BLACKROCK

Via Electronic Delivery

September 20, 2010

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

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

RE: File Number S7-16-10 - Advance Notice of Proposed Rulemaking; Request for Comments: Definitions Contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (75 Fed. Reg. 51429)

Dear Mr. Stawick and Ms. Murphy:

The Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("SEC") (collectively, the "Commissions") have requested public comment on certain key definitions in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank" or the "Act"). Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act, 75 Fed. Reg. 51429 (Aug. 20, 2010). BlackRock is pleased to be given this opportunity to address these issues of importance to the financial markets and to our business operations. In this letter, we describe our operations first and then our thoughts on a number of issues raised under the Dodd-Frank definitions.

BlackRock is one of the world's largest asset management firms, managing approximately $3.2 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, employ over 8,500 people and serve investors in more than 100 countries. We are an independent, publicly-held company with no majority owners and a majority of independent directors on our corporate board. As a fiduciary for our clients, we have a strong interest in a regulatory regime that supports liquid, fair and orderly markets

Our Clients

Our clients include tax-exempt institutions, such as defined benefit and defined contribution pension plans, charities, foundations and endowments; official institutions, such as central banks, sovereign wealth funds, supranationals and other government entities; taxable institutions, including insurance companies, financial institutions, corporations and third party fund sponsors; and retail and high net worth investors. We also serve investors who acquire iShares exchange-traded funds on stock exchanges worldwide. 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.

Our Products and Services

We offer our clients a broad array of equity, fixed income, multi-asset class, alternative investment and cash management products, as well as our risk management and advisory services. We manage equity portfolios of our clients which consist of approximately $1.4 trillion in assets encompassing a broad range of investment strategies. We manage approximately $1.1 trillion of fixed income assets on behalf of our clients across regions, sectors, credit quality, and maturities. Our clients also maintain cash management, multi-asset class, and alternative investment options totaling approximately $529 billion and covering a diverse array of investment strategies and risk levels.[1]

We offer to our clients a range of investment products through separate accounts as well as directly and indirectly through a variety of vehicles that are established as separate and distinct legal entities, including without limitation open-end and closed-end mutual funds, exchange-traded funds, collective investment trusts and hedge funds (collectively referred to as "funds"). These funds and separate accounts use a variety of different types of swaps to manage risk and deliver return in most product categories. Counterparties seeking to trade with these funds and separate accounts understand that they have no recourse to BlackRock as the investment advisor to these funds.

Regulation

Virtually all aspects of our business are regulated. Certain of our U.S. subsidiaries are subject to regulation by the Securities and Exchange Commission ("SEC"), the Commodity Futures Trading Commission ("CFTC"), the Financial Industry Regulatory Authority, and the National Futures Association. One of our subsidiaries, BlackRock Institutional Trust Company, N.A. ("BTC"), is a national trust company supervised by the Office of the Comptroller of the Currency ("OCC"). BTC is subject to the National Bank Act of 1864 and other banking laws and regulations that are designed to protect BTC's customers, not BTC, its affiliates or shareholders. Our asset management advisory businesses are subject to the Investment Advisers Act of 1940, the Securities Exchange Act of 1934 (the "Exchange Act"), and, when managing employee benefit plan assets, the Employee Retirement Income Security Act of

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1 *See* BlackRock, Inc., Quarterly Report (Form 10-Q) (Aug. 6, 2010).

1974 ("ERISA"). We also operate in multiple foreign countries and are subject to regulation as an investment advisor in all jurisdictions in which we do business.[2]

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Our comments will focus primarily on the following definitions in Title VII of the Act: "major swap participant" ("MSP"), "major security-based swap participant" ("MSSP"), "swap dealer," and "security-based swap dealer." Congress has directed the Commissions to promulgate rules implementing these definitions.[3] We believe Congress did not intend asset managers and investment advisors to fall within the scope of these definitions based on their client-related activities. This letter explains why and also describes other aspects of the key terms that we believe should be addressed by the rulemaking.

Major Swap Participant/Major Security-Based Swap Participant

One of the major congressional goals in enacting Dodd-Frank was to avoid another "AIG situation" -- where the counterparty exposure of a single company could threaten the integrity of the financial system in the United States. Early in the legislative process, Treasury Secretary Timothy Geithner testified that:

> The current financial crisis has been amplified by excessive risk-taking by certain insurance companies and poor counterparty credit risk management by many banks trading Credit Default Swaps...on asset-backed securities. These complex instruments were poorly understood by counterparties, and the implication that they could threaten the entire financial system or bring down a company the size and scope of AIG was not identified by regulators.[4]

Secretary Geithner echoed this theme several months later when he wrote that "[a]ll OTC derivatives dealers and all other firms whose activities in those markets create large exposures to counterparties should be subject to a robust and appropriate regime of prudential supervision and regulation."[5]

When the Department of Treasury produced an early version of the financial reform legislation, it incorporated this idea into the definitions of MSP and MSSP, "[t]he term 'major swap participant' means any person who is not a swap dealer and who maintains a substantial net position in outstanding swaps, other than to create and maintain an effective hedge under

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2 *See* BlackRock, Inc., Annual Report (Form 10-K) (Mar. 10, 2010).

3 *See* Dodd-Frank §§ 721(a)(16) (New Commodity Exchange Act ("CEA") § 1(a)(33)) and 731 (New CEA § 4s) (for MSPs). *See also* Dodd-Frank §§ 761(a)(6) (New Exchange Act § 3(a)(67)) and 764 (New Exchange Act § 15F) (for MSSPs).

