



Meeting link: <https://us02web.zoom.us/j/87648777622?pwd=VEtxRytEVHBrUjdDNFBtaTd0T2NKZz09>

Call to Order

Attendees are requested to enter into Zoom their:

- (a) name, and
- (b) firm name

Those dialing in by telephone are requested to email the Chair to confirm their attendance.

- 1. Approval of Minutes from the meeting held on January 18, 2023**
- 2. Matters arising from the minutes of the meeting held on January 18, 2023**
- 3. Action Items**
- 4. CCMA-CETFA letter-Request for Regulatory Guidance-Collateral-Delayed Securities**
- 5. Other Business**
- 6. Next Meeting March 21, 2024 at 11:00 am ET**

Jamie Anderson chaired the meeting and welcomed the attendees. Attendees were requested to indicate in Zoom their (a) name, and (b) firm; those telephoning in to the video meeting were requested to email Jamie or Keith Evans to confirm their attendance.

1. Approval of Meeting Minutes – December 21, 2023

The meeting minutes were approved.

2. Matters arising from Meeting Minutes – December 21, 2023

There were no matters arising from the meeting minutes.

3. Action Items

The open actions items were reviewed. Any updates will be reflected in the action items tracking document.

4. Issue Logs

- **T1LRWG-22 – CDCC**

The CDCC Rule amendment materials (including the Operations manual and the Risk Manual) were included in the meeting materials. The amendments reflected the suggested changes indicated in the issue log. There was a question included in the issue log on Rule C-18 for 30-year Canada Bond Futures – this was included in the CDCC materials and was not missed in the review.

The issue log also contained a suggested drafting change (instead of “up to and including the first last Business Day preceding the last Business Day of the Delivery Month” it was suggested “up to and including the Business Day preceding the last Business Day of the Delivery Month” – the “first” appears to be superfluous). Jamie said he had noted this to CDCC.

- **T1LRWG-2 – NI 62-104 *Takeover Bids and Issuer Bids***

The issue log material was included in the meeting materials. The OWG has agreed that the take-up payment deadline (currently 3 days) should align with the prevailing settlement cycle as it does in the U.S. [Rule 14e-1(c)]. CCMA will coordinate a letter to submit to the securities regulatory authorities requesting an amendment to NI 62-104.

5. Other Business

Jamie reported that Costa Rica is planning to move to T+1.

In regards to the ETFTF, work continues on the draft letter.

6. Next Meeting

January 18, 2024 at **11:00 am ET**

Attendance		Organization	Member
1.		AMF	Julie Boyer
2.		AMF	Francis Coche
3.		AMF	Francis Pignoti Pana
4.		AMF	Herman Tan
5.		AMF	Hector Toriz
6.		ASC	Jan Bagh
7.		ASC	Chad Conrad
8.		ASC	Harvey Steblyk
9.		BMO	Claudia Ardeleanu
10.		BMO	Michelina Crecco
11.		BMO	Adetoun Dinah
12.		BMO	Michael Giancursio
13.		BMO	Natalia Markelova
14.		BMO	Svetlana Perunova
15.		BMO	prem
16.		BMO	Olga Svistoun
17.		BMO	Iris Trotman
18.		Casgrain	Alejandro Hozer
19.		Casgrain	Lysianne Guillemette
20.		Casgrain	Jonathan Lee
21.		Casgrain	Pierre Mital
22.		Casgrain	Andre Zanga
23.		CCMA	Barb Amsden
24.		CCMA	Jamie Anderson - CHAIR
25.		CCMA	Keith Evans
26.		CIBC	Maryam Bashir
27.		CIBC	Carol Elmalem
28.		CIBC	Halyna Fenkanyhawryshko
29.		CIBC	Lavanya Gandhimohan
30.		CIBC	Vikram Gulati
31.		CIBC	Danny Leca
32.		CIBC	Terry Moore
33.		CIBC	Jim Newman
34.		CIBC	Kevin Ooi
35.		CIBC	Kapil Sharma
36.		CIBC Mellon	Frank Baron
37.		CIBC Mellon	Nick Douzenis
38.		CIBC Mellon	Carol Revoredo
39.		Connor, Clarke & Lunn	Patrick Robitaille
40.		CIRO	Muneeb Ahsan
41.		CIRO	Catherine Drennan

	Attendance	Organization	Member
42.		CIRO	Bruce Grossman
43.		Desjardins	Zachary Carmel
44.		Desjardins	Gino Cimetta
45.		Desjardins	Francine Duchesne
46.		Desjardins	Lafleche Montreuil
47.		Desjardins	Éric Primeau
48.		Desjardins	Jean-Gabriel Vigneault
49.		DTCC ITP	Tasneem Novak
50.		DTCC	Vikash Saunders
51.		DTCC	Patricia Wong
52.		E&Y Canada	Esmail Enjilela
53.		E&Y Canada	Stephen Gaon
54.		E&Y Canada	Alexandra Nestyurkina
55.		E&Y Canada	Chris Pimentel
56.		E&Y Canada	Gaurang Sardana
57.		E&Y Canada	Thad Spiker
58.		Edward Jones	Todd Stevenson
59.		Fidelity	Ashley Ramnaraine
60.		IFIC	Pamela Egger
61.		IFIC	Janet Salter
62.		Invesco	Caroline Mingfok
63.		L&T Infotech/IFIC	Janaki Nagulan
64.		L&T Infotech	Kim Barrett
65.		Manulife	Bill Devolin
66.		Morgan Stanley	Brian Choy
67.		Morgan Stanley	Mazen Ghanem
68.		National Bank	Anna Tyniec
69.		Northern Trust - Legal	Scott Kelly
70.		OSC	Matthew Andreacchi
71.		OSC	Aaron Ferguson
72.		OSC	Nick Hawkins
73.		OSC	Annetta Ho
74.		OSC	Frank Lacroce
75.		OSC	Michael Tang
76.		OSC	Emily Sutlic
77.		OSC	Stephanie Wakefield
78.		Questrade	Lawrence Horowitz
79.		RBC	Allan Laurent
80.		RBC - IS	Alan Tonner
81.		RBC	John Coyle
82.		Scotiabank	Siv Angalakuduru

