THE CANADIAN DEPOSITORY
FOR SECURITIES LIMITED
LA CAISSE CANADIENNE
DE DÉPÔT DE VALEURS LIMITÉE

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Saskatchewan Securities Commission
Manitoba Securities Commission
Ontario Securities Commission
Securities Administration Branch, New Brunswick
Securities Office, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Nunavut
Registrar of Securities, Yukon Territory

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Dear Sirs and Madams:

Re: Canadian Securities Administrators' (CSA's) Request for Comment on Discussion Paper 24-401 on Straight-Through Processing, Proposed National Instrument (NI) 24-101 on Post-Trade Matching and Settlement, Proposed Companion Policy 24-101CP to NI 24-101 and B.C. Securities Commission Questions

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The Canadian Depository for Securities Limited[1] (CDS) supports the industry move towards cross-industry straight-through processing (STP) and is pleased to provide comments on the CSA's discussion paper 24-401 (Appendix A) as well as National Instrument 24-101 and Companion Policy 24-101CP (Appendix B). We agree with the documents' precepts, namely, that:

- the continued success of the Canadian capital markets depends on our markets' ability to compete on the global front
- STP will position the Canadian capital markets to remain globally competitive, as well as reduce firm-specific and systemic risk
- solutions for industry-wide STP must take into account the industry's characteristics, including differences in the types and sizes of market participants.

Appendix A also includes our responses to the British Columbia Securities Commission's additional questions.

In early 2004, both Canadian and U.S. capital markets reached turning points in their STP programs with the U.S. announcing Vision 2010 and the Canadian Capital Markets Association (CCMA) entering a new planning phase. Both have completed a large proportion of their respective action plans, including changes to infrastructure and firm-specific changes, review of and requests for legal changes required and development of best practices and standards. Both marketplaces agree that further work is needed and are firming up critical paths in this regard. CDS will continue to support industry STP efforts as it has in the past.

Attached are our detailed comments in regards to the four documents. We would be pleased to answer any questions that you may have.

Yours truly,

Original signed by Al Cooper

[1] CDS is Canada's national securities depository, clearing and settlement hub, providing valued, secure and reliable securities market services that continuously improve efficiency, effectiveness and global competitiveness. CDS supports Canada's equity, fixed income and money markets, holding over $2 trillion on deposit and handling over 37 million domestic securities trades annually. Additionally, CDS settles over 13 million cross-border transactions with the U.S. each year and has custodial relationships with Japan Securities Settlement & Custody Inc. and Euroclear France. Our settlement system handles securities transactions valued in the hundreds of billions of dollars daily.

CDS itself has full connectivity with its participants and CDSX is STP-capable (can send and receive real-time/near-real-time). We can also report that the significant majority of custodian activity is in real-/near-real-time and brokers are also using real-time functionality. CDSX functionality allows for both matching and confirmation as a way to agree on transaction details, since broker-to-broker matching was implemented on the weekend of June 12th of this year. CDS has published standards for vendors wishing to send matched institutional trades to CDSX for settlement and expects to implement the necessary functionality to accept the matched institutional trades from matching service utilities by early 2005. As well, CDS intends to implement the distribution of entitlements information in ISO-15022 compatible format by the end of 2004 to further promote STP.

RESPONSE TO DISCUSSION PAPER 24-401 ON STP

Question 1: If the CSA were to implement mandatory STP readiness certificates, what should be the subject matter of such certificates?

To the extent that the market is moving to greater STP and is not moving to shorten the settlement cycle, we do not believe that certification is required due to the potential cost to market participants that is not offset by benefits. Unlike in the case of Y2K, when there was a perception of commonality of interest and the potential for material systemic risk in not being ready, there may not always be perceived to be an equal sharing of benefits, costs or risks in the industry move to STP, although there must be industry-wide STP for maximum STP benefits.

An alternative could be first reporting by custodians to an appropriately senior level within investment managers on their firm's electronic trade detail delivery and accuracy and by CDS, to a similarly senior level within broker/dealers, on their firm's confirmation rates compared to, in both cases, the relevant industry group average.

Should the Canadian marketplace move to T+1, we believe that point-to-point testing will be required and that the results of such tests could be made available by both counterparties, e.g., by posting on an electronic bulletin board, as an alternative to regulatory certification.

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?

While a move by Canada to T+1 on the same date as the U.S. is critical for T+1, we believe that there is no economic or competitive reason to achieve STP at precisely the same time or in precisely the same way as in the U.S. unless a move to T+1 is expected.

A CCMA-commissioned study by Charles River Associates in 2000 concluded that Canadian and U.S. markets should change settlement cycles at the same time – not earlier and not later – due to the potential loss of capital markets activity to the U.S. and to operational complexities and confusion that different cycles would cause. Securities settlement cycles were reduced from T+5 to T+3 on the same date in 1995 for this reason. This is akin to the "hard date" that Y2K imposed.

As regards STP, however, the underlying investor, first and foremost, is interested in the final result or best execution – and this is a function of a number of different factors, including best price and reliably receiving payment or securities on time. How investors are given the price or payment is less important. There are, in fact, already differences between the Canadian and U.S. marketplaces, however, these are not the determining factor in where investors choose to do business as both marketplaces are economically stable, technologically sophisticated and reliable. This said, we believe that over time there will be convergence on using STP to achieve confirmation on T as institutional

investors become more used to and demand information on a real-time basis from their service providers.

There are a number of factors/challenges in both the Canadian and U.S. marketplaces that will contribute to or impede the move to STP. The U.S. marketplace is advanced on the institutional side and has fewer retail issues but faces challenges with certificates and payments. The Canadian marketplace has increasingly few concerns with respect to payments and certificates, but has challenges in institutional and retail trade processing. Both countries are seeking major improvements to corporate actions information processing; STP securities lending solutions now exist that will serve both countries. Factors and challenges of particular relevance in a comparison between the two markets are as follows:

- that Canada does not have an ID system or equivalent as exists in the U.S. connected to the Depository Trust Company (DTC) that links investment managers, custodians and brokers with the depository: It is not clear that one is required, but it is almost certain that there will be one or two available in Canada. Also, Canada does not have an industry-wide standing settlement instructions (SSI) database, although we could likely convert an existing industry database (the Electronic Settlement Instruction Registry or ESIR) to perform this function.

