

Canadian Securities Administrators' Request for Comment

**Companion Policy 24-101CP
to Proposed National Instrument 24-101–
Institutional Trade Matching and Settlement**

Table of Contents

<u>PART</u>	<u>TITLE</u>
PART 1	INTRODUCTION, PURPOSE AND DEFINITIONS
PART 2	TRADE MATCHING REQUIREMENTS
PART 3	FILING REQUIREMENTS
PART 4	REQUIREMENTS FOR MATCHING SERVICE UTILITIES
PART 5	TRADE SETTLEMENT
PART 6	TRANSITION

**Companion Policy 24-101CP
to Proposed National Instrument 24-101–
Institutional Trade Matching and Settlement**

PART 1 INTRODUCTION, PURPOSE AND DEFINITIONS

1.1 Purpose of Instrument – National Instrument 24-101–*Institutional Trade Matching and Settlement* (Instrument) has been adopted to provide a framework in provincial securities legislation for ensuring more efficient and timely settlement processing of trades, particularly institutional trades. The increasing volumes and dollar values of securities traded in Canada and globally by institutional investors mean existing back-office systems and procedures of market participants are challenged to meet post-execution processing demands, and new requirements are needed to address the increasing risks. The Instrument is being adopted as part of broader initiatives in the Canadian securities markets to implement straight-through processing (STP).¹

1.2 General explanation of matching, clearing and settlement –

(1) *Parties to institutional trade* – A typical trade with or on behalf of an institutional investor may involve at least three parties:

- a registered adviser or other *buy-side* manager acting for an institutional investor in the trade—and often acting on behalf of more than one institutional investor in the trade (i.e., multiple underlying institutional client accounts—who decides what securities to buy or sell and how the assets should be allocated among the client accounts;
- a registered dealer (including an Alternative Trading System registered as a dealer) responsible for executing or clearing the trade; and
- any financial institution or registered dealer (including under a *prime brokerage* arrangement) appointed to hold the institutional investor’s assets and settle trades.

(2) *Matching* – A first step in settling a securities trade is to ensure that the buyer and the seller agree on the details of the transaction, a process referred to as trade

¹ For a discussion of Canadian STP initiatives, see Canadian Securities Administrators’ (CSA) Discussion Paper 24-401 on *Straight-through Processing* and Request for Comments, April 16, 2004 (2004) 27 OSCB 3971 to 4031 (Discussion Paper 24-401); and 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*, February 11, 2005 (2005) 28 OSCB 1509 to 1526.

confirmation and affirmation or trade *matching*.² A registered dealer who executes trades with or on behalf of others is required to report and confirm trade details—not only with the counterparty to the trade—but also with the client for whom it acted. Agreement of trade details—sometimes referred to as *trade data elements*—must occur as soon as possible so that errors and discrepancies in the trades can be discovered early in the clearing and settlement process.

- (3) *Matching process* – Verifying the trade data elements is necessary to *match* a trade executed on behalf of an institutional investor. Matching occurs when the relevant parties to the trade have, after verifying the trade data elements, reconciled or agreed to the details of the trade. Matching also requires that any custodian holding the institutional investor’s assets be in a position to affirm the trade to a clearing agency. At that point, the trade is ready for the clearing and settlement process through the facilities of the clearing agency. To illustrate, the matching of a trade will usually include the following activities:
- (a) The registered dealer notifying the *buy-side* manager of the execution of the trade;
 - (b) The *buy-side* manager advising the dealer and any custodian or custodians how the securities in the trade are to be allocated among the underlying institutional client accounts managed by the buy-side manager. For so-called *block settlement trades*, the dealer sometimes receives allocation information from the buy-side manager based only on the number of custodians holding institutional investors’ assets instead of on the actual underlying institutional client accounts managed by the buy-side manager;
 - (c) The dealer reporting the trade details to the buy-side manager and clearing agency. Generally, a customer trade confirmation delivered pursuant to securities legislation³ or the rules of a self-regulatory organization (SROs)⁴ will contain detailed information pertaining to the trade; and
 - (d) The custodian or custodians of the assets of the institutional investors verifying the trade details and settlement instructions against available securities or funds held for the institutional investors. The buy-side

² The processes and systems for matching of non-institutional trades in Canada have evolved over time and become automated, such as retail trades on an exchange, which are matched or *locked-in* automatically at the exchange, or direct non-exchange trades between two participants of a clearing agency, which are generally matched through the facilities of the clearing agency.