Attendance	Organization	Member
83. 	Scotiabank	Jason Dear
84.	Scotiabank	William Finn
85.	Scotiabank	Alvin Lam
86.	Scotiabank	Chesley Morphy
87.	Scotiabank	Julia Piergeti
88.	Scotiabank	Sean Steele
89.	Société Générale Capital Canada Inc.	Augustin Deprez
90.	Société Générale Capital Canada Inc.	Maxime Frézal
91. 	Société Générale Capital Canada Inc.	Louis-Philippe Nadeau
92.	Société Générale Capital Canada Inc.	Marc-Antoine La Rochelle
93. 	Société Générale Capital Canada Inc.	Anna Wong
94. 	State Street	Christen Henry
95.	TD	Marlene Costa
96.	TD	Jasvir Bhogal
97.	TD	Ellen Lee
98. 	TD	Veronica Lee
99.	TD	Riyaad Munshi
100.	TD	Naudia Nelson
101.	TD	Kenneth Poon
102.	TD	Rajiv Ranjan
103.	TD	Aamir Shahzad
104.	TD	Lucy Vetro
105.	TD	Katherine Yu
106. 	TD Wealth	Paul Garnavos
107. 	TD Wealth Governance & Control	Elodie Goncalves
108.	TMX	Alexandre Prince
109.		Dave O'Marra
110.	Vanguard/CEFTA	Jessica Stern
111.		Chris Madden
112.		Jane Chan
113. 		Laxman
114.		Ashley S.
115.		Judith Marcelo
116.		Sophie
117.		Will Gruska
118.		Mike Salter
119.		Nishant Bhatia
120.		Rakesh Jha
121.		Simple

Action	Status
1. IIAC posting of the standardized Trade Matching Statement	<p>May 23, 2023: At the T1SC, IIAC agreed to post the standardized TMS if there was interest by the OWG.</p> <p>June 8, 2023: OWG indicated its desire to have the standardized TMS posted on the IIAC website.</p> <p>June 29, 2023: The updated standardized TMS was provided to IIAC. The TMS was posted on the IIAC website but changed by IIAC (removing reference to the IIAC and CIRO endorsements).¹ CCMA confirmed that CIRO has no issue with regards to its reference of endorsement and that may be retained. A revised standardized TMS has been drafted (removing IIAC's endorsement) and also made into an interactive fillable pdf.</p> <p>Sept. 28, 2023: CIRO Bulletin issued with fillable TMS form.² Link is also accessible from the CCMA website (see What's New).</p> <p>Sept. 29, 2023: Link to CIRO Bulletin and TMS form emailed to IIAC for posting.</p> <p>Oct. 24, 2023: IIAC advised at the T1SC meeting that it will be issuing a newsletter noting the CIRO Bulletin link and fillable TMS form.</p> <p>Nov. 21, 2023: IIAC is updating its website and will include the TMS once completed.</p>
2. Mutual Funds – clarity re: funds moving to T+1	<p>July 25, 2023: Fundserv has been requested to provide a summary at the end of 2023 of the funds that have indicated their intention (by file submission to Fundserv) to move to T+1.</p> <p>Nov. 28, 2023: Reported at the T1SC meeting, Fundserv is considering the request.</p> <p>Dec. 19, 2023: Reported at the T1SC meeting, Fundserv is discussing a survey with its fund manufacturer members to determine the portion of funds that are moving to T+1 and the expected date of the move.</p> <p>Jan. 18, 2024: NBI and AGF have advised that they are moving 100% of their funds to T+1. Desjardins is moving all but one of its funds to T+1. EFAMA released a consultation response for ESMA's call for evidence on shortening the settlement cycle. The response discusses T+1 and T+0 and highlights the benefits of moving to T+1. The response also notes that European funds hold a significant percentage of U.S. securities (higher than 40%) and that it will be imperative that the European funds move to T+1 to be in synch (https://www.efama.org/sites/default/files/files/EFAMA%20reply%20to%20ESMA%20CfE%20on%20shortening%20of%20the%20settlement%20cycle.pdf).</p> <p>Feb. 13, 2024: Fundserv is planning a survey of funds to determine the intent to move to T+1. Additionally, Fundserv plans on providing daily information on which funds are moving to T+1 during the week leading up to the transition weekend.</p>
3. LRWG-9 – Investment Funds (determination of non-Fundserv cleared funds – communication of	<p>For Fundserv settled funds, the settlement cycle is indicated on Fundserv's website: https://www.fundserv.com/industry-resources/fund-profiles/</p> <p>Oct. 19, 2023: Request to LRWG members for input regarding universe of non-Fundserv cleared funds and the process for communicating settlement cycles (including to investors).</p>

¹ <https://iiac-accvm.ca/wp-content/uploads/2023/08/Standardized-Trade-Matching-Statement-NI-24-101-2023-June-13.pdf>.

