Canadian Securities Administrators | Autorités canadiennes en valeurs mobilières

CSA Notice of publication

Adoption of a T+2 Settlement Cycle for Conventional Mutual Funds

Regulation to amend Regulation 81-102 respecting Investment Funds

August 31, 2017

Introduction

The Canadian Securities Administrators, other than the British Columbia Securities Commission[1] and the Financial and Consumer Affairs Authority of Saskatchewan[2], (the **CSA** or **we**) are adopting *Regulation to amend Regulation 81-102 respecting Investment Funds* (**Regulation to amend Regulation 81-102**) and, consequentially, *Regulation to amend Regulation 81-104 respecting Commodity Pools* (**Regulation to amend Regulation 81-104**) to shorten the standard settlement cycle for conventional mutual funds[3] from three days after the date of a trade (**T+3**) to two days after the date of a trade (**T+2**) (the **Amendments**).

This notice also provides guidance to conventional mutual funds regarding their expected adoption of a T+2 settlement cycle in light of the adoption of a T+2 settlement cycle in equity and long-term debt markets.

In some jurisdictions, government ministerial approvals are required for the implementation of the Amendments. Provided all necessary approvals are obtained, we expect the amendments will come into force on November 14, 2017 (see *Effective Date of the Amendments* below).

Background

On April 27, 2017, we published Draft Regulation to amend Regulation 81-102 and Draft Regulation to amend Regulation 81-104 for a 90-day public comment period (collectively, the **Draft Amendments**).

We received two comment letters on the Draft Amendments. The list of the commenters is attached in Annex A to this Notice. We have considered the comments received, and thank all commenters for their submissions. We provide a summary of the comments on the Draft Amendments, together with the CSA's responses, in Annex B to this Notice.

The Amendments are substantially the same as the Draft Amendments.

Substance and Purpose

On September 5, 2017, markets in the United States are expected to move to a T+2 settlement cycle. As it is in the public interest for Canadian market participants to match U.S. settlement cycles, the CSA published on April 27, 2017 a CSA Notice of publication, *Regulation to amend Regulation 24-101 respecting Institutional Trade Matching and Settlement* (**Regulation 24-101**) (the **Regulation 24-101**

[1] The British Columbia Securities Commission did not publish the Proposed Amendments for comment, although staff anticipates doing so in the near future, after obtaining necessary approval.
[2] The Financial and Consumer Affairs Authority of Saskatchewan will advise of their approach in this matter after the provincial by-election in Saskatchewan on September 7, 2017.
[3] A conventional mutual fund is a mutual fund that offers securities in continuous distribution under a simplified prospectus in accordance with *Regulation 81-101 respecting Mutual Fund Prospectus Disclosure*.

Amendments) that will harmonize settlement cycles to T+2 in Canada for equity and long-term debt markets to coincide with the adoption of a T+2 settlement cycle in the United States. Please see *CSA Notice of publication, Regulation to amend Regulation 24-101 respecting Institutional Trade Matching and Settlement and Amendments to Policy Statement to Regulation 24-101 respecting Institutional Trade Matching and Settlement* published on April 27, 2017.

A trade in a security of a conventional mutual fund is not subject to Regulation 24-101. However, the underlying equity and long-term debt securities owned by conventional mutual funds are subject to Regulation 24-101 and will settle at T+2.

Under *Regulation 81-102 respecting Investment Funds* (**Regulation 81-102**), conventional mutual fund settlement must follow the requirements below (the **Current Requirements**):

- cash received by a dealer or principal distributor for payment of a mutual fund security must be forwarded to the order receipt office of the mutual fund *as soon as practicable* and in any event no later than the third business day after the pricing date (subsection 9.4(1) of Regulation 81-102);
- payment of the issue price of a security must be made on or before the third business day after the pricing date (subsection 9.4(2) of Regulation 81-102);
- in the event that payment is not received by the third business day after the pricing date of the security, the mutual fund must redeem the securities to which the purchase order pertains as if it had received an order for the redemption of the securities on the fourth business day after the pricing date or on the date the mutual fund first knows that the method of payment will not be honoured (subsection 9.4(4) of Regulation 81-102); and
- a mutual fund must pay the redemption proceeds for securities once a redemption order has been received within three business days after the date of calculation of the net asset value per security used in establishing the redemption price (subsection 10.4(1) of Regulation 81-102).

We note that this language is broad enough to permit conventional mutual funds to adopt a T+2 settlement cycle as of September 5, 2017 and prior to the coming into force of the Amendments.

Guidance on the transition to a T+2 settlement cycle

Given that the standard settlement cycle for equity and long-term debt market trades in Canada is being shortened from T+3 to T+2, we are of the view that conventional mutual funds must adopt a T+2 settlement cycle on the coming into force of the Regulation 24-101 Amendments, currently expected on September 5, 2017.

