

BLACKROCK

April 12, 2013

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

Attention:

The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, ON M5H 3S8
Fax: 416-593-2318
E-mail: comments@osc.gov.on.ca

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
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Dear Sirs/Mesdames:

**Canadian Securities Administrators Discussion Paper and Request for Comment 81-407 –
Mutual Fund Fees (“Discussion Paper”)**

BlackRock Asset Management Canada Limited (“**BlackRock**” or “**we**”) welcomes a discussion of mutual fund fees in Canada and commends the Canadian Securities Administrators (“**CSA**”) on its ongoing efforts to protect investors and to preserve investor choice. We strongly encourage effective and meaningful initiatives to enhance disclosure regarding mutual fund fees

and are fully supportive of many of the proposals contemplated by the CSA. However, we do have some concerns regarding certain other proposals referenced in the Discussion Paper as we believe they may, contrary to the CSA's objectives, inadvertently decrease investor choice and lead to some potentially disruptive unintended consequences. We appreciate the opportunity to highlight these concerns and, where appropriate, have suggested alternative proposals for the CSA's consideration with a view to further increasing investors' awareness and understanding of mutual fund fees in Canada.

A. About BlackRock

BlackRock, Inc. is one of the world's largest asset management firms, managing assets for clients in North America and South America, Europe, the Middle East, Africa, Asia and Australia. Its client base includes corporate, public, multi-employer pensions plans, insurance companies, mutual funds and exchange-traded funds, endowments, foundations, charities, corporations, official institutions, banks and individuals around the world.

As of December 31, 2012, BlackRock, Inc.'s assets under management totalled US \$3.792 trillion across equity, fixed income, cash management, alternative investment, real estate and advisory products.

BlackRock is an indirect, wholly-owned subsidiary of BlackRock Inc., and is registered as a portfolio manager, investment fund manager and exempt market dealer in all the jurisdictions of Canada and as a commodity trading manager in Ontario.

B. BlackRock's Framework

BlackRock shares the concern expressed by the CSA in the Discussion Paper regarding the apparent lack of understanding by some investors of trailing commissions and their impact on investor returns¹. Investors should know how much they are paying for investment products and the services of an investment advisor, and we strongly encourage thoughtful measures to make the disclosure of fees more meaningful and accessible to end investors. As such, we have identified a number of specific suggestions as to how trailing commissions can be better described and disclosed to investors which we believe will help achieve this important policy objective of the CSA.

First, BlackRock supports the parallel initiative under consideration by the CSA² to introduce point of sale disclosure documents (currently required for conventional mutual funds in the form of Fund Facts³) to other types of publicly offered investments funds such as exchange-traded funds ("ETFs"). We agree that disclosure documents such as these provide investors with easier access to key information such as past performance, risks and the costs of investing in a mutual fund, and therefore offer a valuable tool in helping them assess appropriate investment options. Should these point of sale documents be mandated for other types of investment funds such as

¹ The Brondesbury Group, Report: Performance Reporting and Cost Disclosure, prepared for: Canadian Securities Administrators (September 17, 2010) at p. 15.

² OSC Staff Notice 81-718 – *Summary Report for Investment Fund Issuers*, at p. 11 and OSC Notice 11-768 – *Statement of Priorities – Request for Comments Regarding Statement of Priorities for Financial Year to End March 31, 2014* at p. 4.

³ See Part II, Item 1.3(6) and (7) of Form 81-101F3 – Contents of a Fund Facts Document ("81-103F3").

ETFs, BlackRock would encourage the CSA to adopt trailing commission disclosure form requirements for these documents which are substantially similar to those in the Fund Facts. Specifically, we would suggest these “summary documents” require a brief description of trailing commissions, a statement that “the trailing commission is paid out of the management fee and is deducted annually for as long as you [the investor] own the fund”, as well as a requirement similar to *Instruction (8)* of 81-101F3 to, for example, include a dollar amount of trailing commission payable for each \$1,000 of investment.