² <https://www.ciro.ca/news-room/publications/national-instrument-24-101-trade-matching-statement>. French: <https://www.ocri.ca/salle-de-presse/publications/declaration-relative-lappariement-des-operations-norme-canadienne-24-101>.

Action	Status
settlement period to investors)	<p>Nov. 22, 2023: For post-trade communication on non-Fundserv cleared funds, a trade confirmation is sent to the client and settlement is by email. MFD rule 5.4.3 under CIRO also require settlement date to be on the trade confirm. Pre-trade communication for settlement cycle is still under review.</p> <p>Dec. 19, 2023: The CEWG is developing an FAQ that may assist in the settlement cycle communication.</p> <p>Jan. 18, 2024: The CEWG FAQ is expected to be posted to the CCMA website in January 2024.</p> <p>Feb. 13, 2024: The CEWG FAQ was posted to the CCMA website on Jan. 30, 2024. A 2nd FAQ is in development.</p>
4. LRWG-15 (MFDA 5.4.3) - Settlement Date on Transaction Confirmations - any amendments for sales compliance procedures	<p>Sept. 21, 2023: CIRO has confirmed that it will be updating its compliance review process in advance of the T+1 implementation date to reflect that T+1 settlement is optional for mutual funds under NI 81-102. CIRO will advise closer to the implementation date regarding status.</p>
5. LRWG-21(a), 21(b) - CDS	<p>Oct. 19, 2023: CDS has identified procedure amendments – these align generally with those indicated in the issue log. Being tabled with SDRC in November 2023, then submitted to the regulatory authorities on a Technical/Housekeeping basis.</p> <p>Nov. 28, 2023: CDS advised that the regulatory notice will be tabled with the SDRC in January 2024.</p> <p>Jan. 18, 2024: Regulatory notice and amendments will be tabled with the SDRC on Jan. 25, 2024.</p> <p>Feb. 13, 2024: The SDRC approved the amendments. Next step is regulatory review.</p>
6. LRWG-22 - CDCC	<p>Oct. 19, 2023: Rules changes being tabled with CDCC Board by end of October 2023, then submitted to the regulatory authorities on a Technical/Housekeeping basis.</p> <p>Jan. 18, 2024: Rules changes approved by the CDCC Board on Oct. 26, 2023. Request for Public Comments Notice published by OSC (https://www.osc.ca/sites/default/files/2023-12/cdcc_20231221_t1settlement.pdf) & the AMF (https://lautorite.qc.ca/fileadmin/lautorite/bulletin/2023/vol20no50/vol20no50_7-3.pdf) on Dec. 21, 2023 – comment period ends Jan. 18, 2024. CDCC notice: https://www.cdcc.ca/u_avis_en/153-23_en.pdf. The amendments were classified material as there were systems changes for T+1.</p>
7. LRWG-30, 31, 32, 33, 34 - TSX Rule Book, TSX Company Manual, MX, TSX-V Rule Book, TSX-V Corporate Finance Manual	<p>Oct. 19, 2023: Work is expected to commence by TMX in early 2024.</p>
8. LRWG-37 & 38 - NEO (Cboe Canada) Trading Policies, Listing Manual	<p>Nov. 13, 2023: Work will commence in 2024 (post NEO and MatchNow amalgamation).</p>

Action	Status
9. LRWG-35 & 38 – CSE Trading Rules, Listing	Nov. 28, 2023: At the T1SC meeting, CSE advised it will review its issue logs.
10. Exchanges' guidance to issuers re corporate actions	<p>Nov. 16, 2023: Exchanges will need to issue guidance to their issuers (such as done for T+2) to avoid setting corporate actions/entitlements to take effect around the May 27, 2024 transition date.</p> <p>TSX issued a staff notice for T+2 on July 13, 2017 (the same date as its rule amendments' notices were issued) indicating the pending rule changes and examples of ex-dates: https://decisia.lexum.com/tsx/sn/en/454524/1/document.do).</p> <p>NEO Exchange (now Cboe Canada) in its T+2 rule amendments notice 2017-032 dated July 27, 2017 referred to corporate actions with ex-dates on the transition date being avoided and that details would be published by notice to NEO Listed Issuers.</p> <p>CSE in its T+2 rule amendments notice 2017-013 dated July 27, 2017 referred to the ex-date methodology being applied transitionally to minimize manual claims between participants. www.thecse.com/notice/notice-2017-013-housekeeping-rule-industry-transition-to-t2-securities/</p> <p>Feb. 13, 2024: TMX has sent a letter to its listed issuers advising that they avoid the transition period for corporate actions. TMX will send a 2nd letter closer to the transition date.</p>
11. LRWG-2 – NI 62-104 Takeover Bids and Issuer Bids	<p>Jan. 18, 2024: OWG agreed in principle at its meeting on Jan. 11, 2024 that there should be alignment with the settlement cycle (matching the requirements in the U.S.).</p> <p>Feb. 13, 2024: OWG confirmed its position on Feb. 8, 2024 that there should be alignment. CCMA to coordinate an industry letter requesting amendments to NI 62-104.</p>
12. LRWG-50 – Candéal	Feb. 13, 2024: Candéal has advised it has the necessary changes for the trading platform ready to be effective for T+1 on May 27, 2024. Followed up to confirm that the systems changes have been tested and will be implemented on the May 25-26, 2024 weekend and that the subscriber agreements do not need any amendments and that there are no Form 21-101F2 filings required for T+1.
13. LRWG-49 – Tradelogiq	Feb. 13, 2024: Inquiry to Tradelogiq regarding (a) any required systems changes/test plan/implementation, (b) historical subscriber agreements needing amendments (current template does not require changes), and (c) that there are no Form 21-101F2 filings required for T+1.