³ See, for example, section 36 of the *Securities Act* (Ontario).

⁴ See, for example, The Toronto Stock Exchange (TSX) Rule 2-405 and Investment Dealers Association of Canada (IDA) Regulation 200.1(h).

manager instructs the custodian(s) to release funds and/or securities to the clearing agency.

- (4) *Clearing and settlement* – The *clearing* of a trade begins after the execution of the trade. After matching is completed, clearing will involve the calculation of the mutual obligations of market participants for the exchange of securities and money—a process which generally occurs within the operations of a clearing agency. The *settlement* of a trade is the moment when the securities are transferred finally and irrevocably from one investor to another in exchange for a corresponding transfer of money. In the context of settlement of a trade through the facilities of a clearing agency, often acting as central counterparty, settlement will be the discharge of obligations in respect of funds or securities, computed on a net basis, between and among the clearing agency and its participants. Through the operation of novation and set-off in law or by contract, the clearing agency becomes a counterparty to each trade so that the mutual obligation to settle the trade is between the clearing agency and each participant.

1.3 Definitions –

- (1) *Regulated clearing agency* – The definition of *regulated clearing agency* takes into account the fact that only the provinces of Ontario and Québec have recognized or otherwise regulate The Canadian Depository for Securities Limited (CDS) under provincial securities legislation.⁵ The term *clearing agency* is not defined in the Instrument, but is defined in the securities legislation of certain jurisdictions.⁶
- (2) *Custodian and institutional investor* – While investment assets are sometimes held directly by investors, most are held on behalf of the investor by or through securities accounts maintained with a custodian or dealer. The definition of *custodian* in section 1.1 of the Instrument expressly excludes registered dealers, and is an important component of the definition of *institutional investor* (see paragraph (b) of the definition *institutional investor*). Thus, even an individual can be an institutional investor if the individual's investment assets are held by or through securities accounts maintained with a custodian instead of a dealer, whether or not the individual has net investment assets of at least \$10,000,000. Most institutional investors, such as pension and mutual funds, hold their assets through custodians. However, others may not—such as hedge funds, which sometimes maintain their investment assets with dealers under so-called *prime-brokerage* arrangements. Paragraph (a) of the definition *institutional investor*

⁵ CDS is also regulated by the Bank of Canada pursuant to the *Payment Clearing and Settlement Act* (Canada).

⁶ See, for example, s. 1(1) of the *Securities Act* (Ontario).

ensures that the scope of the Instrument includes such institutional investors that do not necessarily use custodians.

- (3) *Settlement day* – For determining the date on which $T+1$ falls, a settlement day will be counted for a particular trade only if payment could have been made for the trade on that day in the agreed-upon currency. For example, even if the markets and commercial banks are open in Canada on a particular day, that day will not be considered a settlement day for a securities transaction requiring payment in U.S. currency if that day falls on a U.S. statutory holiday.
- (4) *DAP or RAP trade* – The concepts “delivery against payment” and “receipt against payment” are well understood by the industry. These terms are also defined in the Notes and Instructions (Schedule 4) to the *Joint Regulatory Financial Questionnaire and Report* of the Canadian SROs.
- (5) *Institutional trade* – In this Companion Policy, we use the expression “institutional trade” broadly to mean any trade executed with or on behalf of an institutional investor, whether or not settled by a custodian.

PART 2 TRADE MATCHING REQUIREMENTS

2.1 Trade data elements – Trade data elements that must be verified and agreed to are those identified by industry practice through the SROs or in the best practices and standards for institutional trade processing established and generally adopted by the industry. See section 2.4 of this Companion Policy. To illustrate, trade data elements that should be transmitted, compared and agreed to may include the following:

- (a) *Security identification*: ISIN, currency, issuer, type/class/series, market ID; and
- (b) *Order and trade information*: dealer ID, account ID, account type, buy/sell indicator, order status, order type, unit price/face amount, number of securities/quantity, message date/time, trade transaction type, commission, accrued interest (fixed income), broker settlement location, block reference, net amount, settlement type, allocation sender reference, custodian, payment indicator, IM portfolio/account ID, quantity allocated, and settlement conditions.