- that the Canadian marketplace cannot easily significantly lead the U.S. in areas that have cross-border implications (see Charles River study, 2000): For example, it would be conceivable that Canada could shorten the settlement cycle of debt (e.g., bonds) before the U.S. but not equities, where 15 per cent of securities issued on the TSX and 40 per cent of the trading volume are interlisted.

- that Canada has an advantage in the growing industry practice of using block settlements: The block settlement option simplifies matching between broker and investment manager, but is not an option in the U.S. marketplace. While an adaptation for the Canadian market was investigated by Omgeo, to date, a cost-effective alternative for matching has not been presented for the Canadian marketplace, although FMC and Omgeo, at present, are expected to provide matching service utility (MSU) services.

- that Canada is at a continued disadvantage to the U.S. due to the lack of STP for larger value payments of $25 million and below: In the U.S., payment of entitlements by FedWire to DTC is at 99to 99.5 per cent; in Canada, entitlement payments through the Large Value Transfer System (LVTS) is 87 per cent by value and 31 per cent in volume. This has not just STP impacts, but risk implications as well (see responses to Questions 19 and 20 below).

- that the Canadian marketplace has considerably fewer players proportionally, which allows communication and change to proceed much more quickly in many cases than in the U.S.
    - Canada has 199 brokers compared to the U.S.'s 6,499 brokers (of which 600 are Securities Industry Association (SIA) members).

- Virtually all of Canada's eight custodians have been involved with the CCMA's STP program since inception.
- Investment managers – whose participation in STP is critical – have been involved in the CCMA since the Association's beginning. Canada has an estimated 300 active third-party investment managers. The U.S. has 7,165 investment advisers registered with the Securities and Exchange Commission (SEC).
- All Canada's seven transfer agents are expecting to move to electronic direct registration systems (DRSs). In the U.S., an estimated 20-30 transfer agents out of 1,200 to 1,400 currently offer DRS.

- that a high percentage of individual players in Canada are, we believe, aware of industry STP efforts, in part due to the CSA's broad-based STP-readiness surveys of 2003 and 2004. Neither the Securities and Exchange Commission nor the Securities Industry Association has undertaken such an initiative in the U.S.

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?

As the CCMA and Securities Industry Association have completed the significant majority of their project plans without achieving their target goals, they are currently both developing the critical path to take them to their end goals. The CCMA is expected to develop critical path items for the next phase while continuing with the original CCMA project plan, for example, to publicize broadly the industry best practices and standards, measure and publish progress towards STP, undertake a review of international issues and so on. Of particular relevance is a study currently under way under the auspices of the CCMA's Institutional Trade Processing Advisory Committee regarding the specific reasons for delays or bottlenecks in the trade reporting and confirmation process.

We strongly believe that there is one critical path item at present: institutional trade processing (discussed in Questions 4-16 below). The mandated use of LVTS for all entitlement payments, not only for efficiency, but also for purposes of business resumption planning, risk reduction, paper elimination, equity of treatment of investors and comparability with the U.S. (see answers to Questions 19 and 20 below), is also an issue of concern to CDS.

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 Instrument? Is the effective date of July 1, 2005 achievable?

We believe that it is important to have an understanding of how the Canadian and U.S. "matching" or confirmation data is calculated so that reasonable comparisons can be made. The attached diagram shows that the way the transactions are measured differs between the two countries, both in terms of timing and what is measured.[1]

[1] In the U.S., for purposes of calculating when trade details are agreed to, T ends early on the morning of T+1 (1:30 a.m.) and represents agreement on transaction details between broker/dealer and investment manager (or the custodian on the investment manager's instruction), but there may not be agreement from the custodian that position exists. This leads

Should the CSA require market participants to match institutional trades on trade date?

Yes, we agree that matching or confirmation on trade date should be the goal of the Canadian industry and that the CSA or other lead regulators should mandate this. We agree with the CSA's view that confirmation should be permitted as an alternative to *requiring* (as distinct from allowing or encouraging) use of a matching utility.

Would amending SRO rules to require trade matching on T be more effective than the Proposed Instrument?

At this point, we believe that a Canadian Securities Administrators rule is required, at least to govern investment managers, as they are otherwise unregulated regarding operational matters, and that other entities could be covered by their lead regulators. For example, we hope that the CSA will discuss with counterparts on the Joint Forum of Financial Market Regulators – the Canadian Association of Pension Supervisory Authorities (CAPSA) and Canadian Council of Insurance Regulators (CCIR) – and with the representative of the Office of the Superintendent of Financial Institutions (OSFI) who is an Observer of the CCMA's Board of Directors, extending the rule to the pension funds, insurance companies and custodians that these entities respectively regulate.

Is the effective date of July 1, 2005 achievable?

CDS is STP-ready and we believe that the date of July 1, 2005 is technically feasible for large and sophisticated institutional market participants and probably most brokers as the latter will be required to meet one-hour requirements under the recent Investment Dealers Association of Canada (IDA) rule regarding broker-to-broker trade matching. We are told that the large service bureaus will be ready. We believe that the brokers that are carriers for other firms are likely to be more STP-ready than smaller firms. We recognize that other firms may require more time.

This said, the SIA's response to the Securities and Exchange Commission concept proposal on same-day matching, a shortened settlement cycle and elimination of certificates implies that the broader U.S. marketplace will require two years to reasonably achieve 95 per cent same-day matching, a precursor to T+1. To the extent that achieving

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to a process called delivery orders and reclaims (currently on or after T+3) where the transaction can be reversed. Omgeo reports that a trade not affirmed prior to settlement is 37 times more likely to be reclaimed later in the settlement process or even fail (*STP Magazine,* R. Hughes, Omgeo, June 2004, p. 80).

