BLACKROCK®

December 11, 2019

Submitted via electronic filing: comments@osc.gov.on.ca; consultation-en-cours@lautorite.qc.ca

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Commission
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

Attention:

Ms. Grace Knakowski
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Ontario Securities Commission
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Dear Ms. Knakowski and Me Lebel:

Re: Canadian Securities Administrators Notice and Request for Comment – Reducing Regulatory Burden for Investment Fund Issuers – Phase 2, Stage 1

BlackRock Asset Management Canada Limited (**BlackRock Canada** or **we**) is pleased to have the opportunity to provide the comments below in response to the Canadian Securities Administrators (**CSA**)'s Notice and Request for Comment – *Reducing Regulatory Burden for Investment Fund Issuers – Phase 2, Stage 1* (the **Proposal**).

A. About BlackRock

BlackRock Canada is an indirect, wholly-owned subsidiary of BlackRock, Inc. (together with BlackRock Canada, **BlackRock**) and is registered as a portfolio manager, investment fund manager and exempt market dealer in all jurisdictions of Canada, a commodity trading manager in Ontario, and an adviser under *The Commodity Futures Act* (Manitoba).

BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. As an investment adviser, we embrace our role as a fiduciary to our clients and recognize its importance in protecting investors.

B. <u>General Observations</u>

BlackRock Canada's objectives align with the policy objectives of the CSA: to protect the interests of investors and to ensure the fair and efficient operation of the capital markets. Like the CSA, BlackRock Canada believes that there exists significant scope to improve the existing regulatory framework governing investment fund issuers in Canada so that these objectives can be achieved more efficiently and in a manner that does not decrease investor choice, compromise investor protection or the efficiency of the capital markets.

We are pleased with the CSA's recognition that expenses associated with regulatory compliance are a significant component of the costs that BlackRock Canada and many other Canadian investment fund issuers incur in conducting their operations. Further, a large proportion of these expenses are ultimately borne by investment funds and their unitholders. BlackRock Canada believes that many of the workstreams set out in the Proposal represent a step forward in reducing regulatory burden for investment fund issuers in Canada, which, over time, should hopefully also reduce the costs associated with regulatory compliance.

That said, from BlackRock Canada's perspective as Canada's largest provider of exchange-traded funds (**ETFs**) by assets under management, we note that the Proposal contemplates few changes that will materially reduce the regulatory burden borne by investment fund issuers whose business deals primarily with ETFs, as opposed to conventional mutual funds. In addition, certain aspects of the Proposal may have the effect of contributing to investment fund issuer burden, and we urge the CSA to evaluate each workstream with a view to determining whether the proposed changes will effectively advance the overarching goal of reducing burden. For example, in the absence of a provision permitting the grandfathering of the exemptive relief that the CSA propose to codify in Workstream Five, investment fund issuers will be required to assess and, in some instances, substantially revise their processes – which have been built on, and in reliance upon, existing exemptive relief – to comply with the new codified rules. This is a burdensome process and, for ETF providers in particular, there is little else in the Proposal in the form of burden relief to offset the additional work that will be required in this regard if grandfathering is not permitted. Accordingly, as noted below, BlackRock Canada urges the CSA to permit investment fund issuers to continue to rely on their existing exemptive relief following the final implementation of the Proposal.

BlackRock Canada recognizes that the CSA intend to make further proposals to reduce regulatory burden for investment fund issuers as a part of future stages within Phase 2 of its burden reduction initiative. BlackRock Canada anticipates that such further proposals will include ETF-specific initiatives, including with respect to continuous disclosure obligations and prospectus regime provisions, among other proposals.

We appreciate that the CSA have invited respondents in Question 1 of Appendix A to the Proposal to suggest additional areas that would benefit from a reduction of undue regulatory requirements or streamlining of those requirements. In response to that invitation, we have taken the opportunity in this letter to provide the CSA with our general suggestions for updating and improving the regulatory landscape relating to ETFs. These general suggestions are made with a view to reducing burden and streamlining the existing rules for the benefit of all stakeholders, including investors, ETF providers and the provincial and territorial securities regulators that constitute the CSA. We provide our comments in this regard below in response to Question 1. We have also provided comments in respect of certain other specific questions set out in Appendix A to the Proposal.

