CSA/ACVM Canadian Securities Administrators Autorités canadiennes en valeurs mobilières

Notice and Request for Comments:

Draft *Regulation to amend Regulation 24-101 respecting Institutional Trade Matching and Settlement* and Draft Amendments to *Policy Statement to Regulation 24-101 respecting Institutional Trade Matching and Settlement*

CSA Consultation Paper 24-402 *Policy Considerations for Enhancing Settlement Discipline in a T+2 Settlement Cycle Environment*

August 18, 2016

Part I. Introduction

The Canadian Securities Administrators (the **CSA** or **we**) are publishing for comment (the **Proposed Revisions**) a draft *Regulation to amend Regulation 24-101 respecting Institutional Trade Matching and Settlement* (**Regulation**) and draft Amendments to *Policy Statement to Regulation 24-101 respecting Institutional Trade Matching and Settlement* (**Policy Statement**) (collectively, the Regulation and Policy Statement are referred to as **Regulation 24-101**).

Some of the Proposed Revisions amend the Regulation and change the Policy Statement in anticipation of shortening the standard settlement cycle for equity and long-term debt market trades in Canada from three days after the date of a trade (**T+3**) to two days after the date of a trade (**T+2**). The move to a T+2 settlement cycle is expected to occur on September 5, 2017, at the same time as the markets in the United States move to a T+2 settlement cycle. The other Proposed Revisions are intended to clarify or modernize certain provisions of Regulation 24-101.

The text of the draft Regulation and Policy Statement is published with this notice and will also be available on websites of CSA jurisdictions, including:

www.lautorite.qc.ca
www.albertasecurities.com
www.bcsc.bc.ca
www.gov.ns.ca/nssc
www.nbsc-cvmnb.ca
www.osc.gov.on.ca
www.fcaa.gov.sk.ca
www.msc.gov.mb.ca

Concurrently with this Notice, we are also publishing CSA Consultation Paper 24-402 *Policy Considerations for Enhancing Settlement Discipline in a T+2 Settlement Cycle Environment* (**Consultation Paper**). The Consultation Paper provides an overview of existing settlement discipline measures in the Canadian equity and debt markets. It raises certain policy considerations for addressing the risk that the transition to a standard T+2 settlement cycle may increase settlement failures in our markets. We discuss potential measures to enhance settlement discipline, specifically in relation to Regulation 24-101. We are seeking stakeholder views on the Consultation Paper. Any proposal to adopt measures arising from the Consultation Paper, including a proposal to further amend Regulation 24-101, would require another public comment process. The Consultation Paper is published with this notice.

We are publishing for comment for 90 days this Notice, the Proposed Revisions and the Consultation Paper. The comment period will expire on November 16, 2016. See below under "7. Comment process" of Part IV.

Part II. Background to, and purpose of Proposed Revisions

1. Introduction to Regulation 24-101

Regulation 24-101 came into force in 2007 and was developed largely to encourage more efficient and timely pre-settlement confirmation, affirmation, trade allocation and settlement instructions processes for institutional trades in Canada, otherwise described in this Notice as institutional trade matching (**ITM**).

Registered dealers and advisers trading on a DAP/RAP basis for or with an institutional investor must have ITM policies and procedures designed to match a *DAP/RAP trade* as soon as practical after the trade is executed, but no later than noon on T+1 (**ITM deadline**).[1] In addition, registered firms are required to complete and file exception reports on Form 24-101F1 if they did not meet, with respect to their institutional trades, the ITM threshold of 90 percent (**ITM threshold**) of trades by value and volume matched by the ITM deadline during a calendar quarter. Clearing agencies (in particular, CDS Clearing and Depository Services Inc. (**CDS**)) and matching service utilities (**MSUs**) are required to submit quarterly data on the matching of institutional equity and debt trades of their participants or users.

For more background information on Regulation 24-101, including its history and regulatory objective, please see the Consultation Paper being published concurrently with this Notice.

2. Migration to T+2 settlement cycle

The Canadian securities industry is preparing for the migration to a standard T+2 settlement cycle on September 5, 2017, at the same time as the industry in the United States is moving to T+2. For further information on the move to a T+2 settlement cycle, please see the Consultation Paper being published concurrently with this Notice.

