February 13, 2012

BY ELECTRONIC SUBMISSION

Department of the Treasury
Office of Domestic Finance
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20520

Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
Re: Docket No. R-1432 and RIN 7100-AD82
Re: Docket ID OCC-2011-14

Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Re: RIN 3064-AD85
Re: RIN 3038-AD05

Office of the Comptroller of the Currency
250 E Street, S.W.
Washington, D.C. 20219
Re: File Number S7-41-11

RE: Notice of Proposed Rulemaking
Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds

Dear Sir or Madam:

BlackRock, Inc. appreciates the opportunity to provide comments on the new Section 13 (the “Volcker Rule”) of the Bank Holding Company Act of 1956 (the “BHC Act”) to the regulatory agencies (the “Agencies”) charged with its implementation.¹

BlackRock is an independently-managed public company (NYSE: BLK) that engages solely in providing asset management and risk management services to its clients. We manage over $3.5 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 and multi-employer pension plans, insurance companies, mutual funds and exchange-traded funds, endowments, foundations, charities, corporations, government and other official institutions, banks and individuals around the world. BlackRock provides alternative investment solutions to clients through

hedge funds, private equity funds, funds of hedge funds, private equity funds of funds, real estate and real assets. Our investment business competes against investment solutions offered by a myriad of other providers, including independent and bank-affiliated investment managers both within and outside the United States.

Executive Summary

BlackRock supports the policy behind the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) that are commonly referred to as the Volcker Rule – restricting certain proprietary trading and investing activities by banking institutions that are eligible to receive government support. The statutory provision is expansive in its potential reach, however, and should be implemented carefully with appropriate consideration of congressional intent and the potential impact of the rule on U.S. financial markets and all of its participants. To the extent the Volcker Rule constrains asset management and trading activities of U.S. banks and their affiliates without any commensurate benefit to taxpayers and to the economy, it will limit U.S. banks’ competitiveness and ultimately weaken the very system it was designed to protect. As drafted, we believe the Proposed Rule will lead to a number of significant adverse impacts and unintended consequences that should be resolved in the final rule.

First, as a fiduciary to our clients and a major participant in global markets, we are concerned that the Proposed Rule’s implementation of the ban on proprietary trading creates significant uncertainties for market makers, which will disrupt the markets for many securities. The uncertainties are particularly acute for fixed income securities, where the ability of dealers to hold inventory and commit capital are critical to the efficient operation of the market. A disruption in dealer activities will lead to less liquidity in the market, resulting in wider bid-ask spreads and higher borrowing costs, which will have significant negative economic consequences for savers as well as for corporations and municipalities.

Second, we wish to comment on certain specific provisions of the Proposed Rule that we believe go beyond the intent of the Volcker Rule. We are concerned that the Proposed Rule’s sweeping definition of “covered funds” captures numerous investment vehicles both within and outside the United States, a great many of which we believe the congressional record shows were never intended to be covered by the Volcker Rule. We do not believe that Congress intended, for example, to capture a UCITS fund sold to retail clients in Germany, a long-only exchange traded fund (“ETF”) whose shares trade in Latin America, or a portfolio of fixed income securities created to help a British pension plan fund its future obligations. None of these examples resemble “hedge funds” or “private equity funds” as those terms are commonly understood, yet all could be captured if the rule is not clarified appropriately. A definition of “covered funds” that is so loosely tailored would, for no clear policy reason, create significant business issues for all U.S.-based global asset management firms subject to the Volcker Rule, and a competitive disadvantage with respect to their competitors not subject to Volcker restrictions. Such a definition could also constrain legitimate capital market activity, such as market making in ETFs. We also have concerns regarding the use of name provision, which, particularly with a broad definition of “covered funds,” would have significant adverse impact on asset management brands within U.S. banks.

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2 As described in more detail in this letter, the FSOC Study (as defined below) and the legislative history establish that the Volcker Rule is primarily aimed at banking institutions that receive federal deposit insurance or access to the discount window.
Finally, we will address another unintended consequence of the Volcker Rule – the applicability of the Volcker Rule to managers like BlackRock that have a limited relationship with a U.S. bank. We do not believe it was the intent of Congress to capture independent asset management firms who happen to have a small minority investor that is a bank holding company. Such firms are not eligible to receive federal deposit insurance, nor do they have access to the Federal Reserve discount window. Subjecting these firms to the restrictions of the Volcker Rule creates significant competitive disadvantages and compliance burdens without providing any discernible benefits or protection to taxpayers. We believe that the final rule should exclude such firms through a narrowly crafted exclusion consistent with the intent of Congress when it enacted the Volcker Rule.

