BLACKROCK

February 15, 2013

Ms. Melissa Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, D.C. 20581

VIA ELECTRONIC SUBMISSION

Re: Notice of Proposed Rulemaking on Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations (RIN 3038–AD88)

Dear Ms. Jurgens:

BlackRock, Inc.[1] is pleased to respond to the Commodity Futures Trading Commission's (the "**Commission**") request for comments on the proposed rule on Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations (RIN 3038–AD88) (the "**Proposed Rule**").[2] BlackRock supports the Commission's efforts in the Proposed Rule to ensure adequate protection of customers by enhancing the requirements for futures clearing merchants ("**FCMs**"), derivatives clearing organizations ("**DCOs**"), and enhancing the oversight responsibility of FCMs by their designated self-regulatory organizations ("**DSROs**"). The recent insolvencies of two FCMs, MF Global, Inc. ("**MF Global**") and Peregrine Financial Group, Inc. ("**Peregrine**")[3] continue to highlight the weakness in the current customer protection regime for futures customers. In MF Global and Peregrine, shortfalls of funds in segregated and secured customer accounts resulted in losses for customers and more generally undermined the confidence of investors. We commend the Commission for taking steps to address the issues raised by the MF Global and Peregrine insolvencies with the Proposed Rule.

BlackRock supports regulatory reforms that promote market integrity while balancing costs, benefits and the maintenance of investor choice. BlackRock also believes that the Dodd-Frank Act's ("**DFA**") clearing mandate will contribute to the safety and soundness of the U.S. financial markets and has supported the Commission's efforts to promote

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[1] BlackRock, Inc. ("**BlackRock**") is one of the world's leading asset management firms. We manage over $3.79 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] 77 Fed. Reg. 67866 (November 14, 2012).

[3] See 77 Fed. Reg. 67868 and 67869 (November 14, 2012) for a summary of the MF Global and Peregrine insolvency proceedings.

clearing of standardized swaps.[4] As the voice of and a fiduciary for our clients, BlackRock has a vested interest in the development of a sustainable and fair regulatory regime that minimizes overall risk to the financial system and provides appropriate customer protection for those financial products such as futures, foreign futures, swaps and other derivatives that the Commission oversees and regulates.[5]

While we support the Commission's stated goals to adopt new regulations and amend existing regulations in the Proposed Rule to enhance (i) customer protections, (ii) risk management programs, (iii) internal monitoring and controls, (iv) capital and liquidity standards, (v) customer disclosures, and (vi) auditing and examination programs for FCMs[6] to ensure that customers are adequately protected, we do not believe that these changes are sufficient to provide the necessary protection for customer collateral needed after the failures of MF Global and Peregrine.

In connection with cleared swaps, the issue of customer protection generated considerable debate among industry participants. We appreciate the time the Commission spent reviewing collateral protection practices in the current bilateral swaps market resulting in a final margin rule (the "**LSOC Rule**" or "**LSOC**")[7] for cleared swap transactions that is different from the traditional futures margining model (the "**Futures Model**").[8] The Commission believed that LSOC was the most appropriate balance between competing interests of different industry participants and that LSOC facilitated portability of customer positions and limited non-defaulting customers' exposure to their FCM or other customers who may default.

Segregation of cleared swap collateral serves two purposes: it protects customers and, like the central clearing regime itself, it mitigates systemic risk. In light of MF Global and Peregrine, we believe that the time has come for the Commission to adopt a collateral

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[4] *See* BlackRock Comment Letter dated June 3, 2011 Re: Opening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act.

[5] BlackRock strongly advocated for a clearing regime that supported the protection of customer collateral for cleared swaps. *See* BlackRock's Comment Letter dated November 15, 2010 as a follow-up to the Roundtable held by the Commission on October 22, 2010, BlackRock's Comment Letter dated January 18, 2011 in response to the Advanced Notice of Proposed Rulemaking on the Protection of Cleared Swaps Customers (75 Fed. Reg. 75162) and BlackRock's Comment Letter dated August 8, 2011 in response to the Commission's proposed rule on the Protection of Cleared Swaps Customer Contracts and Collateral (76 Fed. Reg. 33832).

[6] *See* 77 Fed. Reg. 67866 (November 14, 2012).