C. Responses to Question 1 – Suggestions for Stage 2

BlackRock Canada believes that there are significant opportunities for the CSA to modernize and streamline regulatory requirements applicable to ETFs as a part of its broader burden reduction initiative. In our view, the modernization of the regulatory framework governing ETFs is long overdue. We urge the CSA to consider various disclosure and operational requirements in the context of the regime as a whole and having regard to investor behaviour in practice.

i. Updates to Investment Fund Prospectus Form 41-101F2

BlackRock Canada's view is that significant updates to *Form 41-101F2 – Information Required in an Investment Fund Prospectus* (**Form 41-101F2**) are required in order to make real progress toward meaningful burden reduction for ETF providers. Moreover, in light of the introduction of the ETF Facts document under Form 41-101F4, appropriate revisions to Form 41-101F2 will ensure that the critical objective of investor protection is better served, since the form in its current iteration is unwieldy and repetitive, and requires considerable amounts of superfluous information that is overwhelming and not relevant to most investors. Especially in contrast to the simplified prospectus applicable to conventional mutual funds in *Form 81-101F1 – Contents of Simplified Prospectus*, the Form 41-101F2 requirements result in ETF prospectuses that are overlong and difficult even for sophisticated investors to navigate and understand.

An updated ETF prospectus form would lead to clearer, more readable and, most importantly, more relevant ETF disclosure and at the same time meaningfully reduce the burden on ETF providers. The goals of clarity and concision that underpin and animate *National Instrument 81-101 – Mutual Fund Prospectus Disclosure* (**81-101**) and Form 81-101F1, which apply to conventional mutual funds, are no less important for ETFs and the readers of their prospectuses, particularly given the exponential growth in the popularity of ETFs among retail investors over the last several years. These goals are not well served by the existing Form 41-101F2, which is more likely to impede than it is to enhance readability and investor comprehension.

We would be pleased to discuss our specific suggestions regarding changes to Form 41-101F2 at the CSA's convenience.

ii. Prospectus-related and Continuous Disclosure Items

BlackRock Canada submits that there are a number of requirements under *National Instrument 41-101 – General Prospectus Requirements* (**41-101**) and *National Instrument 81-106 – Investment Fund Continuous Disclosure* (**81-106**) that result in unnecessary, duplicative and unduly burdensome disclosure. The provisions in these National Instruments and their associated form requirements would benefit from the CSA's careful consideration, particularly with regard to the intended recipient of the disclosure and whether the mandated disclosure is the most effective means of delivering the information to such recipients.

- ***Prospectus renewal cycles should be extended.*** The requirement that investment funds renew prospectuses every year has not kept pace with other regulatory developments affecting investment funds. BlackRock Canada urges the CSA to adopt at least a two year or, at a minimum, 18 month renewal cycle, with summary disclosure documents (*i.e.*, Fund Facts or ETF Facts, as applicable) continuing to be required to be filed annually. The process for renewing Form 41-101F2 (including the requirements to produce both *pro forma* and final prospectuses in English and French) is work-intensive, costly and time consuming. The total costs of yearly renewals to ETF providers, to the investment funds they manage and, ultimately, to the unitholders of these funds greatly outweigh the benefits to investors. The robust continuous disclosure regime with which ETF providers must comply – including the introduction of the ETF Facts document in 2017 under *Form 41-101F4 – Information Required in an ETF Facts Document* and the longstanding requirement to provide unitholders with updated information about investment funds in Management Reports of Fund Performance (**MRFPs**) – ensures that unitholders receive relevant and current information relating to ETFs on an ongoing basis. Similarly, any material changes in the affairs of investment funds must be disclosed by press releases and material change reports, and prospectuses must be amended accordingly. Beyond the material included in these continuous and timely disclosure documents, there is little, if any, information in ETF prospectuses that requires substantive updating on a yearly basis.

