

**CANADIAN SECURITIES ADMINISTRATORS'
NOTICE AND REQUEST FOR COMMENT ON**

**DRAFT REGULATION 24-101 RESPECTING
INSTITUTIONAL TRADE MATCHING AND SETTLEMENT, AND
DRAFT POLICY STATEMENT TO REGULATION 24-101 RESPECTING
INSTITUTIONAL TRADE MATCHING AND SETTLEMENT**

I. INTRODUCTION

The Canadian Securities Administrators (the CSA or we) are publishing the following revised documents for a 60 day comment period:

- Draft Regulation 24-101 respecting Institutional Trade Matching and Settlement (Regulation), and
- Draft Policy Statement to Regulation 24-101 respecting Institutional Trade Matching and Settlement (Policy Statement).

The comment period will end on May 2, 2006.

II. BACKGROUND

On April 16, 2004, the CSA published the following documents for comment (collectively, the 2004 Documents):¹

- CSA Discussion Paper 24-401 on Straight-through Processing (STP) and Request for Comments (Discussion Paper 24-401),
- Draft Regulation 24-101 respecting *Post-Trade* Matching and Settlement (2004 Regulation), and
- Draft Policy Statement to Regulation 24-101 respecting Post-Trade Matching and Settlement (2004 Policy Statement).

The CSA invited public comment on all aspects of the 2004 Documents and specifically requested comment on 21 questions. We received 26 comment letters. A summary of the comments and our responses were published in CSA Notice 24-301 dated February 11, 2005 (Notice 24-301).²

Most commenters thought the 2004 Documents were helpful in focusing the discussion on various clearing and settlement issues the industry is currently facing. The majority of comments, including some from the buy-side community, supported a CSA rule requiring institutional trade matching on trade date (T). However, almost all of these commenters found it unfeasible to require institutional trade matching on T by July 1, 2005. Rather, the consensus was for the rule to phase-in the requirement to match institutional trades on T, starting with T+1 and gradually shortening the period to T when the industry is ready. Commenters felt that incremental steps would provide market participants with an opportunity to address a number of concerns about an accelerated confirmation and affirmation process.

The STP initiatives in Canada have largely been driven by the Canadian Capital Markets Association (CCMA), which was founded in 2000 by the industry to provide the necessary leadership for reaching STP goals. As discussed in Notice 24-301, the CCMA decided in early 2005 to realign its priorities and focus its efforts on institutional trade processing. As a result of this new focus, the CCMA reshaped its committee structure by folding a number

¹ *Bulletin de l'Autorité des marchés financiers*, Vol. 1 n° 16, May 21, 2004, and Vol. 1, n° 19, June 11, 2004 2004.

² *Bulletin de l'Autorité des marchés financiers*, Vol. 2 n° 6, February 11, 2005.

of working groups and creating an Institutional Program Steering Committee that oversees six new subcommittees. The subcommittees are mandated to address various different objectives for achieving institutional trade matching on T. The CCMA has also employed a new executive director and program director, who have developed specific timing objectives and are developing a critical path to be completed in 2006. In July 2005, the CCMA Board of Directors strongly recommended that the CSA implement an institutional trade matching rule as soon as possible in order to push the industry towards adopting the necessary policies and procedures for matching institutional trades on T.

III. SUBSTANCE AND PURPOSE OF REGULATION AND POLICY STATEMENT

In response to comments received, and after further consideration by the CSA, the 2004 Regulation and 2004 Policy Statement have been materially revised. The purpose of the Regulation is to provide a general framework in provincial securities legislation for ensuring more efficient and timely settlement processing of trades, particularly institutional trades. The Regulation requires registered dealers and registered advisers to have reasonable policies and procedures in place to achieve *matching* of trades as soon as practicable after the trade has been executed and in any event no later than the prescribed timelines. The Regulation requires each *trade-matching party* to enter into a compliance agreement with the registered dealer or registered adviser or, alternatively, provide a signed written statement to the dealer or adviser before an account for an institutional investor can be opened. The Regulation also requires dealers to have reasonable policies and procedures in place to facilitate settlement of trades by the standard settlement date.

The purpose of the Policy Statement is to assist the industry in understanding and applying the Regulation and to explain how we will interpret or apply certain provisions of the Regulation.