Action Items	Status
Pending Closure	
1. Buy Side Task Force – clarity re: scope of NI 24-101 with respect to investment managers that are not advisers, and custodians. (whether these entities are subject [or should be subject] to the mandatory requirements	<p>June 27, 2023: As described in the BSTF report approved by the T1SC, some investment managers such as pension funds have indicated that they are not advisers under securities law and are not registered advisers. However, they are voluntarily meeting the requirements under NI 24-101. T1SC requested that the CCMA seek clarity from the regulators.</p> <p>Aug. 22, 2023: CCMA met with the OSC to provide background and seek clarity; OSC staff will be looking into the matter.</p> <p>Jan. 18, 2024: CCMA-OSC meeting scheduled for Feb. 2, 2024</p> <p>Feb. 15, 2024: CCMA met with OSC Staff on Feb. 2, 2024. NI 24-101 regulatory requirements are imposed on Registered Dealers and Registered Advisers. There is no NI 24-101 regulatory requirement for a custodian or an institutional investor (to the extent it is not a Registered Adviser) to enter into a trade matching agreement or to provide a trade matching statement. As an example, OMERS obtained OSC exemptive relief from the requirement to be registered as an adviser (because it managed some third-party assets - https://www.osc.ca/en/securities-law/orders-rulings-decisions/omers-administration-corporation-s-253-and-741). Another relief application to the OSC provides background on PSP Investments which provides investment management services to various federally-governed pension funds (https://www.osc.ca/en/securities-law/orders-rulings-decisions/public-sector-pension-investment-board-and-its-affiliates). In the relief application it was noted that PSP Investments is not registered as an “adviser” nor acts as an adviser in reliance upon exemptions from the adviser registration requirement under securities legislation. While as noted in discussions with the OSC that amending NI 24-101 could take up to 2 years, if it was desired to widen the net for trade-matching obligations, s. 3.2 and s. 3.4 could be amended to replace “are designed to encourage each trade-matching party...” with “require each trade-matching party...”.</p>

Closed Action Items	Status
1. Discussion re: investment fund prospectuses	Sept. 21, 2023: IFIC has advised that there is no regulatory requirement relating to disclosure in prospectuses, Fund Facts or ETF Facts which require disclosure of settlement periods for purchases and sales of mutual fund units or ETFs. It is each fund manager's decision as to whether to include such disclosure where it is not required. LRWG agreed to close the Action Item.
2. LRWG-16 - Guidance on the regular settlement date to be used for certain foreign exchange hedge trades – CIRO	Oct. 19, 2023: Updated guidance bulletin to be issued Oct. 26, 2023. Nov. 16, 2023: Bulletin published (https://www.ciro.ca/news-room/publications/guidance-regular-settlement-date-be-used-certain-foreign-exchange-hedge-trades). LRWG recommended issue log to be closed by the T1SC.
3. LRWG-17 – CIRO – Corporation Investment Dealer & Partially Consolidated Rules	Oct. 19, 2023: Bulletin indicating regulatory approval to be published Oct. 26, 2023. Nov. 16, 2023: Bulletin published (https://www.ciro.ca/news-room/publications/amendments-umir-and-idpc-rules-facilitate-investment-industrys-move-t1-settlement). LRWG recommended issue log to be closed by the T1SC.
4. LRWG-19 – CIRO – UMIR	Oct. 19, 2023: Bulletin indicating regulatory approval to be published Oct. 26, 2023. Nov. 16, 2023: Bulletin published (https://www.ciro.ca/news-room/publications/amendments-umir-and-idpc-rules-facilitate-investment-industrys-move-t1-settlement). LRWG recommended issue log to be closed by the T1SC.
5. Collateral and the <i>Investment Company Act of 1940</i>	Oct. 19, 2023: A request to the LRWG for information concerning this item. Dec. 21, 2023: It has been determined that the '40 Act does not refer to collateral nor reference payment or unwinding purchase orders to the same level of specificity as NI 81-102. LRWG agreed to close the Action Item.
6. LRWG1 – NI 24-101	Dec. 21, 2023: Regulatory approval received Dec. 14, 2023. LRWG recommended issue log to be closed by the T1SC.
7. ETFTF – data for primary market failed ETF creation, impact on secondary market	Oct. 19, 2023: A request to the LRWG for information concerning these items. Jan. 18, 2024: There is no current source to obtain data on failed creates and resulting impact on the secondary markets. There are discussions in various jurisdictions concerning increasing fail rates and potential solutions such as T-0 creates for ETFs, and increasing use of cash collateral and/or cash-in-lieu payments. https://www.etfstream.com/articles/investors-paying-the-price-for-t-1-creation-inefficiencies . https://www.bbh.com/us/en/insights/investor-services-insights/how-t1-impacts-the-global-etf-ecosystem.html . https://www.investmentexecutive.com/newspaper/news-newspaper/whats-on-the-regulatory-horizon-for-etfs/ .