I. Impact of the Volcker Rule on Financial Markets

While the implementation of the ban on proprietary trading set forth in the Proposed Rule does not affect investment advisers directly, we have significant concerns that the impact of the Proposed Rule on the market making activities of banking entities will have unintended and undesirable consequences for financial markets in general. These consequences will include negative impacts on the performance of investor portfolios. The Volcker Rule specifically carves out market making and customer facilitation activities from the proprietary trading ban. It is critical that the implementation of these exclusions provide a clear framework for these activities to continue without creating regulatory risk and uncertainty for U.S. banks.

While we appreciate that the Volcker Rule requires the Agencies to delineate activities that are considered proprietary trading from those that are market making and facilitating client activities, we believe the rule as proposed creates uncertainty for brokers. Indeed, many of the conditions of the market making exemption in the Proposed Rule are inconsistent with traditional market making activities, creating uncertainty for dealers seeking to comply with the rule. For example, one condition requires that market making revenues be derived from fees, commissions and other income that is not attributable to appreciation in the value of securities. In less liquid markets, such as those for many fixed income securities, dealers may need to hold inventory for an extended period of time. It is difficult to reconcile this with a requirement that the dealer cannot benefit from an increase in value of the securities, creating regulatory uncertainty for dealers. On top of satisfying such conditions, the Proposed Rule requires dealers to construct a highly complex and costly compliance regime.

The result of this cost and uncertainty will be decreased liquidity, especially for credit and securitized fixed income instruments. We note that liquidity in investment grade securities has already been reduced as primary dealer balance sheets have contracted. In addition to the general reduction in liquidity, normal seasonality periods will further hamper liquidity, creating times when it may become difficult to effect transactions in certain securities.

Investment decisions are heavily dependent on a liquidity factor input – investment strategies and decisions require that not only the initial procurement of the securities is considered, but that there also needs to be a degree of confidence that the securities can be sold in a timely, cost-effective manner. Otherwise, those securities will appeal only to a very limited number of investors and strategies. This is particularly true for strategies that are actively managed, as compared to “buy and hold” portfolios. Regarding “buy and hold” strategies, it should be noted that fixed income portfolios, which are often thought of as “buy and hold” portfolios, are not without relevant risks and require comprehensive risk management, which may include selling selected securities based on a change of credit outlook. Credit risk as well as interest rate risk are both very real and can greatly affect the performance of a fixed income portfolio. As liquidity dissipates, investment strategies become more limited, and returns to investors are diminished by wider spreads and higher transaction costs. Diminished returns impact the ability of
investors, such as pension funds, to meet their obligations to their participants and beneficiaries, and also negatively impact savers.

Reduced liquidity will also impact issuers of fixed income securities. We can expect that new issue concessions will increase as brokers manage the risk of decreased liquidity and the ability to comply with the new rules. We expect that all issuers will be impacted to some degree, including both large, frequent issuers and smaller, more episodic issuers.

In light of the issues outlined above, we urge the Agencies to carefully consider the breadth of the proprietary trading ban contained in the Proposed Rule and provide greater certainty around what constitutes permissible activity. As discussed above, the Proposed Rule currently considers several factors in delineating proprietary activities from acceptable market making and customer facilitation, many of which we think are unworkable. We suggest that dealer “market facilitation” books can be monitored most effectively by focusing first and foremost on aging, followed by value at risk (“VAR”), correlation, concentration, average tenor, average credit rating, positions in issues where the dealer participated in the syndicate, as well as positions in issues where the dealer did not participate in the syndicate.

We have additional, specific concerns with respect to the impact of the Proposed Rule on the market for U.S. municipal securities. The municipal market is highly fragmented, made up of millions of individual securities issued by tens of thousands of issuers. A decrease in liquidity in this market could have particularly dramatic impacts on both municipal issuers and market participants. Fortunately, as drafted, the Proposed Rule exempts obligations of any State or of any political subdivision thereof. However, the Proposed Rule fails to extend this exemption to debt issued by an agency of any State or political subdivision thereof, leaving out a significant portion of the current municipal market for no apparent policy reason. This includes the revenue bond market, creating a negative impact on the ability of municipal issuers to borrow for important projects such as roads, airports and hospitals. We urge the Agencies to address this inconsistency and adopt a broad exclusion for municipal debt.

As we have seen in the equity markets, evolution does occur and we fully expect that, over time, fixed income markets will evolve into an “all to all” marketplace with a mix of agency, principal and end-user participants. We welcome a fully integrated market, with an open order book and streaming prices by a myriad of participants providing liquidity. However, until the fixed income markets reach this stage, creating regulatory uncertainty for market makers will likely have a material negative impact on liquidity, resulting in higher borrowing costs for issuers and lower returns for investors.

