BLACKROCK®

December 8, 2014

Submitted via e-mail: commentonlegislation@ccmr-ocrmc.ca

Re: Submissions concerning the proposed *Capital Markets Stability Act* (Canada) – Draft for Consultation ("Proposed Act")

Dear Sirs/Mesdames:

BlackRock strongly supports initiatives to strengthen the stability and integrity of Canada's financial system and is highly supportive of appropriate measures to detect, prevent and manage systemic risks to capital markets. As such, we commend the Government of Canada ("**GoC**") on its efforts to identify and address any potential regulatory gaps and appreciate the opportunity to provide input on a number of important issues and considerations raised by the Proposed Act.

A. About BlackRock

BlackRock, Inc. ("**BlackRock**" or "**we**") is one of the world's leading asset management firms. Our client base ranges from pension funds to sovereign wealth funds and official institutions to financial institutions, foundations, corporations, charities, and individuals around the world. BlackRock supports a regulatory regime that increases transparency, protects investors and facilitates responsible growth of capital markets, while preserving consumer choice and assessing benefits versus implementation costs.

BlackRock Asset Management Canada Limited is an indirect, wholly-owned subsidiary of 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. In addition, five subsidiaries of BlackRock currently rely on the investment fund manager exemption in certain jurisdictions across Canada.

B. BlackRock's Responses

BlackRock supports the underlying principles and policy rationales articulated in the preamble of the Proposed Act. In particular, we share the GoC's view that "the stability and integrity of Canada's financial system affect the well-being and prosperity of all Canadians" and that "events and circumstances in domestic and international capital markets can have a profound effect on the stability and integrity of Canada's financial system and on the Canadian economy as a whole". As such, BlackRock welcomes the provisions of the Proposed Act that: (i) authorize more robust national collection of information relating to Canadian capital markets; (ii) authorize a national regulator to make, where appropriate and in sufficiently defined circumstances, urgent orders to address a serious and immediate systemic risk related to Canadian capital markets; and (iii) provide criminal offences and enforcement powers for white collar crime. In addition,

subject to the discussion that follows and further guidance being provided by the Capital Markets Regulatory Authority ("**Authority**") as to its intended implementation, we believe it may be appropriate for a national regulator to have oversight of certain entities, products and practices which, given their particular functions and roles, may give rise to systemic risk. Nevertheless, we do have some concerns, as outlined below, with the Proposed Act. In particular, we have significant reservations regarding the scope of entities subject to the Proposed Act, the vague qualitative factors that the Authority would apply in making a "systemically important" determination, the absence of adequate procedural safeguards for potential designees, and the lack of comity with global, systemic risk-related initiatives.

1. Scope of the Proposed Act

BlackRock is committed to supporting targeted and well-calibrated measures designed to mitigate systemic risks, but which, crucially, are also balanced by the need to ensure efficient capital markets by reducing undue regulatory uncertainty. However, we believe that certain provisions of the Proposed Act as currently contemplated may engender the latter without meaningfully contributing to the former. Specifically, for the reasons set out below, we strongly encourage the GoC to reconsider the inclusion of the following subsections in the definition of "capital markets intermediaries" [embedded defined terms ours]:

> (b) an issuer whose primary purpose is to invest money provided by its security holders, including an investment fund *[("investment funds")]*;
>
> (d) a person that directs or manages the business, operations or affairs of an issuer referred to in paragraph (b) …;
>
> (e) a person that manages the investments of clients that have granted the person discretionary authority to do so *[(together with (d), "asset manager")]*

a) Asset Managers

In our view, asset managers are not, and cannot be, systemically important. The asset management business model is an "agency" model which is fundamentally different than that of other financial institutions that act in a principal capacity. Asset managers transact on behalf of clients rather than managing assets on their own balance sheet and, as a result, are neither the owner of the assets that they manage nor the counterparty to trades or derivative transactions. Moreover, in the unlikely event that an asset manager becomes insolvent or winds-up its business, clients can simply reassign the asset management to one of many competitors without any significant impact on the broader financial system. In addition, client assets are held in trust by custodian banks or dealers (typically third parties) on behalf of clients, meaning that the assets of the funds are insulated from claims by general creditors of the asset manager. This segregation of assets also facilitates the transitioning of accounts between asset managers as a result of financial distress, key person turnover, or otherwise. For example, record outflows from a U.S. mutual fund totalling over $50 billion USD followed the precipitous departure of

