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Dear Mr. Paré and the Canadian Securities Administrators (CSA) committee responsible for the assessment of investment fund settlement in a T+2 environment:

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

#### **Re: Comments Regarding T+2 Settlement – Investment Funds**

On November 1, 2016, the Canadian Capital Markets Association (CCMA) responded to the CSA's request for comments regarding *Proposed Amendments to NI 24-101 – Institutional Trade Matching and Settlement, Proposed Changes to Companion Policy 24-101 Institutional Trade Matching and Settlement*. The CCMA, on the behalf of its constituency, advised it supported shortening the settlement cycle from three to two days (T+2) and the National Instrument (NI) 24-101 amendments being proposed by the CSA.<sup>1</sup>

In addition to the NI 24-101 proposed amendments, the CCMA has been tracking and monitoring other industry changes that will be required in a move to T+2. This includes changes for investment funds. In late 2015, the CCMA identified potential amendments that may be required for NI 81-102 *Investment Funds* and NI 81-104 *Commodity Pools*. The general consensus was that such amendments were either necessary or preferred. The CCMA did not address this matter in its November 1, 2016 response to the CSA regarding proposed rule changes related to T+2 as the investment funds matter was proceeding

<sup>1</sup> The CCMA also raised one transitional reporting issue regarding NI 24-101.

along a separate discussion path. However, in light of recently raised concerns, the CCMA is issuing this supplementary letter to the request for comment regarding “CSA Consultation Paper 24-402 *Policy Considerations for Enhancing Settlement Discipline in a T+2 Settlement Cycle Environment*” (“CSA 24-402”) as well as to the CSA committee responsible for the assessment of investment fund settlement in a T+2 environment.

In regards to CSA 24-402, this supplementary letter may be considered in response to Question 10:

*“Question 10: Are there other aspects of the securities transaction processing chain that may be a source of delay in meeting a T+2 settlement timeline? If so, please describe them and identify any additional settlement discipline measures that could be taken to address such delays. Please describe such measures in reasonable detail.”*

## **Background**

In late 2016, those investigating the potential changes for regulation of investment funds and T+2 concluded that the existing regulatory framework did not need amendments to accommodate a T+2 settlement cycle for investment funds. It was advised that a policy project of amending NI 81-102 would not be undertaken unless written submissions were made. Specifically, the written submissions should address why amendments are required despite the regulatory view that there is sufficient flexibility in NI 81-102 and outline the impact on the liquidity risk management framework if the proposed amendments were to be adopted.

Following submission of the CCMA’s November 1, 2016 response, the Depository Trust and Clearing Corporation in the U.S. announced that the settlement date of domestic mutual funds that currently have a T+3 settlement/redemption cycle will automatically be changed to T+2; for offshore funds changing to T+2, the system will not automatically convert to T+2, rather a form must be submitted to Fund/SERV.<sup>2</sup> However, in Canada, the change in date of funds is not planned to be automatic.

As well, the decision conveyed verbally that no CSA rule changes would be made led to questions among industry participants and their service providers beginning in December 2016 and continuing to the present date. The CCMA T+2 Steering Committee (T2SC) agreed on January 18, 2017 to bring the issue formally to the CSA’s attention. As the CCMA understands that responsibility for NI 81-102 falls under a different committee to that assessing NI 24-101, and as time to implementation grows shorter, we are taking the liberty of copying representatives of both committees at this time, as well as the relevant self-regulatory organizations (Mutual Fund Dealers Association of Canada (MFDA) and Investment Industry Regulatory Organization of Canada (IIROC)), and the clearing agency (Fundserv). It should be noted that IIROC T+2-related rule changes,<sup>3</sup> issued for comment on July 28, 2016, would require fund purchases and redemptions to move to T+2 settlement, adding a potential further complication should investment funds – as securities – not also move to T+2 from the perspective of fund dealers/distributors and managers/manufacturers.

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<sup>2</sup> [www.dtcc.com/~media/files/pdf/2016/11/29/a8297.pdf](http://www.dtcc.com/~media/files/pdf/2016/11/29/a8297.pdf).

