BLACKROCK®

September 16, 2015

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

Attention:
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Dear Sirs/Mesdames:

CSA Notice and Request for Comment – Mandating a Summary Disclosure Document For Exchange-Traded Mutual Funds and Its Delivery ("Request for Comments")

A. About BlackRock

BlackRock Asset Management Canada Limited ("**BlackRock Canada**" or "**we**") is an indirect, wholly-owned subsidiary of BlackRock, Inc. ("**BlackRock**") 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.

BlackRock is one of the world's leading asset management firms, managing assets for clients in North America and South America, Europe, the Middle East, Africa, Asia and Australia. Our 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 June 30, 2015, BlackRock's assets under management totalled US $4.721 trillion across equity, fixed income, cash management, alternative investment, real estate and advisory products.

B. General Observations

BlackRock welcomes the efforts of the Canadian Securities Administrators ("**CSA**") to codify the disclosure obligations currently required by exemptive relief granted in respect of the delivery of summary documents for exchange-traded funds ("**ETFs**") and applauds your efforts to harmonize, where appropriate, the disclosure regime for conventional mutual funds with that of ETFs. We do, however, have some questions and concerns about certain of the proposed disclosure requirements, each of which are set out in greater detail below for your consideration.

C. BlackRock's Responses

1. Trading and Pricing Information

We commend the CSA for seeking to foster greater understanding of ETFs and strongly support the CSA's initiative to provide meaningful disclosure to ETF investors. We are, however, concerned that, absent a broader understanding of the ETF mechanism, the inclusion of certain of the proposed trading and pricing form requirements may inadvertently result in investor confusion – concerns which are more fully outlined in subsequent sections of our response letter.

In addition, in order to meet certain of the contemplated trading and pricing form requirements (i.e., the average daily volume, number of days traded, average bid-ask spread, and average premium/discount to NAV fields), ETF providers will likely need to source data from third party vendors as this information is not self-sourced content unlike, for example, performance, management expense ratio and trading expense ratio calculations. As a result, ETF managers may not only have issues licensing the necessary information for purposes of public disclosure, but will likely also be exposed to increased liability resulting from the possibility of inaccurate information being provided by vendors. This is particularly the case as we expect that vendors will disclaim liability for the data they provide, thereby forcing ETF providers to take on additional legal risk for content that is not readily verifiable.

Finally, we expect that ETF providers will incur increased costs to access this information. Given that the "official" national best bid and offer is currently only available from one data vendor and that it's unclear whether the use of consolidated trading data from other providers will be permitted, the proposed form requirements may therefore introduce a "captive consumer" issue whereby the data vendor controlling this information can exercise monopolistic pricing.

A. Average Premium/Discount to NAV

Similar to closed-end funds, but unlike conventional mutual funds, there are two prices for ETF securities at any given point in time: the primary market price (i.e. the net asset value ("**NAV**")) for the purposes of creations and exchanges, and the secondary market price (i.e. the prevailing exchange bid and ask price) which is the price at which investors typically acquire and dispose of their ETF securities.

The fact that an ETF can trade at a premium or discount to NAV is sometimes viewed as a failure of the ETF mechanism. However, there are often healthy reasons for the existence of premiums or discounts, particularly for ETFs that have exposure to international or fixed income securities. In order for an investor to properly evaluate the premium/discount disclosure proposed, it is therefore imperative that they understand the inherent limitations of NAV and that NAV is sometimes an imperfect estimate of the fair value of a fund. NAV is a static calculation that is generally based on end-of-day pricing sources, whereas market price trades in real-time and reflects current and forward-looking valuations. This is especially true for ETFs holding international securities where apparent ETF premiums and discounts typically reflect price discovery and the ability to trade the ETF securities in real time. For example, ETFs can be used to express a market view on international securities even when their underlying markets are closed.

In addition, apparent premiums and discounts on securities of fixed income ETFs may arise due to several factors, particularly the challenges of price discovery when valuing the portfolio assets in a primarily non-transparent, over-the-counter market. The NAV of a fixed income ETF is also typically based on either mid or bid market prices, and therefore does not directly reflect the bid/ask spread that exists in the market for each bond. ETF market prices, in contrast, do reflect this spread. The fact that bid/ask spread is observable in ETF market prices, but not in NAVs, can also contribute to differences between a fixed income ETF's market price and its NAV.

As a result, where there is a deviation between market price and NAV, it often has more to do with the NAV being calculated using static valuations of the underlying portfolio securities than with the exchange-determined intra-day market price of the ETF deviating from fair value. Without this deeper understanding – which is difficult to convey in a brief document such as an ETF Facts – many investors may draw incorrect conclusions from this disclosure, especially given that, in practice, ETF investors will not typically transact with an ETF at NAV. We therefore believe that the proposed ETF Facts disclosure overemphasizes the significance of NAV premiums and discounts with respect to ETFs and may incorrectly lead investors to believe that a premium or discount is inherently "good" or "bad", when, in fact, premiums and discounts are often healthy but are not inherently either.

