BLACKROCK®

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

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)
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Superintendent of Securities, Nunavut

Attention:
Josée Turcotte
Ontario Securities Commission
20 Queen Street West
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Toronto, ON M5H 3S8

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
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Montréal, QC H4Z 1G3

Re: CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions ("Consultation")

Dear Sirs/Mesdames:

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. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers, and other financial institutions, as well as individuals around the world.

B. General Observations

BlackRock welcomes a discussion of mutual fund fees in Canada and commends the Canadian Securities Administrators ("**CSA**") on its ongoing efforts to protect investors and preserve investor choice. As a general principle, we support policy changes and regulatory reforms that increase transparency, protect investors, facilitate the responsible growth of capital markets, encourage healthy competition in financial markets, and, based on thorough cost-benefit analysis, preserve investor choice.

Accordingly, BlackRock supports the CSA's objectives of (i) better aligning the interests of investment fund managers, dealers and representatives with those of investors; (ii) delivering greater clarity on the services provided and their costs; and (iii) empowering investors by directly engaging them in the dealer and representative compensation process. However, we believe that the successful implementation of the CSA's policy objectives is dependent on close cooperation with both the industry and investors. Namely, the CSA must focus on reducing regulatory barriers to entry for lower-cost investment product and advice providers to fill any potential advice gap that could be created by the banning of embedded commissions, while continuing to educate investors, including specifically about dealer compensation issues, and promote financial literacy.

In addition, in considering mutual fund fee reform, we encourage the CSA to create a level industry playing field that will maximize the service options available to investors. Specifically, we note that a ban on embedded commissions may have the effect of creating a material competitive advantage for large, vertically-integrated firms over small and/or independent providers, given that such large firms have the ability to cross-subsidize internally by reallocating costs and revenue streams across a range of businesses. The CSA must be mindful of such unintended consequences, which would ultimately reduce industry competitiveness and investor choice.

Beyond these general comments, we have questions and concerns regarding certain of the consultation questions, which are set out in greater detail below. For ease of reference, we have included the full text of each consultation question to which our comments correspond.

C. BlackRock's Responses

12. Based on a consideration of the data and evidence provided in this Part, would a proposal to discontinue embedded commissions address the three key investor protection and market efficiency issues discussed in Part 2?

13. Are there other ways in which the CSA could address these issues that could be introduced in conjunction with, or separate from, the discontinuation of embedded commissions?

17. Do you think this proposal will lead to an advice gap?

While we believe that discontinuing embedded commissions would go a long way towards addressing the three key investor protection and market efficiency issues discussed in Part 2, in order to fully address these issues, we believe the CSA must also take active steps to ensure that investors continue have access to a wide range of competing products and advice models. To accomplish this, the CSA should encourage and support the growth of low-cost products and simplified advice models for retail investors, while at the same time promoting and strengthening investor financial literacy.

A. Supporting the Growth of Lower-Cost Investment Products

We agree with the CSA's assessment that embedded commissions function as a barrier to entry in the investment funds market, and that transitioning away from these fees will likely result in more assets being allocated to lower-cost investment products and more lower-cost product providers entering the market. However, we note that even without embedded commissions, significant regulatory barriers to entry and growth in this market continue to exist, including cumbersome disclosure requirements, outdated rules and rigid registration requirements. Failure to address these barriers may continue to inhibit lower-cost products and their providers from effectively scaling their business models.

To that end, we support the recent initiative announced by the Investment Funds and Structured Products Branch of the Ontario Securities Commission ("**OSC**") aimed at reducing regulatory burden for investment funds, and encourage the CSA more broadly to reconsider these rules, as well as those impacting registration related requirements, while emphasizing the underlying policy goals of increased price competition, lower fees and broader access to advice for retail investors.

Creative initiatives such as the OSC LaunchPad help support start-up technology companies in navigating regulation. We encourage the continued expansion of such initiatives to traditional incumbent firms who may be considering digital innovation as a way to scale low-cost advice models.

Based on our experience with the implementation of the Retail Distribution Review in both the United Kingdom and the Netherlands (as well as similar reforms in other markets), we agree with the concerns outlined in the Consultation that eliminating embedded commissions will result in a reduction in the number of traditional advisors serving mass-market investors, potentially leading to an "advice gap"[1]. In this regard, we encourage the CSA to take active steps to ensure that high quality, unbiased professional support is available to all sectors of the Canadian market. As investors grapple with the growing challenges of inadequate savings, disproportionately high levels of cash[2], longer life expectancies, low interest rates, geopolitical uncertainty and a greater need to take responsibility for their own retirement due to shrinking availability of employer-sponsored pensions, many will require professional support to demystify the savings and investment process. To reflect the wide variety of consumers' savings and investment needs, we encourage the CSA to consider what other models of support for consumers may be relevant to empower all Canadian consumers to make effective decisions about their finances.[3] These needs

[1] The Tower Watson report for the FCA on RDR http://www.fca.org.uk/static/documents/research/advice-gap-analysis-report.pdf and the Joint UK HMT and FCA Financial Advice Market Review 2016 https://www.fca.org.uk/publication/corporate/famr-final-report.pdf. BlackRock's Investor Pulse survey of 4,000 UK investors found that only 15% of those surveyed use the services of a professional advisor.