II. Comments on Specific Provisions of the Proposed Rule

Similar to our concerns with respect to proprietary trading, we believe that the implementation of the prohibition on sponsoring and investing in hedge funds and private equity funds has been drawn too broadly and impacts activity that Congress did not intend to restrict through the Volcker Rule. Specifically, the proposed definition of “covered funds” is overly expansive and would capture, we believe unintentionally, a wide variety of funds that a diversified asset management firm offers to its clients globally. While a firm that engages solely in the U.S. hedge fund or private equity fund businesses would feel little impact from such an expansive definition, it creates adverse consequences for any firm that offers other types of funds to clients within and outside the United States.
Covered Funds

We support a definition of “covered funds” based on characteristics and investment activities that are substantially similar to traditional hedge funds or private equity funds. However, the scope of the definitions in the Proposed Rule is far too broad, and, in certain areas, proves to be unworkable.

We appreciate that the Agencies have recognized there may be other, preferred approaches to the “covered funds” definition, as they have requested comment on what alternative definitions might be more effective in light of the language and purpose of the statute and whether the definition should focus on the characteristics of an entity. Additionally, the Agencies have asked whether non-U.S. similar funds should be defined by reference to structural characteristics, including a limitation on the number or type of investors in the fund and whether the fund operates without regard to statutory or regulatory requirements relating to the types of instruments in which it invests or the leverage it may incur.

These questions resemble the recommendations of the Financial Stability Oversight Council (the “FSOC”) in its study mandated by the Volcker Rule on effectively implementing the statute. In the FSOC Study, the FSOC asked the Agencies to consider the investment activities and other characteristics of funds in determining whether they should be considered “similar funds.” In particular, the FSOC Study specified the following criteria: (i) related compensation structure, (ii) trading or investment strategy, (iii) use of leverage, and (iv) investor composition. Instead of the definitions in the Proposed Rule, we strongly urge that the Agencies adopt this type of approach. A definition based on the investment activities and other characteristics of hedge funds and private equity funds would eliminate the unintended consequences discussed in more detail below.

Problems With the Proposed Definition of Covered Funds

Commodity Pools

The Proposed Rule defines “covered funds” to include both U.S. and non-U.S. “commodity pools,” which would expand the scope of the Volcker Rule well beyond funds that are similar to hedge funds or private equity funds. Prior to the Dodd-Frank Act, the rules of the Commodity Futures Trading Commission (the “CFTC”) defined a commodity pool to include any investment trust, syndicate or similar form of enterprise operated for the purpose of trading in futures and/or commodities. As part of

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4 Joint Proposed Rule Question 221, p. 68,898.
5 Joint Proposed Rule Question 224, p. 68,899.
7 Another potential framework was offered by the Securities Industry and Financial Markets Association (“SIFMA”) in their comment letter in advance of the FSOC Study (November 5, 2010). In that letter, SIFMA provided proposed definitions of “hedge fund” and “private equity fund” based on the characteristics commonly associated with those investment vehicles.
8 17 C.F.R. § 4.10(d)(1). In March of 2011, the CFTC proposed to amend this definition to include swaps. Amendments to Commodity Pool Operator and Commodity Trading Advisor Regulations Resulting From the Dodd-Frank Act, 76 Fed. Reg. 11,701 (Mar. 3, 2011).
the sweeping reform of derivatives under Dodd-Frank, the Commodity Exchange Act (the “CEA”) was amended to add swaps to the list of instruments that, if traded, causes that fund to become a commodity pool and to define the term “swap” broadly under the CEA, capturing commonly used investment instruments such as interest rate swaps, currency swaps and total return swaps.9 Taken together with CFTC and staff interpretations, these two new definitions essentially provide that any collective investment vehicle that trades even one CFTC-regulated future or swap is a “commodity pool.”10 Therefore, the number of potential funds that would be covered by the Volcker Rule would increase dramatically as a result of including commodity pools as “covered funds.”

BlackRock believes that, used appropriately, swaps and other derivatives can be effective tools in seeking to control risks and achieve returns in funds. Funds use swaps and futures for numerous purposes, including reducing portfolio risk, hedging specific positions, “equitization” of cash, the creation of synthetic positions and gaining exposures in a more cost effective manner. Indeed, numerous types of more traditional collective investment funds use swaps or futures in this limited manner, including U.S. registered mutual funds, UCITS and other non-U.S. mutual funds for retail investors, and bank collective trust funds offered as investment options to third-party defined contribution plans. This beneficial and limited use of swaps or futures technically may make any of these funds a commodity pool under the CEA, but it would not make these funds “similar” to a hedge fund or private equity fund as those terms are commonly understood.

Accordingly, we do not believe all commodity pools should be subjected to the Volcker Rule’s “covered funds” prohibition.11 We urge that the proposed definition of “covered funds” be narrowed to capture only those commodity pools that exhibit characteristics similar to hedge funds or private equity funds. In this vein, we recommend that the Agencies adopt simple and straightforward criteria that would clearly exclude more traditional collective investment funds, and funds that only use swaps or futures in a limited manner, from becoming “covered funds” by virtue of being commodity pools.12

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9 Section 721(a)(5) of Dodd-Frank amending Section 1(a) of the CEA; Section 721(a)(21) of Dodd-Frank amending Section 1(a) of the CEA.

