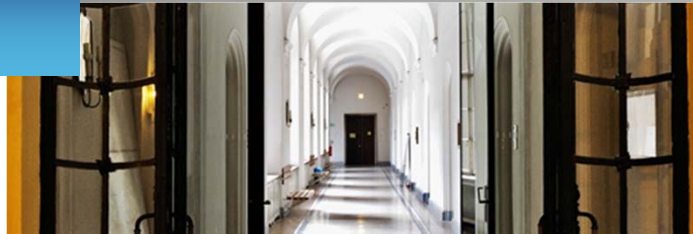


Fin Reg and Beyond Global Implications for Investors



Financial regulatory reform means different things to different people. Depending on one's perspective—as a bank, insurance company, corporation, asset manager, investor or taxpayer—different components may be of more or less interest. Likewise, one's home country and scope of business may impact perspective. Here we look at financial reform in the US and Europe, and the resulting implications for investors.

While many think the passage of the Wall Street Reform and Consumer Protection Act (or, the Act) by the US Congress signals “the end,” in fact, this is just one component of a lengthy, complicated process. As highlighted in the table below, Dodd–Frank (as the Act is more commonly known) encompasses extensive areas of reform. However, it should be considered the shape of things to come. To put this in perspective, Dodd–Frank's more than 2,000 pages have spawned hundreds of rulemakings, definitions and follow-on studies involving the Securities and Exchange Commission (SEC), Government Accounting Office (GAO), Commodity Futures Trading Commission (CFTC), Federal Reserve Board and several other US government agencies.

More importantly, there are many areas of reform not covered by the Act. These include initiatives by US and European regulators (such as retirement plan provisions and securities market structures), many of which have significant implications for investors.

Within Dodd–Frank Act	Beyond Dodd–Frank Act
Derivatives	Future of Housing Finance
Volcker Rule	Money Market Funds
Hedge Funds	Retirement Issues
Systemic Risk Oversight	Distribution Models
Rating Agencies	Market Structure
Municipal Bonds	New Tax Initiatives
Corporate Governance	
Federal Insurance Office	
Consumer Lending	

In Europe, the process for regulatory reform is at an earlier stage. The European Commission published its roadmap of financial reform in June, which contains 26 regulatory initiatives and 12 existing ones. The Commission intends to publish

formal proposals on all initiatives by the second quarter of 2011, with agreement between the European Parliament and the Council of Ministers (which together form the EU legislative branch) in the second half of 2011 and implementation in 2013.

In addition to the broad scope of topics being addressed by regulators, it is important to understand that the process itself involves multiple branches of government, competing agendas and sometimes conflicting visions. While we lay out many of the issues being addressed and report on some that have been finalized, we hesitate to speculate too much on final outcomes. Public roundtables, comment periods and other forums to gather input are gaining momentum and are sure to influence many final regulations. BlackRock is committed to voicing the concerns of investors on key issues and continues to advocate on our clients' behalf.

Derivatives

Given the perception of the role that derivatives played in helping to trigger the financial crisis, it is not surprising that a key component of Dodd–Frank is focused on increasing oversight and transparency of these products. Investors can expect sweeping changes to over-the-counter derivatives, including interest rate swaps, credit default swaps, and foreign exchange. The OTC derivatives market is much larger than the market for exchange-traded derivatives and, as such, it is considered to represent significant systemic risk.

Changes will have far-reaching implications for strategies as diverse as liability-driven investing and commodities. Overall, the changes should result in more transparency, greater standardization and increased liquidity, which hold long-term benefits for investors.

The SEC has been given jurisdiction over most security-based swaps, and the CFTC has authority for all other swaps. This includes foreign exchange derivatives (unless the Treasury deems otherwise).

Swap dealers will have to register with the SEC, the CFTC or both, and they will be subject to new reporting, disclosure and business conduct requirements.

Major swap participants will be subject to similar requirements, as well as capital and margin requirements. Swaps that are accepted for clearing by a designated clearing organization must also be traded on an exchange or swap execution facility. All swaps—cleared and uncleared—must be reported to a data repository or the CFTC. Most of these changes are scheduled to come into effect as of July 2011.