For a successful migration to T+2 settlement, registered firms and other capital market stakeholders will need to review and change, as required, their current clearing and settlement procedures and internal operations and processes. In addition, self-regulatory organizations, marketplaces and clearing agencies will need to change various rules and procedures that specifically mandate a three day settlement cycle, that are keyed to the settlement date and require pre-settlement actions, or that generally facilitate the prompt clearance and settlement of trades.[2] While Regulation 24-101 does not expressly mandate a T+3 settlement cycle, nor would currently prevent the T+2 migration, there are a number of provisions that require revision to facilitate the move to a T+2 settlement cycle.

3. General reform of Regulation 24-101

We are proposing to update the Regulation to reflect certain developments since it came into force in 2007, as well as clarify certain existing provisions. One major development in the Canadian markets since 2007 is the significant rise in the trading of exchange-traded mutual funds (**ETFs**). We also propose to revise the existing requirements applicable to a MSU's systems and business continuity planning.

Part III. Summary of the Proposed Revisions

Section 1 of this Part explains our Proposed Revisions in anticipation of the transition to a T+2 settlement cycle. While we are not proposing any amendments to the ITM deadline or ITM threshold at this time, in the Consultation Paper we discuss potential substantive changes to Regulation 24-101 and other measures that we might consider to increase the likelihood of timely settlement, and we ask specific questions on such potential changes.

Section 2 of this Part describes modernizing and clarifying amendments to the Regulation (including the Forms) and Policy Statement. Minor amendments to modernize and clarify the Regulation, Forms and Policy Statement are not discussed.

We welcome comments from stakeholders on all aspects of such amendments.

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[1] See subsections 3.1(1) and 3.3(1) of the Regulation. A DAP/RAP trade is a trade in a security executed for a client account that permits settlement on a delivery against payment or receipt against payment basis through the facilities of a clearing agency, and for which settlement is completed on behalf of the client by a custodian other than the dealer that executed the trade. See the definition "DAP/RAP trade" in section 1.1 of the Regulation.

[2] On July 28, 2016, the Investment Industry Regulatory Organization of Canada (**IIROC**) published for comment proposed amendments to IIROC's Universal Market Integrity Rules, Dealer Member Rules, and Form 1 to facilitate the investment industry's move to T+2 settlement. See IIROC Notice 16-0177 *Amendments to facilitate the investment industry's move to T+2*, at: http://www.iiroc.ca/Documents/2016/24152644-66ce-4ef2-a1ac-d9403540656e_en.pdf.

1. Proposed Revisions as a result of T+2 migration

a) References to "T+3"

While the primary focus of the Regulation is on having ITM policies and procedures to match trades no later than noon on T+1, Regulation 24-101 contains a number of references to T+3. They can be found in the definitions section of the Regulation (section 1.1), the Forms 24-101F2 and F5, and Part 5 of the Policy Statement. We propose to remove these references or replace them with "T+2".

b) Non-North American trades

The Regulation permits matching to occur no later than noon on T+2 if the DAP/RAP trade results from an order to buy or sell securities received from an institutional investor whose investment decisions or settlement instructions are usually made in and communicated from a geographical region outside of the North American region (**non-North American trades**).[3]

We are proposing to repeal the provisions that extend the ITM deadline to noon on T+2 for non-North American trades. In our view, these provisions are no longer appropriate in a standard T+2 settlement environment. The extended deadline of noon on T+2 for non-North American trades leaves insufficient time to solve problems and avoid failed trades; instead, parties need to match earlier on T+1 regardless of the cross-border nature of the trade, so that they have time to address issues and avoid failed trades. This might require improving processes in order to match on T+1, but the move to a T+2 settlement cycle will align the securities settlement cycle in Canada with the settlement cycles of most of the major foreign markets, including the U.S. and Europe. While several of the complexities with foreign investment or cross-border transactions will continue to exist,[4] market participants will need to review their internal operations and adapt their ITM policies and procedures accordingly to meet the current ITM deadline of noon on T+1. This is consistent with the need for market participants to align their policies and procedures to meet the standard settlement in the U.S., Europe and other T+2 jurisdictions.