10 Rather than narrowing the definition of “commodity pool,” the CFTC historically has preferred to adopt exclusions from the definition of “commodity pool operator” (“CPO”) and exemptions from CPO registration. As a result, the definition of “commodity pool” has remained exceedingly broad while the universe of persons that the CFTC regulates as CPOs is decidedly more narrow. For example, in the preamble to the CFTC’s recently finalized CPO and CTA rules, the CFTC states that, absent a de minimis exemption, “any swaps activities undertaken by a registered investment company would result in that entity being required to register [as a CPO]…[even] one swap contract would be enough to trigger the registration requirement.” Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations, 77 Fed. Reg. ___ (Feb. ___, 2012) (to be codified at 17 C.F.R. Pts. 4.5, 4.7, 4.13, 4.14, 4.24, 4.27, 4.34, 145, 147).

11 In the CFTC Proposed Rule, the CFTC specifically asks whether the use of the “commodity pool” definition will potentially pull in additional pools that may be outside the intent of the proposed regulations. We believe that it does. CFTC Proposed Rule Question 218.1, p. 206.

12 We are aware that other commenters, such as SIFMA, are proposing criteria that would narrow the scope of commodity pools that would be included as covered funds. We support these efforts to develop workable criteria. We would welcome the opportunity to assist the Agencies in further developing and refining any such criteria to ensure that the scope of the definition of “covered funds” will be appropriately tailored to the language of the statute.
We believe Congress did not intend to subject to the Volcker Rule those funds that use swaps and futures in a limited manner and otherwise have none of the characteristics of a hedge fund or a private equity fund. Narrowing the proposed definition of “covered funds” to exclude these types of funds would be consistent with the statute.

**Non-U.S. Funds**

In an effort to capture “hedge funds” and “private equity funds” offered outside the United States, the proposed scope of the Volcker Rule potentially captures a very wide range of funds. The Proposed Rule defines “covered funds” to include:

Any issuer, as defined in section 2(a)(22) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(22)), that is organized or offered outside of the United States that would be a covered fund as defined in paragraphs (b)(1)(i), (ii), or (iv) of this section, were it organized or offered under the laws, or offered to one or more residents, of the United States or of one or more States.13

It is unclear how to interpret this provision, and yet its potential impacts on a global scale are significant. It effectively represents an extra-territorial expansion of U.S. law. The Proposed Rule requires asset managers to consider each fund that they offer outside the United States and assume that such fund is being offered in the United States. Asset managers then have to determine whether such fund fits within the broad definition of “investment company” under the Investment Company Act of 1940 (the “Investment Company Act”), and, if so, analyze on what basis the fund could be offered to U.S. persons. Unless the fund could theoretically register as an investment company under the Investment Company Act14 or satisfy the specific conditions of another exemption or exclusion under the Investment Company Act, the only available means of offering it in the United States would be pursuant to Section 3(c)(1) or 3(c)(7). Therefore, this proposal would appear to turn nearly any non-U.S. fund (including traditional long-only fixed income and equity funds) into a covered fund simply because they could be offered privately in the United States. The Proposed Rule appears to capture most funds sponsored around the world by asset management businesses subject to the Volcker Rule, including the equivalent product to a U.S. registered fund but offered outside the United States under another country’s regulatory framework (i.e., UCITS funds). Aside from the impact on U.S. based asset management firms that offer funds outside the United States, it seems overreaching and inappropriate to export the requirements of the Investment Company Act to other regulatory jurisdictions.

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13 Joint Proposed Rule § __10(b)(1)(iii).

14 Registered investment companies are subject to expansive and detailed regulation with respect to their governance structure, internal operations and investment programs, including matters such as leverage, liquidity, investment concentration, diversification, naming conventions, custody of assets, affiliated transactions and exposure to securities related issuers. Non-U.S. funds – including funds with investment strategies very similar to those of U.S. registered mutual funds – would likely not be in compliance with all the specific requirements of the Investment Company Act. Many non-U.S. funds are subject to extensive regulatory requirements outside the United States, and therefore have governance structures, liquidity profiles and investment programs that are designed to comply with those requirements and which may be inconsistent with the requirements of the Investment Company Act.
The result of this expansion is to create dramatic impacts on the activities of asset managers subject to the Volcker Rule that offer funds outside the United States. The repercussions are similar to those described above with respect to commodity pools—numerous funds that were never intended to be captured by the Volcker Rule become subject to its requirements, without any commensurate protection to taxpayers. We recognize the regulators’ desire to capture certain funds operating outside the United States that have characteristics similar to those of hedge funds and private equity funds. Unfortunately, the mechanism in the Proposed Rule does not appropriately accomplish that goal, but instead captures almost every fund offered outside the United States. Again, we believe the right way to capture funds that are “similar” to hedge funds and private equity funds is to create a definition that is based on the characteristics of those funds, as proposed in the FSOC Study.

