CSA Notice 24-301 Responses to Comments Received on Discussion Paper 24-401 on Straight-through Processing, Proposed National Instrument 24-101 Post-trade Matching and Settlement, and Proposed Companion Policy 24-101CP to National Instrument 24-101 Post-trade Matching and Settlement

CANADIAN SECURITIES ADMINISTRATORS

NOTICE 24-301

RESPONSES TO COMMENTS RECEIVED ON DISCUSSION PAPER 24-401 ON STRAIGHT-THROUGH PROCESSING, PROPOSED NATIONAL INSTRUMENT 24-101 POST-TRADE MATCHING AND SETTLEMENT, AND PROPOSED COMPANION POLICY 24-101CP TO NATIONAL INSTRUMENT 24-101 POST-TRADE MATCHING AND SETTLEMENT

Introduction

On April 16, 2004, the Canadian Securities Administrators (the CSA or we) published for comment the following documents (collectively, STP Release):[1]

- Discussion Paper 24-401 on Straight-through Processing and Request for Comments (Paper)
- Proposed National Instrument 24-101 — *Post-Trade Matching and Settlement* (National Instrument)
- Proposed Companion Policy 24-101CP — To National Instrument 24-101 — *Post-Trade Matching and Settlement* (Companion Policy)

The CSA published the STP Release to: (a) acknowledge the importance of post-execution functions; (b) advance the industry discussions on straight-through processing (STP); and (c) build upon previous initiatives to improve the securities clearing and settlement system in the Canadian capital markets. The Paper described the industry-wide STP efforts and proposed CSA regulatory measures to address inefficiencies in certain clearing and settlement and post-settlement processes. The topics addressed in the STP Release include: (i) the post-execution, pre-settlement process for institutional trades in Canada, particularly the *confirmation and affirmation* process; (ii) the process of disseminating entitlement information on publicly traded securities (also known as *corporate actions*); (iii) entitlement payments made by issuers or offerors (such as dividend, interest, redemption, repurchase or take-over bid payments) to the clearing agency in funds that are not *same-day final* funds; (iv) the

[1] See (2004) 27 OSCB 3971 to 4031.

post-execution processing of investment fund transactions in the context of the *client name* business model as compared to the *nominee name* business model; (v) the processing of securities lending transactions; and (vi) the continued use of physical securities in connection with the settlement of transactions in publicly traded securities.

Because the CSA and the industry, through the Canadian Capital Markets Association (CCMA), identified the confirmation and affirmation—or matching—process for institutional trades as the most pressing STP initiative, we published for comment the proposed National Instrument and Companion Policy. Generally, the proposed National Instrument requires that, as of July 1, 2005, institutional trades be matched as soon as practicable after a trade is executed and in any event no later than the close of business on trade date (or T). In addition, dealers and advisers would be required to enter into a *trade matching compliance agreement* before allowing an institutional client to trade with delivery-versus-payment / receive-versus-payment (DVP/RVP) privileges. Under the National Instrument, the CSA also proposed to adopt a general settlement cycle rule of *trade date plus three* (T+3) and a *good delivery* rule.

This Notice provides an update on industry and regulatory STP developments and a summary of the comments received on the STP Release. The Notice also discusses the CSA process going forward. The CSA remain committed to supporting an institutional trade-matching (ITM) rule in force by January 1, 2006, but intend to pursue this objective through a co-operative approach with the self-regulatory organizations (SROs) that also have an interest in establishing ITM requirements. Our objective is to have the appropriate rule or rules finalized by December 31, 2005.

Recent Developments

A. Industry Developments

- *Capco Study*

Partly in response to a November 2003 letter from the CSA asking the CCMA to identify the key tasks in the critical path to STP, the CCMA commissioned Capital Markets Company (Capco) to assess the readiness of the Canadian capital markets to achieve industry-wide STP and a standard settlement cycle of *trade date plus one* (T+1). Capco was asked to compare efforts in Canada with U.S. efforts, and recommend the critical path for Canada to align its efforts with the United States. Some of the key findings from the Capco report[2] include the following:

- The institutional market is the key area on the critical path—it is the market most subject to global competitive forces, with multiple dispersed market participants.

[2] The Capco report is entitled “Assessment of Canada’s STP/T+1 Readiness and a Comparison of Canada’s vs. United States’ T+1 Readiness—STP/T+1 Readiness Assessment Report for Canada,” July 12, 2004 (Final), available on the CCMA’s Web site at www.ccma-acmc.ca.

- Retail trade processing, securities lending, dematerialization or immobilization, as well as the centralized entitlements notification hub were not deemed to be on the critical path.

Capco assessed Canada to be approximately 14 months behind the U.S. in terms of STP/T+1 readiness. The primary component of this gap is in the institutional trade processing area.[3] Capco listed a number of key activities to progress toward STP and the eventual shortening of the settlement cycle. The list includes the need for the Canadian market to agree on the entity that will supply the governance necessary to mobilize and lead efforts in Canada toward STP and T+1 readiness, with a strong program management office and appropriate budget and resources. It also includes the need to foster common action—including through an ITM rule—to jumpstart improvements in institutional trade processing, as well as other "enablers" of STP and T+1, such as standardized entitlement reporting.