that asset manager's Chief Investment Officer and co-founder[1]. These outflows, however, were easily absorbed by other asset managers, underscoring the high degree of substitutability in the industry. Moreover, the seamless reallocation to other asset managers of these large outflows, 70% of which were from funds directly managed by the departing executive,[2] demonstrates the absence of any perceived systemic risks such as "contagion effects" across and within investment fund platforms.

In addition, asset managers are currently subject to rigorous risk management and compliance requirements such as National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* which prescribes a wide range of protective measures including minimum capital and insurance requirements, auditing standards and service provider oversight. This regulatory framework dovetails with the overarching fiduciary duty that asset managers are also subject to under existing Canadian securities laws and which, in our view, collectively minimize the potential for meaningful systemic risk and, therefore, the need for any parallel policy response.

In light of the role of asset managers in the financial ecosystem, together with the panoply of stringent regulatory protections currently in place, we strongly encourage the GoC to eliminate the regulatory uncertainty and overhang that would otherwise result from this section of the Proposed Act by removing asset managers from the definition of "capital markets intermediaries". Instead, we would urge the GoC to consult extensively with a broad group of asset managers, asset owners and large investors, asking them to identify specific products and activities that may pose systemic risk and to provide suggestions for addressing these concerns. In taking a consultative approach such as this, we believe the GoC can avoid the unintended consequences of imposing regulations on asset managers before adequately assessing whether systemic risks exist and what the appropriate remedies should be. Diagnosing with precision the problem intended to be redressed, in other words, is a critical precondition to properly calibrating an appropriate regulatory response.

b) Investment Funds

Similarly, we believe that investment funds should be excluded from the definition of "capital markets intermediaries" given that the stated objectives of the Proposed Act should already be addressed by existing regulatory regimes. As with asset managers, investment funds are subject to rigorous and comprehensive regulation in the jurisdictions in which they are offered. Retail mutual funds distributed in Canada, for example, are subject to a myriad of investment restrictions, such as those set out in National Instrument 81-102 – *Investment Funds* ("**NI 81-102**") (e.g., concentration limits, short-sale restrictions, prohibitions on the purchase of real property and limitations on the holding of illiquid assets), all of which are designed to foster prudential investing and by extension, mitigate systemic risk. Similarly, non-retail investment funds are generally

[1] Kirsten Grind, "Investors Pulled Record Amount From Pimco's Flagship Fund in October," The Wall Street Journal, 4 November 2014. Available at: http://online.wsj.com/articles/investors-pulled-record-amount-from-pimcos-total-return-fund-in-october-1415137835.

[2] Oliver Seuss, "Pimco Offers Special Post-Gross Bonus to Retain Talent," Bloomberg, 7 November 2014. Available at: http://www.bloomberg.com/news/2014-11-07/pimco-offers-special-post-gross-bonus-to-retain-talent.html.

restricted to sophisticated investors that are typically highly-regulated entities themselves (e.g., pension plans, insurance companies, etc.) and which are therefore subject to their own suite of comprehensive prudential investment standards. In addition, these sophisticated investors routinely require that the investment practices and activities of non-retail investment funds offered in Canada, such as pooled funds, be restricted in a manner that is often similar to the restrictions under NI 81-102. As a result, we believe that product and purchaser-level protections currently in place regarding investment funds in Canada sufficiently address any concerns regarding their potential transmission or amplification of systemic risks.

To the extent regulators believe that additional protections are warranted to address systemic risk, we believe such measures would more effectively be addressed through targeted, product-level regulation which can be uniformly and consistently applied across similarly-situated investment vehicles and other pools of assets. For example, perceived systemic risk concerns identified by regulators in the over-the-counter (OTC) derivatives market in Canada have been addressed through the implementation of reporting, clearing and disclosure requirements, and not by the regulation of specific entities.[3] Similarly, we believe the GoC should evaluate systemic risk on an industry-wide and not a fund-by-fund basis in order to ensure solutions are implemented and applied consistently across all market participants. Doing so, we believe, will help minimize the potential for product arbitrage whereby investors react to regulatory intervention with respect to one product by moving assets into a substitute investment that is not subject to similar restrictions.