4 U.S. Dep't of Treasury, Written Testimony of Treasury Secretary Timothy Geithner before the House of Representatives Financial Services Committee (Mar. 26, 2009), *available at* http://www.ustreas.gov/press/releases/tg645.htm ("Geithner Testimony").

5 Letter from Timothy F. Geithner, U.S. Treasury Secretary, to Harry Reid, U.S. Senator (May 13, 2009), *available at* http://www.financialstability.gov/docs/OTCletter.pdf.

generally accepted accounting principles, as the [CFTC] and [SEC] may further jointly define by rule or regulation."[6] From the time they were first proposed, the MSP and MSSP concepts were a fixture in the Dodd-Frank legislative iterations, including the statute as enacted.

Section 721(a)(16) of the Act defines MSPs with reference to their outstanding swaps positions:

> MAJOR SWAP PARTICIPANT.—
>
> (A) IN GENERAL.—The term 'major swap participant' means any person who is not a swap dealer, and—
>
> (i) maintains a substantial position in swaps for any of the major swap categories as determined by the Commission, excluding—
> (I) positions held for hedging or mitigating commercial risk; and
> (II) positions maintained by any employee benefit plan (or any contract held by such a plan) as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002) for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan;
> (ii) whose outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets; or
> (iii)(I) is a financial entity that is highly leveraged relative to the amount of capital it holds and that is not subject to capital requirements established by an appropriate Federal banking agency; and
> (II) maintains a substantial position in outstanding swaps in any major swap category as determined by the Commission.[7]

The remainder of Section 721's MSP provision provides additional context for determining who should qualify as an MSP:

> (B) DEFINITION OF SUBSTANTIAL POSITION.—For purposes of subparagraph (A), the Commission shall define by rule or regulation the term 'substantial position' at the threshold that the Commission determines to be prudent for the effective monitoring, management, and oversight of entities that are

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[6] U.S. Dep't of Treasury, Title VII - Improvements to Regulation of Over-the-Counter Derivatives Markets, 8:11-15 (Aug. 11, 2010), *available at* http://www.financialstability.gov/docs/regulatoryreform/titleVII.pdf. The proposal contains a substantially similar provision for MSSPs at 8:17-22.

[7] Dodd-Frank § 721(a)(16) (New CEA § 1a(33)).

systemically important or can significantly impact the financial system of the United States. In setting the definition under this subparagraph, the Commission shall consider the person's relative position in uncleared as opposed to cleared swaps and may take into consideration the value and quality of collateral held against counterparty exposures.

(C) SCOPE OF DESIGNATION.—For purposes of subparagraph (A), a person may be designated as a major swap participant for 1 or more categories of swaps without being classified as a major swap participant for all classes of swaps.

(D) EXCLUSIONS.—The definition under this paragraph shall not include an entity whose primary business is providing financing, and uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90 percent or more of which arise from financing that facilitates the purchase or lease of products, 90 percent or more of which are manufactured by the parent company or another subsidiary of the parent company.[8]

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[8] Section 761(a)(6) contains a provision defining MSSP that is substantially similar but lacks the exclusion for captive finance affiliates. It will be incorporated as Exchange Act § 3(a)(67):

MAJOR SECURITY-BASED SWAP PARTICIPANT.—
(A) IN GENERAL.—The term 'major security-based swap participant' means any person—
(i) who is not a security-based swap dealer; and
(ii)(I) who maintains a substantial position in security-based swaps for any of the major security-based swap categories, as such categories are determined by the Commission, excluding both positions held for hedging or mitigating commercial risk and positions maintained by any employee benefit plan (or any contract held by such a plan) as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002) for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan;
(II) whose outstanding security-based swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets; or
(III) that is a financial entity that—
(aa) is highly leveraged relative to the amount of capital such entity holds and that is not subject to capital requirements established by an appropriate Federal banking agency; and
(bb) maintains a substantial position in outstanding security-based swaps in any major security-based swap category, as such categories are determined by the Commission.
(B) DEFINITION OF SUBSTANTIAL POSITION.—For purposes of subparagraph (A), the Commission shall define, by rule or regulation, the term 'substantial position' at the threshold that the Commission determines to be prudent for the effective monitoring, management, and oversight of entities that are systemically important or can significantly impact the financial system of the United States. In setting the definition under this subparagraph, the Commission shall consider the person's relative position in uncleared as opposed to cleared security-based swaps and may take into consideration the value and quality of collateral held against counterparty exposures.
(C) SCOPE OF DESIGNATION.—For purposes of subparagraph (A), a person may be designated as a major security- based swap participant for 1 or more categories of security-based swaps without

Subject to certain exemptions, a person who meets the MSP or MSSP definition must register and comply with a panoply of disclosure and trading requirements, including minimum capital and margin requirements.[9] Congress believed that these measures would reduce counterparty credit risk and foster a healthier financial system, limiting the ability of MSPs and MSSPs to "place our financial system in such dire straits."[10] We agree that monitoring systemically important institutions can reduce counterparty credit risk and we support the development of a regulatory regime to prevent any market participant from threatening the U.S. financial markets through swaps or security-based swaps ("SBS") for its own account.