2.2 Trade matching deadlines for registrants – The obligation of a registered dealer or registered adviser to implement appropriate policies and procedures, pursuant to sections 3.1 and 3.3 of the Instrument, will require the dealer or adviser to take reasonable steps to achieve matching as soon as practicable after the trade is executed and in any event no later than

- (a) 7:30 p.m. on T if the trade is executed before 4:30 p.m., or
- (b) 7:30 p.m. on T+1 if the trade is executed after 4:30 p.m.

The trade matching requirements of a registered dealer or registered adviser apply whether or not a custodian is needed to settle the trade.⁷

2.3 Choice of compliance agreement or signed written statement –

- (1) *Establishing appropriate policies and procedures* – Pursuant to sections 3.2 and 3.4 of the Instrument, a registered dealer or registered adviser can open an account for an institutional customer only if the customer and other trade-matching parties have entered into a written agreement (compliance agreement) with the dealer or adviser or provided a signed written statement (written statement) to the dealer or adviser. The purpose of the compliance agreement or written statement is to establish that all trade-matching parties have appropriate policies and procedures to achieve matching of the institutional trade as soon as practicable after the trade is executed.
- (2) *Compliance agreement* – A registered dealer or registered adviser need only enter into one compliance agreement with the trade-matching parties at the time of opening a trading account of an institutional investor for all future trades in relation to such account. A single compliance agreement is sufficient for the general and all sub-accounts of the institutional customer. If the dealer or adviser uses a compliance agreement, the form of such agreement should be part of the institutional account opening documentation, and may be modified from time to time with the consent of the parties. Registered dealers and registered advisers should use reasonable efforts to monitor compliance with and enforce the terms of a compliance agreement.
- (3) *Signed written statement* – A registered dealer or registered adviser may accept the written statement signed by the chief executive of the trade-matching party without further investigation. The dealer or adviser that has received a written statement from a trade-matching party in relation to an institutional customer account may continue to rely upon the statement for all future trades in such account, unless the dealer or adviser has knowledge that any statements or facts set out in the written statement are incorrect. A single written statement is sufficient for the general and all sub-accounts of the institutional customer.

⁷ Where custodians are not used to settle a trade on behalf of an institutional investor, trades in non-exchange traded securities (including government debt securities) among direct participants of CDS can be matched through the facilities of CDS' trade confirmation and affirmation system. An IDA rule requires their members to confirm and affirm *broker-to-broker* trades in non-exchange traded securities within one hour of the execution of the trade through CDS' trade confirmation and affirmation system. See IDA Regulation 800.49.

2.4 Determination of appropriate policies and procedures –

- (1) *Best practices* – The Canadian securities regulatory authorities are of the view that, when establishing appropriate policies and procedures, a party should consider the best practices and standards for institutional trade processing that have generally been adopted by the industry.⁸ It should also include those policies and procedures into its regulatory compliance and risk management programs.
- (2) *Different policies and procedures* – The Canadian securities regulatory authorities recognize that appropriate policies and procedures may not be the same for all registered dealers, registered advisers and other market participants, as they may vary depending on the nature, scale and complexity of a market participant’s business and the risks it takes in the trading process. For example, policies and procedures for achieving matching may differ among registered dealers that act as an “introducing broker” and registered dealers that act as a “carrying broker”.⁹ In addition, if a dealer is not a participant of a clearing agency, the dealer’s policies and procedures to expeditiously achieve matching should be integrated with the clearing arrangements that the dealer has with any other dealer acting as carrying or clearing broker for the dealer. Establishing appropriate policies and procedures may require registered dealers, registered advisers and other market participants to upgrade their systems and enhance their inter-operability with others.¹⁰

2.5 Use of matching service utility – The Instrument does not require the trade-matching parties to use the facilities or services of a matching service utility to accomplish matching of trades within the prescribed timelines. However, if such facilities or services are made available in Canada, the use of such facilities or services may facilitate a trade-matching party’s compliance with the Instrument’s requirements.

PART 3 FILING REQUIREMENTS

3.1 Exception reporting for registrants – Pursuant to Part 4 of the Instrument, a registrant is required to complete and file Form 24-101F1 and related exhibits only if less than 98 percent of the DAP or RAP trades executed by or for the

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

⁹ See IDA By-Law No. 35 – *Introducing Broker / Carrying Broker Arrangements*.