[2] BlackRock's 2016 Investor Pulse study found that Canadians hold 54% of their investable assets in cash. In addition, more than half of Canadians reject the idea of moving more of their cash into investments, citing insufficient confidence and a lack of understanding of the risks involved.

[3] By way of comparison we recommend considering the Terms of Reference of the UK's Financial Advice Market Review: https://www.gov.uk/government/publications/financial-advice-market-review-terms-of-reference/financial-advice-market-review-terms-of-reference

will only continue to grow as traditional advice providers adapt their business models and fee structures to reflect the new cost of delivering financial advice.

B. Digital Advisors and Digital Tools

Any potential advice gap is also likely to be compounded by the fact that Canadian investors are increasingly faced with choosing between higher cost, full-service investment planning and advice and a 'do-it-yourself' execution-only service which does not provide the tools many investors need to help navigate the complexities of the choices they face. In fact, many mass-market investors are not even afforded this choice, as they do not have the minimum asset levels required for fee-based accounts - an amount that is likely to increase in the face of regulatory change.

We believe that a simplified menu of low-cost investment options, when paired with advice surrounding broader financial circumstances, is sufficient to meet the needs of many Canadians. To that end, financial technology, including digital advisors and digital tools, together with human advisors, can provide a new, scalable means to help bridge the gap by providing tailored solutions that increase efficiency and reduce costs for both providers and end investors.

Digital advisors provide a variety of advisory and educational services to clients via internet-based platforms using algorithmic portfolio management strategies, typically through diversified portfolios of low-cost exchange-traded funds. While digital advisors currently represent a very small segment of the Canadian market relative to more traditional financial advice providers, we see significant room for growth in this industry, particularly in response to regulatory change[4]. However, the current regulatory framework, which was designed with traditional, face-to-face advice models in mind, is ill-equipped to govern digital advice in its varying forms, and may render it difficult for providers of digital advice to offer their services or grow in a scalable way. We recommend that regulators review the existing regulation and consider its applicability to digital advice models to determine appropriate supervisory approaches that allow digital advisors to operate while maintaining important investor protections. For example, know your client requirements should be amended to allow digital advisors to obtain key client information from online questionnaires given their online business models.

Similarly, as more investors move to self-directed investing, we see a growing demand for information and tools that will assist them in making their investment decisions, including model portfolios and other digital tools. However, the current regulatory framework is in flux on this point and recent proposed IIROC guidance would, if adopted, move to prohibit model portfolio information from being provided to execution-only clients[5], possibly to the detriment of investors. Without access to proper guidance, do-it-yourself investors may be forced to turn to other, less regulated sources for information, fail to appropriately diversify their portfolios, or hold disproportionate levels of cash; in each case, frustrating the ability of investors to better meet their retirement needs.

In addition, we worry that other recent regulatory initiatives, including certain of the targeted reforms outlined in CSA Consultation 33-404 – *Proposals to Enhance the Obligations of Advisers,*

[4] According to our 2016 Investor Pulse Survey, while only 1% of Canadians cite using the services of a digital advisor currently, nearly half of Canadians are aware of digital advisors, and forty-three percent would consider using this service in the future.

[5] IIROC Notice- Guidance on Order Execution Only Services and Activities, November 3, 2016 http://www.iiroc.ca/Documents/2016/b7501066-1af8-4e4e-b32e-338d11875b85_en.pdf

Dealers and Representatives Towards Their Clients ("CSA Consultation 33-404") would, if enacted, have significant unintended consequences, including potentially reducing the number of products firms offer and exacerbating the advice gap. We caution the CSA that prescriptive regulations such as these can discourage innovation and create barriers to market entry or growth for smaller, independent firms who may otherwise be well positioned to service smaller clients.

We recognize that appropriate regulatory supervision is important for both digital advisors and execution-only platforms; however, we also note that, without some flexibility in these areas, the growth of technology may be comprised and the advice gap is unlikely to be addressed Without this flexibility, we're concerned that innovative tools may be adopted only by larger industry participants (who can afford to incorporate technology into their traditional business models and offer more scale to their advisors), to the detriment of smaller, independent firms that could target mass-market investors. We strongly support the work the CSA and other jurisdictions are doing with the Regulatory Sandbox and related initiatives, and are encouraged by the fact that IIROC has identified a key priority for 2018 as ensuring IIROC requirements accommodate new advice and service models.[6] We urge the CSA to take these initiatives a step further by working with IIROC to establish specific guidance to allow digital advisors and execution-only providers to operate more flexibly within the traditional registration paradigms. In doing so, we suggest the CSA take a principles-based approach, which focuses on balancing the risk created by innovative tools with the underlying policy goals. For example, the CSA could consider setting appropriate terms and conditions on a firm's advisor registration should they wish to operate an online or digital platform.