IV. SUMMARY OF REGULATION

A. Main Comments on the 2004 Regulation

As mentioned above, a majority of commenters responding to the publication for comment of the 2004 Documents were of the view that the CSA should implement an institutional trade matching rule. However, they raised the following key issues about such a rule: (i) concerns with mandating the requirements through a contractual obligation only among the various parties involved in the institutional trade process; (ii) questions regarding the role of the self-regulatory organizations (SROs) in this initiative; and (iii) the timing of the obligations to match trades on T.

B. Summary of Regulation and Material Changes

The Regulation is divided into ten parts.

Part 1 Definitions and Interpretation

Part 1 of the Regulation contains defined terms and an interpretative section. The terms “institutional client”³ and “relevant party”⁴ in the 2004 Regulation have been replaced with “institutional investor” and “trade-matching party”, respectively.

An institutional investor is any person or company, other than an individual, that has net investment assets of at least \$10,000,000 as shown on its most recently prepared financial statements. It is also any person or company holding securities through a custodian, whether or not the person or company is an individual or has net investment assets of at least \$10,000,000. Most institutional investors, such as pension and mutual funds, hold

³ The term “institutional client” was defined in the 2004 Regulation as a person or company, including a portfolio adviser, that appoints a custodian to hold securities on his, her or its behalf.

⁴ The term “relevant party” was defined in the 2004 Regulation as a person or company involved in the process of comparing trade data that must agree to the details of trade in securities.

their assets through custodians. However, others may not – such as hedge funds – which sometimes maintain their investment assets with dealers under so-called *prime-brokerage* arrangements. Paragraph (a) of the definition “institutional investor” ensures that the scope of the Regulation includes those institutional investors that do not necessarily use custodians.

A trade-matching party, is in relation to a trade executed with or on behalf of an institutional investor, any of the following persons or companies: a registered adviser acting for the institutional investor in the trade; if a registered adviser is not acting for the institutional investor in the trade, the institutional investor; a registered dealer executing or clearing the trade; or a custodian of the institutional investor settling the trade.

Definitions of the terms “delivery-versus-payment”⁵ and “receive-versus-payment”⁶ in the 2004 Regulation have been omitted in this Regulation. Instead the Regulation applies to “DAP or RAP trades”, which are trades in a security for which settlement is made on a delivery against payment or receipt against payment basis. The matching requirements of the Regulation apply to DAP or RAP trades whether or not settled by a custodian.

While the concept of *matching* in the Regulation is generally the same as in the 2004 Regulation, the provision that describes the concept has been considerably simplified. Sections 1.2 and 1.3 of the 2004 Regulation have been replaced with a basic interpretive provision in section 1.2 of the Regulation, which provides that matching is a process by which the details and settlement instructions of an executed trade are reported, verified, confirmed and affirmed or otherwise agreed to among the trade-matching parties.

Question 1: Should the definition of “institutional investor” be broader or narrower?

Question 2: Does the definition of “trade-matching party” capture all the relevant entities involved in the institutional trade matching process?

Question 3: The scope of the matching requirements of the Regulation is limited to DAP or RAP trades. Should the requirements be expanded to include other trades executed on behalf of an institutional investor? Should the requirements capture trades executed with or on behalf of an institutional investor settled without the involvement of a custodian?

Part 2 Application

Part 2 of the Regulation is largely the same as the 2004 Regulation. The Regulation does not apply to the following: a distribution of a security; a trade in a security of a mutual fund to which Regulation 81-102 respecting Mutual Funds applies; a trade in a security to be settled outside of Canada; or a trade in an option or futures contract that is cleared through a clearing house.

Part 3 Trade Matching Requirements

(a) Policies and procedures

Sections 3.1 and 3.3 of the Regulation generally refocus the obligations of the trade-matching parties discussed in the 2004 Regulation from taking all “necessary steps” to match a trade to adopting appropriate policies and procedures to achieve matching. This new approach is consistent with regulatory approaches taken in other areas, such as the investor confidence initiatives, and by other regulators outside Canada.⁷

⁵ The term “delivery-versus-payment” was defined in the 2004 Regulation, as in relation to a purchase or sale of a security, a service available to the buyer which allows him, her or it to pay for the security when the security is delivered at settlement.

⁶ The term “receive-versus-payment” was defined in the 2004 Regulation, as in relation to a purchase or sale of a security, a service available to the seller which allows him, her or it to deliver the security when payment is received at settlement.