(a) *Asset Managers/Investment Advisers Do Not Take Swap Positions as Principals and Should Not Be MSP/MSSPs.*

To be found to be a MSP or MSSP, a person must either maintain a "substantial position" in swaps (paragraphs A(i) and A(iii) of the MSP definition) or have outstanding swaps that "create substantial counterparty exposure" (paragraph A(ii) of the MSP definition). As Representative Collin Peterson, Chairman of the House Agriculture Committee, observed, these requirements were designed to address the concern that one "source of financial instability in 2008 was that derivative traders...did not have the resources to back up their transactions."[11] By requiring entities with large swap positions to register and comply with certain prudential requirements, the MSP and MSSP regulations provide a way to prevent certain swap counterparty's credit risk from creating systemic risk.

When read and applied in the context of Dodd-Frank's terms, Chairman Peterson's statement shows why Congress did not intend to subject asset managers to the MSP/MSSP framework. Asset managers participate in the swaps market as advisors or agents rather than principals and do not trade swaps for their own account. Clients retain an asset manager to invest on the clients' behalf, typically in one or more funds for which the manager has investment discretion.[12] Each fund is an entity legally separate from the manager itself and from every other fund the manager administers. The funds, rather than the manager, "maintain" investment positions, and assume directly all credit risks associated with those positions. In sum, subjecting asset managers to MSP and MSSP regulation would not enhance the safety and

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being classified as a major security-based swap participant for all classes of security-based swaps.

9 *See* Dodd-Frank § 731 (New CEA § 4s) (for MSPs); *see also* Dodd-Frank § 764 (New Exchange Act § 15F) (for MSSPs).

10 Press Release, U.S. House of Representatives Committee on Agriculture, House Agriculture Committee Approves Legislation Strengthening Derivatives Regulation: Committee Bill Will Bring Accountability to Over-the-Counter Markets for the First Time (Oct. 21, 2009) (quoting Chairman Collin C. Peterson) (on file with author).

11 156 Cong. Rec. H5247 (2010).

12 Some clients may use an asset manager in other ways. For example, an asset manager may invest a client's assets in a separate account established by the client, where only the client's assets are at risk.

soundness of the financial markets because asset managers generally "maintain" no positions in swaps or SBS and have no credit exposure to swaps.

Designating asset managers as MSPs or MSSPs would also subject these firms to redundant and sometimes contradictory regulation. As fiduciaries of their clients, asset managers' activities are already comprehensively regulated and monitored.[13] Dodd-Frank's regulation of MSPs/MSSPs was not designed for, and could actually be harmful to, asset managers.[14]

(b) *MSP/MSSP Status Should Not Be Based on the Aggregation of Funds under an Asset Manager's Common Management.*

Asset managers typically advise multiple clients and manage multiple funds. Any rules promulgated by the Commissions should clarify that asset managers will not be found to be MSPs or MSSPs based on the aggregate swap positions of the funds or separate accounts they advise. The text and legislative history of Dodd-Frank, as well as the public policy underlying the Act, support this view.

The MSP and MSSP definitions use the phrase "any person," a term that connotes individual entities such as trusts and investment funds without encompassing all entities in such person's "family tree." A Senate colloquy confirms that the use of the phrase "any person" implies that no aggregation is intended. Senator Kay Hagan asked Senator Blanche Lincoln: "When considering whether an entity maintains a substantial position in swaps, should the CFTC and SEC look at the aggregate positions of funds managed by asset managers or at the individual fund level?" Senator Lincoln replied that "[a]s a general rule, the CFTC and the SEC should look at each entity on an individual basis when determining its status as a major swap participant."[15] The Commissions should follow Senator Lincoln's admonition.

Had Congress intended the Commissions to aggregate an asset manager's client funds, it could have made that intention clear. For example, albeit in a different context, Dodd-Frank expressly authorizes the CFTC to require some market participants to aggregate their futures, options and swap positions in the same physical commodity. Section 737, "Position Limits," provides that the CFTC shall "establish limits...on the aggregate number or amount of positions in contracts based upon the same underlying commodity...that may be held by any person, including any group or class of traders."[16] This section demonstrates that Congress knows how to require aggregation explicitly and the fact that the MSP definitions do not contain such language supports the conclusion that no aggregation was intended.

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[13] Certain BlackRock subsidiaries are subject to regulation by, among others, the SEC, CFTC and OCC. Our asset management advisory businesses are subject to, among others, the Investment Advisors Act of 1940, the Exchange Act, and, with respect to employee benefit plan assets, ERISA.

[14] For example, Sections 731(e) and 764(e) of the Act require that MSPs and MSSPs, respectively, adhere to certain capital and business conduct requirements. Forcing asset managers to comply with these requirements would raise their costs without providing any benefit in terms of financial integrity of swap transactions since the managers have no exposure to swaps or SBS.

[15] 156 Cong. Rec. S5907.

[16] This provision will be included in Section 4a of the CEA.

Determining MSP/MSSP status without aggregating funds or separate accounts under common management also represents sound public policy. Even if different funds or accounts are managed by the same asset manager and enter into swaps of the same type or asset class, the funds or accounts may have very different purposes for entering into those swaps and those purposes could reflect profound differences in the risk-profiles of the swap positions. Fund A, for example, could enter into interest rate swaps to hedge interest rate exposure on its bond portfolio while Fund B may enter into the same swaps to assume a directional market view. The risk of loss on Fund A's positions is different from, and probably less than, that of Fund B's positions. Combining Fund A and Fund B's positions on a gross basis because they are each advised by the same asset manager would not give a true picture of the risk to the financial system these positions could pose.

