

BLACKROCK

April 29, 2011

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

Re: Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges With Respect to Security-Based Swaps Under Regulation MC 17 CFR Part 242 (File No. S7-27-10; RIN 3235-AK74)

Dear Ms. Murphy:

BlackRock, Inc.¹ submits these comments in response to the Securities and Exchange Commission's ("SEC" or "Commission") Notice of Proposed Rulemaking entitled "Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges With Respect to Security-Based Swaps Under Regulation MC," 75 Fed. Reg. 65882 (Oct. 26, 2010) (the "Proposing Release"). In the Proposing Release, the SEC has requested public comment on how best to mitigate conflicts of interest that arise in the operation of security-based swap clearing agencies ("SB swap clearing agencies"), security-based swap execution facilities ("SB SEFs"), and National Securities Exchanges ("Exchanges" collectively with SB swap clearing agencies and SB SEFs, "enumerated entities").

BlackRock supports the Commission's goal to adopt rules that may achieve better governance of and a mitigation of conflicts of interest within the enumerated entities. As the voice of and a fiduciary for our clients, BlackRock has a vested interest in strong governance and mitigating conflicts of interest that arise in the operation of such entities. We believe that strong governance requirements and effectively mitigating such conflicts of interest will serve our clients' interests as well as the interests of the U.S. financial system.

Buy-side market participants should have meaningful representation on the committees that supervise the day-to-day affairs of enumerated entities, such as the risk committees of SB swap clearing agencies. We believe such representation, which would ensure that all constituencies of enumerated entities work together when setting operating policies and procedures, is critical to accomplishing the Commission's goals.

¹ BlackRock is one of the world's leading asset management firms. We manage over \$3.6 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.

i. **The buy-side must have a meaningful voice in SB swap clearing agency operations.**

At the SEC-CFTC Public Roundtable on Governance and Conflicts of Interest in the Clearing and Listing of Swaps, BlackRock observed that “as the [sole] fiduciary on this panel, we talk about membership, we talk about ownership, we believe that very strong governance with the participation of the users of these venues is critically important.” See Comments from Richard Prager, Managing Director, Global Head of Fixed Income Trading, BlackRock, Roundtable Transcript, 131:20-132:3 (Aug. 20, 2010). The essence of BlackRock’s comments is that buy-side market participants, including customers of clearing members and investment managers, need meaningful representation on all of the committees that make the critical determinations about the enumerated entity’s core functions that impact all of its participants.²

Representation on governance committees is more important than representation on the Board of Directors because governance committees will have significant influence over the day-to-day affairs of an enumerated entity. For example, the risk committee of a SB swap clearing agency could be expected to determine which products are eligible for clearing, set standards and requirements for initial and continuing clearing membership eligibility, and advise the Board of Directors about the SB swap clearing agency’s risk model and default procedures. In other words, decisions of the risk committee will have profound and immediate impacts on all SB swap clearing agency constituencies, including customers.

We believe buy-side participants should be guaranteed a meaningful voice on SB swap clearing agency risk committees. We are concerned that the Proposing Release does not achieve this result and, for reasons discussed below, may have an adverse effect on customers. The SEC’s proposal does not require any form of customer representation on the governance committees of enumerated entities. The Commission suggests that customer representation on risk committees may be inappropriate because customers, and other non-participants, do not contribute to the guaranty fund of a SB swap clearing agency and therefore may have a lesser interest in establishing and maintaining robust risk management policies than direct participants.³

In fact, buy-side market participants have a strong interest in ensuring that SB swap clearing agencies have effective risk management processes. Under the current central counterparty clearing agency structure, when a clearing member defaults, that default would have direct and indirect effects on customers, including the possibility that customer collateral is in the front of the default waterfall and, in certain cases, may be used to make the SB swap clearing agency whole. As holders of vulnerable stakes in clearing agencies, buy-side participants have real incentives to ensure prudent risk management practices exist and are observed.

Meaningful customer representation on risk committees will mitigate conflicts of interest by ensuring that clearing members who are dealers cannot act unilaterally to adopt policies

² The focus of this letter is on risk management committees of enumerated entities. However, BlackRock believes the buy-side should be represented on all committees that make critical determinations about an enumerated entity’s core functions that impact all of its participants. We have made similar comments to the CFTC in response to its proposed rules regarding the mitigation of conflicts of interest with respect to derivatives clearing organizations, designated contract markets and swap execution facilities. See BlackRock Comment Letter dated November 15, 2010 entitled “Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest, 75 Fed. Reg. 63,732 (Oct. 18, 2010)”; See also 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).”