The Act also requires CFTC and SEC rulemaking and follow-on studies. The CFTC has identified 30 areas where they are seeking comments. BlackRock is currently focused on the oversight of clearing organizations, particularly as it relates to governance, collateral and segregation. We are also focused on the scope of the definition of major swap participants, as it may be applied to funds and separate accounts. We are engaged with the CFTC and the SEC on these issues, meeting directly, participating in roundtables and providing formal written comments. The two agencies will also address book value wrappers for stable value strategies in a specific joint study; until they decide whether to include this product in the new regulatory regime, they will be excluded.

BlackRock supports financial regulatory reform that increases transparency, protects investors and facilitates responsible growth of capital markets, while preserving customer choice and assessing benefits versus implementation costs.

In addition to these issues, we share concerns voiced by other market participants about the potential lack of global consistency across regulatory jurisdictions for derivatives and the consequences that could reduce opportunities for certain investors or fail to mitigate risk for others. We believe that the need for operational and technology infrastructure to implement these changes is just as important for an effective outcome, which may take longer to develop than the statutory timetable for implementation assumes.

In Europe, we anticipate reform will require broad changes in regulation and leave little room for interpretation by the member states. There will likely be a central role for the European Securities and Markets Authority (ESMA). Early indications of the European Commission proposal point to the ESMA receiving jurisdiction over which derivatives contracts will be subject to mandatory clearing and defining the criteria for eligibility of clearing. Clearing will be conducted by central counterparties and reported to trade repositories, both of which will be authorized by the ESMA. This new process and additional reporting requirements are designed to increase transparency and provide additional oversight for systemic risk.

Volcker Rule

This section of the Act restricts US banks and bank holding companies—after a certain date—from engaging in proprietary trading or acquiring or retaining ownership interests in hedge funds or private equity funds. It is intended to address concerns that proprietary trading exposes an institution and its insured depository bank to a higher risk of failure, which could trigger taxpayer bailouts. Banks will be permitted to act as investment advisors and to co-invest with clients up to 3% of their firm's capital, in aggregate. As a result, several banks are expected to spin off or exit affected businesses (such as Citigroup, JP Morgan, Morgan Stanley, etc.). Others, including Goldman Sachs, have begun to restructure their proprietary trading operations.

Hedge Funds

The lack of transparency and regulatory oversight of hedge funds has also come under increased scrutiny since the start of the financial crisis. Changes to how hedge funds are regulated fall within three categories: registration of advisors, recordkeeping and reporting, and distribution.

Dodd–Frank eliminates the private advisor exemption for registration of managers of US and non-US funds if they include US investors. Previously, many managers used this exemption to establish hedge funds and private equity operations. Managers of venture capital funds (to be defined by the SEC in a new rulemaking) will retain their exemption from registration.

US registered advisors will face new recordkeeping requirements, including information on assets under management, use of leverage, trading and investment positions, and valuation policies. Reports will be provided to the SEC and the Financial Stability Oversight Council (a new regulatory body described below). The SEC may also now require hedge funds and private equity firms to establish a new role of chief compliance officer (CCOs) to be accountable for oversight, which would be similar to the existing requirement for mutual fund complexes.

Changes in the distribution of hedge funds include a new definition for accredited investors in the US that raises the qualification bar for high-net-worth investors. In Europe, the proposed Alternative Investment Fund Managers Directive (AIFMD) is currently subject to intense negotiation. The directive covers funds sold in the EU, regardless of domicile, and goes beyond hedge funds. The AIFMD will impact the distribution of hedge funds, private equity funds, real estate funds, collective funds, investment trusts, charity funds and exchange-traded funds, with consequences for many institutional investors. Although investors will receive additional transparency and protection, these benefits may be overshadowed by the likely reduction in investment options and increased costs.

Systemic Risk Oversight

Dodd–Frank establishes the Financial Stability Oversight Council (FSOC). Its purpose is to identify risk to US financial stability, address potential threats to the financial system, and promote market discipline. See the table below for membership, including heads of the major federal financial regulators (the Federal Reserve, Office of the Comptroller of the Currency [OCC], SEC, Federal Deposit Insurance Corporation [FDIC], CFTC, Federal Housing Finance Agency and Bureau of Consumer Financial Protection) as well as a representative with insurance expertise. The FSOC can determine whether a non-bank financial entity is potentially systemically significant, so as to subject it to prudential regulation by the Federal Reserve. There is speculation that the FSOC may designate insurance companies, hedge fund managers, asset managers and/or consumer finance companies, however, it is too soon to predict who will be designated. For those designated systemically significant, the Federal Reserve will provide risk management standards and will have increased oversight. Because of their role in the financial system “plumbing,” these designated institutions will be granted access to emergency financial support through the Federal Reserve discount window as well as borrowing privileges.