2. Proposed Revisions to clarify or modernize Regulation 24-101

a) Application to ETFs

The Regulation does not currently apply to a trade in a security of a mutual fund to which *Regulation 81-102 respecting Investment Funds* (**Regulation 81-102**) applies.[5] Mutual fund trades were originally carved out of the Regulation because traditional purchase and redemption transactions in mutual fund securities were not cleared and settled through the facilities of a clearing agency such as CDS. However, because ETFs are mutual funds and therefore subject to Regulation 81-102, ETF securities that are bought and sold generally just like any other stock on the secondary markets and settled on a DAP/RAP basis through the facilities of CDS, are not subject to Regulation 24-101.

From a policy perspective, we are of the view that a secondary-market trade in an ETF security that settles on a DAP/RAP basis through the facilities of CDS should be subject to the Regulation, particularly the trade matching requirements of the Regulation (Parts 3 and 4). Such trades bring the same risks to our markets and the clearing and settlement infrastructure that serves such markets as any other trade in equity or fixed-income securities. In addition, non-redeemable investment funds that trade on a marketplace and settle on a DAP/RAP basis through CDS are currently subject to the Regulation. We are of the view that all investment funds that are traded on a marketplace should be treated in the same way under the Regulation. Currently, CDS includes ETF trades in the calculation of the aggregate number and value of equity DAP/RAP trades entered and matched at CDS, as part of its reporting of ITM data under Regulation 24-101. Consequently, we believe that registered firms' ITM policies and procedures should not be materially impacted by the inclusion of ETF trades into the ITM requirements.

We are proposing to amend paragraph (f) of section 2.1 of the Regulation by clarifying that the Regulation does not apply to a trade to which Part 9 or 10 of Regulation 81-102 applies. Part 9 governs purchases of securities of a mutual fund from the mutual fund, and Part 10 governs redemptions of investment fund securities. Moreover, the Policy Statement and forms are being amended to clarify that DAP/RAP trades in ETFs are to be included in the exception reports under Form 24-101F1 by registered firms as "equity" DAP/RAP trades, and not as "debt" DAP/RAP trades.

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[3] See subsections 3.1(2) and 3.3(2). "North American region" means Canada, the United States, Mexico, Bermuda and the countries of Central America and the Caribbean. See section 1.1.

[4] Such complexities include communication lags, structural challenges, currency differences, mismatches in global settlement cycles, and time zone issues.

[5] See paragraph (f) of section 2.1.

b) Clearing agency

In the Regulation, "clearing agency" is defined as a recognized clearing agency in certain CSA jurisdictions, which, in 2007, seemed appropriate as CDS was the only recognized clearing agency at the time. Since 2007, CSA jurisdictions have recognized a number of additional clearing agencies operating in Canada that perform a wide variety of clearing and settlement services, which differ from, and may be broader than, the securities settlement services performed by CDS.[6] We propose to update the definition of the term to fit the context of the Regulation.

c) MSU systems and business continuity planning requirements

To mitigate the probability and effects of systems failures, Part 6 of the Regulation sets out requirements for an MSU governing its systems and business continuity planning. These requirements, adopted in 2007, were based on similar regulatory requirements applicable at the time to marketplaces, information processors and clearing agencies. Such similar provisions have since been modernized and updated so that they continue to be effective in helping ensure that systems are reliable, robust and have adequate controls. Because MSUs play an important infrastructure role in the clearing and settlement of securities transactions,[7] we propose requiring MSUs to follow existing IT practices for technology service providers.

Consequently, we are proposing to update the provisions of section 6.5 of the Regulation to mirror the provisions found in other rules applicable to marketplaces, information processors, clearing agencies and trade repositories, such as those found in *Regulation 21-101 respecting Marketplace Operation* and *Regulation 24-102 respecting Clearing Agency Requirements*. See new sections 6.6 to 6.8 of the Regulation, revised Form 24-101F3 *Matching Service Utility – Notice of Operations*, and sections 4.5 to 4.8 of the Policy Statement. These include new requirements to ensure that, from a systems perspective, the launching of a new MSU or material changes made to an MSU's technology requirements are conducted according to prudent business practices and are implemented so that MSU users and service vendors have a reasonable opportunity to adapt to these changes. An MSU beginning operations or making a material change to its systems can negatively impact many other parties if these actions are not carried out in a careful manner.

d) Amendments to Form 24-101F1 *Registered Firm Exception Report of DAP/RAP Trade Reporting and Matching*

