September 20, 2010

Secretary General Stefan Walter  
Basel Committee on Banking Supervision  
Bank for International Settlements  
CH-4002 Basel, Switzerland

Dear Secretary General Walter:

This letter responds to the request of the Basel Committee (the “Committee”) for comments on the proposed changes in contractual requirements for regulatory capital instruments.

BlackRock is one of the world’s largest asset management firms. As of June 30, 2010, BlackRock manages $3.15 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, union and industry pension plans, insurance companies, third-party mutual funds, endowments, foundations, charities, corporations, official institutions, banks, and individuals. As a fiduciary for our clients, we have a strong interest in the development of a regulatory regime that supports liquid, fair, and orderly markets, and we encourage the adoption of consistent practices across jurisdictions and regulatory regimes. We are also an active participant in the $561 billion market for institutional capital securities outstanding in USD, EUR, and GBP.

We have reviewed the “Proposal to ensure the loss absorbency of regulatory capital at the point of non-viability” and would like to provide feedback on several aspects of the consultative document. We understand and support the efforts of the Committee to internalize the cost of distress for the sector, reducing the call on public finances. We also favor measures that respect contractual provisions in existing debt contracts and preserve the priority of the capital structure. As detailed below, we are concerned that the Committee’s proposal may have the unintended consequence of contributing to a structural increase in the cost of capital for the sector.

While we appreciate the Committee’s efforts to address concerns about moral hazard, we respectfully offer the following observations:

We are concerned that the proposal, if adopted, would significantly reduce the size of the market for potential buyers of regulatory capital instruments. First, many institutional investors are not permitted by their mandates to purchase debt securities with equity conversion features. Second, the current proposal makes the valuation of newly-issued securities challenging by giving regulators a great deal of flexibility to define what constitutes a “conversion event.” Finally, because the trigger for conversion is vaguely defined and subjective, any active market for these types of instruments is likely to be volatile and susceptible to name-specific news and rumors. The inherent volatility of the asset class will further restrict the buyer base for these new instruments.

We believe that the proposal does not provide for sufficient granularity amongst bank capital instruments. Under the current proposal, both newly issued Tier 1 and Tier 2 securities would have equity conversion features, which would lower differentiation between these two classes of capital. Price convergence between Tier 1 and Tier 2 debt is likely to increase the blended cost of capital for banks.
The proposal lacks specificity in its definition of key terms, heightening our concerns about the inconsistent application of requirements across jurisdictions. The new contractual requirements are expected to apply only to internationally active banks, however, a description characterizing those institutions that are to be considered “internationally active” has not been provided. In addition, the proposal does not provide a clear definition of “non-viability.” We are concerned that the proposal may create an uneven playing field between single-country institutions and multinational ones and that implementation will vary across jurisdictions.

In summary, as a large investor in debt and equity securities, we believe that the implementation of this proposal would result in significantly reduced demand by investors for regulatory capital instruments, which, in turn, would result in increased capital costs for banks. Instead, we favor contingent capital securities, which achieve a similar outcome but with a pre-specified conversion event and conversion price.

We thank the Committee for providing BlackRock the opportunity to submit feedback and we would welcome further discussion of our comments with you.

Sincerely,

Barbara Novick
Vice Chairman