Secondly, we fully endorse a number of the CSA’s initiatives regarding the disclosure of mutual fund fees proposed through the Client Relationship Model Project, Phase 2 (“**CRMII**”) which intersect with issues raised in the Discussion Paper. We strongly agree that “information about charges related to investments is crucial”⁴ and that a one-time mention in an offering document of trailing commissions expressed as a percentage of a client’s investment in a fund is a necessary, but not in itself, sufficient component of transparent disclosure. We therefore support the requirement (effective July 15, 2016) to include a *dollar* amount of all trailing commissions generated by the client’s portfolio in annual compensation reports⁵. While mutual fund prospectuses and Fund Facts documents are currently required to disclose trailing commissions as a percentage of fund assets, we believe that a dollar amount (much like an invoice for other ongoing services such as mobile phones, hydro, etc.) will make the disclosure more personalized and relevant for each investor. We would also support broadening the current scope of this provision in CRMII to require dollar figure disclosure of all applicable loads and commissions – front-end, ongoing and deferred – paid by an investor to his/her advisor and the advisor’s firm. Indeed, although percentage-based disclosure about commissions is certainly necessary and useful at the point of sale, we believe that customized and ongoing cost disclosure through compensation reports is a critical component of providing “complete, upfront and understandable [emphasis ours]”⁶ disclosure to investors.

In addition, BlackRock would support an initiative to mandate the renaming of the term “trailing commission” in offering, marketing and other documents in favour of a more precise and descriptive term which better evokes its actual function. We believe that the current formulation of this term lacks inherent meaning and is likely contributing to the confusion amongst investors as to what these fees represent, when they are paid, to whom they are paid, and how they impact returns. We would therefore support replacing the term “trailing commission” with a less neutral and nebulous one such as “ongoing advice fee” or “ongoing payment to advisor”. As a strong proponent of full and fair disclosure, BlackRock believes that initiatives such as this will put a greater emphasis on plain language over technical terms which should, in turn, improve financial literacy and increase investor awareness about the fees associated with mutual fund ownership.

⁴ CSA Notice and Request for Comment on Proposed Amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* and to Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (2nd Publication) (June 14, 2012).

⁵ See paragraph 14.17(1)(h) of CSA Notice of Amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* and to Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (Cost Disclosure, Performance Reporting and Client Statements).

⁶ *Supra* note 4.

C. BlackRock Responses to the Proposals

The Discussion Paper describes seven specific regulatory options which the CSA are considering, either alone or in combination. We have provided separate responses below to each of these proposals.

1. Specifying and Providing Advisor Services in Exchange for Trailing Commissions

With respect to the CSA's recommendation to introduce a mandatory minimum level of services by advisors, we have some concerns with the proposal as currently contemplated. For example, the introduction of prescriptive minimum requirements may inadvertently encourage "form over substance" service whereby advisors focus on technical compliance with the baseline requirements rather than on providing effective, tailored advice to clients; each of whom has their own specific advisory needs. In addition, it's not clear at this stage from the Discussion Paper what metrics would be used to identify this minimum level of advisor services threshold and whether such indicia would themselves be appropriate proxies for the provision of adequate and suitable advisor services. We are also concerned that heavily-prescribed rules governing a complex relationship such as that between a client and his or her advisor could potentially represent a reactive and static response which lacks the flexibility necessary to adapt to changing client needs. We believe further details and clarification, including how this proposal would coexist with existing know-your-client and suitability requirements, are required before we can fully assess its potential efficacy and properly weigh the relative costs and benefits.

While we foresee challenges with a prescriptive, *rules-based* minimum level of service, BlackRock would, however, generally be supportive of a *principles-based* approach to advisor services. For example, the CFA Institute recently released a Statement of Investor Rights⁷ identifying ten rights which buyers of financial service products are entitled to expect from financial service providers. These rights include "disclosure of any existing or potential conflicts of interest in providing products or services" as well as "an explanation of all fees and costs charged". BlackRock would be supportive of requirements similar to these which would help frame the advisor-client relationship as one of a dialogue which encourages the sharing of information, rather than one of simply disclosure. We believe that a principles-based approach such as this would be more adaptable and responsive to both changing market dynamics and client demands, and would therefore more effectively address the important objective of enhancing investor protection.