In Canada, confirmation occurs when the custodian's details from the investment manager match those entered by the broker *and* the custodian confirms that the investment manager has or will have position by affirming in CDSX. Trade date effectively ends at 7:30 p.m. Eastern Time (ET) on T, although transactions continue to come in on trade date, for example, via service providers such as ADP, ISM and ADP Dataphile. These are held until the system opens again and are dated the following day (T+1). There are no delivery orders and reclaims in the Canadian system, thereby providing greater certainty.

T+1 is conditional on achieving a high rate of STP, arguably two years may be required and then an additional year for testing if the market is to move to T+1 settlement.

We believe that a phased approach to implementation of same-day matching makes sense to avoid market disruptions, particularly for smaller players. The SIA has recommended phasing in matching on T by starting with a requirement to match by noon on T+1 within 24 months, then by 9:00 a.m. ET on T+1, before moving to 10:00 p.m. on T.

We suggest that a different approach may be warranted in Canada, although with the same end goal. For example, until there is a move to a shortened settlement cycle or a significant majority of market participants are matching by the end of T, there should be consideration given to requiring reporting by broker/dealers on T and confirmation by custodians by, say, noon ET on T+1. Mandating matching/confirming on T would require many counterparties to ensure the availability of staff in the evening of T, which could have significant cost implications, especially for smaller players. As noted above, we believe that there are material differences in what CDS captures for confirmation and how DTC/Omgeo capture their data. For example, we understand that the U.S. data includes feeds from service bureaus on T that would not be reflected on trade date in Canada even though the timing of receipt would be comparable.

Question 5: Is a close of business definition required? If so, what time should be designated as close of business?

There should be no close-of-business definition because, in today's world, there is no time when many financial businesses are not operating. There are cut-off times, when the date rolls over from one date to the next and it would help to ensure that all processes are targeted against such a common objective. While CDS, which effectively links all parties, begins processing trade reported on a particular day at 7:30 p.m. ET, the choice of this time was originally driven by service bureau requirements. While trades may still be entered and confirmed after this time, the entries will be recorded as of the next business day.

Whatever timeline is chosen, individual participants will be left with a variety of deadlines to meet according to infrastructure processing cut-offs and CCMA institutional best practices and standards. We suggest that the CCMA institutional best practices times be referred to and that a small group meet to discuss a specific time, recognizing that transactions will still be processed after that time, although may be held to be processed with the next day's work.

Question 6: Should the Proposed Instrument expressly identify and require matching of each trade data element, or is it sufficient for the Proposed Instrument to impose a general requirement to match on T and rely on industry best practices and standards to address the details?

The proposed instrument should impose a general requirement to report and confirm based on CCMA best practices and standards. It should be noted that, in different markets (debt, equity), somewhat different data elements may be required and these data elements may change over time, thus a general rather than data-element-by-data-element requirement would be simpler. Also, infrastructure requirements may allow some exceptions, for example, CDS's broker-to-broker trade matching functionality provides for

matching within a tolerance range of $5.00 and we assume that this would still be considered to facilitate "matching." On another matter, and given the work proceeding on preparations for implementing electronic audit trails, we recommend that the data elements, insofar as trades are involved, should be consistent with those requirements.

Question 7: Should the CSA rely on the best practices and standards established by the CCMA ITPWG?

Yes, as noted above, the CSA should rely on the institutional best practices and standards established by the CCMA. They were developed after an exhaustive input, distribution/publication and review process involving brokers, investment managers, custodians, depositories, transfer agents, regulators and others in Canada, small and large. They are also consistent with U.S. business and market practices. By using a reference point outside the formal regulatory process, the best practices and standards can more quickly be updated to adapt to changing market developments. Also as noted above, there should be provision made for some exceptions, for example, infrastructure functionality may allow tolerances or require other information.

Question 8: The CSA seek comments on the scope of the Proposed Instrument. Have we captured the appropriate transactions and 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?

We generally agree with the proposed scope, but suggest that the proposed instrument and/or companion policy clarify the following:

- whether segregated and other unitized funds are excluded by the exclusion for NI 81-102 – Mutual Funds
- whether futures and options, which settle through the Canadian Derivatives Clearing Corporation (CDCC), are included within the instrument's scope.

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?

Consistent with the response to question 4 above, we would prefer a rule applying directly to regulated entities in preference to the contract method. This is because, while the contractual method helps, it may well require material amounts of time and effort to initiate and will require monitoring and enforcement to be more fully successful. As well, while we recognize the rule is consistent with New York Stock Exchange (NYSE) rule 387, we question the appropriateness of having as a penalty the withdrawal by a broker of an investment manager's delivery versus payment/receive versus payment (DVP/RVP) privileges, which would seem contrary to efficiency and risk reduction.

Perhaps the most straightforward approach we have heard mentioned is to require reference to matching as part of annual disclosures by investment managers. If the contract approach is used, a standard sample contract template should be developed to avoid protracted negotiations. Supporting measures could be considered, such as reporting and tiered pricing as in the U.K. and under consideration in the U.S.

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 matching?

Yes. The timeframes in the CCMA institutional business practices should apply, with anything not resolved in the permitted timeframe being carried over to the next business day.

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)?

No, there should be no requirement to report all exceptions to matching by the close of business on T. We should note that those reporting or matching late may have been delayed for different reasons, including reasons that are not clear – this is why the CCMA's Institutional Trade Processing Advisory Committee has undertaken a study to better define the bottlenecks in the process. Measurement and reporting to senior levels within an organization on a firm's rating against an industry benchmark will help bring about peer pressure to improve. This is in use at Crestco in the U.K. and under consideration by the DTC in the U.S. Enforcement is required, but should be as inobtrusive as possible, i.e., not require the creation of new structures. For example, CDS could report to the IDA on an aggregate and broker-specific basis; the brokers would then be subject to examination when under review generally.