By email

DRAFT February 9, 2024

Keith Evans

Executive Director

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Pat Dunwoody

Executive Director

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Attention: Staff of the Investment Funds & Structured Products Branch

Ontario Securities Commission

20 Queen Street West, 22nd Floor

Toronto, Ontario M5H 3S8

E-mail: rchan@osc.gov.on.ca; dmckall@osc.gov.on.ca; mtang@osc.gov.on.ca

Dear OSC Staff:

Re: Request for Regulatory Guidance – Acceptable Use of Cash Collateral for Delayed Basket Securities in ETF Subscriptions

On behalf of the members of the Canadian Capital Markets Association (“CCMA”) and the members of the Canadian ETF Association (“CETFA”), we are requesting guidance from OSC Staff regarding the permissibility under National Instrument 81-102 *Investment Funds* (“NI 81-102”) of the acceptance of cash collateral for “Delayed Basket Securities” in the exchange traded funds (“ETF”) unit subscription process.¹ Delayed Basket Securities are late-delivered Basket Securities that were agreed (at the time of subscription) to be delivered by an authorized participant (“AP”) to an ETF by the settlement date for an in-kind subscription for ETF units.²

As there is no formal process or centralized collateral facility in Canada (such as in other jurisdictions), there is a lack of clarity amongst some industry participants as the permissibility of this practice, notwithstanding the mitigation of failed trades caused by the Delayed Basket Securities. Regulatory guidance would eliminate this lack of clarity and provide certainty to the industry. Furthermore, the industry has agreed there should be established standards for the practice. Regulatory guidance would assist in setting and communicating the expectations for these industry standards.

CCMA’S EXCHANGE TRADED FUNDS TASK FORCE and CETFA’S WORKING GROUP

In the spring of 2023, the CCMA’s Operations Working Group struck the ETF Task Force (“ETFTF”) to explore matters of concern with respect to ETF’s transitioning to T+1. The ETFTF is comprised

¹ While various forms of collateral have been discussed, the industry has coalesced around the use of cash collateral only (for Delayed Basket Securities) at this time.

² An AP may subscribe for ETF units by delivering to the ETF manager as consideration for the purchase a group of securities approved by the manager of the ETF (“Basket Securities”).

of subject matter experts in the ETF space and includes representation from banks, non-bank owned investment dealers, custodians, and CETFA. Various issues were raised, ranging in length of time to address. The principal short-term matter that arose at the beginning of the ETFTF's discussions was the acceptability of collateral in the subscription/redemption processes for ETF units. This matter was narrowed to focus on cash collateral in the subscription process for Delayed Basket Securities.

CETFA also formed a working group to consider the collateral process from the perspective of its investment fund managers and bring their views to the ETFTF. A significant number of CETFA investment fund managers have also been directly involved in ETFTF discussions.

IMPACTS OF DELAYED BASKET SECURITIES

ETFs do not issue ETF units until payment is received in accordance with the requirements of Section 9.4 of NI 81-102. In the case of Delayed Basket Securities, typical practice is to adopt a conservative interpretation approach - ETF units are not delivered to the AP until all Basket Securities, including all Delayed Basket Securities, are delivered to the ETF. Thus Delayed Basket Securities result in "Delayed ETF Units" (ETF units that have not been delivered to an AP, pending settlement of Delayed Basket Securities). Such Delayed ETF Units in turn cause a delay in the onward delivery of such ETF units to market participants who have purchased them in the secondary market.

T+1 and Mitigation of Fail Risk

With the approaching T+1 transition date of May 27, 2024, there is concern that the shortened settlement cycle will increase the incidence of Delayed Basket Securities, resulting in Delayed ETF Units occurring more frequently and increasing the rate of downstream settlement failures.³ The shortened settlement timeline will make it more challenging to obtain, on a timely basis, all Basket Securities required for an in-kind ETF subscription. APs are dependent on other market actors providing timely delivery of securities. The T+1 settlement cycle will make it more difficult to obtain the full basket of securities for in-kind subscriptions within the one day post-trade settlement cycle, simply because there is reduced time to resolve routine issues, such as delayed return of securities on loan, or corporate actions that cause delay in movement. As most ETF units purchased by an AP through subscription orders are ultimately sold in the secondary market, delays in the primary market will adversely impact the secondary market such as increasing failed trades.

A standardized cash collateral process would help to mitigate such delays in the settlement of ETF units and the associated risks, by enabling delivery of ETF units to APs on the original settlement date, and timely onward delivery to other participants and provide consistency for the industry. Such a process would permit an ETF to accept cash delivered by the AP as collateral

³ There are discussions in various jurisdictions concerning increasing fail rates and potential solutions such as "T-0 creates" for ETFs. <https://www.etfstream.com/articles/investors-paying-the-price-for-t-1-creation-inefficiencies>.

against Delayed Basket Securities, and deliver the corresponding ETF units to the AP. This increases efficiency in the capital markets and reduce settlement fail risk (both for primary and secondary markets), while also protecting the ETF and investors.