Use of Name

The Proposed Rule implements the prohibition on a covered fund sharing the same name or a variation of the same name with a banking entity by requiring that a covered fund organized and offered by a banking entity:

(1) Does not share the same name or a variation of the same name with the covered banking entity (or an affiliate or subsidiary thereof).15

We believe that the name prohibition should be implemented to cover only banks that themselves are subject to the Volcker Rule and not affiliates or subsidiaries of such entities. Therefore, we would propose that the name-sharing prohibition be limited to names used by insured depository institutions or the ultimate parent of an insured depository institution, and not to their affiliates and subsidiaries that are not themselves insured depository institutions. An asset management subsidiary of a banking entity may represent a distinct brand separate and apart from that of the bank. Extending the name sharing prohibition to all covered banking entities, including to affiliates and subsidiaries of insured depository institutions and bank holding companies, provides absolutely no additional protection, while at the same time creates significant economic burdens and competitive disadvantages for asset managers subject to the Volcker Rule.

Combined with the currently expansive definition of “covered funds,” this prohibition creates extremely significant business and branding issues. As discussed above, the definition of “covered funds” potentially captures a tremendous number of onshore and offshore funds, including many funds sold broadly on a retail basis. For example, with respect to BlackRock, the definition would capture some or all of our retail mutual funds offered in the United States and the European Union. Those funds are referred to as the “BlackRock Funds,” and a significant amount of time, money and resources has been devoted to developing the BlackRock brand to support the distribution of those products. While we understand the regulatory benefits of not using the “bank” name, we do not believe using another branded name should be limited. Similarly situated asset managers within U.S. banking entities (i.e., an asset management subsidiary using a different name than the bank) will be forced to find another name for their funds, destroying the substantial brand equity they have built up over many years, creating a significant competitive disadvantage with no regulatory benefit.

Impact on Capital Market Activities

The breadth of the covered funds definition may also negatively affect legitimate capital market and market making activity. One example is the likely impact on the trading of ETF shares. ETFs are liquid, transparent, generally lower-fee investment vehicles designed to give investors convenient and efficient access to portfolios of securities that reflect market benchmarks. Many ETFs traded by large U.S. institutions, such as pension funds, may be domiciled, listed and traded in non-U.S. jurisdictions. As noted above, the definition of covered funds in the Proposed Rule sweeps in funds that have little resemblance to hedge funds or private equity funds, potentially including offshore ETFs. Broker-dealers affiliated with U.S. banks are among the most important participants in this market and provide liquidity for ETF shares by buying, selling and creating ETF shares in response to client orders and for risk management. If ETFs are captured as covered funds, trading desks affiliated with banks subject to the Volcker Rule would be unable to fulfill their current market making function, which would negatively impact liquidity and potentially increase the cost of trading. It is difficult to imagine that Congress, through the provisions of the Volcker Rule related to investments in hedge funds and private equity funds, intended to prohibit banks from supplying liquidity to ETFs.16

Similarly, the Proposed Rule could also severely limit, if not eliminate, the ability of dealers subject to the Volcker Rule to provide Tender Options Bond ("TOB") financing for investors in the municipal market. TOB trusts are neither hedge funds nor private equity funds, but rather funding vehicles for high quality municipal securities. Despite this clear distinction, the definition of "covered fund" under the Proposed Rule likely captures TOB trusts within its scope. Subjecting TOB trusts to the Volcker Rule would likely make it significantly more difficult for U.S. banks to continue these programs. Therefore, if not amended, the Proposed Rule could eliminate an important source of demand for long term municipal debt, which will increase the cost of borrowing for municipalities and decrease the investment opportunities in the municipal market.

III. Application of the Volcker Rule to Independently-Managed Asset Management Firms

The Proposed Rule specifically asks for comment on whether there are entities that should not be included within the definition of banking entity since their inclusion would not be consistent with the language or purpose of the statute or could otherwise produce unintended results.17 We strongly believe that the prohibitions and constraints of the Volcker Rule should not be applied to independent asset management firms that have small minority investments by U.S. bank holding companies based on a clear, objective test and do not otherwise have access to government support through federal deposit insurance or access to the discount window. Such firms are potentially drawn into the Volcker Rule due to the historical interpretations of definitions in the BHC Act, which is intended to serve a different purpose (i.e., regulating companies that own depository institutions).

We believe most people would not be aware that the Volcker Rule captures independent asset management businesses that have small minority investments by U.S. bank holding companies. However, such a risk exists because the Volcker Rule’s prohibitions apply to any “banking entity,” which is defined in the Proposed Rule to include:

16 This issue would also be addressed by including an appropriate market-making exemption from the ban on investing in hedge funds and private equity funds.

17 Joint Proposed Rule Question 6, p. 68,856.
(1) Any insured depository institution;
(2) Any company that controls an insured depository institution;
(3) Any company that is treated as a bank holding company for purposes of Section 8 of the International Banking Act of 1978; and
(4) Any affiliate or subsidiary of any entity described in paragraphs (1), (2) or (3) of this section, other than an affiliate or subsidiary that is [a covered fund or an entity controlled by a covered fund].