2. Application of the Proposed Act

The Proposed Act contains broad powers for the Authority to apply "systemically important" designations to a wide range of entities and practices. In each case, the Proposed Act provides that such *prima facie* designations must be based on a prescribed, though – pointedly – non-exhaustive list of qualitative and subjective factors.[4] In light of both the wide scope of the Proposed Act as well as the limited guidance as to how the Authority intends on interpreting and applying these vague and, on their face, opaque factors, BlackRock respectfully recommends that the Authority develop a more robust procedural framework for applying the Proposed Act. We believe that doing so is imperative to ensure that potential designees are able to furnish the information necessary for the Authority to make fair, consistent and informed decisions regarding a "systemically important" designation and, by extension, any attendant regulatory implications which flow from such orders. As currently contemplated, the vagueness in the Proposed Act pertaining to orders the Authority may make in order to address systemic risk creates significant regulatory uncertainty which may, in turn, lead to competitive disadvantages amongst Canadian firms as well as reduced investor choice and confidence. We believe that the interests of the Authority and of potential designees are aligned in bolstering procedural protections as they would improve the transparency,

[3] OSC Rule 91-506 *Derivatives: Product Determination and* OSC Rule 91-507 *Trade Repositories and Derivatives Data Reporting*.

[4] Sections 18(2), 20(2), 23(2), 25(2), 27(2), 30(2) and 32(2) of the Proposed Act.

validity and coherence of any orders made by ensuring that the affected parties have a meaningful opportunity to participate in any proposed or final determinations.

Under the current framework, the Proposed Act provides that potential designees would generally be afforded "an opportunity to make representations"[5] to the Authority in connection with the analysis of the prescribed factors for consideration prior to an order being made. However, the Proposed Act does not explicitly state that the Authority must *consider* the representations made, nor does it provide a mechanism for a formal dialogue between the Authority and a potential designee as to how the applicable designation factors have been evaluated vis-à-vis each other, or how they are weighed relative to other considerations such as any knock-on effects or unintended consequences to the broader market of regulatory intervention. Moreover, the Proposed Act does not provide an opportunity for affected parties to make representations in cases where a product or service may be designated.

In order to ensure the Authority has the necessary information to make appropriate "systemically important" designations, BlackRock would therefore welcome a more fulsome framework similar to the "opportunity to be heard" right available in the registration context under the *Securities Act* (Ontario),[6] which is supported by detailed written procedures and guidance[7] for any entity directly or indirectly impacted by a "systemically important" designation. In particular, we would strongly support additions to the Proposed Act that, at a minimum, include provisions prescribing reasonable notice to a potential designee that it is being considered for designation sufficiently early in the process for the potential designee to meaningfully engage with regulators to help inform any final determinations. We also request that the Authority provide the potential designee with written reasons for its preliminary assessment, detailed procedures outlining the analysis of factors considered, as well as an independent review process to ensure designations are uniformly applied to similarly-situated market participants and products. Most importantly, we believe the Authority should engage a potential designee early in the process, communicating which practices or characteristics, in its view, could pose systemic risk. In doing so, a potential designee would have an opportunity to not only provide additional information necessary for the Authority to make an informed assessment, but also to proactively modify its practices to cure any perceived systemic risks identified, thereby obviating the need for any "systemically important" designation.