In addition to conceptual issues with the baseline level of services requirement as currently proposed, BlackRock also has some practical concerns regarding the mechanism for the withholding of trailing commissions in the event an advisor fails to meet such minimum requirements. Given that investment fund managers such as BlackRock would not be in a position to monitor the compliance of advisors in meeting these baseline standards, further details as to how regulators would communicate a withholding request to investment fund managers are needed. Typically, trailing commissions are accrued daily by the investment fund manager and are remitted to registered dealers at the end of each calendar quarter. It's unclear to us at this stage what would happen to trailing commissions accrued by the investment fund manager, but which are subsequently required to be withheld. We would encourage the CSA to

⁷ <http://www.cfainstitute.org/learning/future/Documents/statement_of_investor_rights.pdf>.

fully consider the logistics of how the monitoring of advisors by the regulators for compliance with such requirements would work in conjunction with the automated remittance of trailing commissions from investment fund managers to advisors.

In sum, BlackRock believes that individual investors, when armed with effective disclosure, are ultimately the best arbiters of whether they are getting value for the advice received. We believe that the goal of the industry and regulators, therefore, should not be to prescribe minimum levels of advisor services, but rather to empower investors with the information necessary to make informed decisions regarding their investments and any concomitant investment advice they receive.

2. Creating a Standard Series or Class of Securities Available for DIY Investors

BlackRock appreciates the concern of the CSA with respect to the perceived lack of options for Do-It-Yourself (“**DIY**”) investors, but disagrees with the suggested diagnosis of the issue. Based on a review of recent industry data, we believe that the offering of mutual fund series featuring minimal or no trailing commissions in the Canadian mutual fund space is both prevalent and rapidly growing, thereby obviating the need for regulatory intervention in this area.

According to a recent Investor Economics report, at the end of 2011, there was more than \$20 billion invested in F-series mutual funds, which carry no upfront or trailing commissions⁸. Furthermore, a total of 172 new funds offering F-series were launched in 2011, helping propel assets under that fee structure to grow by 14.1% per year from 2006 to 2011, compared to just 2.5% for the trailing commission-bearing A-series offerings during the same period⁹. Indeed, as fee-based brokerage and advisor managed programs continue to grow in popularity, industry observers anticipate a continued conversion of A-series to F-series funds¹⁰. In addition, D-series funds – which are sold through online/discount brokerages and which typically carry a reduced trailing commission – represent the single fastest growing fund series over the past five years, albeit from a very low base¹¹.

BlackRock is a strong advocate for investor choice: the more investment product and advisor compensation options for investors, the better. However, we firmly believe that market forces of supply and demand, and not regulation, should drive these options and determine the appropriate allocation of product mixes. As investor demand for DIY and other types of minimal and no trailing commission investment products increases, mutual fund manufacturers will continue to respond in kind by making these products more readily available. The current widespread availability of F-series demonstrates the willingness and desire of mutual fund manufacturers to service these clients. In our view, compelling mutual fund manufacturers to launch execution-only series for all of their products will not only lead to market distortions, but will also unduly burden manufacturers with the operating and administrative costs associated with the offering of products which are not necessarily supported by market demand. As previously discussed, BlackRock believes that increased investor demand, informed – critically – by comprehensible and meaningful fee disclosure, will send to mutual fund manufacturers the appropriate market signals necessary to redress any perceived product supply gaps.

⁸ *Investor Economics Insight, July 2012 Monthly Update* at p. 2.

⁹ *Ibid* at p. 10.

¹⁰ *Ibid*.

¹¹ *Ibid* at p. 3.

In addition, we would also welcome any CSA initiatives to increase product distribution. For example, low cost ETFs already exist and would not require regulation to mandate the creation of a series for DIY investors or others looking for lower fee investment products. One way to make these lower fee products accessible to more potential investors would be for the CSA to allow their distribution via other channels such as permitting mutual fund salespeople registered with the Mutual Fund Dealers Association (“MFDA”) to sell ETFs (in addition to conventional mutual funds). We believe that this would not only greatly increase the universe of available investment products, but would also provide all investors with a wider menu of purchase options.