- *Change of CCMA Focus and Governance Structure*

The CCMA decided to realign its priorities and focus its efforts on the institutional trade processing area. Based in part on the results of the Capco study, the CCMA felt that achieving institutional trade matching on T, through a phased-in approach, would be the area of greatest benefit for the Canadian marketplace.[4] As a result of this new focus, the CCMA reshaped its committee structure by folding a number of the working groups and creating an Institutional Program Steering Committee (IPSC). The IPSC will oversee six new subcommittees to address the various components for achieving institutional trade matching, including a Buy-Side Subcommittee and a Custodian/Broker Subcommittee. Desiring to maintain the momentum achieved in other areas, certain industry organizations have, according to the CCMA, stepped forward to carry on the efforts of the disbanded CCMA working groups:

- the Canadian Depository for Securities Limited (CDS) has undertaken to continue the efforts of the Corporate Actions Working Group to establish an entitlements reporting hub;
- the Securities Transfer Association of Canada (STAC) has assumed the Dematerialization Working Group's work program going forward; and
- the Investment Funds Institute of Canada and FundSERV Inc. are considering taking on some of the Retail Trade Working Group's initiatives within their respective purviews.[5]

- *Identification of Critical Path*

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[3] Capco's report says that this is due primarily to the following factors: the U.S. has long had a system connecting the four key parties to an institutional trade (broker-dealer, investment manager, custodian and depository) and widely used Standing Settlement Instructions (SSI) databases. As well, the SRO rules in the U.S. mandate how and when confirmation/affirmation occurs. Canada has no equivalent system linking all four parties, no widely used SSI database, no confirmation/affirmation rule that is effectively enforced, and a relatively low affirmation rate on trade date compared with the current U.S. rate.

[4] See CCMA News Release, October 12, 2004, "CCMA to Focus on Institutional Trade Matching to Enhance the Competitiveness of Canada's Capital Markets Globally;" and *CCMA News*, Vol. 21, October 22, 2004; available on the CCMA's Web site at www.ccma-acmc.ca.

[5] *CCMA News*, Vol. 21, October 22, 2004, at p. 2.

In revising its governance structure, the CCMA is in the process of employing a chief executive officer and has employed a project manager to provide increased resources and professional project management expertise for its efforts to move the industry toward STP. While a work plan has been developed, a detailed critical path has not been prepared at this time.

B. Regulatory Developments

- *Second CSA Survey*

The CSA undertook in 2004 a second *STP Readiness Assessment Survey* to determine the progress made by market participants towards achieving STP. The survey was nearly identical to the 2003 survey except for slight modifications to some questions and the elimination of two questions. A total of 532 registrants completed the 2004 survey.[6] The main conclusions arising from the survey are as follows:

- There continues to be a low commitment to investment, planning and resource allocation to the STP initiative;
- While large firms are making progress, small firms are still unsure of the implications for their organizations;
- While there is an increase in the degree of automation, there is still a significant amount of manual processing for post-execution trade processing activities;
- The proportion of exceptions (mistakes) in transactions has increased from 2003 to 2004; and
- The top three issues that appear to impede STP are: uncertainty about outside vendors' plans; a low sense of urgency; and a lack of standards driving minimum requirements.

- *LVTS Working Group*

At the urging of the heads of financial regulatory agencies in Canada,[7] a working group (LVTS working group) comprising staff from CDS, the Bank of Canada, Canadian Payments Association (CPA), Ontario Securities Commission (OSC), and Autorité des marchés financiers (Québec) was struck in April 2004 to find ways to require or encourage issuers and their agents that are still using cheques to make entitlement payments to CDS for distribution to CDS participants, to instead use the *Large Value Transfer System* (LVTS). While this entitlement payments issue is not perceived to have a systemic risk impact on our markets, the regulatory agencies have concerns with the effect that the continued use of cheques to make entitlement payments could have on the efficiency and competitiveness of our capital markets. As discussed in the Paper,

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[6] See CSA Staff Notice 33-312 - *The CSA STP Readiness Assessment Survey Report is Now Available on the OSC Website*, (November 5, 2004) 27 OSCB 8953; CSA Staff Notice 33-308 - *The CSA STP Readiness Assessment Survey Report (Survey Report) is Now Available on the OSC Web Site,* (September 19, 2003) 26 OSCB 6429; and CSA Staff Notice 33-309 - *The CSA STP Infrastructure Survey Report is Now Available on the OSC Web Site*, (December 19, 2003) 26 OSCB 8149. These notices, the survey reports and other related notices and news releases are available on the OSC Web site at http://www.osc.gov.on.ca.

[7] The heads of certain financial regulatory agencies in Canada meet periodically to discuss key issues regarding our financial markets. They include the chairs of some of the CSA jurisdictions, the Governor of the Bank of Canada, the Assistant Deputy Minister of Finance, and the Superintendent of the Office of the Superintendent of Financial Institutions (OSFI).

international standards and best practices require the use of same-day, irrevocable final funds for all payments made into a central securities depository utility like CDS. The LVTS working group has met four times to discuss alternative solutions.

The CSA support initiatives to increase the use of LVTS by issuers. The CSA propose to publish a CSA notice to all reporting issuers in Canada whose securities are immobilized with CDS. The notice would strongly encourage all reporting issuers and their transfer agents to make their entitlement payments to CDS in LVTS funds.

C. International Developments

- *SEC Concept Release*

In the Paper, we briefly discussed the March 2004 Concept Release of the United States Securities and Exchange Commission (SEC) entitled *Securities Transactions Settlement.*[8] The SEC Concept Release sought public comment on methods to improve the safety and operational efficiency of the U.S. clearance and settlement system and to help the U.S. securities industry achieve STP. A number of U.S. market participants and industry groups, including the Securities Industry Association (SIA), appear to support a regulatory mandate, phased in over a reasonable time period, to achieve institutional trade matching on T.[9] The SIA suggested in its comment letter dated June 16, 2004 that it did not believe that same-day affirmation/matching will happen without an SEC rule that obligates regulated entities to agree to trade details on trade date.[10]

The SEC has not yet published its responses to the comments, nor published any further releases directly on the issues discussed in the SEC Concept Release. However, the SEC and other U.S. regulatory agencies have been increasingly focused on improving the U.S. national clearing and settlement system. Among other things, the SEC implemented a rule in 2004 to address related settlement issues in the context of short selling transactions.[11]

- *Other International Developments*

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[8] Concept Release: Securities Transactions Settlement; Securities and Exchange Commission; 17 CFR Part 240 [Release No. 33-8398; 3449405; IC-26384; File No. s7-13-04] (SEC Concept Release). The release is available on the SEC Web site at: http://www.sec.gov/rules/concept/33-8398.htm. See *supra*, note 1, at p. 3986 for the discussion in our Paper.