Financial Stability Oversight Council Membership	
Voting Members	
Secretary of Treasury	Timothy Geithner
Chairman of Federal Reserve	Ben Bernanke
Comptroller of the Currency	John Walsh
Chairman of SEC	Mary Schapiro
Chairman of FDIC	Sheila Bair
Chairman of CFTC	Gary Gensler
Director of Federal Housing Finance Agency	Edward DeMarco
Chairman of National Credit Union Administration Board	Deborah Matz
Representative of Bureau of Consumer Financial Protection	TBA *
Representative of Insurance Industry	TBA *
Non-Voting Advisory Members	
Director of the Office of Financial Research	TBA *
Director of the Federal Insurance Office	TBA *
A state insurance commissioner	John Huff
A state banking supervisor	William Haraf
A state securities commissioner	David Massey

* Subject to Presidential appointment and Senate confirmation

At its first meeting on October 1, the FSOC issued an Advanced Notice of Proposed Rulemaking (ANPRM) concerning the criteria

it is considering using in the designation process. An ANPRM is the first step in rulemaking—the Council has indicated that it expects to issue a proposed rule by the end of the year, and a final rule by March 31, 2011. At that point, it will begin to consider particular companies for designation.

The Act also gives the FDIC “Orderly Liquidation Authority,” allowing it to seize control of any covered financial company in situations where imminent collapse could threaten the financial system. This is where the Act deals with “too big to fail.” The FDIC’s powers as liquidator are similar to those it currently has for insured banks; these are broader than in the Bankruptcy Code, which could impact creditors.

On October 12, the FDIC issued its first proposed rule on the application of resolution authority, establishing the following process for dealing with a troubled financial institution. Upon a vote by a council of regulators, the FDIC can seize a large systemically important institution. All convertible debt instruments must have been converted into equity prior to seizure. Upon seizure, management will be removed and the FDIC will provide strategic direction to the remaining employees. The FDIC will have authority to create a bridge financial company in order to continue “systemically important” operations, services and transactions so as to prevent serious adverse effects on the financial system’s stability. Certain creditors will be allowed to receive payments following the seizure, as long as these payments are approved by the board of the FDIC. The FDIC will have broad authority to sell assets of the seized institution, including selling assets to the newly created bridge financial company. Large companies will be required to develop resolution or unwind plans in advance (“living wills”) and submit them to the FDIC. If a company cannot submit a credible resolution plan, the FDIC and the Federal Reserve have authority to jointly impose increasingly stringent requirements that ultimately can lead to the divestiture of assets or operations. The proposal, which is subject to a 30-day public comment period, does not address several logistical matters, including the mechanics of dismantling a troubled institution. Officials have announced that they will focus on these issues during future rulemaking periods.

In Europe, a new framework for oversight of the financial services sector, the European System of Financial Supervisors (ESFS), will commence in January 2011. The ESFS is intended to provide ultimate authority for financial supervision at a pan-European level, creating a coordinated and comprehensive structure across the member states that seeks to ensure financial stability, similar to the Financial Stability Oversight Council in the US. Three European Supervisory Authorities (ESAs) will be responsible for micro regulation covering securities, banks and insurance companies. The ESAs’ powers will include binding technical standards and certain powers to act in emergency situations. At a more macro level, the European

Systemic Risk Board (ESRB) will be introduced to work in conjunction with the three European Supervisory Authorities. The ESRB is expected to identify potential areas of systemic risk and to issue risk warnings and recommendations. It will act in an advisory capacity, with no legally binding powers.