- ***Requirement for auditor review of unaudited interim financial report included in an ETF's long form prospectus should be eliminated for prospectus renewals.*** Section 38.2 of Form 41-101F2 requires an ETF prospectus to include unaudited interim financial statements if the prospectus is filed 60 days or more after the end of that interim period. Section 4.3 of 41-101 requires that any unaudited financial statements, including the interim financial statements described in section 38.2 of Form 41-101F2, must have been reviewed in accordance with the relevant standards set out in the Handbook of the Canadian Institute of Chartered Accountants for a review of financial statements by an auditor. However, if a prospectus is filed or renewed before 60 days after the end of the interim period, then auditor review of such interim financial statements is not required, even though the interim financial statements are incorporated by reference under section 37.1 of Form 41-101F2. There is no benefit to the additional auditor review of interim financial statements, particularly considering that (1) no such requirement exists in connection with funds' continuous disclosure obligations under 81-106; and (2) each fund must prepare and file audited annual financial statements, which are incorporated by reference into the prospectus.[1]

- ***Quarterly Portfolio Disclosure (QPD) should be eliminated where funds already disclose the same information.*** Canadian securities regulations can be and should be made flexible enough to permit investment fund issuers who do more than what is required under the regulations to be exempted from obsolete and duplicative disclosure requirements. The existing QPD rule is an example of an area where such flexibility could result in meaningful burden reduction and cost savings for investment fund managers and unitholders. Part 6 of 81-106 requires investment fund issuers to prepare and disseminate on a quarterly basis a summary of the portfolio holdings for each fund,

[1] We note that section 3.1.2 of 81-101 sets out a similar requirement for simplified prospectuses for conventional mutual funds. We suggest that the CSA also consider the elimination of this requirement in 81-101.

including (among other information) the top 25 positions held by the fund, within 60 days of the end of the quarterly period. QPDs made sense when fund portfolio information was not otherwise available to investors by other means. However, in 2019, most, if not all, ETF providers in Canada publish on the websites for their transparent ETFs portfolio information that is superior in all respects to the contents of QPDs. For its part, BlackRock Canada provides on the landing page for each of its transparent ETFs detailed information about those funds' holdings, which is updated and current on a daily basis. Given the CSA's proposal to require all investment fund issuers to designate a qualifying website, BlackRock Canada suggests that the CSA exempt from the QPD requirement investment fund issuers who post the same information contained in QPDs on a more frequent basis on their fund landing-pages.

- ***Interim MRFPs should be eliminated:*** We believe that the burden and expense of preparing interim MRFPs outweighs the usefulness of this disclosure to investors, especially in light of the requirements for continuous and timely disclosure in 81-106, and the suite of ongoing portfolio information that the majority of investment fund issuers make available on an ongoing basis on their websites. The CSA should consider eliminating interim MRFPs, which would provide meaningful burden reduction to investment fund issuers without compromising investor protection.

iii. Operational Items

BlackRock Canada believes that there are a number of operational requirements under *National Instrument 81-102 – Investment Funds* (**81-102**) that would benefit from the CSA's scrutiny. In our view, these existing requirements under 81-102 could be modernized, streamlined and updated to reduce needless impediments to smooth and efficient investment fund operations.

- ***Subscription and redemption rules are overly prescriptive.*** In BlackRock Canada's view, the rules in Parts 9 and 10 of 81-102 governing subscriptions and redemptions should be re-evaluated for ETFs. These rules were designed for conventional mutual funds and do not reflect, and in certain respects can be incompatible with, the very different primary market operations of ETFs, including the fact that nearly all primary market ETF transactions are conducted with sophisticated market participants, specifically IIROC-regulated dealers who are self-clearing CDS participants that are transacting in a principal capacity. In addition, a significant proportion of ETF primary market transactions take place in-kind (*i.e.*, a basket of securities is delivered against the units), which introduces settlement scenarios that are difficult to reconcile with Parts 9 and 10 of 81-102. We urge the CSA to reconsider the requirements in Parts 9 and 10 with current ETF operations in mind, including with a view to a less rigid and more principles- and risk-based approach to settlement that will afford ETF managers a reasonable measure of discretion in the subscription and redemption process, in a manner that is consistent with their fiduciary obligations.