3. Implementation of the Proposed Act

Finally, BlackRock has some concerns regarding the indicative timeline for the enactment of the Proposed Act. The regulation of systemic risk is a far-reaching initiative which requires close coordination and harmonization amongst global policy makers and regulators to ensure both consistency of approach and the minimization of jurisdictional arbitrage. As such, we believe that by the proposed enactment date of June 30, 2015,[8] neither a global regulatory consensus will have been achieved on the approach to this issue, nor will industry participants have been afforded sufficient time to

[5] Sections 18(3), 20(3), 23(3), 27(3) and 29(2) of the Proposed Act.
[6] *Securities Act*, R.S.O. 1990, c S-5, s. 31.
[7] <http://www.osc.gov.on.ca/en/Dealers_otbh_20111025_procedures.htm>.
[8] http://ccmr-ocrmc.ca/about/.

adequately review the forthcoming regulations which we anticipate will provide clarity and guidance as to how the Authority intends on applying the Proposed Act.

With respect to the former, global policy makers are actively considering the issue of systemic risk and how best to manage it while maintaining efficient capital markets. For example, the Financial Stability Board ("**FSB**") and International Organization of Securities Commissions ("**IOSCO**") as well as the U.S. Financial Stability Oversight Council ("**FSOC**") have been considering whether asset managers and/or investment funds pose risks to the financial system for some time. In the course of these efforts, it has become apparent that systemically important identification frameworks have not been easily applied to asset managers or investment funds. In January 2014, the FSB jointly with IOSCO published a Consultative Document[9] intended to define a methodology for identifying non-bank non-insurer (NBNI) global systemically important financial institutions (G-SIFIs) – a category which appears to closely align with the definition of "capital markets intermediaries" in the Proposed Act. The FSB and IOSCO received multiple responses from market participants and interested parties and have since committed to issuing a new consultation at the end of this year.[10] In the U.S., the FSOC met on July 31, 2014 directing their Staff to "undertake a more focused analysis of industry-wide products and activities to assess potential risks associated with the asset management industry".[11] Recent press reports indicate that the FSOC will look more closely at activities in asset management in the coming months.[12] In light of these parallel global initiatives, we believe it would be prudent for the GoC to first evaluate the outcomes of these timely and topical reviews before enacting legislation governing systemic risk in Canada. BlackRock has consistently encouraged policy makers around the world to consider harmonization of regulation, where possible, to promote a more cohesive regulatory framework and to avoid both conflicting rules and unintended gaps in regulation.

Secondly, in order to minimize regulatory uncertainty, we urge the GoC to release companion regulations or other detailed interpretive guidance regarding the intended application of the Proposed Act; specifically, with respect to how the various qualitative factors enumerated will be weighed and evaluated by the Authority in assigning a "systemically important" designation. We believe it is critical that industry and other market participants have the opportunity to evaluate such guidance in tandem with the Proposed Act in order to ensure that the final result fosters fair and efficient capital markets and promotes investor confidence.

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[9] "Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions," FSB-IOSCO. January 2014. Available at http://www.financialstabilityboard.org/wp-content/uploads/r_140108.pdf.

[10] "Meeting of the Financial Stability Board in Cairns on 17-18 September," FSB Press Release. September 18, 2014. Available at http://www.financialstabilityboard.org/wp-content/uploads/pr_140918.pdf.

[11] "Financial Stability Oversight Council Meeting July 31, 2014," U.S. Treasury Department Press Release. July 31, 2014. Available at http://www.treasury.gov/initiatives/fsoc/council-meetings/Documents/July%2031%202014.pdf.

[12] See Ian Katz and Robert Schmidt, "Panel Steps Up Review of Threats Posed by Asset Managers," Bloomberg. November 6, 2014. Available at http://www.bloomberg.com/news/2014-11-06/panel-steps-up-review-of-threats-posed-by-asset-managers.html.

C. Conclusion

BlackRock remains a vocal advocate of balanced reform and will continue to work with regulators to find solutions that mitigate risk, protect investors and facilitate responsible growth of capital markets while preserving consumer choice, maintaining a level playing field across similar products and reducing regulatory uncertainty. To the extent the GoC or provincial securities regulators have concerns about a particular activity, product or practice, we would strongly encourage them to identify such risks and to make, wherever possible, specific recommendations for industry consideration. Indeed, BlackRock believes that a targeted regulatory response to specific perceived risks is the most effective means of addressing some of the important policy objectives outlined by the GoC.

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

"*Noel Archard*"

Noel Archard
Chief Executive Officer