Rating Agencies

Credit rating agencies are broadly known for their part in the financial crisis and the understatement of risk related to securitization of subprime mortgages. A significant outcome of the Act is the SEC's increased authority over designated national securities rating organizations (such as Moody's, Standard & Poor's and Fitch). This change was designed to prevent issuers of securitized products from being able to shop for a higher rating, to reduce conflicts of interest and to generally improve the marketplace. The SEC has two years to consider establishing a credit rating board that would determine which agencies would be permitted to rate specific securitized products.

Another result of Dodd–Frank is that rating agencies will no longer be exempt from “expert” liability when they knowingly provide false or misleading information, making the agencies accountable to investors and subject to civil lawsuits. However, the rating agencies are pushing back on this change and have not allowed their ratings to be used. As a result, the SEC provided a no-action letter to facilitate the continued securitization of asset-backed securities. We believe that Congress will need to revisit this issue.

The Act also seeks to reduce or eliminate the reliance on credit ratings in numerous regulations, including for federal bank capital standards and money market mutual funds. The ubiquitous nature of ratings and the absence of a good substitute will make this extremely difficult to achieve.

In Europe, the European Securities and Markets Authority (ESMA) will begin directly to oversee all credit rating agencies registered in the EU and all ratings used in the EU. It will also define a procedure to determine equivalence of third country ratings. Overall, initiatives mirror those in the US, the goal being to reduce conflicts of interest and improve the marketplace for consumers. Regulations will address board composition, disclosure of rating methodologies, specific obligations for structured finance products, provisions on possible ratings withdrawal, reporting of historical ratings performance and potential conflict of interest similar to an SEC provision. Other areas of investigation for additional regulations include ways to increase competition among agencies (and, specifically, the possibility of a European rating agency), options to reduce regulatory reliance on ratings, methods used for rating sovereign debt, and alternatives to the current model, in which issuers are the agencies' paying clients.

Municipal Bonds

On a positive note, we believe Dodd–Frank is likely to bring the municipal bond market closer to the corporate bond market in terms of disclosure and management of potential conflicts of interest. More transparency, more timely information and stronger reporting requirements for issuers will benefit investors and, we believe, improve trading and liquidity of these securities.

The Municipal Securities Rulemaking Board, a self-regulatory organization created by the US Congress in 1975, will change to increase the number of independent members and to limit terms. In addition, the Act will require registration with the SEC of municipal advisors providing increased oversight of their activities.

Municipal Securities Rulemaking Board Membership	
New transitional 21-member board	Former 15-member board
11 public members	5 public members
7 broker-dealer and bank deal members	5 commercial bank members
3 municipal advisor members	5 broker-deal members

Corporate Governance

The Act contains several provisions on corporate governance, particularly as it relates to executive compensation, director elections and incentives for whistleblowers. Some provisions codify standard industry practices; consequently, we believe that they will have marginal impact on companies. For example, we support provisions of the Act that mandate independent membership for compensation committees and establish claw-back compensation policies. However, we believe that some of the other rules will fail to provide investors with meaningful information. In particular, we are concerned that provisions of the Act that revise proxy rules and that institute granular executive compensation disclosure requirements will distract corporate management teams and reduce the efficiency and overall effectiveness of corporate boards. Please refer to our *ViewPoint* paper “Financial Regulatory Reform: Reform Arrives in the Boardroom” for a more detailed analysis of this area of Dodd–Frank.

In Europe, the Commission is expected to finalize a corporate governance proposal in early 2011. Current areas of focus include risk management, the boards of financial institutions, external auditors and supervisory authorities, shareholder responsibilities, executive compensation, and potential conflicts of interest for financial institutions. Overall, early work from the Commission represents a move away from “comply or explain” to

regulation. BlackRock agrees with many of the points made, in principle, but questions whether regulation is necessary to achieve the stated goals. Remuneration within financial institutions will also be covered by the Commission's proposal, and this is addressed by a number of other directives as well (e.g., Capital Requirements Directive III, commonly known as CRD III, and the AIFMD).

Federal Insurance Office

Dodd–Frank establishes the Federal Insurance Office (FIO), a new agency residing within the Treasury Department. The Director of the FIO, appointed by the Treasury Secretary, will serve on the Financial Stability Oversight Council in a non-voting advisory capacity.