Aggregating the swap positions of the funds and separate accounts a manager advises also would create other significant distortions. First, a manager has no credit risk associated with the swap positions of its funds and separate accounts because it does not act as a principal; the risk of the positions resides with each fund or account (or the separate account client). Each fund is an entity legally and factually distinct both from the asset manager and from all other funds advised by the manager. When a fund or account trades a swap, the assets of that fund or account are available to cover losses associated with that swap. The individual fund or account therefore exclusively has the counterparty credit risk, market risk, legal risk and operational risk, as would any swap counterparty. Counterparties are aware that their recourse is limited to the respective funds or accounts they trade with and assess their risks based on the fund or account that is the party to the swap. The asset manager is never part of that consideration.

(c) *The Substantial Position Threshold in the MSP/MSSP Definitions Should Be Set at a Systemically Significant Level as the Statute Provides.*

Subject to certain exceptions, Dodd-Frank requires any person, other than a dealer in swaps or SBS, who maintains a "substantial [swaps] position for any of the major swap categories" to register as a MSP or MSSP. The Act, however, does not define "substantial position" and "major swap category."[17] Instead, the Act directs each Commission to define "substantial position" for any of the major swap categories "at a threshold [it] determines to be prudent for the effective monitoring, management, and oversight of entities that are systemically important or can significantly impact the financially system of the United States."[18] To fulfill this statutory directive, the Commissions should promulgate clear, objective criteria by first defining the major swap categories and then determining what level of open swap positions in each category would be considered to be "substantial" within the meaning of the MSP and MSSP definitions.

The Commissions will surely be in a better position to define the critical "major swap categories" when swap market participants have submitted reports of their swaps as required under Dodd-Frank and the Commissions have had an opportunity to analyze those reports.

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[17] Dodd-Frank § 721 (New CEA § 1a(33)(B)).

[18] *Id.*

Until then, the CFTC could set the major swap categories as follows: interest rate; equity (except single issuer or narrow-based groups of issuers); credit (except single entity or narrow-based groups of entities); energy; metals; agricultural, foreign currency (unless the Treasury Department acts to exempt currency swaps from the generally applicable regulatory regime) and other commodities. Similarly, the SEC should set two "major security-based swap categories": equity swaps on single issuers or narrow-based groups of issuers and credit default swaps on single entities or narrow-based groups of entities. For each of these major swap categories, Dodd-Frank calls upon the Commissions to establish a "substantial position" threshold in a way that would enable the Commissions to oversee only MSPs and MSSPs that are "systemically important" or "can significantly impact the financial system of the United States."[19]

(i) "Systemically Important" Should Mean the U.S. Financial System or U.S. Capital Markets as a whole.

In the statutory MSP/MSSP definitions, Congress has signaled its intent for MSP/MSSP regulation to be applied to entities that could affect the capital markets as a whole, also known as "systemically important" firms. This statutory standard suggests that for each major swap category the "substantial position" threshold should be high; MSP/MSSP positions are not just important within the context of the particular swap category, they must present a risk of loss of "systemic importance." Although Dodd-Frank does not define the term, Congress intended "systemically important" position levels to be those that could materially impact the capital markets or "financial system of the United States."[20] An entity's swap positions are "substantial" and "systemically important" if they pose potential risk to the stability of the financial system.

The statute provides that the MSP/MSSP determination should proceed on a category by category basis for a given entity. For example if a person's position in energy swaps poses a systemic risk, that person has a "substantial position" and, unless an exemption applies, must register as an MSP or MSSP. But, if the person's energy swap positions are not substantial enough to pose a systemic risk, the evaluation proceeds to the next category because the pertinent statutory inquiry is whether a party "maintains a substantial position in swaps for any of the major swap categories."[21] The Act contemplates a cumulative determination across major swap categories with respect to a person only if that person's "outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets" under the second prong of the MSP definition.[22]

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[19] *Id.*

[20] *Id.*

[21] Dodd-Frank §§ 721(a)(16) (New CEA § 1a(33)(A)(i)) (for MSPs) and 761(a)(16) (New Exchange Act § 3(a)(67)(A)(i)) (for MSSPs).

[22] Dodd-Frank § 721(a)(16) (New CEA § 1a(33)(A)(ii)) (for MSPs) and 761(a)(16) (New Exchange Act § 3(a)(67)(A)(ii)) (for MSSPs).

(ii) The "Substantial Position" Threshold Should Account for Various Factors that Impact the Credit Risk Level of Swaps.

In addition, the Commissions' substantial position threshold should not count all swaps equally. Rather, it should weigh swaps individually, evaluating the risks posed by each swap. The text of the Act supports such a formula, by directing the Commissions to consider a "person's relative position in uncleared as opposed to cleared swaps" when determining whether that person maintains a "substantial position" in swaps. Dodd-Frank further provides that the Commissions "may take into consideration the value and quality of collateral held against counterparty exposure" when developing the "substantial position" threshold.[23] By including this provision, Congress demonstrated its understanding that all swaps are not created equal from a credit risk perspective -- some are inherently riskier than others. The Commissions' "substantial position" formula should effectuate this basic congressional policy.

Congress has determined that cleared swaps are less risky than uncleared swaps.[24] Effective clearing systems materially reduce counterparty risk by mutualizing this risk among a clearinghouse's clearing members. Clearinghouses are supervised by the Commissions and have a long record of financial reliability and integrity. Given this track record, it is not surprising that Congress directed the Commissions to consider whether a particular swap position is cleared or uncleared for purposes of the "substantial position" calculation. The Commissions should follow this directive by entirely excluding cleared swaps from the "substantial position" determination.