[9] Comment letters on the SEC Concept Release can be found on the SEC Web site at: http://www.sec.gov/rules/concept/s71304.shtml. A number of Canadian market participants and industry groups provided comments on the SEC Concept Release, including the CCMA, CDS and STAC. The CCMA emphasized the close integration of the Canadian and U.S. capital markets and the importance of ensuring "that initiatives on both sides of the border do not work at cross-purposes and will enhance rather than impede cross-border transactions." In particular, it was suggested that any move to shorten the settlement cycle should be coordinated among the two countries.

[10] The SIA's letter explains the rationale for this view:

"Previously, the [SIA's Institutional Oversight Committee] explored the feasibility of an SRO rule that would prohibit broker-dealers from extending [DVP/RVP] privileges to any customer unless all trades with that customer are confirmed and affirmed on T+0, but determined that such a rule would place the onus of enforcement on broker-dealers who have limited control over the behavioural changes that would have to occur, particularly with respect to their buy-side customers."

[11] Regulation SHO was adopted by the SEC on June 23, 2004. See Release No. 34-50103; File No. S7-23-03. For example, Rule 203 of Regulation SHO, which is intended to address "naked" short selling in equity securities, forces clearing agency participants to close out open positions in securities that are experiencing substantial settlement failures within ten days after normal settlement date (i.e., 13 consecutive settlement days).

The Group of Thirty (G-30) announced last year the formation of a senior Monitoring Committee of industry leaders and technical experts that will conduct assessments of the implementation of the G-30's recommendations set out in its January 2003 report *Global Clearing and Settlement—A Plan of Action*.[12] The Committee will undertake periodic evaluations of progress against the recommendations and will issue a public scorecard on implementation that will identify problem areas. In July 2004, the Committee made important progress in establishing a framework to assess and report progress against the recommendations. Key organizations have agreed to take a role in promoting and monitoring progress against each of the recommendations.[13]

Improving clearing and settlement systems continues to be a major objective of the European Union (EU). The European Commission issued its second consultative Communication on securities clearing and settlement, aimed at ensuring EU securities clearing and settlement systems are efficient, safe and provide a level playing field for participants. The Communication takes into account the first and second Giovannini reports on Cross-Border Clearing and Settlement.[14]

Since July 1, 2004, the Securities and Exchange Board of India (SEBI) has been requiring all institutional trades executed on stock exchanges to be processed through its STP System. The SEBI released guidelines in May 2004 supporting an STP centralized hub, facilitating a platform for communication between different STP service providers.[15]

Summary of Comments and Responses

The comment period on the STP Release ended on July 16, 2004 and we received 26 comment letters. The list of commenters is attached as Appendix "A" to this Notice. We thank the commenters for taking the time to consider the STP Release. The comments will be useful in assisting the CSA to fine-tune its regulatory approach to STP and broader securities clearing and settlement issues.

We have provided a summary of comments received on the STP Release together with our responses in the attached table Appendix "B". We also briefly outline below our response to the issue of an ITM rule. The CSA have also received a number of technical and drafting comments on the proposed National Instrument and Companion Policy. Given our responses and the general direction that we propose to take on the matter of an ITM rule, we are not publishing a summary of, nor responding to these technical and drafting comments at this time.

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[12] See *supra*, note 1, at p. 3983-6 for a brief discussion or citations of the G-30 report in the Paper.

[13] This includes a mix of important regional committees for Europe, the Asia-Pacific and soon for North America, and key organizations with particular expertise in the each area of recommendation. As progress takes place in this complex field it will be mapped on the G-30's website, highlighting key areas where further effort is still required and enabling interested parties to target their activity. More information on the G-30's report and monitoring activities can be obtained from the G-30's website (www.group30.org).

[14] See *CCMA News*, Vol. 20, June 16, 2004, at p. 6. See *supra*, note 1, at p. 3986 for a brief discussion of the Giovannini reports in the Paper.

[15] *Ibid.*

Almost all the commenters thought the STP Release was helpful in focussing the discussion on the various clearing and settlement issues with which the industry is currently faced. Many agreed with the broad objectives of the STP Release to: (i) reduce risk in, and improve the overall efficiency of, clearing and settlement and post-settlement processes and (ii) maintain the global competitiveness of our markets.

More specifically, we received many comments on the proposed National Instrument. The majority of comments on this issue—including some from the *buy-side* community—supported a CSA ITM rule. However, almost all of these comments found it unfeasible to require institutional trade matching on T by July 1, 2005. Rather, the consensus was for an ITM rule to provide for phasing in the requirement to match institutional trades, starting with T+1 and progressively shortening the period to T when the industry is ready. Commenters felt that such incremental steps would provide market participants with an opportunity to address a number of concerns about an accelerated confirmation and affirmation process. Some of the comments also suggested that, as an alternative to exclusive CSA or SRO rules, we should consider complementary CSA and SRO rules.

We have carefully considered the comments and new developments described above. We are of the view that a rule is required to support institutional trade matching within phased-in timeframes. However, we agree that we should work with the Investment Dealers Association of Canada (IDA), other interested SROs and CDS to consider whether there should be one or more rules to require dealers and advisers to report, match and settle their trades in accordance with best practices and standards.

It is our intention to have the appropriate rule or rules in place by January 1, 2006. The regulatory solution will take into consideration who has effective jurisdiction over the different market participant groups involved in the ITM process and what are the practical methods to enforce compliance with best practices and standards (including: whether the timing of trade reporting should be subject to clearing agency penalties, price incentives or restrictions and/or additional SRO net capital requirements; the criteria for regulatory escalation; and who has responsibility for monitoring). It will also take into consideration how to ensure a viable Standing Settlement Instructions database that will be used widely by Canadian market participants.