- ***Designated rating requirements should be reviewed.*** The "designated rating" framework under 81-102 is overly rigid, over-reliant on ratings agencies and extremely burdensome to comply with in practice. The current rules require investment fund issuers to consume ratings information from each of the four specified ratings organizations on a continuous basis, to consider the application of issuer versus security-level ratings and long-term versus short-term ratings, and to monitor for announcements by these ratings organizations. These rules result in investment fund managers being bound by outlier ratings (*e.g.*, a lower rating from one of the four designated rating organizations) as opposed to majority/consensus ratings. In our view, the designated ratings rules should be revised to adopt a more principles-based and less of a prescriptive approach to assessing risk.

- ***Single custodian requirement should be reconsidered.*** Part 6 of 81-102 requires investment funds to appoint a single custodian for portfolio assets. This requirement is unnecessarily inflexible, and investment fund issuers are unduly limited operationally as a result. The CSA have signaled their willingness in recently granted exemptive relief (*e.g.*, the **Purpose Relief**) to permit multiple custodians in appropriate circumstances where the safety of portfolio assets will not be compromised.[2] In addition, the updated custody regime under *National Instrument 31-103 – Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**31-103**) imposes no such single custodian limitation on non-public mutual funds. We urge the CSA to reconsider the requirements under Part 6 in light of the principles articulated in the Purpose Relief and the updated rules in 31-103.

- ***Derivatives rules should be amended.*** The rules relating to transactions in specified derivatives are outdated and difficult to apply in practice. We believe the CSA should include a review of the derivatives rules in 81-102 as a part of Stage 2 of their burden reduction initiative and in light of the proposed business conduct and registration regime applicable to over-the-counter (**OTC**) derivatives.

- ***Risk rating framework should be reviewed.*** The risk rating framework is an imperfect means by which an investor can gauge the actual risks associated with investing in a given fund. Because risk ratings are based on historical volatility of returns, fund risk ratings can and do change over time when particularly volatile years of fund performance ultimately roll out of the 120-month period. As a result of this backward-looking approach, risk rating changes often occur even where there have been no changes in the investment objective or strategies of the fund, which may be confusing and misleading for investors. Given these significant weaknesses with the risk rating system, and in light of the upcoming implementation of the CSA's Client Focused Reforms, including the know-your-product and suitability requirements applicable to registered advisors, we believe the CSA should reconsider its approach to the treatment of risk ratings under 81-106. As described in more detail below, BlackRock Canada believes that, at the very least, risk rating changes should no longer be treated as deemed material changes.

- ***Definition of "illiquid assets" should be revisited.*** In our view, the definition of "illiquid assets" in 81-102 would benefit from redrafting in order to clarify the amount of illiquid assets that can be held by a mutual fund. Currently, "illiquid assets" are defined as "portfolio assets that cannot be readily disposed of <u>through market facilities on which public quotations in common use are widely available</u> at an amount that at least approximates the amount at which the portfolio asset is valued in calculating the net asset value per security of the mutual fund." The underlined phrase is difficult to interpret when dealing with securities that commonly trade in OTC markets such as fixed income securities, and creates ambiguity surrounding the liquidity of these securities for regulatory purposes, even when they are actively traded. Refining this definition to more

[2] *In the Matter of Purpose Investments Inc.* (August 23, 2019).

appropriately capture OTC traded securities would be a welcome clarification in order to reflect current market practices and align with the CSA's policy goals.

- **National Instrument 81-107 – Independent Review Committee *(81-107) regime should be examined.*** Given that 13 years have passed since 81-107 was implemented, we believe that the CSA should include a review of the existing Independent Review Committee framework as a part of its overall burden reduction initiative in order to ensure that the regime is functioning as effectively and efficiently as intended.

D. <u>Responses to Specific Questions</u>

Q2: 90-day Time Period

As noted above, the proposed codification of exemptive relief represents a significant additional burden on BlackRock Canada and the many other investment fund managers who have ordered their affairs based on the specific terms of their existing exemptive relief. We therefore strongly urge the CSA to permit investment fund issuers to continue to rely on their existing exemptive relief in order to avoid this outcome. Otherwise, there is no "real" regulatory burden reduction that results from this workstream.