⁷ See National Association of Securities Dealers, Inc. (NASD) Rule 3013 *Annual Certification of Compliance and Supervisory Processes* which requires each NASD member firm’s chief executive officer to certify annually that senior executive management has in place processes to establish, maintain,

Section 2.4(1) of the Policy Statement states that, when establishing appropriate policies and procedures, a party should consider the best practices and standards for institutional trade processing that have generally been adopted by the industry.⁸ It should also include those policies and procedures in its regulatory compliance and risk management programs.

(b) *Compliance agreement or signed written statement*

We considered a number of alternatives to requiring a trade matching compliance agreement. Sections 3.2 and 3.4 of the Regulation now provide that a trade-matching party may either (i) enter into a compliance agreement or (ii) provide a signed written statement confirming that each trade-matching party has appropriate policies and procedures to achieve matching as soon as practicable after a trade is executed.

Registered dealers and registered advisers are required to use reasonable efforts to monitor compliance with and enforce the terms of the compliance agreement. Section 2.3(2) of the Policy Statement states that a single compliance agreement is sufficient for the general and all sub-accounts of the institutional customer.

Trade-matching parties do not need to enter into a compliance agreement if they have provided a signed written statement to the registered dealer or registered adviser. The signed written statement is an alternative to the contractual approach. Section 2.3(3) of the Policy Statement states that a registered dealer or registered adviser may rely on the written statement signed by the chief executive of the trade-matching party without further investigation, unless the dealer or adviser has knowledge that any statements or facts set out in the written statement are incorrect. A single signed written statement is sufficient for the general and all sub-accounts of the institutional customer.

Section 2.3(1) of the Policy Statement states that the purpose of a compliance agreement or signed written statement is to establish that all trade-matching parties have appropriate policies and procedures in place to ensure an institutional trade is matched as soon as practicable after the trade has been executed.

Question 4: Are each of these methods (compliance agreement and signed written statement) equally effective to ensure that the trade-matching parties will match their trades by the end of T? Should trade-matching parties be given a choice of which method to use?

Part 4 Reporting Requirements for Registrants

Part 4 of the Regulation contains a new *exception* reporting requirement for registrants. A registrant is required to complete and file Form 24-101F1 and related exhibits only if less than 98 percent of the DAP or RAP trades executed by or for the registrant in any given calendar quarter have matched within the prescribed deadline. Form 24-101F1 requires registrants to report information on the circumstances or underlying causes that resulted in, or contributed to the failure to achieve the percentage threshold of matched DAP or RAP trades within the deadline prescribed by Part 3 of the Regulation. Section 3.1 of the Policy Statement states that the reporting requirements apply to DAP and RAP trades, whether or not settled by a custodian.

The 98 percent threshold is effective as of July 1, 2008. Pursuant to Part 10 of the Regulation, the 98 percent threshold is being gradually phased in for trades executed after the Regulation comes into force on July 1, 2006 and before July 1, 2008.

and review polices and procedures reasonably designed to achieve compliance with applicable NASD rules, Municipal Securities Rulemaking Board rules, and federal securities laws and regulations. Rule 3013 can be found at http://nasd.complinet.com/nasd/display/display.html?rbid=1189&element_id=1159000466.

⁸ The CCMA released in December 2003 the final version of a document entitled *Canadian Securities Marketplace Best Practices and Standards: Institutional Trade Processing, Entitlements and Securities Lending* (CCMA Best Practices and Standards White Paper) that sets out best practices and standards for the processing for settlement of institutional trades, the processing of entitlements (corporate actions), and the processing of securities lending transactions. The CCMA Best Practices and Standards White Paper can be found on the CCMA website at www.ccma-acmc.ca.

Exception reporting by registrants will facilitate monitoring and assessment by the Canadian securities regulatory authorities or the SROs of the Regulation's trade-matching requirements. Such exception reporting will be supplemented by the filings of regulated clearing agencies and matching service utilities pursuant to Parts 5 and 6, respectively, of the Regulation.

Question 5: Will exception reports enable practical compliance monitoring and assessment of the trade matching requirements?

Question 6: Is it necessary to require custodians to do exception reporting in order to properly monitor compliance with this Regulation?