Posting protected collateral for uncleared swaps also reduces the counterparty credit risk associated with such swaps because collateral that is posted, segregated, and held by an independent third-party custodian is available to meet the obligations of a counterparty, even if that counterparty is the subject of a bankruptcy proceeding. According to Senator Lincoln:

> Where a person has uncleared swaps, the regulator should consider the value and quality of such collateral when defining "substantial position." Bilateral collateralization and proper segregation substantially reduces the potential for adverse effects on the stability of the market. Entities that are not excessively leveraged and have taken the necessary steps to segregate and fully collateralize swap positions on a bilateral basis with their counterparties should be viewed differently.[25]

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[23] *See* Dodd-Frank §§ 721(a)(16) (New CEA § 1a(33)(B)) (for MSPs) and 761(a)(16) (New Exchange Act § 3(a)(67)(B)) (for MSSPs).

[24] *See* Dodd-Frank § 731 (New CEA § 4s(e)(3)(A)) ("To offset the greater risk to the swap dealer or major swap participant and the financial system from the use of swaps that are not cleared..."); *see also* Remarks of Chairman Gary Gensler, Over-the-Counter Derivatives Reform, Institute of International Bankers Washington Conference, March 1, 2010 ("[c]learinghouses have effectively reduced risk since they were first developed in the futures markets in the late Nineteenth Century.").

[25] 156 Cong. Rec. S5907.

The best way to view these entities "differently" is by not counting their uncleared swap positions toward the "substantial position" threshold to the extent they are fully collateralized. This result comports with Congressional intent because these entities have already taken precautions to remove the counterparty and systemic risk associated with the swap.

The Commissions should also acknowledge that whether a position is substantial from either a credit or systemic risk perspective depends more on the risk of loss than the position's pure size. As we have seen, swaps that are hedges against assets or liabilities typically have less risk than those that take a market view. From their oversight of clearing systems and applications of value at risk or portfolio margining methodologies, the Commissions also know well that a long and short swap position in a correlated commodity (like crude oil and jet fuel, for example) generally have less risk than two positions in uncorrelated commodities. Such offsetting swaps on different commodities with correlated pricing histories, and other types of offsetting positions, including on rates or financial assets, should therefore be recognized to present less risk than the aggregation of these positions.

(d) *The Scope of the Hedging/Mitigating Exclusion for Employee Benefit/Governmental Plans Should Be Clarified.*

Dodd-Frank provides an exclusion from the MSP/MSSP definition for "positions maintained by any employee benefit plan (or any contract held by such a plan) as defined in paragraphs (3) and (32) of section 3 of [ERISA] for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan."[26] Congress intended this exclusion to be read "to avoid doing any harm to pension plan beneficiaries."[27] This means the exclusion should cover swap positions for all employee benefit plans defined in ERISA §§ 3(3) and 3(32), including governmental plans and plans maintained by certain international organizations. ERISA requires plan fiduciaries to prudently manage risk to help ensure the viability of a given plan. Plan fiduciaries regularly use swaps to satisfy this mandate and the statutory formulation illustrates that Congress intended employee benefit plans -- both corporate and public plans -- to be able to use swaps for something more than just to hedge the risks of assets they hold, and even, as a secondary matter, to take a directional view of a particular asset class.

According to a well-known dictionary, "hedge" means to "try to avoid or lessen loss by making counterbalancing bets, investments, etc."[28] "Mitigate," however, means to "make or become milder, less severe, less rigorous, or less painful; moderate."[29] The use of the term "mitigate" acknowledges that employee benefit plans may use swaps to manage "any risk directly associated with the operation of the plan" by maintaining positions other than those

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[26] Dodd-Frank §§ 721(a)(16) (New CEA § 1a(33)(A)(i)(II)) (for MSPs) and 761(a)(6) (New Exchange Act § 3a(67)(A)(ii)(I)) (for MSSPs).

[27] *See* 156 Cong. Rec. S5906 (quoting Sen. Lincoln).

[28] *Webster's New College Dictionary* 659 (2007).

[29] *Id.* at 923.

traditionally regarded as "hedging" positions.[30] Employee benefit plans mitigate various risks through swaps. For example, plans use swaps to manage their exposure to interest rate fluctuations and to reduce the risk of volatility in plan assets. Employee benefit plans also use swaps as a tool to rebalance their portfolios to adhere to their stated investment policies. These risk-mitigation techniques help ensure that employee benefit plans will be able to meet their obligations to participants and beneficiaries and the Commissions should confirm that positions maintained for such purposes will not count against an employee benefit plan's "substantial position" threshold.

Swaps used to manage the risk of under-diversification should also be excluded from the "substantial position" threshold. Diversification is one component of a prudently managed portfolio and plans sometimes diversify by opening swap positions in alternative investment classes.[31] Such holdings are "for the primary purpose" of mitigating a risk "directly associated with the operation" of an employee-benefit plan and should play no role in the "substantial position" calculation.[32]

(i) Employee Benefit Plan Assets in Pooled Investment Vehicles Should Be Excluded from the "Substantial Position" Threshold, under the Statutory Carve-Out for ERISA-Defined Plans.