However, if the CSA will not grandfather existing relief that would otherwise be impacted by the Proposal, then BlackRock Canada considers 180 days to be a more reasonable time period for investment fund issuers to assess the effect of the proposed codifications and to make the required changes in their internal processes and controls in order to ensure compliance with the modified rules.

Q8: Material Change Regime

BlackRock Canada submits that the material change requirements in section 11.2 of 81-106 can be significantly streamlined while maintaining investor protection and market efficiency. Our suggestions in this regard include the following:

- The material change regime set out in section 11.2 of 81-106 results in duplicative disclosure. There is no practical benefit to having to create *both* a press release and a material change report, which typically contain the same information. Press releases are filed on SEDAR and should be sufficient for material changes.

- As noted above, given the nature of the current risk rating methodology, risk rating changes should not be required to be treated as material changes. Risk ratings are generally prominently reflected on the website for a given fund, and are included in ETF Facts. This disclosure ought to be sufficient.

Q14: Designated Website

As noted above, BlackRock Canada already has a comprehensive website for each of its funds, on which it posts detailed information about the funds, as well as press releases, together with regulatory documents.

The proposed codification of the widespread practice by investment fund issuers of posting information to websites is a welcome recognition from the CSA of the need to modernize rules to reflect the fact that websites are now the principal means by which investors seek and obtain information. BlackRock Canada is therefore generally supportive of the CSA's proposal to require investment funds governed by 81-102 to designate and maintain a website.

However, in order to make this new regulatory requirement a meaningful feature of the CSA's burden reduction mandate (as opposed to merely an additional burden on investment fund issuers), BlackRock Canada's view is that the CSA must follow up promptly with a related suite of proposals that will leverage the potential of websites to significantly reduce or eliminate antiquated disclosure and delivery required under the existing rules (*e.q.*, the QPD requirements, as described above). In addition, we believe that a requirement to post certain continuous disclosure on fund websites should replace the existing regime that requires investment fund issuers to either mail materials to unitholders or to seek standing instructions or annual instructions from unitholders. These requirements are expensive and wasteful given the low number of unitholders who have indicated a desire to receive paper mailings. For example, in 2019, the response rate to BlackRock Canada's request for standing instructions was only approximately 2% for ETF unitholders and 4% for mutual fund unitholders.

In addition, BlackRock Canada has two specific comments regarding the proposed designated website:

- Proposed subparagraph 16.1.2(2) of 81-106 states that a "qualifying website" must be established and maintained by the fund or its investment fund manager, an affiliate or an associate of its investment fund manager or another investment fund that is part of its investment fund family. We suggest that the CSA expand the definition of a "qualifying website" under proposed subparagraph 16.1.2(2) of 81-106 to include websites maintained and serviced by third party service providers who are overseen by the investment fund manager or its affiliates. In this regard, we note that the general obligations of investment fund managers to oversee service providers are set out in section 11 of 31-103 and in *Companion Policy 31-103 CP*.

- Proposed Part 16 of 81-106 requires an investment fund to designate a "qualifying website", but does not indicate the means by which the website is to be designated. We ask that the CSA clarify the designation process (if any) and how designated website changes are expected to be communicated.

Q18: Exemptive Relief Codification – Notice-and-Access

In our experience, unitholder attendance at meetings of investment funds already tends to be very low (*i.e.*, less than 10%) even with full paper mailings. Accordingly, we do not believe that unitholder notice is the cause of low unitholder participation rates, and we anticipate that such rates will be unaffected by a transition to notice-and-access.

Q19: Exemptive Relief Codification – Conflicts Applications

We have concerns that the proposed codification of certain exemptive relief is more restrictive than the exemptive relief that many investment fund issuers have obtained from the CSA and are currently relying upon. The time and expense required to evaluate all affected relief, and to update internal processes to ensure compliance with the newly-proposed codified rules, will be significant. In addition, in the absence of grandfathering the relief, non-reporting issuer master funds currently holding non-Canadian underlying funds to achieve their investment objective in reliance on the relief may face undue disruption to their investment strategies in order to align with the newly-proposed codified rules. Such disruption could trigger unnecessary portfolio turnover and attendant potential tax implications.

