BLACKROCK®

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

Alberta Securities Commission
Autorité des marches 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:

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, QC H4Z 1G3

Grace Knakowski
Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, Ontario M5H 3S8

Re: Canadian Securities Administrators Notice and Request for Comment – Proposed National Instrument 93-102 – *Derivatives: Registration* and related Companion Policy 93-102CP (together, "Proposed Registration Rule")

Dear Me Beaudoin and Ms. Knakowski:

A. About BlackRock

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

BlackRock supports the Canadian Securities Administrators' ("**CSA**") development of a regulatory regime "to protect investors, reduce risk and, improve transparency and accountability in the over-the-counter (OTC) derivatives markets"[1] by introducing both the Proposed Registration Rule and Proposed National Instrument 93-101 and Proposed Companion Policy 93-101CP – *Derivatives: Business Conduct* (the **"Proposed Business Conduct Rule"**). We have also provided comments on the Proposed Business Conduct Rule, which should be read together with this letter. From the perspective of a firm registered as an adviser (or equivalent) for both the securities and exchange-traded derivatives markets, BlackRock Canada is of the view that many of the requirements of the Proposed Registration Rule are duplicative with current registrant requirements and therefore, unnecessarily adds regulatory burden with no corresponding additional benefit to investors or the capital markets. We disagree with the CSA's conclusion that the costs to be borne by registered advisers in complying with the Proposed Registration Rule are in line with the benefits to be gained by the Canadian market, and ultimately, investors[2]. We do not see a well-articulated policy rationale for introducing a separate registration regime for registered advisers who already owe a fiduciary obligation to clients and who must meet the highest proficiency standards as portfolio managers under National Instrument 31-103 - *Registration Requirements, Exemptions, and Ongoing Registrant Obligations* (**"NI 31-103"**). Furthermore, BlackRock believes that the Proposed Registration Rule and Proposed Business Conduct Rule are focused on addressing policy issues arising from certain dealing activities resulting in the 2008 financial crisis and that the CSA has not identified any specific activities or behaviours from registered advisers that require a regulatory response[3].

In our experience, asset managers such as BlackRock would typically implement robust compliance and risk management programs applicable to their entire business and continually monitor these programs to ensure their effectiveness and make improvements when needed. In the investment context, registered advisers would not generally differentiate between asset classes in applying compliance and/or risk management policies and procedures.

As a general principle, we support initiatives that encourage long-term savings by improving the quality of advice, better aligning interests of registrants with those of their clients, and broadening the choice of investments and services offered to investors. The introduction of new regulatory requirements or significant amendments to regulation must be assessed using this lens to ensure benefits versus implementation costs can be appropriately weighed. The Proposed Registration Rule may result in smaller, independent firms and also foreign firms that conduct OTC derivatives business with Canadian firms and clients from exiting the market, as the requirements under the Proposed Registration Rule are potentially very costly and onerous, especially as it is duplicative of, or lacking harmonization with, other Canadian and/or international regulations. Alternatively, derivative firms may decide to decrease their participation in the Canadian OTC derivatives market, thereby impacting liquidity or may pass on the additional costs of complying with the Proposed Registration Rule to clients, both of which would be unfortunate unintended consequences.

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[1] (2018), 41 OSCB 3254.

[2] (2018), 41 OSCB 3264.

[3] "During the financial crisis of 2008, some firms *dealing in derivatives* [emphasis added] contributed to the crisis by not effectively managing their own derivatives related risks." (2018), 41 OSCB 3254.

Finally, the Proposed Registration Rule and the Proposed Business Conduct Rule should be enacted and come into force concurrently, given both are intended to be the comprehensive regime for the regulation of OTC derivatives. Given that many of the issues we point out in our submissions, the substantive content is reflected in both proposed rules, and the publication of the appendices relevant for full consideration and feedback from industry is still outstanding, BlackRock believes that enacting the Proposed Business Conduct Rule prior to the Proposed Registration Rule will be an inefficient way for industry to implement the new requirements and have a negative, disruptive impact on both investors and the market.

Beyond these general observations, our specific feedback on certain questions posed about the Proposed Registration Rule is set out below. All capitalized terms used in this letter but not defined herein have the same meaning given to them in the Proposed Registration Rule. We have also kept the numbering of the questions consistent with the numbering in the notice section of Proposed Registration Rule.