The statutory text of the Volcker Rule does not define “affiliate” or “subsidiary.” The Proposed Rule, however, imports the definitions of those terms from the BHC Act. We believe it is important for the Agencies to clarify the scope of those definitions in the context of the Volcker Rule so that they are consistent with congressional intent.

The BHC Act and Regulation Y promulgated by the Board of Governors of the Federal Reserve System (the “Federal Reserve”) define “subsidiary” and “affiliate” primarily in terms of “control,” which, in turn, is broadly interpreted. Under the definition of “control,” an entity is “controlled” by, and thus is a “subsidiary” of, a bank holding company when 25% or more of its voting equity is owned by a bank holding company. In addition to this bright line threshold, however, the BHC Act also finds control to be present where a bank holding company has the ability to exercise a “controlling influence” over the management or policies of another company. The Federal Reserve can determine that a “controlling influence” exists at ownership levels significantly less than 25%.

For example, under current Federal Reserve interpretations of the “controlling influence” standard, it is difficult for a bank holding company to effectively divest control of a subsidiary. This difficulty arises because a certain amount of controlling influence is presumed to continue even after the bank holding company divests its voting interest to below 25%. Thus, once the 25% threshold has been exceeded, the ownership of voting equity must fall much lower before an entity is no longer considered a “subsidiary.”

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18 Joint Proposed Rule § __.2(e) (emphasis added).
19 Joint Proposed Rule § __.2(a) and (bb).
20 BHC Act § 2(d) (“subsidiary”); Reg. Y §§ 225.2(a) (“affiliate”), 225.2(e) (“control”), 225.2(o) (“subsidiary”). A “subsidiary” is a company controlled by another company, while an “affiliate” is a company that controls, is controlled by, or is under common control with another company.
21 For example, BlackRock was at one time a wholly-owned subsidiary of The PNC Financial Services Group, Inc. (“PNC”). PNC currently owns approximately 24% of BlackRock’s voting equity, but as a consequence of this interpretive approach, BlackRock is deemed to be “controlled” by PNC for purposes of the BHC Act, even though PNC’s current voting ownership is below the BHC Act threshold.

The BHC Act and Regulation Y definitions of “control” include many relationships that cause affiliation for purposes of the BHC Act and Regulation Y but that would not cause a company to be considered a “subsidiary” or “affiliate” for other purposes. For example, ownership levels that could cause affiliation under the BHC Act and Regulation Y would not create an affiliation under the “control person” definitions of the Securities Act of 1933 or the Securities Exchange Act of 1934.
In the absence of clarification in the Volcker Rule, the historical interpretation of the definitions in the BHC Act – which was established for different purposes – could be read into the Volcker Rule. This might result in independent asset management firms that have only small, minority investments by U.S. bank holding companies being deemed “banking entities” under the Volcker Rule. This has the potential to tilt the competitive landscape in the highly competitive and fee conscious asset management marketplace, subjecting certain asset managers to the substantial costs and restrictions of the Volcker Rule, while leaving other substantively identical asset managers completely outside its compliance regime.22

As discussed further below, the Federal Reserve has recently made just such a clarification in formulating the definition of “subsidiary” for purposes of implementing the Dodd-Frank Act’s single counterparty credit exposure limitations relating to “systemically important financial institutions.” In proposing to narrow the definition of “subsidiary” from that in Regulation Y to a 25% equity or voting position or consolidation, the Federal Reserve explained that a simpler, more objective definition would be more consistent with the objectives of these limitations. For parallel reasons, the Federal Reserve should take similar action in relation to implementing the Volcker Rule.

**The Policy Background of the Volcker Rule**

The policy objectives of the Volcker Rule are limited to banking organizations that have access to government support, whether through federal deposit insurance or access to the discount window, and to subsidiaries through which such banking organizations could engage in the activities the Volcker Rule restricts or prohibits. The legislative history and agency guidance relating to the Volcker Rule strongly support the conclusion that the Volcker Rule is targeted at banking organizations that benefit from federal deposit insurance or discount window access.

As noted above, the Volcker Rule mandated that the FSOC conduct a study and make recommendations on effectively implementing the Volcker Rule. The FSOC Study, released in January 2011, confirmed the focus of the Volcker Rule on entities that receive government support, going so far as to include federal deposit insurance or discount window access as an inherent part of the definition of “banking entity.” Specifically, the FSOC Study states:

- The Volcker Rule prohibits banking entities, which benefit from federal insurance on customer deposits or access to the discount window, from engaging in proprietary trading and from investing in or sponsoring hedge funds and private equity funds, subject to certain exceptions.23

Elsewhere, the FSOC Study raises the Agencies’ broader concern that taxpayer funds will be used to engage in risky investments or transferred to such investments:

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22 There would have to be a substantial difference with respect to accomplishing the policy objectives of the Volcker Rule in order to justify such vastly disparate treatment between, for example, an asset manager with a new 22% banking entity investor and an asset manager with a banking entity investor that has sold its interest down to 22%. Such differences, however, do not exist.