<sup>3</sup> [http://www.iroc.ca/Documents/2016/24152644-66CE-4EF2-A1AC-D9403540656E\\_en.pdf](http://www.iroc.ca/Documents/2016/24152644-66CE-4EF2-A1AC-D9403540656E_en.pdf).

## **Investment Funds**

NI 81-102 – *Investment Funds* currently provides in subsections 9.4 “Delivery of Funds and Settlement” and 10.4 “Payment of Redemption Proceeds” that, in the ordinary course, settlement for an order must occur “as soon as practicable and in any event no later than the third business day [ $T+3$ ] after the pricing date [ $T$ ]”. While the current drafting does not prevent an investment fund from moving to T+2, it does maintain a T+3 maximum settlement period notwithstanding the industry’s move to T+2. Significant concern has been raised that this would be out of sync with the underlying securities comprising an investment fund and could raise liquidity management issues for investment funds subject to NI 81-102 as a result of the mismatch between the respective settlement cycles. A similar issue was discussed with the OSC’s Investment Funds and Structured Products Branch in late 2014 as a result of Europe’s move to T+2 settlement on October 6, 2014. This resulted in the OSC providing guidance in the November 2014 Investment Funds Practitioner regarding borrowings effected by investment funds within the 5% limit of paragraph 2.6(a) of NI 81-102.<sup>4</sup> Significant concerns have also been raised in terms of the expectations of investors and confusion in the marketplace (as well as potential investor cost).

That said, the list of financial products and securities moving to a T+2 settlement cycle, compiled by the CCMA and published in July 2016, indicates that some mutual funds may not move to T+2 (just as some equities and debt will not). The asset list commentary advises industry participants to “... check fund prospectuses/offering documents for exceptions. Note that the settlement cycle for transactions involving physical certificates and nonredeemable investment funds, as well as direct purchases from the fund manufacturer [which already settle on T+1], are not expected to change as a result of the move to T+2.” Settlement cycle exceptions exist in the T+3 environment (in the case of equities and debt, provision for non-standard settlement cycles is made by way of “special terms orders” as defined in s. 1.1 of the Universal Market Integrity Rules)<sup>5</sup> and we agree that if there is a need for similar exceptions or exemptive relief for what would otherwise be NI 81-102 investment funds, we support it. Any solution should accommodate both the significant majority of investment funds that will move to T+2 and those few that must remain on a T+3 settlement cycle.

While the current NI 81-102 section 9 drafting accommodates T+2, and so not making a change is an option for that specific section, Fundserv in Canada reports that close to 70,000 investment funds – more than 95% of all of the Fundserv fund codes – currently settle on a T+3 basis and discussion at CCMA Mutual Fund Working Group meetings during the summer of 2016 suggested that a very significant majority of these were expected to move to T+2 settlement. The few exceptions we learned of that may not move to T+2 would primarily be investment fund structures that hold positions in Luxembourg-domiciled and other European-domiciled funds (i.e. fund of funds structures), and possibly other investment funds with unusual features, although these investment funds may not fall within the ambit of NI 81-102. The approach the U.S. is taking with respect to U.S. domiciled fund of funds would appear to default in the Fund/SERV system to T+2 and a manual override may be necessary to switch back to T+3.

Furthermore, subparagraph 9.4(4)(a) of NI 81-102 requires an investment fund to redeem securities (that is, “buy in” in industry terms) to which a purchase order relates on the fourth business day after the pricing date (T+4) should the purchase order “fail” (or when the investment fund first learns payment will not be received). Leaving the drafting as is would, in fact, potentially put an investment fund out of compliance with the rule (for example, if the buy-in takes place on T+3 in a T+2

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<sup>4</sup> [http://www.osc.gov.on.ca/documents/en/InvestmentFunds/ifunds\\_20141127\\_practitioner.pdf](http://www.osc.gov.on.ca/documents/en/InvestmentFunds/ifunds_20141127_practitioner.pdf).

<sup>5</sup> [http://www.iroc.ca/industry/rulebook/Documents/UMIR0101\\_en.pdf](http://www.iroc.ca/industry/rulebook/Documents/UMIR0101_en.pdf).

environment) or, if the T+4 buy-in requirement is adhered to, leave an unplanned one-day gap, with attendant operational and cost implications.