It is noted that it has been reported that globally there will be an increased use of cash collateral and/or cash-in-lieu⁴ in the ETF primary market due to the timing changes associated with T+1.⁵

Investment Dealer Capital

Situations where an AP is awaiting delivery of Delayed ETF Units also have the potential to negatively impact the capital charges to which investment dealers are subject. APs will often deliver Basket Securities throughout the day as they become available, and cannot perfectly forecast situations where delivery to the ETF of a given security will be delayed. For example, if an investment dealer delivers \$9.9 million of Basket Securities on a subscription for \$10 million of ETF units, without the use of collateral for the \$100,000 of Delayed Basket Securities, the ETF units cannot be delivered to the AP. The investment dealer's balance sheet is negatively impacted (its assets drop by \$9.9 million). This can result in capital charges that ultimately are passed on to the investor.

Settlement Efficiency

Where APs do not have the ability to provide cash as collateral for Delayed Basket Securities, they typically will wait until they have possession of all of the Basket Securities before delivering the securities as payment for the ETF units. Otherwise, if the APs delivered a partial basket of securities, and the remaining component of the basket was not received in time by the AP and could not be delivered to the ETF, there would be Delayed ETF Units.

Where the APs can use cash collateral, they will be able to deliver the securities of the basket as they become available, rather than all at once in bulk at the payment deadline with the knowledge that they will receive the ETF units whether all of the Basket Securities are delivered or part of the Basket Securities plus cash collateral are delivered. Operationally, this is a more efficient process.

COLLATERAL IN VARIOUS JURISDICTIONS

U.S.

⁴ Cash-in-lieu refers to the permanent replacement of Delayed Basket Securities with cash (the Delayed Basket Securities will not be provided by the AP).

⁵ <https://www.bbh.com/us/en/insights/investor-services-insights/how-t1-impacts-the-global-etf-ecosystem.html>. See also, https://www.investmentexecutive.com/newspaper/_news-newspaper/whats-on-the-regulatory-horizon-for-etfs/.

In the U.S., the practice of collateral provision for Delayed Basket Securities is publicized, accepted, and well established.⁶ As reported to the ETFTF, market participants using the collateral mechanism in the U.S. find that this stabilizes transaction processing and improves the “smoothness” of the market.

Primary market settlement in the US for ETFs is conducted either through continuous net settlement (“CNS”) at the National Securities Clearing Corporation (“NSCC”),⁷ or for non-CNS eligible securities, settled on a bilateral basis (manually through The Depository Trust Company).

The bilateral collateral arrangements are governed by agreements between the parties. AP Agreements address two different cash mechanisms to address Delayed Basket Securities, cash-in-lieu or collateral⁸. Under the cash-in-lieu process, the ETF manager will acquire the Delayed Basket Securities rather than the AP providing such securities at a later date and receiving back the deposited cash. Under the collateral mechanism, cash is temporarily provided by the AP. Upon delivery of the Delayed Securities to the ETF manager, the cash is returned to the AP. The collateral is delivered in accordance with “Cash Collateral Settlement Procedures”.⁹

From a legal and regulatory perspective, the U.S. *Investment Company Act of 1940* (“40 Act”) is silent on collateral use for Delayed Basket Securities – it neither explicitly prohibits nor explicitly permits such collateral use. It is understood that the collateral practice developed early in the offering of ETFs in the U.S. ETF managers described the practice in exemption applications they filed with the United States Securities and Exchange Commission (“SEC”) for relief to enable them to issue ETFs. A description of the practice is contained in various filings to the SEC, such as noted in footnote 23 of In the Matter of iShares Trust, BlackRock Fund Advisors, iShares, Inc., BlackRock Fund Advisors, and SEI Investments Distribution Co., dated November 12, 2010:

“To the extent contemplated by an AP Agreement, Creation Units will be issued to such Authorized Participant notwithstanding the fact that the corresponding Fund Deposits have not been received in part or in whole, in reliance on the undertaking of the Authorized Participant to deliver the missing Deposit Securities as soon as possible, which undertaking shall be secured by such Authorized Participant’s delivery and maintenance of collateral consisting of cash in the form of U.S. dollars in immediately available funds (marked-to-market daily) of 105% or more of the value of the missing Deposit Securities. The AP Agreement will permit the Fund to buy the missing Deposit Securities at any time and will

⁶ APs that create and redeem ETFs that hold foreign underlying securities are also generally required to post collateral. https://www.ici.org/doc-server/pdf%3Appr_15_aps_etfs.pdf.

⁷ Note that NSCC is targeting May 28, 2024 to launch its T0 Create/Redeem cycle with submission of a Cash Collateral Amount (buffer) and an end of day Collateral Cash Adjustment (true-up) <https://dtcclearing.com/products-and-services/equities-clearing/etf-processing/etf-release.html>. NSCC rules are approved by the Securities and Exchange Commission.

⁸ E.g., <https://www.sec.gov/Archives/edgar/data/1479026/000119312515282875/d837615dex99h2.htm>.