Part 5 Reporting Requirements for Regulated Clearing Agencies

Part 5 of the Regulation contains a new requirement for a regulated clearing agency to file quarterly information relating to the matching activities of their participants. Section 3.3 of the Policy Statement states that the purpose of this information is to facilitate monitoring and enforcement by the Canadian securities regulatory authorities or SROs of the Regulation's matching requirements.

Part 6 Requirements for Matching Service Utilities

Part 6 of the Regulation sets out the filing, reporting, systems capacity, and other requirements of a matching service utility. Trade-matching parties are not required to use the facilities or services of a trade matching utility to accomplish matching of trades within the prescribed deadline. However, if any person or company intends to carry on business as a matching service utility, the person or company must file Form 24-101F3 at least 90 days before it begins to carry on business as a matching service utility. If there is a significant change to the information filed in Form 24-101F3, section 6.2 of the Regulation requires that the matching service utility file an amendment to the information provided at least 45 days before implementation. The type of information considered to be significant has been expanded to include, among other things, information relating to constating documents, ownership, and independent systems audits.

Section 4.2 of the Policy Statement states that the Canadian regulatory authorities will review Form 24-101F3 to determine whether the person or company who filed the form is an appropriate person or company to act as a matching service utility for the Canadian capital markets.

Section 6.4(1) of the Regulation requires matching service utilities to file Form 24-101F5 no later than 30 days after the end of a calendar quarter. Section 4.4(1) of the Policy Statement states that the information filed quarterly by the matching service utility will allow regulators to monitor a matching service utility's operational performance and management of risk, the progress of inter-operability in the market, and any negative impact on access to the markets.

Part 7 Trade Settlement by Registered Dealer

The 2004 Regulation's T+3 settlement rule has been replaced with a general obligation on dealers to have reasonable policies and procedures in place to facilitate settlement of trades for no later than the standard settlement date prescribed by the SROs. Section 7.1 of the Regulation is intended to support and strengthen the general settlement cycle rules of the SROs.

Part 8 Equivalent Requirements of Self-regulatory Entities and Others

Section 8.1 of the Regulation states that a regulated clearing agency, marketplace or matching service utility will be required to have rules or other instruments to promote compliance by its members, participants or users with the requirements of Parts 3 and 7 of

the Regulation. Section 8.2 of the Regulation states that a member of a self-regulatory entity will be considered to be in compliance with the Regulation if it is in compliance with a rule or other instrument of the self-regulatory entity dealing with the same subject matter. These new provisions have been included in part to respond to comments suggesting that the self-regulatory entities be more involved in promoting an institutional-trade matching rule.

Part 9 Exemption

Pursuant to Part 9, the regulator or securities regulatory authority may grant an exemption from this Regulation, in whole or in part.

Part 10 Effective Date and Transition

Pursuant to section 10.1 of the Regulation, this Regulation comes into force on July 1, 2006. The 7:30 p.m. on T deadline referenced in Part 3, and the 98 percent threshold referenced in Part 4 of the Regulation, are being gradually phased in for trades executed after the Regulation comes into force on July 1, 2006 and before July 1, 2008 in the following manner:

For trades executed:	Matching deadline for trades executed before 4:30 p.m. on T (Part 3 of Regulation)	Percentage trigger of DAP or RAP trades for registrant exception reporting (Part 4 of Regulation)
after December 31, 2006, but before July 1, 2007	12:00 p.m. (noon) on T+1	Less than 70% matched by deadline
after June 30, 2007, but before January 1, 2008	7:30 p.m. on T	Less than 80% matched by deadline
after December 31, 2007, but before July 1, 2008	7:30 p.m. on T	Less than 90% matched by deadline
after June 30, 2008	7:30 p.m. on T	Less than 98% matched by deadline

These new transitional provisions have been included in part to respond to comments suggesting that the Regulation provide for the phasing in of the matching requirements.

Question 7: Is it feasible for trade-matching parties to achieve a 7:30 p.m. on T matching rate of 98 percent by July 1, 2008, even without the use of a matching service utility in the Canadian capital markets?

Question 8: Are the transitional percentages outlined in Part 10 of the Regulation practical? Please provide reasons for your answer.