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? 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?

Use of a matching service utility should not be mandated given the varying circumstances of different firms. This said, CDS has established a protocol to enable MSUs to connect to the depository for settlement and expects to implement necessary systems changes late in 2004 or early 2005. We believe that STP-consistent local matching alternatives to an MSU exist in the marketplace and should be allowed to continue.

Question 13: Should the scope of functions of a matching service utility be broader?

We have no comments at present.

Question 14: Are the filing and reporting requirements set out in the Proposed Instrument for a matching service utility sufficient, or should a matching service utility be required to be recognized as a clearing agency under provincial securities legislation?

We agree that MSUs should be subject to some form of regulation due to potentially systemic problems that could arise should an MSU not be able to provide its services, but otherwise have no other comments at present other than to suggest that reporting and filing requirements be limited to what is truly relevant for assessment purposes.

Question 15: Can the Canadian capital markets support more than one matching service utility? If so, what should be the interoperability requirements?

CDS and representatives of three brokers, three custodians and nine investment managers undertook an exhaustive analysis of MSUs in 2002, concluding that there was no business case for a single stand-alone *de novo* MSU that met the requirements of the Canadian marketplace at the time. With further developments at CDS and elsewhere in the Canadian and U.S. securities marketplaces, and with current MSU candidates that are expected to be North-American in reach, this may no longer be the case.

This said, interoperability and other requirements set in the U.S. were problematic. Many of the ones set out for Canadian MSUs seem reasonable, but may prove to be equally challenging. As key participants (e.g., custodians) at this time expect to have to connect to more than one MSU, which may indirectly resolve the interoperability issue, we suggest that a decision in regard to how interoperability should be achieved be held in abeyance.

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?

A T+3 settlement cycle should not be mandated and may cause confusion as there are securities that settle on a shorter (or longer) cycle, for example, T+2-settling government debt. Also, the TSX proposed T+2 settlement for stocks traded in U.S. dollars where there is a banking holiday in the U.S. but not Canada.

We are also not clear how imposing such a rule now for T+3 will facilitate a change to a shorter settlement cycle in conjunction with the U.S.

The Canadian marketplace should move to a shorter settlement cycle, whether T+2, T+1 or T+0, at the same time as the U.S. to avoid any dislocation of market activity. It should be noted, however, that a CSA rule was not required when Canada moved successfully to T+3 from T+5 in 1995 and there were no issues that arose at that time of which we are aware.

Question 17: Should the CSA require the reporting of corporate actions 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?

While this is not an immediate priority, a hub with mandated electronical reporting of entitlement information by issuers in field-based format would maximize market efficiencies. We believe that corporate actions in particular and, to an extent, entitlements generally, remain a risk in the securities industry. While risks associated with different parts of the process vary, significant gains can be achieved if the process “starts right”

(this would also likely improve Canada's rating within the global securities marketplace). "Starting right" in STP terms means removing every possible manual step in the process of entitlement information dissemination.

Question 18: Should the CSA wait until a hub has been developed by the industry before it imposes any requirements?

No, there are already entitlement data providers and there is no need to regulate their commercial relationships with users. For a firm to develop a central hub, it will require certainty that issuers/offerors/agents will be required to file centrally or that they will not be. The CSA should make a declarative statement now as to whether broader filing will be required and as to whether any hub that is developed will be regulated.

Question 19: Should the CSA require issuers and offerors to make their entitlement payments by means of the LVTS?

As the CSA recognizes, "same-day, irrevocable final funds for payments into the CDS/CCP utility in Canada" is important. Paradoxically, it is the efficiency of Canada's payment system that means that the lag in achieving payment finality associated with payment of entitlements by cheques is trivialized. However, cheques and even certified cheques can be returned in Canada, sometimes days after deposit. Quebec market participants have indicated that caisses populaires have 72 hours to return a cheque. A service provider has stated that entitlement payments paid to it by cheque are now not credited by the provider until 48 hours after the payment is payable due to uncertainty about finality. While the payment, assumed good after two days, is credited retroactively, there is a cost to this that may well exceed the cost of an LVTS payment equal to the value of the money for the two-day period it is not available to the recipient to re-invest in a profitable way.

The current situation, in which entitlements can be paid using funds that cannot be considered final until the next day at the earliest, creates unnecessary (albeit not systemic) risks in the securities settlement system. It is inconsistent with the recommendations of the following organizations, on some of which Canadian regulatory bodies are represented, including, most recently, the International Organization of Securities Commissions (IOSCO):

- the International Monetary Fund (IMF), which has urged countries to promote stability in their financial systems by maximizing the value flowing through systems that provide certainty of settlement, such as LVTS
- Committee on Payment and Settlement Systems (CPSS)-IOSCO Recommendation #8
- International Securities Services Association Recommendations 2000 Recommendation #5 and
- the Group of Thirty Report "Global Clearing and Settlement: A Plan of Action" Recommendation #11.

Extensive industry discussions over the last several years have failed to solve the lack of finality of entitlement payment problem in Canada. There has been consideration of whether requiring the use of LVTS would benefit one type of investor over another – in

fact, we believe that it should promote equity as we understand that transfer agents mail dividend and interest cheques three days in advance of payment so investors can cash their cheques on pay date. Ensuring payment of entitlements via LVTS on pay date will ensure that investors receiving payment by cheque, direct deposit from the transfer agent or payment via the nominee system should all be able to receive value on the same day.

In the U.S., payment of entitlements by FedWire to DTCC is 99 to 99.5 per cent by value down to the first penny and the only offenders, reportedly, are municipalities, whose entitlements, in turn, do not get paid until they clear. In Canada, 69 per cent of entitlement payments and 13 per cent of value – close to $3 billion – was not received through LVTS in June 2004 alone. This has not just STP impacts, but risk implications as well, despite Canada's traditional and continued high levels of efficiency in cheque clearing and settlement.