¹⁰ See Discussion Paper 24-401, at p. 3984, for a discussion of *inter-operability*.

registrant in any given calendar quarter have matched within the time required by the Instrument. The reporting requirements apply to DAP or RAP trades, whether or not settled by a custodian. The tracking of a registrant's trade-matching statistics may be outsourced to a third party service provider, including a regulated clearing agency or custodian. However, despite the outsourcing arrangement, the registrant retains full legal and regulatory liability and accountability to the Canadian securities regulatory authorities for its exception reporting requirements.

- 3.2 Regulatory reviews of registrant exception reports** – The Canadian securities regulatory authorities propose to review the completed Form 24-101F1 filings on an ongoing basis to monitor and assess compliance by registrants with the Instrument's matching requirements. We intend to identify problem areas in matching, including identifying trade-matching parties that have no or weak policies and procedures in place to ensure matching of trades is accomplished within the time prescribed by Part 3 of the Instrument. Monitoring and assessment of registrant matching activities may be undertaken by the SROs in addition to, or in lieu of, reviews undertaken by us.
- 3.3 Other filing requirements** – Regulated clearing agencies and matching service utilities are required to complete in Forms 24-101F2 and 24-101F5 certain trade-matching information in respect of their participants or users. The purpose of this information is to facilitate monitoring and enforcement by the Canadian securities regulatory authorities or SROs of the Instrument's matching requirements.
- 3.4 Forms filed in electronic form** –The Canadian securities regulatory authorities have agreed among themselves that completed Forms 24-101F1 must be filed
- by Ontario registrants with the Ontario Securities Commission,
 - by Québec registrants with the Autorité des marchés financiers in Québec, and
 - by registrants in other provinces and territories with either the Ontario Securities Commission or the Autorité des marchés financiers in Québec.

Regulated clearing agencies and matching service utilities need only file their completed forms pursuant to Parts 5 and 6, respectively, of the Instrument with the Ontario Securities Commission or the Autorité des marchés financiers in Québec. We request that all forms and exhibits required to be filed under the Instrument be filed in electronic format by e-mail, where possible, to:

if to the Ontario Securities Commission, NI24101forms@osc.gov.on.ca

if to the Autorité des marchés financiers in Québec,
NI24101forms@lautorite.qc.ca

Registrants, regulated clearing agencies and matching service utilities will be considered to have complied with their filing requirements under the Instrument in all jurisdictions if they file in the manner described above. To the extent indicated in the form by a filer, the Canadian securities regulatory authorities will maintain certain information in a completed Form 24-101F3 or Form 24-101F5 that is filed by a matching service utility in confidence. The Canadian securities regulatory authorities are of the view that certain parts of completed Forms 24-101F3 and 24-101F5 may contain private financial, commercial and technical information and that the interests of the filers in non-disclosure out-weigh the desirability of adhering to the principle that the forms be available for public inspection.

PART 4 REQUIREMENTS FOR MATCHING SERVICE UTILITIES

4.1 Matching service utility –

- (1) Part 6 of the Instrument sets out filing, reporting, systems capacity, and other requirements of a matching service utility. The term *matching service utility* expressly excludes a regulated clearing agency and any recognized or authorized exchange, stock exchange or quotation and trade reporting system, and any exchange, stock exchange or quotation and trade reporting system that is exempted from a requirement to be so recognized or authorized. These recognized, authorized or exempted entities will not be subject to the requirements of Part 6 of the Instrument in the event they decide to provide centralized facilities for the matching of trades because they are subject to similar requirements under the terms and conditions of their recognition, authorization or exemption. A matching service utility would be any entity that provides the services of a post-execution centralized matching facility for registered dealers, institutional investors, and/or custodians that clear and settle institutional trades. It would use technology to match in real-time trade data elements throughout a trade's processing lifecycle. A matching service utility would not include a registered dealer who offers "local" matching services to its institutional clients.

- (2) A matching service utility would be viewed by the Canadian securities regulatory authorities as a critical infrastructure system involved in the clearing and settlement of securities transactions and the safeguarding of securities. The securities regulatory authorities believe that, while a matching service utility operating in Canada would largely enhance operational efficiency in the capital markets, it would raise certain regulator concerns. Comparing and matching trade data are complex processes that are inextricably linked to the clearance and settlement process. A central matching utility concentrates processing risk in the entity that performs matching instead of dispersing that risk more to the dealers and their institutional clients. Accordingly, the Canadian securities regulatory authorities believe that the breakdown of a matching service utility's ability to accurately verify and match trade information from multiple market participants

involving large numbers of securities transactions and sums of money could have adverse consequences for the efficiency of the Canadian securities clearing and settlement system. The requirements of the Instrument applicable to a matching service utility are intended to address these risks.