V. SUMMARY OF POLICY STATEMENT

The Policy Statement has been amended to reflect the changes to the Regulation. The Policy Statement provides guidance on the Regulation's matching requirements, including the requirements of registrants to have reasonable policies and procedures in place to ensure timely matching of trades and to enter into a compliance agreement with, or alternatively to receive a signed written statement from, each of the relevant trade-matching

parties confirming that such parties have also policies and procedures in place to ensure timely matching of trades. In addition, the Policy Statement briefly explains the registrant exception-reporting filing requirements and the filing requirements of regulated clearing agencies and trade matching utilities.

VI. ALTERNATIVES TO REGULATION CONSIDERED

In proposing the Regulation, the CSA had considered as an alternative not implementing any regulatory requirement, relying instead primarily on the SROs to impose matching by the end of T. We believe that market participants are seeking assurances that, before they invest in the necessary financial and technological resources to improve institutional trade processing, a requirement to complete matching by the end of T will become a rule subject to compliance and enforcement by the Canadian securities regulatory authorities.

VII. ANTICIPATED COSTS AND BENEFITS

Please refer to Discussion Paper 24-401, in particular *Part I: The Canadian Securities Clearing and Settlement System and Straight-through Processing — C. Why is STP important to the Canadian capital markets?*

In summary, the CSA are of the view that the Regulation offers several benefits to the Canadian capital markets, including but not limited to the following:

- reduction of processing costs due to development of STP systems;
- reduction of operational risk due to development of STP systems;
- protection of Canadian market liquidity;
- reduction of settlement risk; and
- overall mitigation of systemic risk in, and support of the global competitiveness of, the Canadian capital markets.

The CSA recognize, however, that implementing the Regulation may entail costs, which will be borne by market participants. In the CSA's view, the benefits of the Regulation justify its costs. General securities law rules that require market participants to have policies and procedures to complete matching before the end of T and settle trades within the standard settlement periods (e.g., T+3) will augment the efficiency and enhance the integrity of capital markets. It promises to reduce both risk and costs, generally benefit the investor, and improve the global competitiveness of our capital markets. In addition, in assessing the anticipated costs and benefits of the Regulation to the industry, we carefully considered the industry's express desire for CSA regulatory action in this area.

VIII. QUESTIONS AND COMMENTS

You are invited to comment on any aspect of the Regulation and Policy Statement and specifically on the questions asked in this notice.

Please submit your comments in writing before May 2, 2006.

Submissions should be sent to all Canadian securities regulatory authorities listed below in care of the Ontario Securities Commission in duplicate, as indicated below:

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
New Brunswick Securities Commission
Office of the Attorney General, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland & Labrador
Registrar of Securities, Northwest Territories
Legal Registries Division, Nunavut
Registrar of Securities, Yukon Territory

c/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1903, Box 55
Toronto, Ontario
M5H 3S8
jstevenson@osc.gov.on.ca

Submissions should also be addressed to the *Autorité des marchés financiers (Québec)* as follows:

Madame Anne-Marie Beaudoin
Directrice du secrétariat de l'Autorité
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, Tour de la Bourse
Montréal (Québec) H4Z 1G3
Telephone: 514-940-2199 ext 2511
Fax: 514-864-6381
e-mail: consultation-en-cours@lautorite.qc.ca

A diskette containing the submissions should also be submitted. As securities legislation in certain provinces requires a summary of written comments received during the comment period be published, confidentiality of submissions cannot be maintained.

Questions may be referred to:

Serge Boisvert
Analyste en réglementation
Direction de la supervision des OAR
Autorité des marchés financiers
514-395-0558 poste 4358
serge.boisvert@lautorite.qc.ca

Randee Pavalow
Director, Capital Markets
Ontario Securities Commission
(416) 593-8257
rpavalow@osc.gov.on.ca

Maxime Paré
Senior Legal Counsel, Market Regulation
Capital Markets
Ontario Securities Commission
(416) 593-3650
mpare@osc.gov.on.ca

Emily Sutlic
Legal Counsel, Market Regulation
Capital Markets
Ontario Securities Commission
(416) 593-2362
esutlic@osc.gov.on.ca

Shaun Fluker
Legal counsel
Alberta Securities Commission
(403) 297-3308
shaun.fluker@seccom.ab.ca

Sandy Jakab
Manager, Policy
Capital Markets Regulation
British Columbia Securities Commission
(604) 899-6869
sjakab@bcsc.bc.ca

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