This said, in March 2003, CDS took steps, where it could directly, to mandate payment by LVTS or funds account debit – CDS Rule 8.2.5 covers CDS participants as issuers requiring payment by LVTS or funds account debit without limit. As well, industry participants have made some progress in increasing the amount of entitlement payments made in LVTS funds.

While we believe that a CSA requirement for LVTS is of secondary priority to the institutional trade processing goal, we believe that the CSA had once considered a notice to issuers on LVTS and hope that the CSA will pursue this route. It should be noted that issuers have traditionally paid for the cost of payment of entitlements and they have already benefited and do benefit *in a material way and on an ongoing basis* from the nominee system, where intermediaries assumed responsibility for distribution of millions of entitlement payments. The savings issuers experience by regularly replacing thousands of payments to individual security-holders offsets by many times the relatively small cost per LVTS payment, as set out in the CCMA's letter to the CSA dated May 12, 2003. We believe that the CSA could help advance use of LVTS by issuers by making sure that they understand the value and the importance of:

- Having these payments within the securities clearing and settlement system final and irrevocable
- Enabling beneficiaries to receive entitlement payments that are immediately available to them on an unconditional basis
- Making Canadian capital markets more efficient and attractive to investors.

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?

Refer answer to the above question.

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?

We recognize the importance of all parts of the Canadian marketplace becoming more STP-capable for greater efficiencies and risk reduction. We defer to the investment fund industry and CCMA to respond in greater depth.

Question 22: Should the CSA develop rules that require the immobilization and, to the extent permitted by corporate and other law, dematerialization of publicly traded securities in Canada?

Yes, rules requiring, preferably, dematerialization and, where not possible, immobilization should be promoted as much as possible. Additionally, the earliest possible enactment of the Uniform Securities Transfer Act (USTA) and of consequential amendments to other legislation, such as the provincial Personal Property Security Acts, remains very important for the Canadian securities marketplace, as set out in our letter of May 6, 2003. There are numerous reasons for this legislation to proceed, well beyond a purely STP rationale. For example, from the perspective of market efficiency, risk reduction and equity between investors, a move more formally to electronic securities holding is recommended. In particular, it would reduce risks associated with catastrophic events, for example, due to the events of September 11, 2001 in the U.S., 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.

The nominee and transfer agent DRS models do not go far enough to achieve true STP efficiency in that they do not start with the premise that, for the greatest operational efficiencies, all issuance and holding must be electronic in a single location until there is a specific request from an investor to hold directly with the transfer agent in DRS form or for a certificate. Over time, deposits into CDS have always exceeded withdrawals and now electronic depository holdings represent an estimated 90-95 per cent of Canadian CDS-eligible securities holdings. As this trend is expected to continue, starting with all holdings being in CDS will provide the marketplace with the greatest economies of scale. As well, as neither issuers (except in the resource industry) nor transfer agents can charge for certificates, DRS does not provide the disincentive to physical holding that the nominee system, with a withdrawal charge, would. Finally, we believe that issuers should be permitted to choose to issue *only* in electronic form, as long as investors who ordinarily choose certificated holding know upfront that their only option is electronic through the nominee system or DRS.

We believe that CDS should hold all new securities issued (and certificates returned through financial intermediaries) in electronic form and this is consistent with dematerialization directions taken in France, Denmark and other countries. These will be reflected in the nominee system in CDS as today and any directly registered holdings with the transfer agents will be reflected as a bulk DRS position per transfer agent with reconciliation between CDS and each transfer agent. This will require all Canadian transfer agents to be at least limited CDS participants and means that all Canadian holdings can be transferred in electronic form whether via the transfer agents or financial intermediaries, unless an investor chooses to hold in physical form (for as long as this option remains available).

Question 23: To the extent DRS systems operate in Canada, should a securities regulatory authority regulate transfer agents that are operating or using such DRS systems?

To the extent that DRSs provide a service similar to clearing and settlement, and become more systemically important in the absence of certificates, the DRS services should be subject to regulation (as they are in the U.S.). For example, as the document notes, there is potentially material risk in DRSs as more and more firms in the securities industry begin to rely on them – business resumption planning demands are more important as thousands of investors could be affected if the DRS is out of operation for any extended length of time.

Also, the CCMA has established best practices that apply to DRSs and entitlement reporting and payment. Any regulation should refer to or be consistent with these practices so that investors and other intermediaries can benefit from the most transparent and efficient system possible.

Question 24: Should there be separate DRS systems and should they be required to be inter-operable?

We believe that transfer agent DRSs will effectively be interoperable as transaction instructions are transferred through a single point: CDSX. Transfer agent DRSs do not need to be interoperable between each other because, we understand, they will not need to interface with each other.

Question 25: Is it sufficient for the Canadian capital markets to rely solely on existing SRO segregation 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?

While in principle supporting the recommendations of the CPSS-IOSCO, International Securities Services Association and Group of Thirty regarding segregation of assets (cash, securities, used as margin or collateral), we are not aware of evidence that there is a problem in the indirect holding system through which the majority of securities are held in Canada. As well, firms in Canada are subject to independent external audit that should be testing internal controls, which could impact the firm's financial viability. We suspect that this would include testing for segregation of assets.

B.C. SECURITIES COMMISSION ADDITIONAL QUESTIONS

Question 1: Is the rule necessary?

A rule is or rules are necessary if there is to be prompt concerted action to accelerate the move to STP, although the rule(s) could be simpler than as drafted. Consistent with our response to Question 9 above, we believe that a contractual approach is more onerous than necessary due to the requirement for new or rewriting old agreements. As clearing and settlement will continue to change, there is value in allowing flexibility by requiring that firms meet basic outcomes for matching and settling, possibly requiring disclosure of their matching and settlement rates on request.