We intend to publish the results of our discussions with the IDA, other interested SROs and CDS, including any proposed amendments to the National Instrument and Companion Policy, by the Spring of 2005.

While working with the SROs and CDS, we will continue to monitor industry efforts and liaise with industry on other issues discussed in the Paper to reassess what action may be needed in addition to those set out in our responses in Appendix “B”.

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APPENDIX "A" TO CSA NOTICE 24-301

DISCUSSION PAPER 24-401 ON STRAIGHT-THROUGH PROCESSING, PROPOSED NATIONAL INSTRUMENT 24-101 POST-TRADE MATCHING AND SETTLEMENT, AND PROPOSED COMPANION POLICY 24-101CP TO NATIONAL INSTRUMENT 24-101 POST-TRADE MATCHING AND SETTLEMENT

List of Commenters

ADP
BMO Financial Group
Canadian Capital Markets Association
The Canadian Depository for Securities Limited
CIBC Mellon
CIBC
Confident Financial Services (1969) Limited
eClientscope Inc.
E*Trade Canada Securities Corporation
Hydro-Québec
Investment Dealers Association of Canada
Mackenzie Financial Corporation
Ministère des Finances du Québec
Omgeo LLC
OMERS
Pension Investment Association of Canada—Section Québec
Peters and Co. Limited
RBC Dominion Securities Inc.
RBC Global Services
Sceptre Investment Counsel Limited
Scotiabank
State Street Trust Company Canada
Simon Romano, Stikeman Elliott LLP
TD Bank Financial Group
TSX Group Inc.
UBS Securities Canada Inc.

APPENDIX "B" TO CSA NOTICE 24-301

DISCUSSION PAPER 24-401 ON STRAIGHT-THROUGH PROCESSING, PROPOSED NATIONAL INSTRUMENT 24-101 POST-TRADE MATCHING AND SETTLEMENT, AND PROPOSED COMPANION POLICY 24-101CP TO NATIONAL INSTRUMENT 24-101 POST-TRADE MATCHING AND SETTLEMENT

Summary of Comments and Responses on Discussion Paper

Question/Theme	Summary of Comments	CSA Response
General support for the STP initiatives	A number of commenters noted that the STP Release was helpful in focusing the discussion on the various clearing and settlement issues with which the industry is currently faced. One commenter agreed with the Paper's precepts, namely, that: (i) the continued success of the Canadian capital markets depends on our market's ability to compete on the global front; (ii) STP will position the Canadian capital markets to remain globally competitive, as well as reduce firm-specific and systemic risk; and (iii) solutions for industry-wide STP must take into account the industry's characteristics, including differences in the types and sizes of market participants. One commenter stated that it is their understanding that STP for the Canadian market is a vital component of an efficient post-trade execution processing model, which helps to maintain and enhance the competitiveness of the Canadian capital markets. The commenter noted that many other markets have similar issues as the Canadian capital markets, notably: • the desire to reduce processing costs through greater processing efficiency; • the need to minimize operational, systemic and credit risk; and • the need to reduce the rate of trade reclaims and/or trade failures, particularly as transaction volumes grow. One commenter questioned the need for STP.	
Question 1 – If the CSA were to implement mandatory STP readiness certificates, what	Thirteen commenters stated that the CSA should not implement mandatory STP readiness certificates. Reasons cited include: • STP is different than Y2K (e.g. there is no perception of commonality of interest and no material systemic risk if the industry is not STP	At this time, there appears to be no need for mandatory STP readiness certificates. Nonetheless, we will continue to assess the need for mandatory readiness certificates in the

Question/Theme	Summary of Comments	CSA Response
should be the subject matter of such certificates?	ready); • the completion of an STP readiness certificate will not guarantee that the organization completing the certificate is capable of achieving the targeted results; • STP is an evolution towards end-to-end automation inside and outside the firm that will continue indefinitely. It will be virtually impossible to maintain an unambiguous definition of STP readiness; and • the potential cost and burden to market participants will not be offset by the benefits of mandatory readiness certificates. Two commenters supported the implementation of STP readiness certificates because the certificates would be helpful to determine the status of industry participants and would ensure senior management commitment to STP. One commenter advocated the use of readiness certificates in the future as Canada approaches the move to a T+1 settlement cycle, in order to ensure that all market participants will be in a position to make the adjustment from T+3 to T+1.	future.
Question 2 – Is it important to the competitiveness of the Canadian capital markets to reach STP at the same time as the U.S.? Please provide reasons for your answer. Are there any factors or challenges unique to the Canadian capital markets?	Eleven commenters agreed that it is important for the Canadian capital markets to reach T+1 at the same time as the U.S. Ten commenters stated that it is not important for the Canadian capital markets to reach industry-wide STP at the same time as the U.S. Reasons cited include: • the consequences of failing to affirm are quite different from the consequences of failing to settle; • Canada and the US should adopt similar processes and standards to maximize operational efficiencies without reaching STP; • STP can progress at a different pace as long as the settlement day remains T+3 in both countries; and • there is no evidence to suggest that a gap in STP rates (e.g. measured by trade dated and T+1 affirmation) is having a negative effect on the competitiveness of the Canadian market. Nine commenters thought that it would be important for the Canadian capital markets to reach STP at the same time as the U.S. Reasons cited include: • if the US becomes discernibly more efficient and cheaper to trade in, then Canadian dealers may be motivated to trade inter-listed securities in the	While achieving STP will help the Canadian capital markets to prepare for a shorter settlement cycle, there are no current plans to shorten the standard T+3 settlement cycle in Canada and the U.S. However, we agree that the Canadian capital markets must move to T+1 at the same time as the U.S. when that decision is made. Therefore, the STP efforts in Canada need to be reasonably in sync with U.S. efforts, particularly with respect to institutional trade processing.