4.2 Initial filing requirements for a matching service utility – Section 6.1(1) of the Instrument requires any person or company that intends to carry on business as a matching service utility to file Form 24-101F3 at least 90 days before the person or company begins to carry on business as a matching service utility. The Canadian securities regulatory authorities will review Form 24-101F3 to determine whether the person or company that filed the form is an appropriate person or company to act as a matching service utility for the Canadian capital markets. The Canadian securities regulatory authorities will consider a number of factors when reviewing the filed form, including:

- (a) the performance capability, standards and procedures for the transmission, processing and distribution of details of trades in securities executed on behalf of institutional investors;
- (b) whether market participants generally may obtain access to the facilities and services of the matching service utility on fair and reasonable terms which are not unreasonably discriminatory;
- (c) personnel qualifications;
- (d) whether the matching service utility has sufficient financial resources for the proper performance of its functions;
- (e) the existence of another entity performing the proposed function for the same type of security; and
- (f) the systems report referred to in section 6.5(b) of the Instrument.

4.3 Change to significant information – Under section 6.2 of the Instrument, a matching service utility is required to file an amendment to the information provided in Form 24-101F3 at least 45 days before implementing a significant change involving a matter set out in Form 24-101F3. In the view of the Canadian securities regulatory authorities, a significant change includes a change to the information contained in the General Information items 1-10 and Exhibits A, B, E, G, I, J, O, P and Q of the Form 24-101F3.

4.4 Ongoing filing and other requirements applicable to a matching service utility –

- (1) Ongoing quarterly filing requirements will allow regulators to monitor a matching service utility's operational performance and management of risk, the progress of inter-operability in the market, and any negative impact on access to the markets. A matching service utility will also provide trade matching data (e.g., number of trades matched on T) and other information to the securities regulatory authorities so that they can monitor industry compliance.
- (2) Forms 24-101F3 and 24-101F5 completed and filed by a matching service utility will provide useful information on whether it is:
 - (a) developing fair and reasonable linkages between its systems and the systems of any other matching service utility in Canada that, at a minimum, allow parties to executed trades that are processed through the systems of both matching service utilities to communicate through appropriate, effective interfaces;
 - (b) negotiating with other matching service utilities in Canada fair and reasonable charges and terms of payment for the use of interface services with respect to the sharing of trade and account information; and
 - (c) not unreasonably charging more for use of its facilities and services when one or more counterparties to trades are customers of other matching service utilities than the matching service utility would normally charge its customers for use of its facilities and services.

4.5 Capacity, integrity and security system requirements –

- (1) The activities in section 6.5(a) of the Instrument must be carried out at least once a year. The Canadian securities regulatory authorities would expect these activities to be carried out even more frequently if there is a significant change to trading volumes that necessitates that these functions be carried out more frequently in order to ensure that the matching service utility can appropriately service its clients.
- (2) The independent review contemplated by section 6.5(b) of the Instrument should be performed by competent and independent audit personnel, in accordance with generally accepted auditing standards.
- (3) The notification of a material systems failure under section 6.5(c) of the Instrument should be provided within one hour from the time the incident was identified as being material and should include the date, cause and duration of the interruption and its general impact on users or subscribers. Material systems

failures include serious incidents that result in the interruption of the matching of trades for more than thirty minutes during normal business hours.

PART 5 TRADE SETTLEMENT

5.1 Trade Settlement by Dealer – Section 7.1 of the Instrument is intended to support and strengthen the general settlement cycle rules of the SROs. Current marketplace and SRO rules mandate a standard T+3 settlement cycle period for most transactions in equity and long term debt securities.¹¹ If a dealer is not a participant of a clearing agency, the dealer’s policies and procedures to facilitate the settlement of a trade should be combined with the clearing arrangements that the dealer has with any other dealer acting as carrying or clearing broker for the dealer.

PART 6 TRANSITION

6.1 Transitional dates and percentages – The following table summarizes the transitional provisions of Part 10 of the Instrument.

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

¹¹ See IDA Regulation 800.27.