⁹ These are maintained by the transfer agent for the ETF manager and are available to the AP upon request.

subject the Authorized Participant to liability for any shortfall between the cost to the Fund of acquiring such Deposit Securities and the value of the collateral.”¹⁰

Similar language may be found in other ETF documentation.¹¹

Europe

The Central Bank of Ireland issued a report on ETFs in 2017 that included reference to collateral for Delayed Basket Securities.¹² ETFs that are under the Undertaking for Collective Investment in Transferable Securities contain the flexibility in their prospectuses for collateral for Delayed Basket Securities. At the time of the report it was noted that European ETFs typically function on a cash (delivery versus payment) basis compared to the predominant in-kind (free of payment) basis for creations in the U.S. and as such, the collateral mechanism for Delayed Basket Securities is not typically used in Europe.

While Europe is still on a T+2 settlement cycle, European Fund and Asset Management Association’s reply to the European Securities and Markets Authority’s call for evidence on shortening the settlement cycle highlights the benefits of funds moving to T+1.¹³ It would be expected that issues such as Delayed Basket Securities would arise when Europe moves to T+1, possibly increasing the use of collateral as a mitigation against increased failed transactions.

Canada

In Canada, there is no centralized collateral facility for ETFs and until such a facility is operational, collateral use would be left to bilateral arrangements governed by contract between the parties (akin to the non-CNS eligible securities process in the U.S.). Similar to the U.S.’s 40 Act, NI 81-102 is silent in regards to the use of collateral for Delayed Basket Securities.

The lack of a mature collateral process in Canada (i.e. no centralized facility) and the silent nature of NI 81-102 regarding collateral for Delayed Basket Securities has led to some uncertainty in the industry as to the permissibility of cash collateral use and the adoption of a conservative stance in the absence of a “bright-line” rule. While a parallel may be drawn between the silent nature of both the 40 Act and NI 81-102 regarding the permissibility of collateral for Delayed Basket Securities, there is more specificity around payments and unwinding of purchase orders in NI 81-102.

¹⁰ https://www.sec.gov/Archives/edgar/data/1006249/000119312510258899/d40appa.htm#tx118362_22.

¹¹ See “Procedures for Creation Unit Purchases” at p. 30 of Statement of Additional Information dated December 30, 2023: <https://institutional.fidelity.com/app/proxy/content?literatureURL=/B-CT12-PTB.PDF>.

¹² <https://www.centralbank.ie/docs/default-source/publications/discussion-papers/discussion-paper-6/discussion-paper-6---exchange-traded-funds.pdf>.

¹³

<https://www.efama.org/sites/default/files/files/EFAMA%20reply%20to%20ESMA%20CfE%20on%20shortening%20of%20the%20settlement%20cycle.pdf>.

The provisions of Part 9 of NI 81-102 prescribe how primary market purchases of securities of mutual funds, including ETFs, are completed. Section 9.4(2) of NI 81-102 provides that payment of the issue price of such securities must be made on or before the second business day after the pricing date for the securities by cash, making good delivery of the securities that comply with the requirements of that section, or a combination of these methods.¹⁴ An ETF cannot release units into the CDS account of a purchasing dealer until full consideration has been delivered to the custodian on behalf of the ETF in accordance with the terms of NI 81-102.

In the case of Delayed Basket Securities, if a cash-in-lieu payment arrangement is not acceptable to the parties, without an alternative payment, Section 9.4(4) of NI 81-102 provides that the ETF manager must redeem the ETF units and the purchase cannot be completed because sufficient consideration for the ETF units has not been delivered. There is not uniform agreement amongst all of the industry participants whether cash delivered to the ETF and held as collateral against future delivery of Delayed Basket Securities clearly satisfies the requirements of NI 81-102.

Notwithstanding competing views of permissibility based on the current drafting of NI 81-102, from a policy perspective, the acceptance of cash collateral for Delayed Basket Securities is in the interest of the markets, their participants and investors. A collateral process allows subscriptions to settle on a timely basis and reduces failed trades. The acceptance of cash collateral for Delayed Basket Securities as payment for ETF units does not import additional risk to ETFs or the markets and should be permitted. The collateral process should be standardized, with agreed upon governance and procedures such as recommended in this letter. Under such a collateral process:

- (a) the ETF receives cash in an amount that exceeds the value of the Delayed Basket Securities;
- (b) cash is delivered to the ETF, held by the ETF's custodian in an account in the ETF's name;
- (c) the cash amount is adjusted mark-to-market on the Delayed Basket Securities value (with the ETF receiving additional cash or the AP receiving cash back based on the mark-to-market calculation); and
- (d) the ETF manager has a contractual right, upon delivery of appropriate notice to the AP, to use the cash to purchase the Delayed Basket Securities if the ETF manager in good faith believes it is in the best interest of the ETF.

There would be no reason or need to unwind the purchase order – the ETF is whole, without loss. Further details of the proposed process parameters are outlined in Appendix 1.