³ See Proposing Release at 65887-88.

contrary to the interests of the other constituencies of enumerated entities. In addition, as a major group of intended users of cleared products, buy-side participants would be able to explain why clearing a particular product would be useful and whether the risks associated with such a product could be prudently managed. Client margin is also a core component used in calculating the size of a clearing member's contribution to the guaranty fund of a clearing house. The clearing model reduces systemic risk by mutualizing risk among clearing members; care must be taken that there is not a transference of mutualization risk onto clients by unnecessarily increasing customer margin requirements.⁴

Moreover, failing to provide buy-side participants with meaningful representation on a SB swap clearing agency's risk committee could lead to unintended consequences. Currently, buy-side participants who do not wish to clear their derivative trades may transact in the over-the-counter SB swaps market. However, once the dual clearing and exchange-trading mandates in Section 763 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") take effect, many, perhaps most, buy-side participants will need to use SB swap clearing agencies and national securities exchanges or SB SEFs for the bulk of their SB swap transactions. Without meaningful representation on governance committees, buy-side participants will have no real voice in the operations of the enumerated entities the Dodd-Frank Act requires investors and other end-users to use.

ii. Strong conflict of interest rules should prevent any one group of market participants from dominating the risk committee of a SB swap clearing agency.

We request that the Commission adopt a mechanism to guarantee buy-side participants and other constituencies real input on governance committees, including SB swap clearing agency risk committees.⁵ This means the Commission should make certain that dealer clearing members cannot unilaterally change SB swap clearing agency policies and procedures. We believe that the Commission should take two steps to guarantee that risk committee decisions reflect input from non-dealer clearing members and to prevent any single class of participant from dominating the risk committee:

- The Commission should require that the risk committee and other governance committees of each SB swap clearing agency include customer representatives and independent directors. As discussed, customer representation is critical to achieving the Commission's goals of improving governance and mitigating conflicts of interest with respect to enumerated entities.

⁴ BlackRock has, on numerous occasions, commented on the importance of protecting customers of clearing members. Giving customers a voice in the operation of enumerated entities is one facet of customer protection. Another critical, related aspect of customer protection involves developing mechanisms to protect customer collateral in the event a clearing member defaults. We have expressed to the CFTC our view that clearing systems should offer customers the option of having their collateral segregated from the collateral of other customers. Individual segregation would protect customer collateral more effectively than the mechanisms for collateral protection in the current clearing framework. See BlackRock Comment Letter dated January 18, 2011 entitled "Advanced Notice of Proposed Rulemaking-Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies RIN 3038 AD99."

⁵ The SEC has proposed governance rules for SB SEFs that we believe would accomplish this objective. Specifically, Proposed Rule 811(c)(2) would impose a fair representation standard on the swap review committee of the SB SEF. Under this standard each class of participant, as well as other market participants, must be given the right to participate on the swap review committee and no category of market participant may predominate. As we noted in our letter in response to the SEC's proposed regulations for SB SEFs, such representation is critical to building a robust and sustainable regulatory framework for SB SEFs. See BlackRock Comment Letter dated April 4, 2011 entitled "Registration and Regulation of Security-Based Swap Execution Facilities (File Number S7-06-11)."

- The Commission should establish mechanisms to ensure that dealer clearing members do not dominate risk and governance committees. Appropriate mechanisms could include a requirement that customer representatives and independent directors comprise a majority of the risk and governance committees. This approach would provide meaningful representation to the buy-side community and would also assuage clearing member concerns that too few independent directors have the expertise required to execute the duties of the risk committee. Alternatively, the Commission could require risk committees and other governance committees to act by a supermajority vote. For each committee, the supermajority required would be set at a level that would prevent dealer representatives of dealer clearing members, as a group, from making any decisions without having those decisions supported by at least some non-dealer representatives.

Either of these options would mitigate conflicts of interest by ensuring that the governance committees of enumerated entities incorporate customer views.

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We thank the Commission for the opportunity to comment on its proposed rules. We believe that requiring buy-side perspectives on the governance committees of enumerated entities will help mitigate conflicts of interest and we urge the Commission to include a fair representation requirement in its final rules. If you have any questions or would like further information, please contact either of us.

Sincerely,

Joanne Medero
Richard Prager