23 FSOC Study at 1 (emphasis added).
• The statutory prohibitions on relationships with private equity funds and hedge funds should also be implemented to prevent banking entities from having incentives or opportunities to inappropriately provide support to investors in such funds or otherwise transfer the government subsidy inherent in the federal safety net for banks to speculative proprietary investments.24

This focus was reiterated by Paul Volcker, the former Federal Reserve chairman and namesake of the Volcker Rule, in his October 2010 comment letter:

• The plain intent of Section 619 of the Dodd-Frank Act is to restrict certain high risk, proprietary trading activities by banks and bank holding companies, institutions that receive government protection and support.25

In addition to the statements that access to government funds is a central focus of the Volcker Rule’s “banking entity” definition, the FSOC Study expresses the specific concern that a banking entity will bail out private funds that they sponsor, thereby putting taxpayer funds at risk. The FSOC Study states:

• The purpose of [the prohibition on sponsorship of and investments in hedge funds and private equity funds] is to eliminate incentives and opportunities for banking entities to “bail out” funds that they sponsor, advise or where they have a significant investment.26

It is thus clear that the Volcker Rule was designed to protect banking entities that benefit from deposit insurance or access to the discount window by (i) preventing banking entities from conducting risky endeavors like proprietary trading activities and investing in hedge funds and private equity funds for their own account, (ii) preventing banking entities from using subsidiaries and affiliates to engage in such activities indirectly, and (iii) by eliminating incentives for banking entities to provide support to private funds that they sponsor and advise. The common theme with respect to each of these factors is the existence of government support and the incentive to use such government funds in pursuit of activities that could pose a threat to U.S. taxpayers.

Proposed Definition of “control” for the Volcker Rule

In the FSOC Study, the FSOC “recommend[ed] that the relevant Agencies carefully consider the impact of certain BHC Act definitions on the Volcker Rule’s definition of “banking entity” and implement the term in a way that avoids results that Congress clearly did not intend in enacting the Volcker Rule.”27 We believe that Congress very clearly did not intend to capture independent asset managers that have only small, minority investments by U.S. bank holding companies, because such entities are sufficiently removed from access to taxpayer funds.

24 FSOC Study at 56 (emphasis added).
25 Paul Volcker comment letter, October 29, 2010 (emphasis added).
26 FSOC Study at 6.
27 FSOC Study at 69 (emphasis added).
The Federal Reserve has recently recognized the potential impact of utilizing these exact same BHC Act definitions in new regulatory requirements. In its proposed rules released December 20, 2011, regarding Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies (the “Proposed Prudential Standards”), in the section regarding single counterparty exposure limits, the Federal Reserve expressly chose not to use the definition of “control” found in the BHC Act and Regulation Y, but instead used a simpler and more objective standard. Under that section of the Proposed Prudential Standards, a company would “control” another company if it:

(i) owns or controls with the power to vote 25 percent or more of a class of voting securities of the company;
(ii) owns or controls 25 percent or more of the total equity of the company; or
(iii) consolidates the company for financial reporting purposes.

The Federal Reserve proposed this different standard because “a simpler, more objective definition of control is more consistent with the objectives of single counterparty credit limits.”

We strongly believe that this simpler, more objective standard (the “Objective Control Standard”) is also appropriate for the objectives of the Volcker Rule. The single counterparty exposure limits in the Proposed Prudential Standards and the Volcker Rule have the same objectives – to protect banking organizations and the government funds that support them. The Objective Control Standard recognizes that single counterparty exposure limits should not apply to two entities that are separately owned and managed, are not related for credit evaluation purposes and are not viewed by the companies themselves or analysts as being part of the same enterprise for financial purposes. The same elements apply in relation to the Volcker Rule. Where a banking organization and a nonbanking organization are separately owned and managed, the nonbanking organization has no direct or indirect access to government funds and no one commercially views them as related, the nonbanking organization should not be treated as a banking entity under the Volcker Rule. We believe it is essential that there be a clear, objective standard that is applied consistently regarding which companies, in which a U.S. bank holding company has an investment, are subject to the Volcker Rule. Therefore, we propose that the Agencies adopt the Objective Control Standard for the Volcker Rule. This would minimize the variety of definitions of “subsidiary” under the Federal Reserve’s various rules, while preserving completely the objectives of the Volcker Rule.