We would strongly encourage the CSA to continue to monitor the trends identified above regarding the proliferation of minimal and no trailing commission funds and to consider expanding the product set MFDA registered salespersons are permitted to distribute before further pursuing this proposal.

3. Unbundling the Trailing Commission Component from the Management Fees

BlackRock welcomes initiatives to put the cost of investing in terms that investors can better understand. We therefore support the CSA’s proposal requiring mutual fund manufacturers to charge and disclose trailing commissions separately from the management fee component in order to enhance the transparency of a fund’s expenses. To further empower investors with control over advisor compensation costs, BlackRock is also supportive of the proposal to subject increases in trailing commission rates to unitholder scrutiny and approval by deeming any such increase to be a “fundamental change” under Section 5.1 of National Instrument 81-102 – *Mutual Funds*. Simply put, investors in a mutual fund should know how much they are paying in trailing commissions and should have a say when they are to be increased.

It should also be noted that the trailing commissions paid by investors are often not for the exclusive benefit of the individual advisor providing advice. In many cases, a percentage of these fees flow through to the advisor’s firm. We believe this, together with the fact that certain advisory fees are tax deductible¹² in Canada, provides important context for a discussion of mutual fund fees which the CSA should take into consideration when contemplating potential regulatory reforms in this area.

4. Creating a Separate Series or Class of Funds for Each Purchase Option

Different fund series are generally created in order to fit the needs of different investors and dealer compensation models. BlackRock’s view is that the ability to create different series of a single mutual fund generates considerable benefits for both investors and investment managers, and is an important feature of Canada’s mutual fund landscape. However, consistent with our support of unbundling the trailing commission component from the management fee, BlackRock is supportive of measures designed to ensure that all investors in a particular fund series pay a uniform rate of management fee and trailing commission. Such a requirement would help to ensure fair treatment of all investors in a given series, and also be conducive to transparent and easy-to-understand disclosure of fees, both prior to and after purchase. We note also that a single fund series could continue to offer multiple purchase options, and remain compliant with such a requirement, provided that the management fee and trailing commission rates are not affected by

¹²M.N.R., Interpretation Bulletin IT-238R2, “Fees Paid to Investment Counsel” (6 October 1983).

the purchase option chosen. We therefore do not believe that such a requirement would result in fewer series or purchase options being available to investors.

5. Imposing a Limit on the Proportion of Fund Assets that would be Used to Pay Trailing Commissions

While BlackRock acknowledges the CSA's concern regarding the potential lack of alignment between advisor compensation and services, we do not believe that the most appropriate regulatory response to address this is the imposition of price ceilings such as caps on trailing commissions. Relatively high trailing commissions may themselves not be inherently problematic, as they could be warranted due to a commensurately high level of advisory services being provided. Nevertheless, we strongly agree with the CSA that investors should know how much they are paying for the investment advice received so that they can properly assess its value. To that end, we would encourage industry collaboration to prepare and make available benchmark fee guidelines which identify, for instance, median commissions charged by fund or asset type¹³. Investors could then compare the trailing commissions for their funds with the appropriate category in the fee guidelines, thereby allowing them to better assign value for the advisory services received. We believe this approach, coupled with increased client-advisor dialogue, rather than the proposed price ceiling, better achieves the CSA's objective while also preserving investor choice.

6. Introducing Additional Standards or Duties for Investment Advisors

BlackRock encourages initiatives to increase trust and confidence in the investment industry and supports the views expressed on this proposal in the response letter of the Portfolio Management Association of Canada (of which we are a member) dated February 22, 2013.¹⁴ We support the CSA's ongoing analysis of the implications of a statutory best interest standard as contemplated in Consultation Paper 33-403 – *The Standard of Conduct for Advisers and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail Clients* and their continued monitoring of international developments with respect to similar proposals.