Question/Theme	Summary of Comments	CSA Response
	U.S. to keep costs down; • there is an unusually short linkage between Canada and the US, therefore, Canada must remain competitive; and • if it is determined that STP is the precursor to achieving T+1, then close tracking of the U.S. progression towards STP to ultimately achieve T+1 would be beneficial.	
Question 3 – Should it be one of the CCMA's tasks to identify the critical path to reach specific STP goals? If so, what steps and goals should be included?	Twenty commenters agreed that it should be the CCMA's task to identify the critical path to reach specific STP goals. Some of the commenters made particular recommendations in this regard, such as: • the CCMA should narrow their focus and concentrate on the most pressing areas of STP (e.g. institutional trade matching—improving affirmation rates); • identify the critical paths necessary to reach specific cross-industry STP goals, including identifying transaction paths that support critical business process, real time measures of performance, trend analysis, industry benchmarks and compliance measurements; • the primary concern should not be the establishment of a critical path for each core objective but rather to identify what the regulators (e.g. the CSA, OFSI and SROs) can do from a rulemaking standpoint to assist in achieving these milestones; and • the steps and goals should be consistent with the G-30 recommendations.	We agree that the CCMA should identify the critical path to reach specific STP goals. In October 2004, the CSA sent another letter to the CCMA asking it to identify the critical path in light of the conclusions and recommendations of the Capco report. We understand that the CCMA has revised its governance structure and is in the process of employing a chief executive officer and has employed a project manager to provide increased resources and professional project management expertise for its efforts to move the industry toward STP. While a work plan has been developed, a detailed critical path has not been prepared at this time.
Question 4 – Should the CSA require market participants to match institutional trades on trade date? Would amending SRO rules to require trade matching on T be more effective than the proposed National Instrument? Is the effective date of July 1, 2005	Twelve commenters were of the view that the CSA should require market participants to match institutional trades on trade date for the following reasons: • in order to govern investment managers, as they are otherwise unregulated regarding operational matters; • trade matching on T and achieving true STP will never happen without a CSA mandate; and • a clear indication of CSA resolve to see the Canadian capital markets move to matching on T will instil a sense of urgency and imperativeness among market participants. A majority of the commenters who supported the mandating of institutional trade matching suggested that the CSA *phase in* the implementation of the proposed National Instrument and co-ordinate trade matching rules	We are of the view that a rule is required to support institutional trade matching with phased-in timeframes. We agree that the CSA should work with the IDA, other interested SROs and CDS to consider whether there should be one or more rules. It is our intention to have the appropriate rule or rules in place by December 31, 2005. The regulatory solution will take into consideration who has effective jurisdiction over the different market participant groups involved in the ITM process and what are the

Question/Theme	Summary of Comments	CSA Response
achievable?	Instrument and co-ordinate trade matching rules with other regulators (e.g. OFSI) and SROs. Six commenters thought that amending SRO rules would be more effective than the proposed National Instrument for the following reasons: • it is important to use the existing framework of SRO rules to the maximum extent possible in order to minimize changes to the existing regulatory framework and to avoid jurisdictional questions where possible; and • SRO regulation is the most effective and efficient method of achieving STP. One commenter stated that, where possible, regulation should come through the SROs, but as all market participants are not members of SROs, a non-prescriptive CSA rule could be considered to ensure industry and jurisdictional consistency. Two commenters are of the view that market participants should not be required to match institutional trades on trade date. Eighteen commenters believed that the effective date of July 1, 2005 is not achievable. One commenter was of the view that the date of July 1, 2005 is technically feasible for large and sophisticated institutional market participants and most brokers who will already be required to meet the one-hour reporting requirements under the recent IDA *broker-to-broker* trade matching rule.	practical methods to enforce compliance with best practices and standards (including: whether the timing of trade reporting should be subject to clearing agency penalties, price incentives or restrictions and/or additional SRO net capital requirements; the criteria for regulatory escalation; and who has responsibility for monitoring). It will also take into consideration how to ensure a viable Standing Settlement Instructions database that will be used widely by Canadian market participants. We intend to publish the results of our discussions with the IDA, other interested SROs and CDS, including any proposed amendments to the National Instrument and Companion Policy, by the Spring of 2005.
Question 5 – Is a *close of business* definition required? If so, what time should be designated as close of business?	Sixteen commenters agreed that a close of business definition is required. A number of commenters suggested that the designated time should be linked to the time (e.g. 7:30 p.m. Eastern time) that CDS begins to process daily trades. One commenter noted that work will be required by industry participants to establish a definition for "close of business" which satisfies a variety of issues including: service providers, depository cut-off times, time zone issues and industry standards and practices. Three commenters did not support a close of business definition because, in today's world, many financial businesses are operating on a 24-hour basis. Whatever time is chosen, individual participants will be left with a variety of deadlines to meet according to infrastructure processing cut-off times and CCMA institutional best practices and standards.	We agree that it is important to specify a cut-off time for the reconciliation of the trade details (trade matching).