EXAMPLE OF CASH COLLATERAL USE

An example may help outline the desired clarity for cash collateral permissibility. Assume an ETF is comprised of 5 underlying Basket Securities (A, B, C, D, and E). The AP places an order for 1,000 units of the ETF. At the time of order on the pricing date, the AP anticipates having all of the Basket Securities available for delivery on the settlement date. The AP and the ETF manager agree that payment will be 1,000 shares of A, B, C, D, and E. However, on settlement date, the AP is

¹⁴ Pending amendments to NI 81-102 would change the payment deadline to a reference settlement date, The reference settlement date for ETFs is expected to be T+1 on May 27, 2024.

waiting for receipt of 1,000 shares of security E from another counterparty. Assume that on the pricing date (the date of the purchase order) that 1,000 shares of security E has a market value of \$1 million. Being unable to remit payment as agreed to as per the purchase order/trade ticket, and the AP and ETF manager having previously agreed to a cash collateral mechanism for Delayed Basket Securities, the AP delivers securities A, B, C, D and the cash collateral for 1,000 shares of security E to the ETF manager and the ETF units are delivered to the AP. Assuming a haircut of 2% for this example, and assuming there was no market price change in security E between the pricing date and the settlement date, the cash collateral provided on settlement date is \$1,020,000. There is no re-ticketing of the purchase order.

Assume that the market value of security E changes so 1,000 shares is now worth \$1,010,000. The AP tops up the cash collateral with an additional mark-to-market amount of \$10,000. The ETF manager now has \$1,030,000 of cash for the pending 1,000 shares of security E. If it is determined that the 1,000 share of security E will not be delivered, the ETF manager can use the cash collateral and purchase the 1,000 shares of security E for \$1,010,000). The ETF manager would return the excess cash collateral it possesses (i.e. \$20,000 less expenses associated with purchasing the 1,000 shares) to the AP.

Alternatively, if the AP is able to deliver the 1,000 shares to the ETF manager prior to the ETF manager deciding to acquire the 1,000 with the cash collateral itself, the AP makes such delivery and the ETF manager returns the cash collateral it was holding to the AP (in this case, \$1,030,000).¹⁵

The AP's payment is made with a combination of cash (on a temporary basis) and securities; once the Delayed Basket Securities are available and delivered, the cash collateral is returned. Whether the ETF manager receives the 1,000 shares of security E or uses the cash collateral to acquire the shares, the ETF is never in a loss position.

If however the AP was not able to use cash collateral, the purchase transaction would fail, and would continue to fail until 1,000 shares of security E were delivered or the purchase order cancelled. If 1,000 shares of securities A, B, C, D had been delivered in anticipation of settlement, they would need to be returned to the AP on purchase order cancellation. This adds operational burden to the process.

COLLATERAL GOVERNANCE

The ETFTF and the CETFA working group agree that there should be industry consensus as to the parameters governing cash collateral for Delayed Basket Securities. The recommended framework parameters are set out in Appendix 1 to this letter. The industry proposes to follow these framework parameters, incorporated into agreements between the parties.

¹⁵ Note that if it was agreed that a cash-in-lieu payment would instead be made for the delayed security E, the purchase order would need to be re-ticketed and the ETF manager would use the cash payment to purchase security E itself.

The industry has also agreed that the Delayed Basket Securities cash collateral mechanism should be optional. Parties should not be required to agree to cash collateral use; however, they may do so at their discretion by entering into agreements meeting the framework parameters and in accordance with regulatory guidance. Generally, the mechanism is to be an exception-based solution.

REQUEST FOR GUIDANCE AND PUBLICATION

The industry submits it is important to obtain clarity regarding cash collateral for Delayed Basket Securities since the ability to make use of the mechanism requires consensus between three parties in each instance – the ETF manager, the Authorized Dealer and the custodian. Without direction as to a common view that should be adopted by the industry as to the compliance of this solution with NI 81-102, this mechanism may be available only to certain industry participants depending on the parties to any subscription of Units and the legal advice they receive. Many industry participants wish to utilize this mechanism, but of course only to the extent it complies with NI 81-102. It may be difficult to arrive at consensus amongst the required parties depending on the level and nuance of legal analysis each such party has undertaken to consider this issue.

Additionally, the uncertainty that persists also gives rise to uncertainty around how to properly comply with the requirements of section 12.1 of NI 81-102 and how managers meet their obligations to properly complete compliance reports. Receiving guidance from the regulatory authorities would help alleviate the uncertainty related to this obligation as well.

Thus the question to OSC staff: *“Can an ETF accept the delivery of cash, to be held by the fund as collateral until Delayed Basket Securities are delivered by an AP, to satisfy the requirements of section 9.4 of NI 81-102?”* We submit this as an issue of regulatory interpretation that needs to be resolved for the comfort of the industry broadly. Accordingly, we are requesting regulatory guidance in a written form that can be relied on by the industry at large, including, for example, incorporating such guidance into the amendments to NI 81-102 and its companion policy that were published for comment on October 19, 2023, or the issuance of a standalone guidance notice.

We would be pleased to answer any questions or elaborate on industry views at your convenience.

Yours sincerely,

[original signed by Keith Evans]

[original signed by Pat Dunwoody]

APPENDIX 1

(a) The collateral:

- has a market value equal to at least 102 percent of the market value of Delayed Basket Securities,
- transaction is made under a written agreement that implements these Appendix 1 requirements,
- transferred by the purchaser is immediately available for good delivery under applicable legislation,
- is received by the ETF either before or at the same time as it delivers the ETF units,
- is marked to market on each business day, and the amount of collateral in the possession of the ETF is adjusted on each business day to ensure that the market value of collateral maintained by the ETF in connection with the transaction is at least 102 percent of the market value of the Delayed Basket Securities, and
- is held by the custodian an account in the name of the ETF.

(b) The ETF is entitled to realize on the collateral in good faith at any time.