C. BlackRock's Responses

3) Definition of "eligible derivatives party"

Paragraphs (m), (n) and (o) provide that certain persons and companies are eligible derivatives parties if they meet certain criteria, including meeting certain financial thresholds. Are these criteria appropriate? Please explain your response.

Obtaining a written representation on "knowledge and experience"

We note that concerns regarding the need to obtain a written representation on "knowledge and experience" were raised by several commentators in the first publication of the Proposed Business Conduct Rule and that the CSA did not make any changes. We ask that the CSA re-consider its position in obtaining the written representation both in that rule and the Proposed Registration Rule. While BlackRock agrees that certain eligible derivatives parties (**"EDP"**) should have the requisite knowledge and experience to evaluate information about derivatives, its appropriateness and characteristics, the requirement to obtain a written representation from such an EDP under paragraphs (m), (n), and (o) of the Proposed Registration Rule is too rigid and will not enhance investor protection. In fact, we would argue that if a "bright line test" based on financial thresholds available in other exemptions under securities laws is sufficient (i.e. under the "permitted client" and "accredited investor" exemptions, there is currently no requirement to obtain a representation about "knowledge and experience"), then unless there is a compelling reason, this approach should be no different in the context of OTC derivatives. There may be other ways to conclude an EDP's knowledge and experience outside of obtaining a written representation[4].

It is not appropriate to impose a requirement for derivatives advisers that provide services only to sophisticated, institutional parties to obtain a written representation from those parties as to their "knowledge and experience". Such a requirement will impose a significant new

[4] Furthermore, allowing other means to make this "knowledge and sophistication" determination would still be consistent with section 7 of the *Québec Derivatives Act*, where there is no express requirement to obtain a written representation.

administrative burden on both the derivatives adviser and its institutional clients, with virtually no investor protection or risk reduction benefit. For example, registered pension plans and regulated financial institutions do not require additional regulatory protection and have the resources to obtain independent advice and can negotiate the commercial arrangements they desire with derivatives dealers and advisers. The additional complexity introduced in assessing sophistication and knowledge against potentially three sets of definitions (i.e. permitted client, accredited investor and now, EDP) is unduly burdensome and does not have a corresponding benefit to investors, particularly institutional clients. The CSA should also take into account the fact that the same sub-set of large institutional clients will be asked by several derivatives firms for the same written representation prior to the transition period lapsing[5]. It is clear they can make the representation, but it will be highly frustrating for them to deal with the extra paperwork.

Other categories of EDP to be included in the definition

The CSA should also reconsider including persons and entities that qualify as "permitted clients" under NI 31-103, in the definition of EDP. Permitted clients already participate in the exempt market for securities without the full set of protections contemplated for non-EDPs and no justification has been outlined for excluding any category of "permitted client" from the definition of EDP.

The net asset test of $25mil included in paragraph (m)(ii) of the EDP definition is too high and should be decreased to $10mil. This would make the financial requirement more harmonized with the US Commodity Exchange Act definition of "eligible contract participant" (although in US dollars) and address the competitive disadvantage derivatives firms will encounter when conducting business in the Canadian OTC derivatives market.

4) Application of the derivatives adviser registration requirement to registered advisers/portfolio managers under securities legislation

BlackRock strongly believes that registered advisers should be exempt entirely from registration as a derivatives adviser. As referenced above and in our submission on the Proposed Business Conduct Rule, registered advisers are already subject to robust and extensive regulation under NI 31-103. Furthermore, for firms that are also registered under commodity futures statues in the applicable provinces to advise on exchange-traded derivatives, there is another layer of regulatory oversight on top of NI 31-103. Portfolio managers are also subject to a common law fiduciary duty when dealing with their clients[6]. In meeting these regulatory and common law obligations, registered advisers do not vary the standard of care they are operating under between asset classes such as equities, fixed income and derivatives. The additional regulatory burden created for registered advisers under the Proposed Registration Rule is unnecessary given no specific risks have been identified resulting from the actions of registered advisers. It is also contrary to the good work the CSA has recently undertaken in reducing the regulatory burden for reporting issuers and investment fund issuers.