Question/Theme	Summary of Comments	CSA Response
Question 6 – Should the proposed National Instrument expressly identify and require matching of each trade data element, or is it sufficient for the proposed National Instrument to impose a general requirement to match on T and rely on industry best practices and standards to address the details?	Sixteen commenters stated that it is sufficient for the proposed National Instrument to impose a general requirement to match as opposed to expressly identifying and requiring the matching of each data element. Reasons cited include: • in different markets (debt, equity) somewhat different data elements may be required and these data elements may change over time making the NI outdated; and • it is far more flexible and practical to rely on industry best practices and standards. Three commenters believed that the proposed National Instrument should expressly identify and require matching of each trade data element because defined trade elements will allow service bureaus to be consistent with their programming when reporting trades.	We agree that it is sufficient for a CSA rule to rely on industry best practices and standards to address the required data elements, provided such best practices and standards are referenced in a rule to avoid any regulatory uncertainty.
Question 7 – Should the CSA rely on the best practices and standards established by the CCMA Institutional Trade Processing Working Group (ITPWG)?	Seventeen commenters were of the view that the CSA should rely on the best practices and standards established by the CCMA ITPWG. Reasons cited include: • the best practices and standards were developed after an exhaustive public consultative process involving brokers, investment managers, custodians, depositories, transfer agents, regulators and others in Canada; and • the best practices and standards are a reasonable starting point and must continue to develop in line with international and US standards and guidelines for the effective implementation of STP in the Canadian market place.	We generally agree that the CSA should rely on the best practices and standards established by the CCMA. We propose to confirm this with the IDA and other interested SROs.
Question 8 – The CSA seek comments on the scope of the proposed National Instrument. Have we captured the appropriate transactions and	Seventeen commenters confirmed that the CSA have captured the appropriate transactions and types of securities that should be governed by the requirements to effect trade comparison and matching by the end of T and settlement by the end of T+3. A number of commenters also confirmed that the CSA have appropriately limited the rule to *public* secondary market trades. Two commenters requested clarification and/or consideration of the following: • whether segregated funds are excluded by the	We believe that a CSA rule should, at a minimum, apply to all DVP/RVP trades in CDS-depository eligible securities that currently settle on T+3 or less. Derivatives would generally not be included in the CSA rule. We will review the scope of a CSA rule with the IDA and other interested SROs, including whether trades

Question/Theme	Summary of Comments	CSA Response
types of securities that should be governed by requirements to effect trade comparison and matching by the end of T and settlement by the end of T+3? Have we appropriately limited the rule to *public* secondary market trades?	exclusion of mutual fund securities governed by National Instrument 81-102—*Mutual Funds*; • whether futures or options, which settle through CDCC, are included in the instrument's scope; and • including transactions that have been traded in Canada irrespective of where they are going to settle, or even traded outside of Canada/settled outside of Canada but with Canadian participants/clients.	executed in Canada but settled in the U.S. should be caught by the rule.
Question 9 – Is the contractual method the most feasible way to ensure that all or substantially all of the *buy side* of the industry will match their trades by the end of T?	Ten commenters were of the view that the contractual method is not the most feasible way. Reasons cited include: • not only do contractual requirements operate indirectly, but their implementation could impose costly burdens on everyone, and generate additional paperwork of the very type the CCMA is trying to reduce; • a rule applying directly to regulated entities is far more preferable then the contract method; and • the most effective way to ensure that buy side firms can meet requirements for matching on trade date is a sound business case. Six commenters were of the view that the contractual method is the most feasible way for ensuring buy side compliance. A number of commenters recommended that any contractual method include the custodian in addition to the adviser and dealer.	We are of the view that, to implement trade matching, it is necessary to require dealers to enforce an obligation to match each trade. The obligation may arise as a condition of the trade or under a trade matching compliance agreement or by other enforceable means. We will consider other alternatives to requiring a trade matching compliance agreement.
Question 10 - Should an exception to the requirement to match a trade on T be allowed when parties are unable to agree to trade details before the end of T and are required, as a result, to correct the trade data elements before	Eighteen commenters felt that an exception to the requirement to match a trade on T should be allowed. However, a number commenters suggested the following restrictions to the exception: • consideration should be given to balancing the interests of STP timelines and the legitimate resolution of errors; • the participants must notify CDS that the trade cannot match with a reason code to explain why; • should only be allowed when parties are unable to agree to the trade details before the end of trade date; • is acceptable only in the initial phases of the	As noted, we agree a rule is required to mandate institutional trade matching within phased-in timeframes, commencing with T+1 and progressively shortening the trade-matching period to T over a reasonable period of time (*intended matching date*). We agree that an exception to the requirement to match a trade on the intended matching date should be allowed when parties are unable to agree to trade details before the end of the intended

Question/Theme	Summary of Comments	CSA Response
matching?	STP implementation; • mandatory exception reporting should be required by the close of business on T and the match should take place no later than the close of business on T+1; and • caution should be taken to ensure that accommodating matching exceptions after T does not open a loophole for wholesale processing of transactions outside the established timeframes. One commenter argued that providing exceptions within the rule could have a negative impact on compliance and would make measurement and enforcement a more complicated process.	matching date. We will discuss what restrictions, if any, to exception reporting should be adopted with the IDA and other interested SROs.
Question 11 – Should registrants be required to report all exceptions from matching by the close of business on T? If so, who should receive the report (e.g. recognized clearing agency, SROs, and/or securities regulatory authorities)?	Eleven commenters believed that registrants should not be required to report all exceptions from matching by the close of business on T. Reasons cited include: • measurement and reporting to senior levels within an organization on a firm's rating against an industry benchmark will help bring about industry pressure to improve (e.g. Crestco in the U.K.); • exception trade information should be retained and made available upon request to the SRO and/or securities regulatory authority by either the registrant or, where a trade matching utility is being used, by the recognized clearing agency or the trade matching facility operator; • it would create an unnecessary amount of paper and overhead; and • the best and most consistent source of data relating to trade matching and settlement is CDS – CDS should be the utility to report this information. Three commenters were of the view that if a trade cannot be matched on T then it should be tracked at CDS or an appropriate trade matching utility.	In lieu of reporting all exceptions, we will consider requiring registrants to maintain an electronic audit trail of their orders and trades. This information can then be reviewed by regulators as part of routine examinations. The CSA will also require all *matching service utilities* and CDS to keep a record of all exceptions processed.
Question 12 – Is it necessary to mandate the use of a *matching service utility* in Canada? If so, how would the appropriate centralized trade matching system be identified?	Sixteen commenters to these questions felt that it is not necessary to mandate the use of a *matching service utility* (MSU) in Canada. Reasons cited include: • third party technology vendors are now coming up to the market with solutions; • industry best practices and standards have been developed both with and without MSUs, and STP can be achieved without a MSU; • concerns about the financial burden it potentially has on the broker-dealer community, especially	At this time, there is no need to mandate the use of a *matching service utility* in Canada.