As a result, we repeat our request that the CSA permit existing relief to be grandfathered to be apply to both existing and future funds. Such an approach would be consistent with the CSA's efforts to reduce, rather than increase, the burden on investment fund issuers.

BlackRock Canada's specific comments on the proposed codifications are set out below.

- Proposed amendments under section 2.5.1 of 81-102 seek to codify conflict of interest relief relating to fund-on-fund investments by non-reporting issuer funds (**Fund-on-fund Conflict Relief**). The existing Fund-on-fund Conflict Relief achieves the CSA objective of ensuring investor protection and facilitates the important goal of enhancing investor choice. There are valid business reasons for fund managers to be able to continue to use non-Canadian underlying funds managed by affiliates in order to provide Canadian investors, on a prospectus-exempt basis, certain investment exposure and strategies in the most cost effective way while not being detrimental to the interests of Canadian investors. This investment structure allows the smaller Canadian investor pool to gain access to a larger variety of investment strategies, including offshore, than would otherwise be available.

  However, the proposed amendments include numerous new restrictions that are not present in the existing Fund-on-fund Conflict Relief, on which many investment fund issuers currently rely. One fundamental difference is that the proposed amendments only contemplate a fund-on-fund structure involving investments in underlying funds that are *domiciled in Canada* (and are subject to NI 81-106) and managed by the same manager as the top fund (*i.e.*, affiliates of the top fund's manager are not permitted to manage the underlying funds). The result of the proposed codification is that investing in non-Canadian underlying funds managed by an affiliate of the fund manager of the top fund will no longer be permissible. This is a departure from existing Fund-on-fund Conflict Relief that the CSA have granted to investment fund issuers. In particular, we have noted the following new restrictions in the proposed codified relief:

  - Proposed paragraph (c) will require the underlying fund to comply with 81-102 restrictions on liquidity;

  - Proposed paragraphs (d) and (f) will require the underlying fund to comply with 81-106;

  - Proposed paragraph (e) will require the underlying fund to have the same redemption and valuation dates; and

  - Proposed paragraph (g) will impose numerous new disclosure requirements.

- Moreover, proposed section 2.5.1 of 81-102 includes new requirements for non-reporting issuer funds when investing in underlying funds that do not apply to fund-on-fund investments by reporting issuer funds pursuant to section 2.5 of 81-102. For example, under section 2.5, reporting issuer funds can invest in an index participation unit traded in the U.S. that is not subject to 81-106. Reporting issuer funds are not restricted to investing only in underlying fund managed or advised by the same manager. Similarly, reporting issuer funds are also not subject to the same disclosure obligations under proposed paragraph 2.5.1(g).

Q24: Approval Period for Draft Information Circular

Based on the information provided in the Proposal, we are not in a position to determine whether securities regulator review and approval of draft information circulars relating to changes of managers serves the goal of burden reduction. However, if the CSA plans to introduce such a requirement, we urge the CSA to be mindful of the often tight timelines with which investment fund managers must comply in the context of transactions that involve a change of manager. In this regard, taking a period of 10 business days as suggested in the Proposal could present timing issues for investment fund issuers, and we therefore suggest that securities regulators take no longer than 5 business days to review and approve information circulars.

Q25: Form 51-102F2

We believe that Form 51-102F2 of *National Instrument 51-102 – Continuous Disclosure Obligations* should be replaced with an Information Circular that is tailored to investment funds. We believe the benefits of a form designed to address the specific circumstances of investment funds would outweigh the upfront burden associated with migrating to new form requirements.

We do not consider that a summary of key information from the information circular in a separate part of the circular itself would be useful to unitholders. Summary information is typically included in the management letter that accompanies the information circular. A further requirement to prepare a summary would increase repetition and do little to facilitate investor understanding.

E. <u>Conclusion</u>

BlackRock Canada appreciates the opportunity to provide input on this important regulatory initiative and would be pleased to make appropriate representatives available to discuss any of these comments with you.

Sincerely,

[redacted]

Margaret Gunawan
Chief Compliance Officer and Secretary,
BlackRock Asset Management Canada Limited