Many employee benefit plans are required to hold their assets in trust and many invest their assets in pooled investment vehicles such as registered investment companies, private funds and bank maintained collective trust funds (collectively "pooled funds"). Pooling assets typically reduces investment costs and increases returns through economies of scale and other efficiencies. Many pooled funds consist in substantial part, or even entirely, of pension plan assets. Pooled funds, like pension trusts, use swaps and SBS to hedge or mitigate risks relating to the operation of employee benefit plans, i.e., market risk, interest rate risk, legal risk, and counterparty risk.

Under the ERISA plan asset rules, privately-offered pooled funds in which at least 25% of the value of any class of equity interests is held by ERISA-regulated employee benefit plans, and bank collective trust funds to which an ERISA-regulated employee benefit plan contributes any assets, are regulated as "plan assets" and are covered by ERISA fiduciary duty protections.[33] The Commissions should clarify that employee benefit plan assets invested in such pooled funds and trusts qualify for the exclusion from the substantial position threshold.

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[30] Dodd-Frank §§ 721(a)(16) (New CEA § 1a(33)(A)(i)(II)) (for MSPs) and 761(a)(6) (New Exchange Act § 3a(67)(A)(ii)(I)) (for MSSPs).

[31] *See* 29 C.F.R. § 2550.404a-1 (providing that one of the duties of a plan fiduciary is to consider "the composition of the [plan's] portfolio with regard to diversification.")

[32] Dodd-Frank §§ 721(a)(16) (New CEA § 1a(33)(A)(i)(II)) (for MSPs) and 761(a)(6) (New Exchange Act § 3a(67)(A)(ii)(I)) (for MSSPs). The legislative history also supports this position. *See* 156 Cong. Rec. S5907 (colloquy from Sen. Lincoln).

[33] ERISA § 3(42) and 29 C.F.R. § 2510.3-101. Bank maintained collective trust funds are subject to ERISA if they have a single plan investor, regardless of the percentage of that investment. Since the legislative history of the employee benefit plan exclusion suggests that these market participants are already comprehensively regulated by ERISA, the Commissions should recognize

If their assets are managed as separate accounts, the economic benefits of pooling will be lost. This would run contrary to Congress' intent not to harm employee benefit plan beneficiaries.[34]

(e) *The Scope of the Hedging/Mitigating Exclusion Generally Should Be Clarified.*

Dodd-Frank also exempts positions generally held "for hedging or mitigating commercial risk" from the "substantial position" threshold.[35] Other provisions in the Act permit the Commissions to define the term "commercial risk."[36] Because various financial and regulatory burdens accompany designation as a MSP or MSSP, it is important that an entity be able to predict whether its swaps will satisfy the general hedging exclusion or whether it is at risk of being considered a MSP or MSSP.

To reduce this uncertainty, the Commissions should define "commercial risk" objectively and should publish clear guidelines that allow the users of swaps and SBS to accurately predict their status. The definition of "commercial risk" should reflect the fact that Congress intended that "few, if any end users will be major swap participants, as [the Act] excluded 'positions held for hedging or mitigating commercial risk' from being considered as a 'substantial position.'"[37]

Swap Dealer/Security-Based Swap Dealer Definition Should Be Interpreted in a Manner Consistent with the SEC's Dealer Interpretations under the Exchange Act

Under Dodd-Frank, a person must register as a swap dealer or security-based swap dealer if that person "(i) holds itself out as a dealer in swaps [or SBS]; (ii) makes a market in swaps [or SBS]; (iii) regularly enters into swaps [or SBS] with counterparties as an ordinary course of business for its own account; or (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps [or SBS]."[38] A person who

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that when a fund is subject to ERISA, the exclusion will apply. Registered investment companies are excluded from the plan asset rule.

[34] *See* 156 Cong. Rec. S5906..

[35] *See* Dodd-Frank § 721(a)(6) (New CEA § 1a(33)(A)(i)(I)).

[36] *See* Dodd-Frank §§ 721(b)(1) and § 761(b)(1).

[37] 156 Cong. Rec. H5248 (quoting Rep. Peterson).

[38] Dodd-Frank §§ 721(a)(21) (New CEA § 1a(49)) (for swap dealers) and 761(a)(21) (New Exchange Act § 3(a)(71)) (for security-based swap dealers).

The entirety of § 721(a)(21) reads:

SWAP DEALER.—
(A) IN GENERAL.—The term 'swap dealer' means any person who—
(i) holds itself out as a dealer in swaps;
(ii) makes a market in swaps;
(iii) regularly enters into swaps with counterparties as an ordinary course of business for its own account;

qualifies as a swap dealer or security-based swap dealer must, with a few exceptions, register with CFTC or SEC, as appropriate, and comply with disclosure and trading requirements, including minimum capital and margin requirements, just like MSPs and MSSPs.[39]

We believe that Congress' use of the term "dealer" evidences an intent for the Commissions to apply the definitions of swap dealers and security-based swap dealers in a manner that follows the application of the term "dealer" in the Exchange Act. Section 3(a)(5) of the Exchange Act defines a dealer as, subject to certain exceptions, "any person engaged in the business of buying or selling securities for such person's own account through a broker or

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or
(iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps,
provided however, in no event shall an insured depository institution be considered to be a swap dealer to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer.

(B) INCLUSION.—A person may be designated as a swap dealer for a single type or single class or category of swap or activities and considered not to be a swap dealer for other types, classes, or categories of swaps or activities.

(C) EXCEPTION.—The term 'swap dealer' does not include a person that enters into swaps for such person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business.

(D) DE MINIMIS EXCEPTION.—The Commission shall exempt from designation as a swap dealer an entity that engages in a de minimis quantity of swap dealing in connection with transactions with or on behalf of its customers. The Commission shall promulgate regulations to establish factors with respect to the making of this determination to exempt.