Moreover, ETFs incorporate a number of features that seek to minimize discrepancies between the market price and fair value such as the continuous distribution mechanism and the market-making roles played by designated brokers and other liquidity providers. Generally, because of the flexibility of the creation and exchange mechanism, liquidity providers are able to quickly meet demand to buy and sell ETF securities at appropriate prices relative to an ETF's NAV. In addition, the unique arbitrage mechanism of ETFs, which allows liquidity providers to profit from any mispricing between an ETF and its underlying holdings, helps to both keep market prices in line with the value of the ETF's underlying portfolio securities and to eliminate sustained premiums or discounts to NAV.

Therefore, we respectfully caution the CSA from placing undue emphasis on NAV premiums/discounts in the ETF Facts as we believe this information is not particularly instructive for most investors and may lend credence to the myth that trading at a premium or discount to NAV is a shortcoming – rather than a positive feature – of the ETF mechanism.

B. Average Daily Volume and Number of Days Traded

We believe that, without a complete understanding of ETF liquidity and structure, requiring the disclosure of average daily volume and number of days traded may mislead investors as to an ETF's true liquidity. Focusing solely on the liquidity of the ETF security as if it was a conventional equity stock, while ignoring the liquidity of the ETF's underlying portfolio securities, may give ETF investors an incomplete picture of an ETF's liquidity as secondary market turnover discounts the ability of the primary market creation mechanism to meet demand. Although an ETF may have a low average daily volume or a relatively few number of days traded, underwriters can nevertheless create new ETF securities as needed to satisfy investor demand or, conversely, redeem ETF securities where there is little demand. As many Canadian ETFs do not trade on a daily basis, this may lead investors to mistakenly believe these ETFs are not liquid because they do not appreciate an ETF's creation/redemption mechanism; a mechanism which generally allows liquidity to be added as needed through primary market transactions with underwriters.

C. Average Bid-Ask Spread

We are concerned that focusing on average bid-ask spread, regardless of the size of trade, may be misleading for investors that place larger trades (i.e. outside "top of book") as the bid-ask spread often increases with the size of the trade. Instead, we suggest it may be more useful for investors to use a sample trade size (for example, show the average bid-ask spread for a $1,000 trade, which aligns with the amount used in connection with the proposed performance disclosure). We also suggest that this disclosure be moved under the heading "Trading information".

Finally, if the CSA proceeds with the inclusion of trading and pricing information such as average bid-ask spread, average daily volume and average premium/discount to NAV, we strongly encourage the CSA to clarify the calculation methodology that they expect to be applied in order to ensure both a level playing field across ETF providers and a clearer understanding by ETF investors. We would greatly benefit from sample calculations to ensure that we understand and can apply the methodologies contemplated and can appropriately source the data required. We note that, to the extent data is sourced from different data vendors, this may affect the consistency and comparability of the information across different ETF providers.

2. How ETFs are Priced

While BlackRock supports the underlying policy rationale of facilitating investor access to key information about an ETF in language they can easily understand, we believe that the proposed disclosure in Item 7 of proposed Form 41-101F4 – *Information Required in an ETF Facts Document* oversimplifies the relationship between market price and NAV of an ETF and overstates the significance of NAV premiums and discounts with respect to ETFs for the reasons described earlier in our response.

As discussed above, while the fact that an ETF can trade at a premium or discount to NAV is sometimes viewed as a failure of the ETF mechanism, our view is that, given that markets are imperfect, the ETF mechanism can actually facilitate an ETF's ability to provide liquidity at the intrinsic value of the underlying assets. For example, in times of market stress, or where an underlying market is closed or illiquid, we have seen that ETFs have generally proven to be extremely effective price discovery vehicles given that ETFs trade in real-time and reflect current and forward-looking valuations. In cases like these, an investor would not be paying "more or less than an investment is worth" (as the proposed disclosure provides); but rather a price that more accurately reflects currently available information regarding an asset's intrinsic value.

Rather than attempting to summarize the complex relationship between NAV and market price in a brief document like the ETF Facts, we suggest that the CSA instead publish an "ETF 101" document for investors (similar to the *Investing 101: Indices and Index Funds* publication the Ontario Securities Commission has previously released)[1], that provides guidance on ETF pricing and trading. This document could include a more nuanced and detailed discussion of market price and NAV, as well as some suggested best practices for trade execution (for example, avoiding placing trades early in the morning or late in the afternoon to limit volatility and advocating the use of limit orders rather than market orders). BlackRock would welcome the opportunity to assist the CSA with the preparation of such a document.