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[5] Currently, there is a one year transition period contemplated under section 45 of the Proposed Business Conduct Rule.

[6] In some provinces, the fiduciary duty is statutory and exists in the provincial securities acts.

We are also concerned that the additional burdens placed on smaller independent firms who are registered advisers will be detrimental to the ultimate end client and the competitiveness of the asset management industry generally. These smaller businesses do not have the same breadth and depth of resources such as BlackRock to rely upon. In looking at the requirements for an independent review of risk management systems under subsection 39(4) as an example, this means retaining and paying for an external firm or individual to conduct the review as firms need to be of a sufficient size and scale to justify creating an internal audit department. Further, there is also no equivalent requirement in NI 31-103 for advisers to do an independent review of compliance policies and procedures. Smaller, independent firms play an important role in ensuring Canadian investors have the option of choosing not to do business with a large domestic or global financial firm. Should these types of firms shutter their doors or decrease their investment offerings, it would reduce investor choice and impact the ability to use OTC derivatives in a cost-effective way that creates a meaningful investment outcome.

There is a real possibility that the regulatory burden imposed by the Proposed Registration Rule and the Proposed Business Conduct Rule may increase the cost of using OTC derivatives and impact the liquidity of these instruments as the CSA acknowledges. This unintended result is not, in our view, proportionate to the benefits identified, particularly as NI 31-103 and the fiduciary duty portfolio managers operate under impose substantively the requirements being introduced.

Exemption related to provision of incidental advice on OTC derivatives

BlackRock is of the view that introducing an "incidental advice" concept into the Proposed Registration Rule will pose practical challenges for advising firms. For instance, the current guidance in the companion policy on what factors are viewed as business triggers for registration are too broad and nebulous (i.e. "recommending a derivatives trading strategy"). In practical terms, it may be difficult (or arbitrary) to determine where the line is crossed from providing incidental advice to triggering the requirement to register, such as in the case of using derivatives to hedge risk. We experience this already under current "incidental advice" exemptions available[7] and firms will typically err on the side of caution and register, incurring additional costs and taking on compliance obligations which may not be needed in the context of their business models. For these reasons, an express exemption for registered advisers is preferable.

Applicability/scope of the Proposed Registration Rule to foreign registered (or exempt) derivatives advisers

BlackRock respectfully submits that foreign advisers who are registered or rely on an exemption in a foreign jurisdiction should also be exempt from the Proposed Registration Rule by adopting the well-recognized and well-functioning international adviser and international sub-adviser exemptions currently available in NI 31-103[8]. The Proposed Registration Rule (and Proposed Business Conduct Rule) currently introduce a completely new "substituted compliance" regime which, from a policy perspective, is unwarranted. It is also difficult to assess the full impact of complying with the requirements of the exemptions when the relevant appendices have not yet been published for comment.

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[7] For example, section 31 of the *Commodity Futures Act* (Ontario) and section 33 of *The Commodity Futures Act* (Manitoba).

[8] Sections 8.26 and 8.26.1 of NI 31-103, respectively.

It is common practice for Canadian registered advisers to retain foreign firms as sub-advisers for various reasons. The foreign sub-adviser may have particular expertise and a strong performance track record managing specific types of mandates, allowing the domestic adviser to offer diversified portfolios to its clients without needing to build its own expertise in-house. In our own case, BlackRock Canada does not have a portfolio management function in Canada and similar to other global firms, we outsource the management of our Canadian domiciled products and accounts to affiliates in other jurisdictions, relying on the international sub-adviser exemption. These affiliates are registered or exempt from registration in their applicable home jurisdiction. We are comfortable operating under the current international sub-adviser exemption and are concerned that uncertainty has now been introduced for several of our affiliates who are exempt, for example, from registration as a commodity trading adviser under the US Commodity Exchange Act. The Proposed Registration Rule will make it a prerequisite for these exempt affiliates to potentially apply for discretionary relief to continue to act as a sub-adviser to BlackRock Canada only in respect of OTC derivatives and not for other securities. The potential disruption this would entail for our clients is very concerning.

BlackRock questions what additional protection from risk a client gains by requiring foreign sub-advisers to comply with substituted compliance when one of the prerequisites of the international sub-adviser exemption under section 8.26 of NI 31-103 is for the Canadian registered adviser to be ultimately responsible for the acts of the foreign sub-adviser. This requirement already insulates Canadian clients from potential losses arising out of the failure of the foreign sub-adviser to meet its standard of care.