7. Eliminating the Payment of Trailing Commissions by Mutual Fund Manufacturers Entirely

BlackRock wholeheartedly agrees with the CSA's statements made during the CRMII initiative in June 2012 that the most effective way of addressing the potential compensation conflicts of interest between advisors and clients is not through bans or prohibitions on trailing commissions, but rather through informed investor choice predicated on complete and comprehensible disclosure:

Some regulators in other countries [U.K., Australia] are moving to ban compensation models such as those involving trailing commissions altogether. We are not proposing to do so. We believe different dealer compensation models can offer benefits to investors. However, it is essential that there be a significant increase in the transparency to investors

¹³ See, for example, Morningstar Direct at August 14, 2012.

¹⁴ <http://www.osc.gov.on.ca/documents/en/Securities-Category3-Comments/com_20130222_33-403_walmsleyk_mahaffys.pdf>.

of the compensation their dealers or advisers receive. We think this means disclosure that is complete, upfront and understandable to the average investor.¹⁵

We echo these earlier statements by the CSA championing investor choice in choosing appropriate compensation models and agree that transparency must be the *sine qua non* of any proposals designed to mitigate conflicts of interest – real or perceived – between advisors and their clients. To that end, we believe that the myriad initiatives currently being advanced by the CSA (e.g., CRMII, the Point of Sale initiative, the statutory best interest standard), together with some of the proposals referenced here in the Discussion Paper will, collectively, provide investors with the disclosure necessary to help them make informed decisions about the appropriate compensation model most suitable to their needs. We believe this approach would preserve investor choice by keeping available to investors the full spectrum of compensation models (ongoing commissions, fee-for-service, etc.) currently on offer, thereby allowing each investor to decide which model best suits his or her particular investment circumstances.

If, however, this proposal were to be pursued, BlackRock has some significant concerns which we would encourage the CSA to further explore before any actions are taken that would have the effect of limiting the current availability of compensation models. For example, if trailing commissions were banned, there could potentially be adverse unintended consequences as some investors may balk at suddenly being subjected to significant upfront advisory fees, leading them to make unsuitable investments in products or instruments for which they are not otherwise obtaining advice. Indeed, it is investors with the most price elasticity to upfront advisory fees that are also those most likely in need of investment advice, and every effort should be made to ensure they are not inadvertently marginalized from receiving appropriate investment advice.

Secondly, an outright ban of commissions may lead to some investors eschewing upfront advisor fees payable in traditional investments like mutual funds and instead favour non-securities investments (e.g., real estate, etc.) which could, in turn, give rise to its own set of adverse unintended consequences. Given that other similarly-situated jurisdictions (UK and Australia) have recently adopted a proposal much like this one, the CSA is uniquely positioned to be able to assess any potential unintended effects in those “legislative laboratories” in the near to medium term – a position which we would encourage the CSA to take full advantage of before experimenting with this potentially far-reaching proposal in Canada. Once sufficient data is available to properly weigh the relative costs and benefits of proposals such as these, BlackRock welcomes a further exploration of them with a view to bolstering investor protections.

C. Conclusion

BlackRock appreciates the opportunity to provide responses to the Discussion Paper on the important issue of mutual fund fees in Canada. We strongly endorse effective and meaningful investor protection initiatives for all types of investment products and believe that a number of the proposals suggested by the CSA achieve this objective.

We encourage the CSA to consult extensively with investors and industry participants on the issues raised in the Discussion Paper to ensure that any proposed measures foster fair and efficient capital markets, maximize investor choice and minimize the potential for regulatory arbitrage vis à vis investment products which are not subject to securities law regulation (e.g.,

¹⁵ *Supra* note 2.

segregated funds). BlackRock would be pleased to make appropriate representatives available to discuss any of these comments with you.

Yours very truly,

BlackRock Asset Management Canada Limited

A handwritten signature in blue ink, appearing to read "Noel Archard", with a large, stylized flourish at the end.

Noel Archard
Chief Executive Officer