The Rule could be sunsetted in the case of the B.C. securities commission as, presumably, once STP is achieved, there would be no incentive to, and peer pressure not to, revert to old manual practices. At the same time, to the extent that there is a securities commission rule that is not replicated in B.C., it is not clear to us whether there will be any impact on investors and institutional market participants in the B.C. marketplace as there will still be an incentive for B.C. participants to match on trade date like their competitors are required to in other parts of Canada.

Question 2: Can industry achieve STP without regulatory intervention?

Yes, however, a considerably longer time would be required and, should the American markets proceed considerably ahead of Canada, Canada would be less efficient and less capable of moving to a shorter settlement cycle should the U.S. Securities and Exchange Commission mandate a T+1 settlement cycle within a short period of time. We suspect that the latter would definitely pose a major reputational and market risk to the Canadian marketplace.

Question 3: If the Commission adopts the rule, should the rule include filing and reporting requirements for matching service providers?

Reporting of material information should be mandated, but the range of what is to be reported should be reviewed to ensure that only material information is required. Recognizing the desire to minimize regulation, and the fact that any MSU would likely operate across the country, we believe that MSUs should report to one lead regulator.

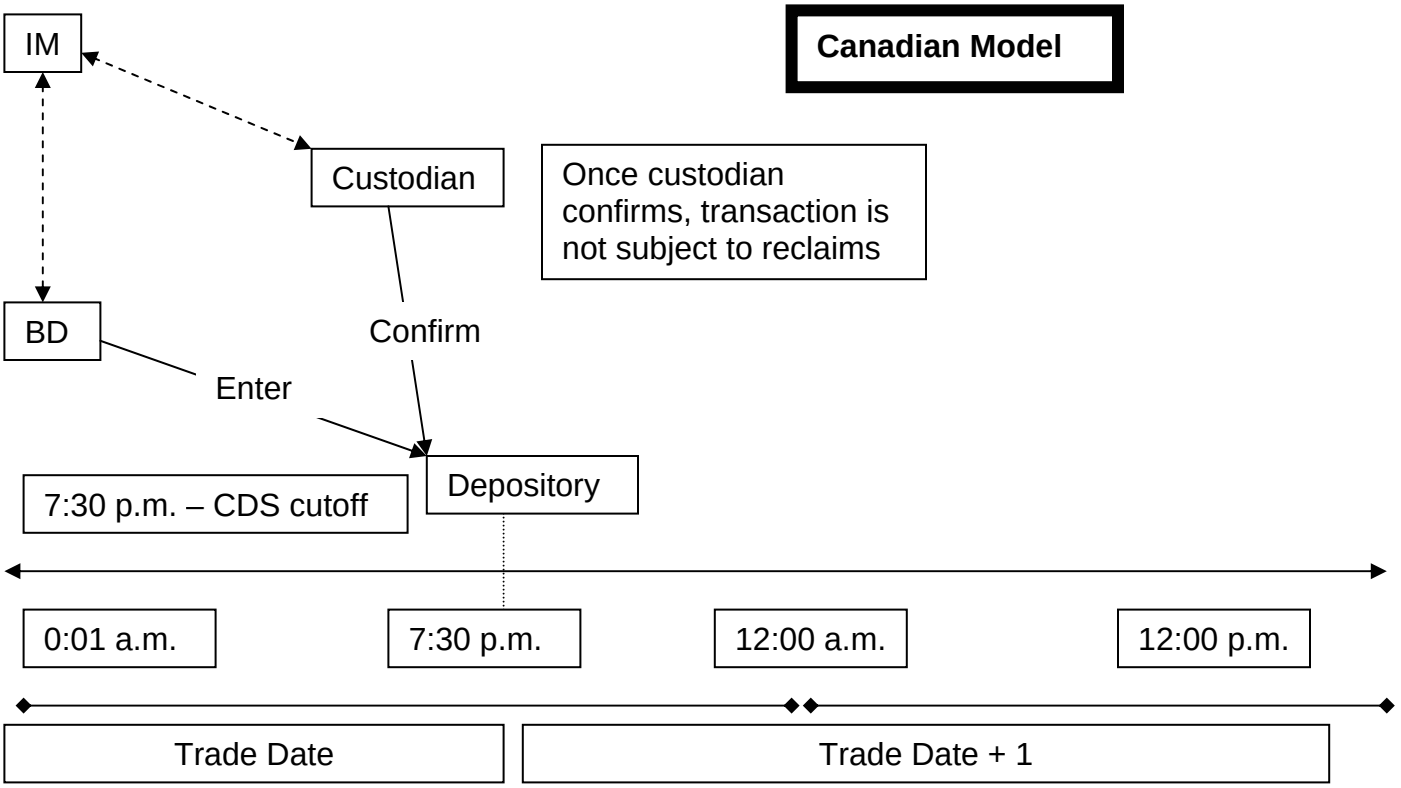
RESPONSE TO PROPOSED NI 24-101 ON POST-TRADE MATCHING AND SETTLEMENT AND PROPOSED COMPANION POLICY 24-101CP TO NI 24-101

Note: The situation continues to change and we are awaiting the results of an industry study identifying bottlenecks in institutional trade processing. We therefore believe that, rather than proceeding at this time with the proposed Canadian Securities Administrators rule recommended previously by the CCMA, the CSA should consider, in addition to the feedback on the discussion paper and draft rule, the results of the industry study, results of the CSA's STP Readiness Surveys and the outcome regarding discussions in the U.S. before proceeding. The comments below are provided in that context.