To avoid the quarterly exception reporting requirement in Part 4 of the Regulation, a registered firm must have matched during a calendar quarter at least 90 percent of its DAP/RAP trades by volume or value by noon on T+1. Form 24-101F1 (**Form F1**) should only be submitted for DAP/RAP trades for the type of security (equity or debt) that did not meet the 90 percent threshold by the relevant timeline. If a registered firm does not meet the threshold for both equity and debt DAP/RAP trades, then it should submit **Form F1** for both equity and debt DAP/RAP trades (i.e., by completing both tables in Exhibit A of **Form F1**). If the firm does not meet the threshold only for one type of security (i.e., for equity but not debt, or for debt but not equity), it should only submit **Form F1** for the one type of security, by completing only one of the tables in Exhibit A of **Form F1**. As noted above, a DAP/RAP trade in an ETF security should be reported as an equity DAP/RAP trade, and not as a debt DAP/RAP trade. We are proposing amendments to **Form F1** and Policy Statement to clarify this approach to completing **Form F1**.

Part IV. Other Matters

1. Authority for Regulation

In those jurisdictions in which amendments to the Regulation will be adopted, securities legislation provides the securities regulatory authority with authority in respect of the subject matter of the Regulation.

2. Alternatives considered to the Proposed Revisions

The alternative to the Proposed Revisions would be not to proceed with making amendments to the Regulation or changes to the Policy Statement to facilitate the move to T+2 settlement or to clarify or update provisions in the Regulation that are unclear or outdated. Not proceeding with the T+2 related Proposed Revisions would generally be inconsistent with the desire to facilitate the move to T+2. In addition, without the proposed amendments to clarify and update the Regulation, there would be less certainty and clarity with respect to the application and interpretation of Regulation 24-101. Moreover, not updating the MSU systems and business

[6] See, for example, in Québec: http://www.lautorite.qc.ca/en/clearing-houses.html.
[7] See ss. 4.1(2) of the Policy Statement.

continuity planning requirements could have adverse consequences to our markets. See discussion below under "4. Anticipated costs and benefits".

3. Unpublished materials

In proposing revisions to the Regulation and Policy Statement, we have not relied on any significant unpublished study, report, or other material.

4. Anticipated costs and benefits

As noted above, not proceeding with the T+2 related Proposed Revisions would generally be inconsistent with the desire to facilitate the move to T+2. See the Consultation Paper, which discusses the importance of ensuring that the transition in Canada to a standard T+2 settlement cycle occurs simultaneously with the move to T+2 by the securities industry in the United States. Also, the Proposed Revisions to clarify and update the Regulation would bring more certainty and clarity with respect to the application and interpretation of Regulation 24-101. In addition, updating the MSU systems and business continuity planning requirements will promote more reliable and robust MSU controls and is consistent with requirements imposed on other market infrastructures that pose similar risks to the integrity of Canadian capital markets. The failure of an MSU's systems could have wide-reaching and unintended consequences.

5. CSA Staff Notice 24-305

If the Proposed Revisions are made following the comment process, CSA Staff intend to update and republish CSA Staff Notice 24-305 *Frequently Asked Questions About Regulation 24-101 respecting Institutional Trade Matching and Settlement and Related Policy Statement.*

6. Effective date for Proposed Revisions

If the Proposed Revisions are made following the comment process, all of the Proposed Revisions will be brought into force or, in respect of the Policy Statement, be adopted as of September 5, 2017.

7. Comment process

Please submit your comments in writing on or before November 16, 2016. If you are not sending your comments by email, please include a CD containing the submissions. Address your submission to the following CSA member commissions:

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

Please deliver your comments only to the addresses that follow. Your comments will be forwarded to the remaining CSA member jurisdictions.

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The Secretary
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20 Queen Street West, 22nd Floor
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Fax: 416-593-2318
E-mail: comments@osc.gov.on.ca

Please note that comments received will be made publicly available and posted on the Websites of certain CSA jurisdictions. We cannot keep submissions confidential because securities legislation requires that a summary of the written comments received during the comment period be published. In this context, you should be aware that some information which is personal to you, such as your e-mail and address, may appear in the websites. It is important that you state on whose behalf you are making the submission.

Questions with respect to this Notice, the Proposed Revisions, and the Consultation Paper may be referred to:

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