We believe that a nonbanking organization which is not consolidated with any U.S. banking organization and less than 25% of the voting power and equity of which is owned by any U.S. banking organization is sufficiently removed from access to government support. Such investees of banking entities do not have access to federal deposit insurance and guarantees that apply to consolidated bank subsidiaries and that are at the heart of the Volcker Rule’s restrictions. Using the definitions of “subsidiary” and “control” from the BHC Act and Regulation Y – and potentially importing all the historical Federal Reserve interpretations of those terms – has the potential to create inconsistent application of the Volcker Rule, and thereby impose competitive harm without furthering the objectives of Congress in enacting the rule.

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29 Prudential Standards Proposed Rule at 614.

30 Id. (emphasis added).
In summary, for the reasons set forth above, whether the recipient of a minority investment should be considered a “banking entity” for Volcker Rule purposes should depend on the factors that affect potential exposure to losses by the government-supported banking entity (and hence potential losses of taxpayer funds), not on a wholesale importation of the historical interpretations of the BHC Act definitions of “subsidiary” and “affiliate.” Congress recognized that exclusions from the definition of “banking entity” are appropriate in similar circumstances, and, consistent with this expressed policy, we believe the Agencies should exercise their interpretative authority to adopt an exclusion along the lines suggested.

Impact of the Proposed Rule on Independently-Managed Asset Management Firms

The Proposed Rule, if applied to independent asset managers that have only a limited relationship with a U.S. bank, would impose significant costs and place such asset managers at a competitive disadvantage compared to those asset managers who will not be subject to the rule. Ultimately, this will harm the ability of these firms to grow their businesses, create jobs and provide the best investment opportunities to their clients.

Asset managers are already subject to significant regulation by numerous regulatory bodies in the jurisdictions where they do business. BlackRock strongly supports the practice of establishing robust policies, procedures, technology systems and internal controls to provide for compliance with laws and regulations that govern our industry globally. As a general matter, these laws seek to protect investing clients, to ensure that they are adequately apprised of the risks and conflicts involved in the management of their assets, and to protect against market abuse and manipulation. In the case of the Volcker Rule as applied to asset managers, however, significant time, money and resources would have to be dedicated to comply with laws that do not provide any additional protection to investors, the marketplace or to the U.S. taxpayer funds that the Volcker Rule was designed to protect. The resources that would be required to be dedicated to compliance with the Volcker Rule could instead be invested by asset managers directly into their businesses for the benefit of their investing clients – which also creates jobs.

The Volcker Rule’s investment restriction is another example of the significant competitive disadvantage that would be imposed on asset managers subject to the Volcker Rule relative to standalone asset managers that are not. Alternative investment clients demand that the investment manager have “skin in the game,” and managers of alternative investments stand ready to invest alongside clients to support the products they develop and demonstrate their conviction in the strategies they offer. Telling clients that you are “required by law” to limit co-investments and refusing to bear the risks you are asking them to bear would ring hollow in a highly competitive business where other investment managers would not be similarly constrained.

Conclusion

BlackRock supports the policy behind the Volcker Rule, but we are extremely concerned that the implementation in the Proposed Rule goes beyond congressional intent and constrains legitimate asset

31 The definition of “banking entity” in the Volcker Rule includes an exclusion for certain limited purpose trust institutions which requires, among other things, that such institutions not accept demand deposits or have access to the Federal Reserve discount window.

32 For the avoidance of doubt, we propose that this exclusion would apply only to the application of the Volcker Rule, not to any other application of the terms “control” or “subsidiary” under the BHC Act.
management and trading activities of U.S. banks. First, we are concerned that the market making exemption does not provide enough clarity for dealers, which will negatively impact market liquidity and client portfolios. We recommend that the Agencies propose a clearly articulated market making exemption based on appropriate objective criteria that provides certainty to banks around what constitutes permissible activity, and does not subject them to second-guessing and regulatory risk. We also recommend a broad exemption for all municipal securities. Second, we are concerned that the current definition of covered funds is extraordinarily broad and captures numerous types of funds that have no resemblance to hedge funds or private equity funds, with significant adverse consequences. We urge the Agencies to adopt a definition based on the actual characteristics of hedge funds and private equity funds, as recommended in the FSOC Study. Finally, we do not believe Congress intended to subject independent asset management firms to the Volcker Rule because they happen to have a small minority investor that is a bank holding company. Such firms do not have access the Federal Reserve discount window and are not eligible to receive federal deposit insurance, and, therefore, subjecting them to Volcker restrictions serves none of the policy goals behind the Volcker Rule. We urge the Agencies to adopt an objective 25% ownership test to determine which subsidiaries of bank holding companies are subject to the Volcker Rule, consistent with the standard recently included in the Proposed Prudential Standards.

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February 13, 2012
Page 15
We thank the Agencies for providing BlackRock the opportunity to express its views on the proposed Volcker Rule. We are prepared to assist the Agencies in any way we can, and we welcome a continued dialogue on these important issues. Please contact the undersigned if you have any questions or comments regarding BlackRock’s views.

Sincerely,

Barbara Novick
Vice Chairman

Matthew J. Mallow
General Counsel