PAGE	REFERENCE	COMMENT
4011	**1 – Definitions and Interpretation**	
4011, 4025	ss. 1.1 – "institutional client"	Institutional clients that are high net-worth individuals will not likely be in a position to meet electronic reporting requirements in the same way as other institutional clients; the definition is clear that an institutional client can be a person who appoints a custodian, but p. 4025 appears to distinguish between the investment manager or portfolio adviser as institutional client and the underlying client. • **Is an exemption required for "individual" institutional clients, at least as regards the tasks they may be required to fulfill through matching service utilities? Alternatively, should the wording in the instrument or companion policy be clarified to identify whether there is any difference in expectations between an individual client and, say, a portfolio adviser?**
4011, 4027	ss. 1.1 – "depository eligible security"	"[M]eans a publicly traded security in respect of which settlement of a trade in the security may be performed through the facilities or services of a recognized clearing agency" • **As noted in the response to Question 8, we suggest that the companion policy clarify whether futures and options, which settle through the Canadian Derivatives Clearing Corporation (CDCC), are included within the instrument's scope.**
4012, 4026	ss 1.2(1)(c) – "Interpretation – Comparing Trade Data"	Comparing trade data is a process between "… (c) the counterparty to the trade if the dealer was not acting as principal in a trade." • **The Companion Policy should clarify why the term "the counterparty to the trade" is qualified by "if the dealer was not acting as principal in a trade.**"
4012, 4026	ss 1.3 – "Institutional Trade Matching" and 1.5(2) of the companion policy	A transaction is matched when "(a) the process of comparing trade data is completed, (b) the relevant parties have agreed to the details of the trade, and (c) either the custodian of the institutional client or a matching service utility is in a position to notify a recognized clearing agency of the trade" • **While if the custodian is in a "position to notify a recognized clearing agency," it is our understanding that most if not all in Canada do so immediately (even if this is "held" by CDS pending re-opening of the system), we are not sure how "in a position to" would be measured. We suggest that the phrase "in a position to" either be deleted or clarified.** • **We suggest rewording ss. 1.3(c) as follows: "… to ~~notify~~ *confirm the trade to* a recognized clearing agency ~~of the trade~~." The word "confirm" is the vernacular used in the industry for the final communication by a custodian (and likely matching service utility in the context of a matched trade) to the clearing agency that the trade is ready to be settled. Accordingly, we think it preferable to use this term, rather than "notify."** • **For the same reason, we suggest rewording ss. 1.5(2) of the companion policy to read "to ~~report~~ *confirm* the trade to a recognized clearing agency" and to mention matched trades provided to the clearing agency. At that point, the trade is "... ready for the ~~clearing and~~ settlement process through the facilities of the clearing agency" – "reporting of trades" is an action usually undertaken by the dealer early in the clearing process; "confirming"**

PAGE	REFERENCE	COMMENT
		is the final step by the custodian before settlement.
4013, 4026	ss. 1.4 – "Interpretation: Trade-matching Compliance Agreement"	The trade matching compliance agreement must require that the dealer and institutional client "take all necessary steps" to complete the process of comparing trade data and matching the trade as soon "as is practicable" after the trade has been executed and "in any event no later than the close of business on T" – • **We suggest that "take all the necessary steps" be amended to read "take all the reasonable steps," where reasonable will be based on the firm's business. This should help address concerns of very small firms.** • **Regarding "as soon as is practicable," elsewhere the documents refer to CCMA final institutional best practices and standards; we recommend that the timing of the industry best practices be referenced here as well.** • **Regarding "in any event no later than the close of business on T," see comments in response to Question 5 of the discussion paper. Also, note that there are timelines set out in the industry best practices, which suggest that transactions occurring late in the day have set periods in which separate tasks are to be completed by specific parties to the transaction, which could extend to early on the following business day should details not be agreed to by CDS cut-off times.**
4026	ss. 1.5(4) – "The Process of Comparing Trade Data"	Requirement to match and agree on trade detail elements; "the trade data elements that must be transmitted compared and agreed upon may include the following, where applicable:" • **A few of those elements listed appear to extend beyond the CCMA's best practices; to avoid confusion, we suggest that they be limited to items listed in the industry best practices.**
4027	ss. 1.9 – "Trade Matching Compliance Agreement"	Binds "even those that the Canadian securities regulatory authorities do not regulate, such as pension and insurance funds." • **See our response to Questions 4 and 9 above.**
4013	**2 – Application**	
4013	ss. 2.1 – "Application of Instrument"	The instrument does not apply to trades that are a distribution of a security or to mutual funds. • **We suggest that the proposed instrument and/or companion policy clarify whether segregated and other unitized funds are excluded by the exclusion for NI 81-102 – Mutual Funds.**
4013	**3 – Trade Matching**	
4013, 4026	ss. 3.1 – "Trade-Matching Compliance by Dealer"	Is there a need to define a "trade"? • **We assume that a trade could include a block settlement on the part of the broker and individual allocations on the part of the investment manager and custodian. Ss. 1.5(a)(b) seems to imply blocks are treated like any other trade and we suggest that the companion policy reflect this clearly.**
4028	ss. 3.2 – "Trade-Matching Compliance Agreement"	Assumes brokers should use "reasonable efforts" to monitor and enforce compliance or otherwise suspend DVP/RVP trading privileges until the situation is remedied • **We are concerned by indirect forms of regulation. As well, we understand some industry participants believe that there will be a requirement to have the agreement between dealer, investment manager *and* custodian and not just the first two. As noted in our response to question 9, we believe that negotiating agreements could be very time-consuming unless a streamlined way of standardizing an agreement is identified.**
4013	ss. 3.3 – "Trade Matching Compliance by Adviser"	The instrument says that as the CSA regulates portfolio advisers, they must take steps to match trades and the broker does not have to rely on compliance agreements and enforcement of contract law by the dealer. • **Please outline how the CSA will monitor and enforce investment manager compliance.**
4014	ss. 3.5 – "Trade Data" and correcting trade details	Correcting errors on T will be difficult, especially for those operating in batch mode (and there is some question as to whether even intraday batch is a solution as at least one broker has advised that even if intraday batch is feasible, reconciliation intraday would be problematic, i.e., re the possibility for intraday TSX batches). • **Currently, a number of firms use batch processing. Brokers using batch**