The FIO will monitor the insurance industry and will advise the President and the Congress, but it will hold little, if any, substantive regulatory authority. In its current design, except in cases of international agreements, the FIO will not preempt state regulation of insurance rates, premiums, underwriting practices, sales, solvency or anti-trust. However, we assume that the creation of this office, even with its limited powers, will advance efforts to develop uniformity across state regulatory regimes and that it may evolve into a national insurance regulator over time.

Consumer Lending

One of the most controversial aspects of Dodd–Frank is the creation of the new Bureau of Consumer Financial Protection. Its establishment consolidates the consumer protection powers that previously involved the federal banking system and various agencies. Because of this centralization, some observers have voiced concern that the Bureau could become increasingly detached from the banking industry. In particular, the Bureau has been given broad scope over many areas of consumer lending. Generally deemed positive, the Bureau also has oversight for certain areas (e.g., mortgage brokers) where it previously did not exist. Financial products and professionals that are covered by the SEC and insurance regulatory bodies are currently beyond the scope of the Bureau.

Housing Finance

In spite of the fact that mortgage lending and securitization played a critical role in the financial crisis, the Dodd–Frank Act only addresses a small aspect of housing finance. Sellers of mortgages are expected to keep a retained interest to reflect “skin in the game.” Depending on loan quality, this requirement can be waived.

Notably absent from Dodd–Frank are legislative provisions that address the future of government-sponsored enterprises (GSEs). Fannie Mae and Freddie Mac were put into conservatorship in September 2008. Since then, they have reported losses of over \$145 billion, and expectations are for significantly more losses in

the portfolio holdings and the guarantee program. Going forward, the government needs to clearly define the mission of the housing agencies and then create a blueprint to transition from the current status to the new program. BlackRock and others recommend that the two GSEs be consolidated into one “public” housing agency and that the new group's balance sheet be reduced in size. In this scenario, the hybrid public/private capital structure would be eliminated, strict underwriting standards would be established and enforced, and credit enhancement would be limited to standardized products. The Administration's plan to Congress on the GSEs is due in January 2011.

Debate also continues over the Home Affordable Modification Plan (HAMP), the federal program established to help eligible homeowners with loan modifications on their existing mortgage debt. The program has significantly altered historical standards by placing first lien mortgage holders in a “first risk” position, and placing holders of unsecured consumer loans behind them. We believe that HAMP should be overhauled and replaced with a program that more appropriately balances the needs of homeowners, holders of first lien mortgage debt, and holders of other types of debt. In fact, BlackRock has encouraged government officials to consider the Judicial Mortgage Restructuring (JMR) as an alternative to HAMP. The JMR program was designed to empower bankruptcy courts with the jurisdiction to amend the terms and principal balance of a first lien residential mortgage loan as a new chapter of bankruptcy filing by qualified mortgagors. We envision this new chapter to be a temporary resolution, with sunset provisions in place, for the purpose of addressing the urgently critical mortgage dilemma. Under this plan, the bankruptcy courts would provide an independent and unbiased arbiter of a consumer's entire balance sheet and could implement a debt modification system designed to be sustainable and successful.

Money Market Funds

The SEC Money Market Reform rules, effective May 2010, have gone a long way in addressing concerns about money market funds. However, the SEC has indicated that additional proposals remain under consideration. Chief among them is a recommendation that money market funds—known and appreciated for their stable net asset value (NAV)—assume a floating NAV structure.

Money market funds play a critical role in the US, bringing together issuers of and investors in short-term financial instruments. These funds are attractive to investors specifically because they provide a stable NAV and daily access to funds, while also offering a competitive yield relative to bank deposits and direct investments. Prior to the financial crisis, money market funds had successfully provided this service to the financial markets since the early 1970s without requiring government intervention.

The unprecedented events of the credit crisis, including the historic “breaking of the buck” by the Reserve Primary Fund, exposed both idiosyncratic (fund-specific) and systemic (industry-wide) risks associated with money market funds, and gave rise to several reform measures designed to mitigate such risks. The changes enacted to Rule 2a-7—the rule governing money market funds—include more conservative investment parameters related to credit quality, maturity and liquidity, as well as enhanced guidelines around transparency to investors.

