addition, given the need to evaluate and price counterparty credit risk before entering an uncleared swap, we respectfully suggest that the Commission clarify that only cleared swaps will be offered on a central limit order book.

V. Market Development

An important aspect of a sustainable regulatory regime is sizing appropriately the costs of regulation. One way to keep costs relatively low is to harmonize compliance duties across agencies where possible. The Dodd-Frank Act provides this opportunity for SEFs by establishing SBSEFs, the security-based swap analog to SEFs. Although the CFTC will register and supervise SEFs and the SEC will do the same for SBSEFs, the statutory language establishing SBSEFs is nearly identical to the language establishing SEFs. Moreover, the Dodd-Frank Act contemplates that some facilities may register as both a SEF and SBSEF, further indicating that there should be significant overlap between the regulation of SEFs and SBSEFs.

However, the CFTC's Proposed Rules for SEFs differ dramatically from the SEC's proposal on SBSEFs. We recognize that some differences may be inevitable since the swap and security-based swap markets differ in some respects, but greater harmonization is possible and desirable for buy-side market participants. Differences

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[10] *See* BlackRock comment letter filed March 7, 2011 entitled "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)

between the CFTC's and SEC's rules that are not required by differences between the financial products each agency regulates will "drive up the cost of implementation, without improving the regulatory structure."[11] Before either the Commission or the SEC adopts final rules for SEFs or SBSEFs, we urge the Commissions to meet and harmonize their rules as much as possible to create a more streamlined approach to SEF and SBSEF regulation.

In addition, we urge the CFTC and SEC to engage foreign regulators to take a flexible, harmonized approach towards devising the new market rules for execution platforms. Swaps in one market are often hedged in or linked to other markets, and it is critical that SEFs (or their equivalents) in different jurisdictions operate in a compatible manner. This need for compatibility is another factor favoring flexibility in SEF regulation. We note that, to date, both the SEC and the European Commission have indicated their intention to be flexible in their SEF regulation and would urge the CFTC not to develop rigid rules.

VI. Sequencing and Implementation

BlackRock recommends that the CFTC allow sufficient time for the rule writing, design, and implementation of SEFs. SEFs are a new and unknown entity for all market participants. We would recommend SEF implementation follow clearing implementation. Once the transition of standardized products from the OTC bilateral market to a cleared environment has been successfully achieved, introducing SEFs will be more orderly and will have a higher probability of acceptance and adoption by market participants.

Thank you for the opportunity to share our views on this important issue. If you would like to discuss further, please contact any of us.

Sincerely,

Jack Hattem
Joanne Medero
Richard Prager
Supurna VedBrat

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[11] *See* Letter from Barney Frank, House Committee on Financial Services, to Mary L. Schapiro and Gary Gensler (Feb. 18, 2011).