Question/Theme	Summary of Comments	CSA Response
Are there institutional investors or investment managers that may not benefit from being forced into an automated centralized trade matching system? Can STP trade matching be achieved without a *matching service utility*?	has on the broker-dealer community, especially small firms that would otherwise satisfy STP requirements; • buy-side firms with relatively low trade volume would be particularly disadvantaged if they were forced to use a MSU; and • mandating a MSU would hamper normal competitive forces and discourage investment in research and development to the detriment of the marketplace. Two commenters stated it may be necessary to mandate MSUs in Canada if there is a high level of industry consensus. A number of commenters were of the view that STP trade matching in Canada can be achieved without a *matching service utility*.	
Question 13 – Should the scope of functions of a *matching service utility* be broader [than the functions described in the Paper]?	Three commenters were of the view that the functions of a MSU should not be broader while two commenters felt that the scope of a MSU should be broader. One commenter recommended that the CSA focus on two core functions of a MSU: trade matching and delivery to the depository. Another commenter recommended that the functions be broader to support complete trade processing, including *cancels* and *amendments* that surface after a matched trade has been reported to CDS. One commenter recommended that the following functions be added to the scope: • the matching service utility should not be limited to equities, but support all types of securities transactions; • when there is a discrepancy in a transaction, provide real-time or near real-time advice of the particulars of the discrepancy to all parties; and • systems should be inter-operable with both the Canadian and U.S. markets.	We will consider these comments when reviewing this issue in the future.
Question 14 – Are the filing and reporting requirements set out in the proposed National Instrument for a matching service utility sufficient,	Four commenters were of the view that the filing requirements are sufficient. Five commenters stated that a MSU should not be recognized as a clearing agency. Two commenters felt that the CSA should consider recognizing a MSU as a clearing agency. A few commenters on this issue believed that a MSU should be tightly regulated due to the potentially systemic problems that may arise should the MSU not be able to provide its services	We are of the view that the filing and reporting requirements set out in the proposed National Instrument for a matching service utility are sufficient.

Question/Theme	Summary of Comments	CSA Response
or should a matching service utility be required to [seek recognition] as a clearing agency under provincial securities legislation?	and the MSU's direct access to CDS accounts.	
Question 15 – Can the Canadian capital markets support more than one matching service utility? If so, what should be the inter-operability requirements?	Three commenters stated that the Canadian marketplace cannot support more than one MSU. Ten commenters are of the view that market/competitive forces will determine the appropriate number and type of MSUs. Ten commenters stated that multiple MSUs should be inter-operable.	We agree that multiple MSUs must be inter-operable.
Question 16 – Should the CSA mandate a T+3 settlement cycle? Should the CSA mandate a T+1 settlement cycle when the U.S. moves to T+1 and the SEC amends its T+3 Rule?	Sixteen commenters were of the view that the CSA should not mandate a T+3 settlement cycle. Reasons cited include: • mandating would not serve any useful purpose given the low fail rates today; • mandating would cause confusion in the market and divert the focus from STP implementation and not solve any known existing problems; • largely a philosophical question since it will have no impact on the marketplace; and • CSA mandating is not required since SRO rules were adopted to mandate the change from T+5 to T+3. Similarly, the majority of commenters on this issue felt that the CSA should not mandate a T+1 settlement cycle. Reasons cited include: • any rule changes that are required can be adequately accommodated at the SRO level; • a CSA rule was not required when Canada moved successfully from T+5 to T+3; and • a CSA rule is not necessary given the competitive pressures to move to T+1. Three commenters suggested that the CSA take direction from the SEC in order to ensure operational consistency.	We agree that the vast majority of trades currently settle within T+3 or less, without any significant problems. As a result, we do not propose to adopt a specific T+3 settlement cycle rule. However, we may consider a rule that confirms the basic principle that settlement must occur within the current recognized *intended settlement date* for the security type. We will also consider the need for a specific T+1 settlement cycle rule when a move to shorten the settlement cycle to T+1 is reconsidered in the future.
Question 17 – Should the CSA require the reporting of corporate actions	Eleven commenters were of the view that the CSA or other appropriate authorities should require the reporting of corporate actions into a centralized hub. Reasons cited include: • mandated reporting of entitlement information by	The CCMA Corporate Actions Working Group (CAWG) had been studying the implementation of a centralized hub, and was assessing the

Question/Theme	Summary of Comments	CSA Response
into a centralized *hub*? If not, is it more appropriate for exchanges and other marketplaces to impose this requirement through listing or other requirements? Who should pay for the development and maintenance of the central *hub*?	issuers in field based format would maximize market efficiencies; and • it seems unlikely that a hub would be developed without legislation. However, a number of commenters noted that the mandating of corporate actions into a centralized hub was not an immediate priority. The commenters were divided as to who should pay for the hub. Some commenters stated that it should be just the issuers while others believed that it should be all "users" including issuers, offerors, and custodians. One commenter noted that further analysis of cost benefits associated with the development of the hub is needed prior to making a decision to proceed. The commenter also noted that undertaking a cost benefits analysis would allow equitable development and maintenance of cost distribution among all industry participants. Without completion of a cost benefit analysis, and a clear understanding of the functionality and mandating requirements, it is difficult to estimate the cost impact of the hub development and decide who should pay for it.	need for a cost-benefit analysis. Such an analysis would be important before we consider a CSA rule mandating the reporting of corporate actions to a centralized hub. It would also be useful for determining which stakeholder groups should pay for the development and maintenance of the hub. As noted above, the CCMA has realigned its efforts to focus exclusively on institutional trade matching. The reporting of corporate actions to a centralized hub is no longer a priority for the CCMA at this time. We understand, however, that CDS has undertaken to continue the work of the CAWG to establish the benefits of a centralized hub and is working to expand its entitlement services to deliver as many of the desired features identified in the CCMA hub model as possible.
Question 18 – Should the CSA wait until a *hub* has been developed by the industry before it imposes any requirements?	Nine commenters were of the view that the CSA should not wait until a hub has been developed by the industry before the CSA impose any requirements. Reasons cited include: • to avoid confusion, the CSA should impose specific requirements in advance of any development; and • CSA regulation is the only way to make a central hub a reality. One commenter noted that the implementation of a corporate-actions industry solution must include clear policies and penalties regarding non-compliance.	See response above to question 17.
Question 19 – Should the CSA require issuers and offerors to make their entitlement payments by means of the LVTS?	Nine commenters stated that the CSA should require issuers and offerors to use the LVTS. Reasons cited include: • the current situation, in which entitlements are paid using funds that cannot be considered final until the next day at the earliest, creates unnecessary risks (albeit not systemic) in the securities settlement system; and • the relatively small costs of using LVTS are more than offset by the benefits of having a	The CSA propose to publish in the Spring of 2005 a CSA notice to all reporting issuers in Canada whose securities are immobilized with CDS. The notice would strongly encourage all reporting issuers and their transfer agents to make their entitlement payments to CDS in LVTS funds.