Some industry members argue that a floating NAV would reflect a fund’s true market value, allowing investors to see regular fluctuations in their investment and providing a clearer idea of the risks associated with a particular fund. Essentially, proponents claim that floating the NAV reduces the likelihood of a run on a fund because, in a crisis, the fund would redeem people at less than \$1.00 per share, thereby reducing the incentive to flee and protecting the remaining shareholders.

For many investors, floating the NAV would negate the value of the product. A floating NAV fund generates taxable gains and losses with each subscription and redemption, creating a tax and accounting burden for individual investors and for institutions that use these funds on a daily basis for their working capital. Perhaps most importantly, floating the NAV does not solve the underlying issue of investors fleeing the funds and disrupting the cash markets and the broader financial system.

In our view, it is critical to preserve the stable value status of money market funds, recognizing their importance to financing companies, financial institutions and municipalities, and, by extension, their contribution to the health of the broader financial system. Sweeping reform that would alter the very nature of this product would be counterproductive and result in unintended consequences, with regard to funding for corporations and municipalities. Please refer to our *ViewPoint* paper “Money Market Mutual Funds: The Case Against Floating the Net Asset Value” for a more detailed analysis. Modest changes and regular monitoring are less-disruptive solutions and seem the most prudent course at what is a pivotal juncture for the financial system and the economy.

In Europe, the term money market fund has been applied to stable NAV funds and a wide range of fluctuating NAV funds. In May 2010, the Committee of European Securities Regulators limited the type of funds able to call themselves money market funds and created new categories: short-term money market funds (stable and fluctuating) and money market funds (fluctuating only). This was designed to foster transparency, making it easier for investors to distinguish between fund types and to help identify suitable funds in terms of liquidity and preservation of capital.

Retirement Plans

Pension plan funding ratios have continued to decline, as low interest rates have increased liabilities while the financial crisis hurt asset values. To help with funding levels, the Pension Protection Act of 2006 (the PPA) laid the groundwork for establishing appropriate contribution levels among US defined benefit pension plans. These levels seem unachievable given what has transpired since the PPA was enacted. This year, the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010 provided relief to plans that incurred significant losses in asset value as a result of the market downturn, allowing them to amortize certain losses over 15 years. Fortunately, the final Dodd–Frank language on derivatives preserved the ability of pension funds to use swaps in managing their portfolios.

Other proposed regulatory changes by the Governmental Accounting Standards Board address accounting issues for state and local defined benefit plans. The focus of current proposals is on how pension plans calculate and report liabilities, with changes to how unfunded liabilities are valued and to certain aspects of liability projections. If implemented as discussed, these proposals would have profound implications for public pension plans, making funding deficits more visible and more volatile, and possibly promoting accelerated contributions. Given the taxpayer issues involved, some are calling for a shift to defined contribution plans for public employees.

For defined contribution plans, there are several regulatory proposals in process. The US Department of Labor (DOL) is focused on fees and investment advice for participants in DC plans. As of October 12, the DOL issued a new rule on disclosing fees and providing participants with additional information by November 2011. In addition, in conjunction with the SEC, the DOL is considering regulatory changes relating to disclosures about target date funds. Recently, the DOL and Treasury held hearings to solicit industry opinions regarding retirement income (the concept of annuitization, in particular). Finally, as mentioned above, book value contracts essential to stable value funds—commonly used as investment options in defined contribution plans—are under review by the CFTC and SEC.

For both defined benefit and defined contribution plans, the new Bureau of Consumer Financial Protection may receive regulatory oversight for plan service providers such as recordkeepers, custodians and investment consultants. It is uncertain what impact this may have on plan sponsors or investment managers.

Beyond the challenges facing employer-sponsored retirement plans, the Social Security Trust Fund is projected to be exhausted by 2037. This only adds to the anxiety about the security of retirement income, if not the urgency around finding solutions.

In Europe, there is also increasing concern about governments' abilities to continue funding state pensions, and the private pension market that may be unable to make up the gap in retirement funding. The European Commission has published a consultative green paper "towards adequate, sustainable and safe European pension systems" as part of an initiative to provide a deeper and more integrated market for private pensions in Europe. Part of the Green Paper addresses questions of high-level public policy such as the sustainability of public finances and the overall retirement age. The paper also seeks answers on how the European private pension market can increase its cross-border efficiency, the development of a defined-benefit or defined-contribution UCITS-style retail product or, Undertakings for Collective Investment in Transferable Securities), and what regulatory environment might be necessary to facilitate this. On the back of the Green Paper, the EU's Directive on Institutions for Occupational Retirement Provision, which governs European pension funds, is scheduled for review in 2011. One element of the Commission's thinking points is the possible introduction of solvency-based risk metrics for European pension funds, as part of the effort to increase the safety of pension funds for a broader role in retirement provision.