Summary of the Amendments

The Amendments amend sections 9.4 and 10.4 of Regulation 81-102 to remove references to a T+3 settlement cycle and replace them with references to a T+2 settlement cycle. The Amendments also amend paragraph 9.4(4)(a) of Regulation 81-102 to require a mutual fund, in the case where payment of the issue price of the securities has not been received, to redeem the securities on the third business day after the pricing date, instead of the fourth. Furthermore, a consequential amendment is made to section 6.3 of Regulation 81-104 to harmonize it with the amended section 10.4 of Regulation 81-102.

Effective date of the Amendments

We expect the Amendments will come into force on November 14, 2017, subject to obtaining ministerial approvals in certain CSA jurisdictions. Given prescribed timelines necessary to obtain ministerial approval, November 14, 2017 is the earliest date on which the Amendments can come into force.

Markets in Canada and the United States are expected to transition from a T+3 settlement cycle to a T+2 settlement cycle on September 5, 2017. The Regulation 24-101 Amendments will come into force concurrently with the date the United States transitions to a T+2 settlement cycle. However, while remote, it is possible that this target date may be deferred if certain regulatory and industry contingencies are not covered on time, which would delay the market transition to a T+2 settlement cycle and postpone the coming into force of the Regulation 24-101 Amendments. As a result, while we have specified November 14, 2017 as the earliest date when the Amendments will become effective, the Amendments contain language that will allow for the effective date to be postponed in order to match any delay of the coming into force of the Regulation 24-101 Amendments should it happen after November 14, 2017.

Local Matters

Certain jurisdictions are publishing other information required by local securities legislation with this Notice.

Annexes

This Notice includes the following Annexes:

- Annex A: List of Commenters
- Annex B: Summary of comments on the Draft Amendments and CSA responses

Questions

Please refer your questions to any of the following CSA staff:

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Where to find more information

The text of the Amendments is published with this Notice and will also be available on websites of CSA jurisdictions, including:

www.albertasecurities.com
www.mbsecurities.ca
www.osc.gov.on.ca
www.lautorite.qc.ca
www.fcnb.ca
nssc.novascotia.ca

ANNEX A
LIST OF COMMENTERS

1. Canadian Capital Markets Association
2. Osler, Hoskin & Harcourt LLP

ANNEX B
SUMMARY OF COMMENTS ON THE DRAFT AMENDMENTS AND CSA RESPONSES

1. Theme/question	2. Summary of comments	3. General responses
General		
Support for T+2 amendments	One Commenter expressed support for the rule amendments to confirm two-day settlement for conventional mutual funds. The Commenter also expressed appreciation for the CSA's work to support the adoption of the transition to T+2 and for providing guidance to those manufacturing and distributing conventional mutual funds on the regulatory expectation that these entities will adopt a T+2 settlement cycle.	We acknowledge and thank the Commenter for its remarks.
Implementation	One Commenter recommended that the amendments to Regulation 81-102 relating to the transition to a T+2 settlement cycle by conventional mutual funds be implemented as quickly as possible and ideally before September 5, 2017. If this is not possible, the Commenter advised that it should be as soon as possible thereafter, with the clear understanding that the guidance communicates the regulatory expectation that conventional mutual funds transition to a T+2 settlement cycle on September 5, 2017.	Staff included guidance in the Notice and Request for Comment published on April 27, 2017 that the regulatory expectation was that conventional mutual funds adopt a T+2 settlement cycle on September 5, 2017 and have reiterated that guidance in this Notice. The amendments will come into force on November 14, 2017 or, in the event that the amendments made to Regulation 24-101 come into force after November 14, 2017, the date on which such amendments come into force.
Exposure to markets remaining on a T+3 settlement cycle	One Commenter expressed concern that the draft amendments could create compliance and liquidity challenges for Funds that have exposure to markets remaining on a T+3 settlement cycle, such as Japan, Brazil, the Philippines, Indonesia, and Singapore, once the draft amendments come into force. The Commenter submitted that if a fund with significant investments in markets remaining on a T+3 settlement cycle were to receive a	Staff note that in accordance with section 2.6 of Regulation 81-102, a conventional mutual fund may borrow up to 5 percent of its net asset value in order to accommodate requests for the redemption of securities of the mutual fund. Furthermore, Staff would be prepared to consider appropriate exemptive relief in cases where conventional mutual funds hold a large portion of their net assets in jurisdictions in which securities will trade on a T+3 settlement cycle.

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	redemption request requiring it to liquidate securities in order to satisfy the redemption request, it may not be possible to raise sufficient cash to pay out the redemption proceeds by T+2. The Commenter also commented that index funds must generally trade in proportion to the index being tracked and therefore cannot raise cash by simply liquidating securities in other markets that settle within T+2. The Commenter suggested that this would result in funds maintaining higher cash balances than would otherwise be required in order to satisfy redemption requests and, in the case of index funds, will result in increased tracking error to the fund's index. The Commenter recommended that the draft amendments be revised to include transition relief to permit a fund to continue to complete redemption transaction on a T+3 basis if the fund invests a substantial portion of its assets in securities traded only in markets that continue to remain on a T+3 settlement cycle.	We note that the global trend is towards T+2 settlement. Staff is also of the view that investors will find it very difficult to manage a portfolio of mutual funds that could have differing settlement periods.