Question/Theme	Summary of Comments	CSA Response
	single consistent, reliable and irrevocable payment system. Three commenters are of the view that the CSA should not mandate entitlement payments via LVTS.	
Question 20 – If there is a CSA requirement to make entitlement payments in LVTS funds, should the requirement apply only to payments in excess of a certain minimum value? If so, what should that minimum value be?	Five commenters felt that a requirement to pay in LVTS funds should apply to all payments—there should be no minimum value. Four commenters suggested the following minimum values: • the minimum value should be the same as the CPA requirement (currently $25 million); and • consideration should be made by the CPA to reduce the general ceiling to $5 million.	See response above to Question 19.
Question 21 – Should the CSA consider implementing any additional rules to encourage and facilitate the investment funds industry to move towards an STP business model? If so, what issues should be addressed by the CSA?	Eight commenters were of the view that the CSA should consider implementing additional rules to encourage and facilitate the investment funds sector to move towards an STP business model. A number of commenters suggested that the CSA consider the following: • a single funds depository for Canadian fund settlement with a requirement that all distributors and manufacturers be participants of this utility; • continued work on *Documentation Agreements*, under which the documentation to be exchanged between a broker/distributor and a fund company in relation to client transactions would be governed; • rules to modify the current processing of investment funds; and • subjecting the investment funds industry to the same STP requirements being implemented industry wide.	We will continue to monitor the progress of the industry groups that have assumed responsibility for the various CCMA Retail Trade Processing Working Group initiatives, with a view to ultimately publishing for comment proposed amendments to National Instrument 81-102—*Mutual Funds* and Companion Policy 81-102CP to facilitate the processing of investment fund transactions on an STP basis. Concurrent with those amendments, the OSC and Alberta Securities Commission (ASC) will propose amending OSC Policies 5.3 and 5.4 and ASC Policies 4.3 and 4.4 to remove the requirement for certain unincorporated closed-end investment funds to issue certificates to their security holders.
Question 22 – Should the CSA develop rules	Ten commenters stated that the CSA should develop rules in this area. Reasons cited include: • the risks associated with the handling of physical	As noted above, the CCMA has realigned its efforts to focus exclusively on institutional trade

Question/Theme	Summary of Comments	CSA Response
that require the immobilization and, to the extent permitted by corporate and other law, dematerialization of publicly traded securities in Canada?	certificates are extremely high; • it would reduce risks associated with catastrophic events, such as the events of September 11, 2001 in the U.S., where millions of physical share certificates in vaults or in transit were destroyed and had to be replaced at great cost prior to trading, while computerized book-entry systems, such as DTC and the U.S. direct registration system, were up and running from off-site locations within hours or days; and • the use of certificates is an impediment to STP and results in increased risk when processing entitlements. Four commenters were of the view that the CSA should not develop immobilization and dematerialization rules since only small numbers of trades involve certificates.	matching. Dematerialization issues are no longer a priority for the CCMA at this time. Nevertheless, we will continue to monitor the progress of the industry groups that have assumed responsibility for the various CCMA Dematerialization Working Group initiatives, and consider these comments when reviewing this issue in the future.
Question 23 – To the extent direct registration systems (DRS) operate in Canada, should a securities regulatory authority regulate transfer agents that are operating or using such DRS systems?	Only one commenter felt that the CSA should not regulate transfer agents operating or using a DRS system. All other commenters on this issue were of the view that securities regulatory authorities should regulate transfer agents if they operate or use DRS systems. Reasons cited include: • given the importance DRS systems would play in maintaining client accounts, it is important that they be considered essential infrastructure in the same way as a MSU or depository; and • processes and controls should be established for operating DRS systems to ensure public confidence in book based direct holdings.	We are considering the best method for providing regulatory oversight of DRS systems operating in Canada.
Question 24 – Should there be separate DRS systems and should they be required to be inter-operable?	The majority of commenters said that there will be separate DRS systems and inter-operability was not an issue in this context. Six commenters are of the view that DRS systems should not be required to be inter-operable. Five commenters are of the view that DRS systems should be inter-operable.	We are of the view that separate DRS systems should nevertheless develop common standards that would facilitate communication among the transfer agent for the securities in question, and the investors, dealers, custodians and CDS holding or dealing in such securities.
Question 25 – Is it sufficient for the Canadian capital markets to rely solely on existing SRO segregation rules? Or, given	The majority of commenters on this issue believed that it is sufficient for the Canadian capital markets to rely solely on existing SRO segregation rules. Two commenters were of the view that the current segregation rules should be reviewed in order to assess the impact to the indirect holding system and the recent changes in the bankruptcy laws.	We propose to review this issue after the proposed provincial *Uniform Securities Transfer Act* has been enacted in a number of CSA jurisdictions.

Question/Theme	Summary of Comments	CSA Response
rules? Or, given the growing reliance on the indirect holding system, should the CSA consider an active role in developing comprehensive rules on segregation of customer assets?		