Market Structure

Key issues in terms of equity market structure relate to liquidity and execution. Prior to the passage of Dodd–Frank, the SEC had already begun a review of equity market structure issues, at first focusing on flash orders (orders that are displayed to certain traders a fraction of a second ahead of other market participants) and direct access issues, but also issuing a comprehensive concept release querying whether current market structures are appropriate given the rapid technology changes that have occurred.

The "flash crash" of May 6, 2010, generated additional focus on the role of high-frequency trading and resulted in the establishment of a pilot program of stock-specific circuit breakers. Despite the fact that impact of the flash crash on investors was relatively limited due to widespread trade cancellations, it is clear that better rules are needed to maintain liquidity and protect investors. BlackRock also supports additional areas of reform that would give market makers greater certainty during extreme market events, improve inter-market order routing, set limits on stop loss orders, and incent designated market makers to provide liquidity and maintain orderly markets on volatile trading days.

The SEC is also expected to take up the role of "dark pools" (off-exchange liquidity sources) some time this fall, and is expected to issue a report in conjunction with the CFTC on emerging regulatory issues shortly.

BlackRock supports comprehensive review of market structure that would improve investor protection, but we remain concerned about any changes that could hamper market efficiency.

Investor Protection and Distribution Models

The SEC has proposed sweeping changes to mutual fund distribution fees that could significantly change the manner in which fund products are distributed and may negatively impact the products and services available to investors. BlackRock is particularly concerned about potential impacts on smaller investors and smaller 401(k) plans.

- ▶ The first proposal seeks to limit fund sales charges by restricting cumulative ongoing sales charges to an amount equal to the maximum front-end load charged by any class of the relevant fund.
- ▶ The second proposal seeks to improve transparency by renaming 12b-1 fees and adding sales charge disclosures to transaction confirmations.
- ▶ The third proposal is designed to encourage price competition among broker-dealers by allowing mutual fund companies to sell shares through broker-dealers at commission rates established by the broker-dealers rather than being subject to a sales charge at the fund level.
- ▶ The fourth proposal would revise mutual fund directors' duties by proscribing limits on sales charges and eliminating the need for directors to spend time reviewing detailed data about 12b-1 fees.

While BlackRock supports increased transparency and protection of investors, we also support preserving consumer choice and realistically assessing the benefits of changes versus the implementation costs. We are concerned that the current package of regulatory changes will fundamentally impact investors' ability to choose the products they want and to pay for mutual funds as they choose. In addition, we fear the increased operational costs will either be passed along to consumers in the form of higher fees, or will result in a lowering of service levels.

Overall, we recommend a less disruptive approach that emphasizes clear guidelines for allowable fees and improved disclosure for investors. For a more detailed analysis, please refer to our *Viewpoint* entitled "Mutual Funds in the Spotlight: Is a Paradigm Shift Necessary or Desirable?"

Voicing Investor Concerns

Historically, investors and asset managers have played a limited role in public policy debates. Given the scope and implications of financial reform, this must change. During the Dodd–Frank discussions, many pension plans were quite active in explaining their views regarding key issues. Clearly, these efforts were fruitful, as evidenced by beneficial changes made to various sections of the Act in the intervening months.

Many issues are still on the table, as regulations continue to be written. BlackRock supports changes that improve the marketplace for investors, and will continue to be a vigorous advocate for clients with regulators in the coming months and

years. We strongly encourage investors to continue voicing their opinion on important issues to legislators and regulators. We remain available to discuss any issues of concern.

Related *ViewPoint* Papers

Money Market Mutual Funds:
The Case Against Floating the Net Asset Value

Financial Regulatory Reform:
Reform Arrives in the Boardroom

Mutual Funds in the Spotlight:
Is a Paradigm Shift Necessary or Desirable?

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