The entirety of § 761(a)(21) reads:

SECURITY-BASED SWAP DEALER.—

(A) IN GENERAL.—The term 'security-based swap dealer' means any person who—
(i) holds themself out as a dealer in security-based swaps;
(ii) makes a market in security-based swaps;
(iii) regularly enters into security-based swaps with counterparties as an ordinary course of business for its own account; or
(iv) engages in any activity causing it to be commonly known in the trade as a dealer or market maker in security-based swaps.

(B) DESIGNATION BY TYPE OR CLASS.—A person may be designated as a security-based swap dealer for a single type or single class or category of security-based swap or activities and considered not to be a security-based swap dealer for other types, classes, or categories of security- based swaps or activities.

(C) EXCEPTION.—The term 'security-based swap dealer' does not include a person that enters into security- based swaps for such person's own account, either individually or in a fiduciary capacity, but not as a part of regular business.

(D) DE MINIMIS EXCEPTION.—The Commission shall exempt from designation as a security-based swap dealer an entity that engages in a de minimis quantity of security- based swap dealing in connection with transactions with or on behalf of its customers. The Commission shall promulgate regulations to establish factors with respect to the making of any determination to exempt.

[39] Dodd-Frank §§ 731 (New CEA § 4s) (for swap dealers) and 764 (New Exchange Act § 15F) (for security-based swap dealers).

otherwise." Like other asset managers, we do not buy or sell securities for our own account and are not considered to be a dealer under the Exchange Act relating to our securities activities for clients. The Commissions should make clear that providing asset management services and advice relating to swaps and SBS on behalf of our clients will similarly not subject us to regulation as a swap dealer or security-based swap dealer.

(a) *Trading by Asset Managers/Investment Advisors on Behalf of Managed Funds or Advised Accounts Does Not Constitute Acting as a Swap/Security-Based Swap Dealer.*

None of the four categories of swap dealer or security-based swap dealer applies to asset managers. These entities do not "hold [themselves] out as [dealers] in swaps." To the contrary, they offer their services as financial advisers and fiduciaries. The swap-related activities of asset managers are incidental to their other duties. Similarly, asset managers do not "make[] a market in swaps." A "market maker," as defined in the Exchange Act, is a person who trades a security "for his own account," so an asset manager who conducts no trading for its own account does not make a market in swaps or SBS.[40] Such an asset manager also would not "regularly enter[] into swaps with counterparties as an ordinary course of business for its own account" because asset managers do not regularly enter into swaps for their own account. Finally, acting as an asset manager should not cause a person to be "commonly known in the trade as a dealer or market maker in swaps," since providing asset management and advice for third-party investors is quite different from acting as a dealer or market maker.[41]

Labeling asset managers and investment advisers as swap dealers or security-based swap dealers also would not advance Dodd-Frank's purpose of protecting the stability of the United States financial system because, as discussed in our MSP/MSSP section, asset managers do not buy and sell swaps for their own account. Swaps trading is undertaken by individual funds with distinct legal identities or on behalf of particular clients through separate accounts. The fund or account holding a swap is liable for any credit risk associated with that position -- the manager has no credit risk exposure. Additionally, asset managers generally, and BlackRock in particular, are already highly regulated.[42] If we are forced to register as a swap dealer or security-based swap dealer, we may be subject to conflicting regulatory regimes and be forced to curtail our client-service activities. At a minimum, increased regulation will raise costs to our clients.

In either case, more regulation will result in little, if any, additional protection of the United States financial system. As the legislative history of these provisions shows, Congress intended the swap dealer and security-based swap dealer classifications to apply to entities

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[40] Exchange Act § 3(38).

[41] We note that the definition of "dealer" in the Exchange Act, does not encompass a person who becomes "commonly known in the trade as a dealer or market maker," but because asset managers engage in very different activities from dealers and market makers, it is extremely unlikely they would become so known.

[42] *See supra* at 7 and note 13.

whose trading activities are not already subject to regulatory supervision. The swap dealer definition was designed not to "inadvertently pull in entities that are appropriately managing their risk."[43] Comprehensively regulated asset managers have no risk from the swaps positions maintained in the funds they advise so they fall outside the scope of the swap dealer and security-based swap dealer definitions.

(b) *Trading by a Fund or Other Entity for its Own Account Does Not Constitute Acting as a Swap/Security-Based Swap Dealer.*

Traditionally, funds and other entities have been permitted to trade for their own accounts without registering as either futures commission merchants under the Commodity Exchange Act or as dealers under the Securities Exchange Act of 1934. A series of no-action letters identifies factors that differentiate dealers from traders. As a result of these letters, most market participants, including active traders, do not need to register as dealers. Our understanding of this no-action precedent is that a fund, when acting for its own account, closely resembles a trader and does not have to register as a dealer under the Exchange Act if it does not, among other things: i) act as an underwriter; ii) carry a dealer inventory in securities; and iii) purchase or sell securities as principal from or to customers.[44] Based on this precedent, funds should not have to register as swap dealers or security-based swap dealers.

Exclusions From the Definition of Swap Should be Clarified Consistent with Floor Colloquies and Economic Reality

The Act defines "swap" very broadly but then provides certain exclusions from this definition.[45] We believe some of these exclusions require further clarification from the CFTC to effect Congressional intent. Specifically, we believe the CFTC should clarify the exclusion for physically settled forward contracts and the scope of contracts involving a contingency.