Deviation from the regulatory approach in NI 31-103 has not been satisfactorily explained in the guidance (for example, the requirement to notify the applicable Canadian securities regulator of instances of material non-compliance is both vague and onerous) nor has a policy rationale been articulated as to why there are more limited exemptions for foreign advisers in the Proposed Registration Rule. The substituted compliance regime will impede Canada's competitiveness and foreign advisers may be reluctant to continue to operate, or establish a presence, here. Ultimately, decreasing investor choice is not a good outcome.

Should the CSA decide to stay with the substituted compliance option, BlackRock requests that a process be developed to update the foreign jurisdictions that are included in Appendix G and that an opportunity for public comment on the process to add and delete jurisdictions be provided.

6) Exemption from the individual registration requirements for derivatives dealing representatives and derivatives advising representatives

We believe that individuals acting as an adviser for a managed account should be eligible for a registration exemption and that the carve out under subparagraph 16(4)(b)(iii) is not appropriate. Similar to the reasons set out above as to why registered firms should be wholesale exempt from the Proposed Registration Rule, individual advising representatives have already been sufficiently vetted by the regulators for both proficiency and experience and are subject to a fiduciary duty when advising on a discretionary basis. In addition, there are ongoing obligations applicable to the registered individual to maintain his or her registration in good standing. BlackRock does not see a compelling policy rationale for requiring an additional registration category for advising representatives in respect of OTC derivatives.

At a minimum, the managed accounts of EDPs should be removed from subparagraph 16(4)(b)(ii) of the Proposed Registration Rule to maintain consistency with its removal from the equivalent section in the Proposed Business Conduct Rule.

7) Specific proficiency requirements for individual registrants

Although BlackRock's preference is to exempt registered advisers and individuals acting on their behalf, there should be consistency between the Proposed Registration Rule and NI 31-103 with respect to both the (i) categories of registration and (ii) proficiency requirements for each individual registration category. We suggest, for instance, that a derivatives associate advising representative category is necessary to address succession planning concerns and allow for the career development of professionals.

BlackRock is supportive of grandfathering individuals who currently manage OTC derivatives or who are currently registered under provincial commodity futures legislation provided they have a minimum number of years of relevant investment management experience relating to derivatives (for example, minimum 10 years).

8) Derivatives ultimate designated person ("UDP")
9) Requirements, roles and responsibilities of UDPs, chief compliance officers ("CCO") and chief risk officers ("CRO")

In general, sections 27 to 29 of the Proposed Registration Rule are potentially duplicative and overlapping with respect to the requirements, roles and responsibilities of the UDP, CCO and CRO. Exacerbating this is the requirement to designate a senior derivatives manager under the Proposed Business Conduct Rule who, in turn, has similar obligations as the UDP, CCO and CRO[9]. For a global firm like BlackRock which does not have a portfolio management presence in Canada and is part of a broader organization, the individuals assigned to fill at least a few of these roles will not be in Canada and the coordination required will be extensive. This is the best case scenario but we could foresee a situation where a smaller firm or a foreign firm with a small Canadian business or client base may be less committed to serving clients here given the perceived hassle of complying with duplicative and overlapping requirements.

Requiring the derivatives UDP to report instances of material non-compliance is more onerous than what is mandated of the UDP with respect to securities under NI 31-103 and BlackRock does not see any obvious reason why this requirement is necessary in the context of OTC derivatives, particularly when the derivatives CCO has a similar reporting obligation to the UDP and must also submit, at a minimum, an annual report to the board.

There should be permission to delegate all reporting, whether to the CSA or the board of directors of the registered firm, to the CCO. This would make the reporting obligations much more straight-forward.

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[9] Please refer to our more specific comments regarding the designation of one or more senior derivatives managers in our submission on the Proposed Business Conduct Rule.

The instances of non-compliance to be reported should also conform with the current requirements in NI 31-103 as the "material" qualifier included in the Proposed Registration Rule sets out two differing standards for securities and OTC derivatives for no clear reason.

D. Conclusion

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.

Sincerely,

[redacted]

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