[7] *See* 77 Fed. Reg. 6336 (Feb. 7, 2012). Under the ''LSOC Rule'' (legal segregation with operational comingling), the DCOs that clear swaps transactions have greater information regarding the margin collateral of individual swaps customers, and each swaps customer's collateral is protected individually. The LSOC model permits a DCO to access the collateral of the defaulting cleared swaps customers, but **not** the collateral of the non-defaulting cleared swaps customers. At this time, the Commission has not extended the LSOC model to futures.

[8] The Futures Model involves what has become known as "fellow customer risk." In contrast to the protection that the Commission has afforded cleared swaps customers with the finalization of the LSOC Rule, under the Futures Model, FCMs are permitted to commingle all futures collateral for all customers in one account. When an FCM defaults under the Futures Model, due to a default by a customer, following the depletion of the FCM funds, the clearinghouse would be permitted to access the collateral of the non-defaulting customers before applying its own capital or the guaranty fund contributions of other non-defaulting clearing members. In other words, in contrast to the rules for cleared swaps, under the Futures Model, the funds of non-defaulting customers of an FCM are at the top of the waterfall to cure any losses to the clearinghouse after the funds of the defaulting customer and the defaulting FCM are depleted.

protection model for the futures markets that, like the protection for cleared swaps, eliminates fellow customer risk and reduces "FCM risk" by facilitating "immediate" portability of customer positions. Eliminating these risks will give futures customers security that their collateral is protected and used only for a known set of risks. Like cleared swaps customers, it is important that futures customers be able to "port" their positions and related collateral without delay from one FCM to another FCM. This will allow futures customers to continue to participate in the market with minimum business disruption in case there is a concern about their FCM.

Accordingly, we encourage the Commission to issue a proposal to adopt a model akin to LSOC for futures. Such a proposal, which has been discussed at numerous public forums over the past two years, is now long overdue. We recognize that LSOC for futures raises some different issues than LSOC for cleared swaps, but this argues for making a formal proposal and seeking public comment on solutions for these issues. The Proposed Rule provides many improvements but the Commission will not have addressed the core protection for futures customers until it adopts LSOC for futures.

BlackRock supports the Commission's proposed changes to require enhanced transparency, reporting and disclosure by FCMs to the Commission, their DSROs, customers and the public. However, increased reporting to customers should not be seen as a substitute for the supervision, review and audit which an FCM's DSRO must conduct. In addition, BlackRock believes that there should be an obligation placed on an FCM and its DSRO to inform other clients of an FCM if the FCM is exposed to unusual risks because a "fellow customer" is in a "stress" or potential default situation to allow customers to assess their FCMs' stability, and to transfer their positions if necessary. Further, the DCO should be obligated to inform promptly the customers of a clearing member FCM that has triggered the "early warning" levels in capital requirements or is in violation of applicable segregated and secured amounts maintenance levels.

While we believe more transparency and credit information disclosures made by FCMs will help clients of an FCM monitor the financial strength of their FCMs there also has to be a balance in the amount of information provided to customers and its costs. The issue of costs is not only the cost to the FCM to provide this data, but also the cost to the customer to analyze it. Although customers will continue to monitor the credit quality of their carrying FCM, not all customers will have the resources like a large asset manager such as BlackRock to perform the continued detailed due diligence of the information that is provided. The Commission should be careful in adopting an approach that presumes all customers will be able to use this information to effectively reach conclusions about the financial health of their FCM. As stated above, we do not believe that more disclosures are a substitute for the Commission's and DSRO oversight. We note further that there are market efficiencies in having DCOs perform this detailed due diligence function, rather than the thousands of customers with varying resources each attempting to perform a detailed due diligence review of FCMs.

Under the Proposed Rule, an FCM is required to keep books and records that identify each customer's relevant collateral and provide this information to the DCO or clearinghouse. Currently, there exists no process for the customer to verify the information provided by the FCM to a DCO or clearinghouse regarding that customer's collateral, and a customer's single source of this information is the FCM itself. BlackRock considers this

a weak link since the customer cannot independently verify that the DCO or clearinghouse's records match the collateral it has provided the FCM. We recommend that the Commission mandate that DCOs and clearinghouses be required to provide customers of an FCM their customer-level information that was previously reported to the DCO or clearinghouse by the FCM in an operationally efficient manner. This will create a system of "checks-and-balances" between the information that the FCM provides its DCO or clearinghouse and what the FCM provides its customers.

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BlackRock thanks the Commission again for its efforts and for the opportunity to provide the foregoing comments and recommendations regarding the Proposed Rule. 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