(a) *For the Exclusion of Physically Settled Forward Contracts, the CFTC Should Confirm that "Intended to be Physically Settled" Will Be Interpreted Consistently With Existing CFTC Principles.*

The "forward contract exclusion" of the Commodity Exchange Act removes contracts contemplating actual delivery of a physical commodity from the CEA's regulatory structure for futures contracts.[46] Dodd-Frank incorporates this policy by excluding from the definition of "swap" any "sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled."[47] This exception should apply

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[43] 156 Cong. Rec. H5248 (quoting a letter from Sens. Lincoln and Dodd to Reps. Frank and Peterson).

[44] *See generally* Robert L.D. Colby & Lanny A. Schwartz, *What is a Broker-Dealer?*, Practicing Law Institute Corp. Law and Practice Course Handbook Series, 39, 85-90 (2010) (distinguishing dealers from traders).

[45] *See* Dodd-Frank § 721(a)(21) (listing by name 22 different types of swaps) (New CEA § 1a(47)).

[46] *See* CEA § 1(a)(19) (2006).

[47] Dodd-Frank § 721(a)(21) (New CEA § 1a(47)(B)(ii)).

even if the parties to such a trade "book-out" their delivery obligations. A book-out refers to an arrangement between parties to a forward contract who are in a delivery chain or circle at the same delivery point. Instead of settling their obligations with a physical commodity, they agree to exchange a net cash payment. This lessens transaction costs and saves consumers money.

The Commission should confirm that the phrase "intended to be physically settled" will apply to forward contracts even if delivery obligations are booked-out. The use of the word "intended" contemplates that the exception should apply in situations where physical delivery ultimately does not occur. Additionally, a colloquy on the floor of the House of Representatives confirms this understanding. Specifically, Representative Peterson stated that the "fact that the parties may subsequently agree to settle their obligations with a payment based on a price difference through a book-out does not turn a forward contract into a swap."[48]

(b) *The Scope of Contracts Involving a Contingency Should be Appropriately Narrowed to Avoid Over-Inclusion.*

The CFTC should also promulgate straightforward criteria to clarify which contracts involving a contingency are swaps. As written, the Act provides that any agreement, contract, or transaction that "provides for any purchase, sale, payment, or delivery...that is dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence" is a swap. A literal interpretation of this phrase could sweep in various contingency contracts that Congress did not intend to include in the definition of swap.

For example, a manufacturer and a salesman could enter an employment contract calling for the manufacturer to pay the salesman a bonus depending on the number of units sold by the salesman. This contract, which makes the bonus contingent on an economic event, could be considered a swap even though nothing elsewhere in the statute or its legislative history suggests that Congress intended Dodd-Frank to cover private employment agreements. To avoid this type of situation, and to clarify the scope of the swap definition, we believe the CFTC should specify that the phrase "event or contingency" means an event or contingency that is outside of either party's control, i.e., an interest rate or level of a particular index of securities.

Conclusion

BlackRock supports the efforts of Congress and the Commissions to address counterparty credit risk through regulatory oversight of those entities whose exposure to swaps and SBS could threaten the financial integrity of the United States. Effectively implementing this legislation will help prevent future financial crises and create a more stable financial market environment. We agree with Congress and the Commissions that monitoring MSPs, MSSPs, swap dealers and security-based swap dealers is an essential part of a robust regulatory regime. Congress intended these categories to be reasonably tailored to capture the

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[48] 156 Cong. Rec. H5247.

risk to the United States financial markets. We believe the Commissions should and will faithfully execute this mandate.

Asset managers do not trade for their own account and are not swap dealers, security-based swap dealers, MSPs or MSSPs. They are not MSPs or MSSPs because their swaps activity is in a representative capacity, undertaken for their managed funds and other accounts they manage on behalf of clients. Dodd-Frank does not require and the Commissions should not impose aggregation requirements for the swaps positions asset managers enter into across all the funds they manage. Furthermore, as fiduciaries of their clients, asset managers are already comprehensively regulated.

It is also important that the Commissions clarify the scope of certain terms in the MSP and MSSP definitions to avoid needless and duplicative regulation. The Commissions should focus particularly on ensuring that the threshold established for determining when any party has a "substantial position" in swaps takes into account the particular risk levels of that party's swap holdings. The Commissions should also set clear parameters for the exclusions from the "substantial position" definition. For employee benefit plans, this means giving effect to the broad exclusion Congress intended. For end users, this means interpreting the term "commercial risk" in a way that allows these entities to continue their swap-related hedging and mitigation activities and to ascertain whether their swaps trading will subject them to regulation.

The Commissions should interpret the swap dealer and security-based swap dealer definitions consistently with long-standing SEC precedent. Under this precedent, asset managers are not swaps dealers or security-based swaps dealers because their activities (and the activities of the funds they advise) constitute trading, not dealing. This result is consistent with Dodd-Frank's intent to regulate unregulated swap dealers, not highly regulated investment fiduciaries.

Lastly, the CFTC should ensure that certain exclusions from the definition of "swap" comport with congressional intent and economic reality. Congress intended that users of forward contracts who ultimately book-out their trades would not be subject to the CEA. The CFTC should promulgate regulations implementing this goal. Similarly, regulations relating to contingency contracts should provide more definite criteria to identify contracts not covered. Unless these steps are taken, we fear the definition of "swap" will be over-inclusive.

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

Sincerely,

Joanne T. Medero
Managing Director