### **Commodity Pools**

While it is understood it is likely that NI 81-104 – *Commodity Pools* will be repealed, it is worthwhile to note that this NI contains a provision that refers to the current three-day settlement process in NI 81-102. If NI 81-102 is amended, a concordance amendment should be made to NI 81-104 or its successor rule. To the extent that it is decided it would be prudent to amend NI 81-102 and NI 81-104, an outline of the possible amendments is included in the appendix to this letter.

### **Recommendation**

The implications of both continuing to reference three days for settlement and four days for buy-ins were discussed in detail by the Legal and Regulatory Working Group (LRWG) of the CCMA. With the LRWG's recommendation, this issue was tabled with the T+2 Steering Committee (T2SC) on January 18, 2017. As noted, concerns expressed included operational issues and investor confusion. There is also a potential cost to investors if they sell investment funds expecting to purchase exchange-traded or over-the-counter securities that settle on a T+2 basis.

The CCMA strongly believes that a notice or other clear public guidance statement should be issued by CSA members as soon as possible that investment funds should settle on T+2 (unless a fund is not able to settle on T+2).

Barring reasons we may not be aware of, and for market efficiency and competitive reasons with the U.S. and within Canada, we believe there is an urgent need for clarity regarding the industry standard investment fund settlement cycle (that is, two-day settlement effective September 5, 2017).

### **Conclusion**

We would like the opportunity to meet with interested members of the CSA in the latter half of February to discuss our concerns, given the steadily declining time until T+2 implementation later this year. In the meantime, we would be pleased to answer any questions or elaborate on the expressed views at your convenience.

Yours sincerely,

*[original to be signed by Keith Evans]*

Cc: Mark Gordon (MFDA); Andrew Kriegler (IIROC); Paul Bourque (IFIC); Mark Hubbard (Fundserv); Meg Tassie (BCSC); Martin Picard (AMF); Nick Hawkins (OSC)

## Appendix

### Possible Amendments to NI 81-102 and NI 81-104

#### **NI 81-102 Investment Funds**

##### 9.4 "Delivery of Funds and Settlement"

- (1) A principal distributor, a participating dealer, or a person or company providing services to the principal distributor or participating dealer must forward any cash or securities received for payment of the issue price of securities of a mutual fund to an order receipt office of the mutual fund so that the cash or securities arrive at the order receipt office as soon as practicable and in any event no later than the ~~third~~ second business day after the pricing date.
- (2) Payment of the issue price of securities of a mutual fund must be made to the mutual fund on or before the ~~third~~ second business day after the pricing date for the securities by using any or a combination of the following methods of payment: ...
- (4) If payment of the issue price of the securities of a mutual fund to which a purchase order pertains is not made on or before the ~~third~~ second business day after the pricing date or if the mutual fund has been paid the issue price by a cheque or method of payment that is subsequently not honoured,
  - (a) 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~~ third business day after the pricing date or on the day on which the mutual fund first knows that the method of payment will not be honoured; and...

##### 10.4 "Payment of Redemption Proceeds"

- (1) Subject to subsection 10.1(1) and to compliance with any requirements established by the mutual fund under paragraph 10.1(2)(b), a mutual fund must pay the redemption proceeds for securities that are the subject of a redemption order
    - (a) within ~~three~~ two business days after the date of calculation of the net asset value per security used in establishing the redemption price; or
    - (b) if payment of the redemption proceeds was not made at the time referred to in paragraph (a) because a requirement established under paragraph 10.1(2)(b) or a requirement of subsection 10.1(1) had not been satisfied, within ~~three~~ two business days of (i) the satisfaction of the relevant requirement, or (ii) the decision by the mutual fund to waive the requirement, if the requirement was a requirement established under paragraph 10.1(2)(b).
- ...

#### **NI 81-102 Commodity Pools**

##### 6.3 "Payment of Redemption Proceeds"

The references in subsection 10.4(1) of National Instrument 81-102 to "~~three~~ two business days" shall be read as references to "15 days" in relation to commodity pools."