In the alternative, if the CSA chooses to proceed with including the aforementioned disclosure, we recommend revising the language in Item 7 of proposed Form 41-101F4 per the blackline provided in Appendix A.

3. Suitability

While we acknowledge that brief statements regarding the suitability of investments are currently required for Fund Facts in respect of conventional mutual funds[2], we harbour reservations about mandating a similar requirement for ETFs as set out in Item 8 of proposed Form 41-101F4 – *Information Required in an ETF Facts Document*. Specifically, we don't believe that investment fund managers are well positioned to provide suitability assessments on investment products given their lack of privity with end investors; a principle borne out in other areas of Canadian securities law where, for example, investment fund managers are exempted from the application of "know your client" and suitability requirements[3].

Given that suitability is a function of *both* the investment product in question but also, crucially, its application to an investor's particular circumstances, we believe the lack of transparency by ETF managers into the latter make it a problematic – and potentially misleading – form requirement for ETF Facts. Instead, we believe that other disclosure requirements that speak

[1] http://www.osc.gov.on.ca/documents/en/Investors/inv_news_20150727_indices-index-funds.pdf
[2] Item 7, Form 81-101F3 – *Contents of Fund Facts Document*.
[3] Section 13.1 of National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations*.

specifically to the product itself, such as the introduction of risk ratings[4], are a far more meaningful and appropriate metric for ETF managers to include in ETF Facts.

4. <u>Currency of Data and Transition Period</u>

We support the CSA's proposal to harmonize the currency of data requirement for ETF Facts with those of Fund Facts by moving to 60 days before the date of the summary document. However, we strongly recommend that a carve-out from the 60 day currency requirement be introduced in respect of ETF Facts filed in conjunction with a material change where data fields are otherwise not impacted by the material change. Given that timely disclosure obligations require an issuer to file a prospectus amendment (and, if applicable, an accompanying ETF Facts document) within 10 days of the material change, we believe there are significant operational constraints on collecting and presenting the required data in such a short period of time – this is particularly the case in light of the additional form requirements proposed regarding trading and pricing information, some of which entail third party sourcing and/or manual calculations. From a policy perspective, we don't believe that investors would be negatively impacted by such a carve-out as, absent a material change, the data otherwise remains "static" for approximately a year leading up to the applicable ETF's prospectus renewal.

Finally, we support the CSA's proposal to implement a phased transition of the ETF Facts requirement which follows the prospectus renewal cycle rather than a single switch-over date. Doing so, we believe, would considerably reduce costs and lessen the operational burden of implementation.

D. <u>Conclusion</u>

BlackRock very much 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 at your convenience.

Yours very truly,

"*Warren Collier*"

Managing Director (Head of iShares)
BlackRock Asset Management Canada Limited

[4] Item 4, Form 41-101F4 – *Information Required in an ETF Facts Document*.

Appendix A

Form 41-101F4 – *Information Required in an ETF Facts Document*
Item 7 - Pricing

How ETFs are priced

ETFs are unique because they hold a basket of investments, like mutual funds, but trade on exchanges like stocks. For this reason, they have two sets of prices: market price and net asset value (NAV).

Market price

• You buy and sell ~~ETFs~~ETF securities at the market price on the exchange. The market price can change throughout the trading day. Factors like supply, demand and changes in the value of the ETF's portfolio investments can affect the market price for an ETF's securities.

• You can get price quotes any time during the trading day. Quotes have two parts: **bid** and **ask**.

• The bid is the highest price a buyer is willing to pay if you want to sell your ~~units.~~ETF securities. The ask is the lowest price a seller will accept if you want to buy ~~units~~ETF securities. The difference between the two is called the "**bid-ask spread**".

• In general, a smaller bid-ask spread means the ETF is more liquid. That means you are more likely to get the price you expect.

Net asset value (NAV)

• Like mutual funds, ETFs have a NAV. It is calculated after the close of each trading day and reflects the value of the ETF's investments at the point in time when it was calculated.

• NAV is used to calculate financial information for reporting purposes – like the returns shown in this document.

• If the market price is lower than the NAV, the ~~ETF is~~ETF's securities are trading at a **discount**. If the market price is higher than the NAV, the ~~ETF is~~ETF's securities are trading at a **premium**. If you sell an ETF at a discount, you may be getting less than its investments are worth. If you buy an ETF at a premium, you may be paying more than its investments are worth. Premiums and discounts may also result from changes in the value of the ETF's investments that have not yet been reflected in the ETF's NAV. Since ETF's continuously offer their securities, it is generally unlikely that large premiums or discounts to NAV would be sustained.