We also suggest that the CSA re-evaluate the framework for providing an investment recommendation and Know Your Client (KYC) and suitability requirements with a view to implementing rules that are thoughtful and adjust for the reality that business models and technology are evolving. Enabling firms to move more fluidly and to engage in a lighter touch KYC process when recommending digital solutions will also serve to increase efficiency and cut costs, ultimately increasing access to advice for investors. When assessing online advisors in particular, we also suggest that the CSA focus on such areas as appropriateness of algorithm design and oversight, disclosure standards and cost transparency, policies and procedures surrounding trading practices, and robustness of data protection and cybersecurity.[7]

C. Financial Literacy

Encouraging the growth of scalable, digital tools will go a long way towards reducing the advice gap by increasing the supply of potential advice options available to retail investors. However, it is imperative that the CSA also focus on the demand side of the equation by working to improve the financial literacy of Canadians.

Financial literacy is an essential skill now more than ever. It is integral that investors have the knowledge, skills and confidence to make informed investment choices and build their financial futures. Furthermore, financial literacy is integral to effective financial advice. Studies have shown

[6] IIROC 2018 Statement of Priorities

[7] See BlackRock Viewpoint- Digital Investment Advice: Robo Advisors Come of Age. September, 2016 https://www.blackrock.com/corporate/en-zz/literature/whitepaper/viewpoint-digital-investment-advice-september-2016.pdf

that investors with a low level of financial literacy are less likely to consult with an advisor, while they delegate their portfolio choice more often or do not invest in risky assets at all.[8]

We applaud the work the OSC is doing to increase investor education through its Investor Office, particularly the creation of online resources and tools for new investors. We suggest that the OSC, together with the CSA, take this a step further by making this information more widely available to investors when they need it the most. For example, the CSA could mandate this information be given to investors at specific decision touchpoints, like when they open their first account, or make an investment decision. Investor education should also focus on dealer compensation issues and continue to highlight the impact of costs on performance and investment returns. We also encourage the CSA to collaborate with the Financial Consumer Agency of Canada on its National Strategy for Financial Literacy. In particular, we would like to see basic financial education form a part of school curriculums from an early age.

D. <u>Impact on Competition and Market Structure</u>

21. Please describe how discontinuing embedded commissions will affect competition and market structure and whether you agree with the analysis set out in Part 4?

We are generally supportive of regulatory reforms that encourage long-term savings by broadening the choice of investments offered to investors. In this regard, we encourage the CSA to be mindful about implementing any reforms that may unfairly advantage large, vertically integrated players over small and independent providers, as this could negatively impact the competitive landscape and unfairly prejudice end investors. Specifically, we note that, depending on the regulatory response to embedded commissions adopted, vertically-integrated firms might maintain the ability to provide bundled combinations of product and advice without needing to charge or disclose an explicit "advice" fee[9]. In contrast, independent firms would, in practice, be forced to charge an explicit, unbundled, advice fee. The CSA must be thoughtful about preventing this outcome in pursuing its policy goals. One potential solution we encourage the CSA to consider is requiring enhanced disclosure of mutual fund fees on client statements, similar to the detailed dealer compensation disclosures (including absolute dollar amounts) now required on annual client statements as part of CRM2. We also note that even without embedded commissions, there are conflicts within the industry that may remain unaddressed, and could stand in the way of achieving the CSA's objectives.[10] We encourage the CSA to be mindful of these conflicts when drafting this and other policy reforms, including the revised targeted reforms under CSA 33-404.

That being said, we do see a number of potential market opportunities for both independent and integrated asset managers in a post-embedded commissions environment. As noted above, we anticipate significant growth in low-cost investments and in digital advice models (both new, direct to consumer models and business to business platforms). We also expect that dealers and advisors will look more to asset managers for insights and capabilities in an effort to increase scale and reduce costs. We see an opportunity for product providers such as ourselves to partner

[8] Financial Literacy and the Demand for Financial Advice; Riccardo Calcagno and Chiara Monticone, February 11, 2013.

[9] For example, vertically integrated firms may significantly reduce trailing commission payments made from an asset manager to an affiliated dealer, without changing the total fee paid by the client or earned by the firm overall.

[10] See for example IIROC Notice 16-0068 – Managing Conflicts in the Best Interest of the Client, which identified higher payouts for in-house managed accounts where cost savings are not passed on to the client.

with advice providers to deliver digital tools, calculators and services that would streamline and simplify their business models. This could include model portfolios, risk analysis tools, performance calculators and portfolio analysis.

D. <u>**Conclusion**</u>

BlackRock 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. We would also be happy to participate in any roundtable discussions.

Sincerely,

"Margaret Gunawan"

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"Warren Collier"

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