PAGE	REFERENCE	COMMENT
		have the option of correcting errors in real-time on T+1. Does the CSA agree that this will be acceptable?
4014	ss. 3.6 – "Matching Service Utility"	Matching service utilities can be used if the facilities and services "are reasonably designed to accomplish the matching of trades by the end of T" • **We assume this absolves those not able to match by the end of T if there is a problem at the MSU?**
4014	**4 – Requirements for a Matching Service Utility**	
4014	ss. 4.1 – "Initial Filing Requirements"	Matching service utility requirements • **Is it necessary for the MSU to be real-time?**
4014	ss 4.4 – Ongoing Filing and Other Requirements	Quarterly filing detail on pages 4022 and 4023 • **We believe that filing requirements should perhaps evolve over time and suggest that further discussion of this is required.**
4015	**5 – Trade Settlement**	
4015	5.1 – trade settlement by dealer	This section requires settlement no later than T+3. • **We believe that this provision should be deleted (see our response to Question 16).**
4015	5.2 – good delivery rule	This section requires dealers not to accept an order to trade unless payment and delivery is to be made on DVP/RVP and unless settlement is to be effected through a recognized clearing agency • **See response to Question 9 and on ss. 3.2 above.**
4015	**6 – Exemption**	
4015	6.1 – Exemption	Exemption • **Please amend the companion policy to identify in what circumstances an exemption from the instrument may be granted?**
4015	**7 – Effective Date**	
4015	7.1 Effective date	Implementation date • **While CDS is STP-capable, we believe that further consultation will be required to set a date; refer our answer to Question 4 above.**


Canadian Model
IM
Custodian
Once custodian confirms, transaction is not subject to reclaims
BD
Confirm
Enter
Depository
7:30 p.m. – CDS cutoff
0:01 a.m.
7:30 p.m.
12:00 a.m.
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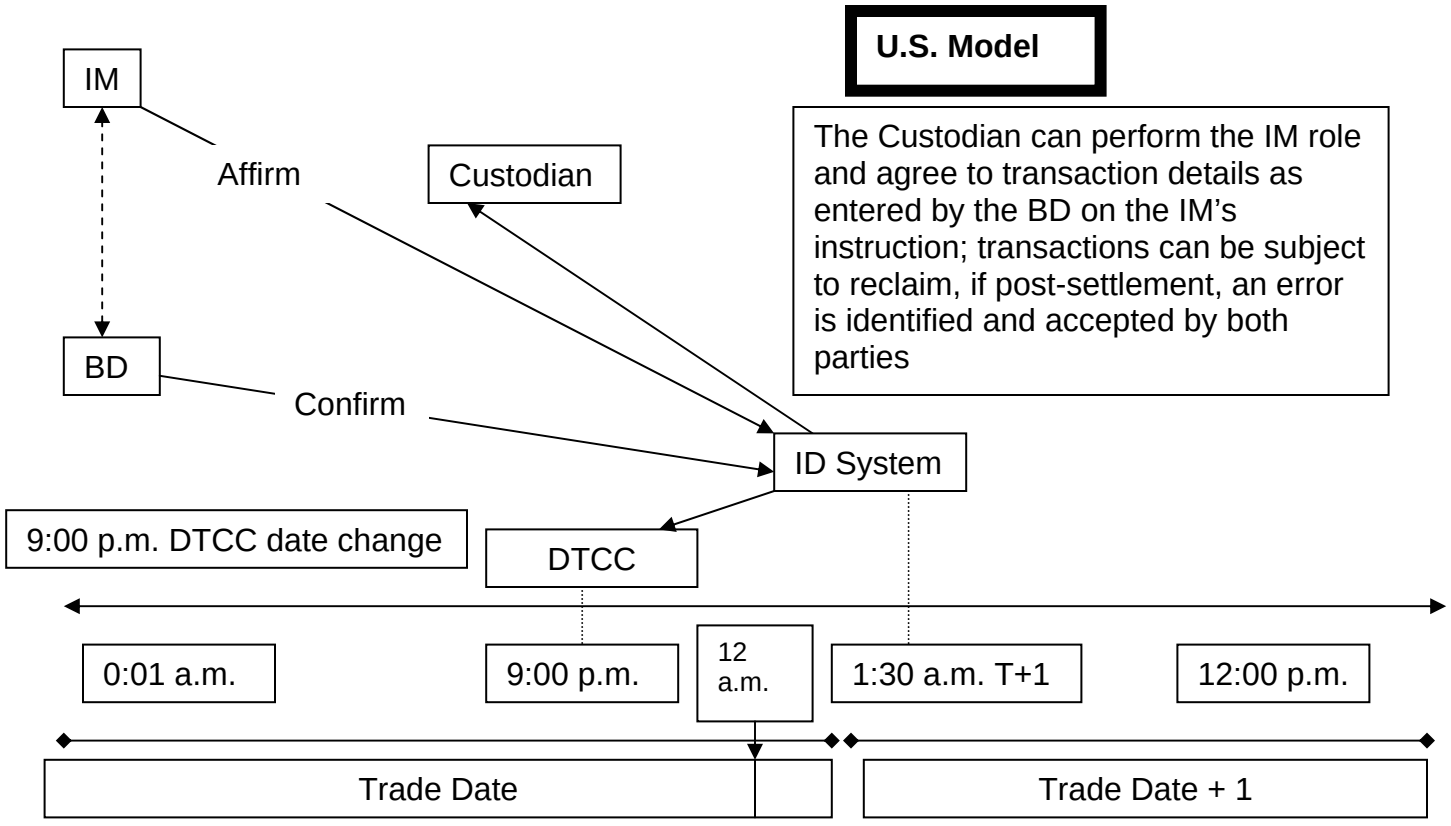
U.S. Model
IM
Affirm
Custodian
The Custodian can perform the IM role and agree to transaction details as entered by the BD on the IM's instruction; transactions can be subject to reclaim, if post-settlement, an error is identified and accepted by both parties
BD
Confirm
ID System
9:00 p.m. DTCC date change
DTCC
0:01 a.m.
9:00 p.m.
12 a.m.
1:30 a.m. T+1
12:00 p.m.
Trade Date
Trade Date + 1