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Alberta Securities Commission
Saskatchewan Financial Services 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 Mr. Stevenson and Mme. Beaudoin:

Re: Discussion Paper 24-401 on Straight-Through Processing and Proposed National Instrument 24-101 Post-Trade Matching and Settlement

We are writing to provide views of the Canadian Capital Markets Association (CCMA) in relation to the questions posed in Discussion Paper 24-401 (the Discussion Paper) and the related material, including Proposed

National Instrument 24-101 (the Proposed Instrument) and Companion Policy 24-101CP. We believe that the Discussion Paper is a very helpful addition to the discussion of the settlement and processing issues with which the CCMA has been dealing.

Turning to the Proposed Instrument, we believe that its objective is important. However, as the situation continues to change here and in the U.S., and in particular given our understanding that the U.S. securities industry does not expect to contemplate movement to settlement by the end of T+1 before mid 2007, we think that phased-in implementation of any changes is the appropriate approach. We expect that approach will benefit from further information currently being gathered, including the ITPAC Study referred to below,[1] the results of the current STP Readiness Survey of the Canadian Securities Administrators (CSA) and feedback you receive on the Discussion Paper and Proposed Instrument. Finally, we believe that any rules that may be required should be developed in a framework that maximizes use of the existing rule structures and rule makers through involvement of appropriate self-regulatory organizations (SROs), in coordination with the CSA. This process, will allow the various industry participants to reach their goals as efficiently as possible, will minimize disruption and will give everyone the maximum ability to choose their own most appropriate methodologies.

In relation to the other specific straight-through processing (STP) initiatives, as you know we have been discussing with relevant industry participants the potential improvements that STP initiatives can bring to their various industry sectors for some time now. Out of those discussions and related analysis, it has become clear that achievement of industry goals in the area of institutional trade matching is by far the most important of the various STP objectives. This is the area where Canada appears to be lagging behind the U.S., and it is also an area where cost/benefit considerations are strongly supportive. Given the importance of achieving institutional trade matching, and its importance relative to other STP objectives, the CCMA has concluded that its critical path going forward, at least for present planning purposes, must focus on this objective. Further aspects of that path as we see it are referred to below.[2]

The following more specific comments do not seek to address all of the questions raised in the Discussion Paper. Rather, we have sought to summarize our current views on issues as appropriate, and to supplement views and information we have provided to you previously. Looking to the future, we will be interested in the views you receive on these matters from the public and individual industry participants, and hope that examination of the issues and possible solutions with appropriate industry and regulatory bodies can continue.

The CCMA has also written to the U.S. Securities and Exchange Commission (SEC), expressing our general interest in similar initiatives in the United States, and emphasizing the importance of coordinating any future initiatives to implement shortening transaction settlement times. We have attached a copy of that letter here for your information.

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1 See our response to Question 3.
2 See our responses to Questions 3 and 4.

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

We believe that mandatory STP readiness certificates are not required, and would be inappropriate. The filing of readiness certificates in relation to the Year 2000 (Y2K) issues was an important aspect of building public confidence that the reporting entity would be operational on January 1, 2000. For the securities industry, the main Y2K question was whether assets would be available to beneficial owners after midnight December 31, 1999 – and either they would or would not be. While there could be similar concerns in relation to T+1 (will a firm be able to settle within one business day by the target date), the consequences of STP compliance involve primarily cost reduction and related competitive considerations, and there is likely to be a continuum of achievement. There are certainly risk issues as well, but they are not considered systemic in scope.

In addition, the criteria to measure an organization's state of STP readiness, if STP encompasses the range of objectives dealt with in the Discussion Paper, cannot be easily defined and translated into a certificate format that could be universally applied across the industry. A relative assessment of firm readiness in this context would be inappropriate. If STP readiness is narrowed to focus solely on trade matching, we believe measurement is possible, but that other channels for tracking readiness are more appropriate.

While we believe that certification would mislead the public as to the consequences of STP readiness, we fully support surveys of the type currently being conducted by the CSA. The surveys provide assessments of industry readiness for STP. They are also useful in informing and influencing industry activity in relation to the various STP initiatives.

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?

We have mentioned in general terms our views as to the environment for STP going forward, and the intentions of the CCMA in that context. As some background for those views and our response to this question, it may be useful to review briefly the evolution of the CCMA's work on T+1 and STP. The CCMA was initially established to co-ordinate Canada's achievement of T+1 – i.e., settlement of trades within one business day after trade date. In that context, the 2000 Charles River Associates' study showed that Canadian capital markets needed to move to a T+1 settlement timeframe at the same time as the U.S. to maintain their competitiveness, and to avoid the potential loss of capital markets activity to the U.S. and the operational complexities and confusion that different cycles would cause.

When the U.S. Securities Industry Association (SIA) decided in July of 2002 to defer its T+1 objective and refocus on STP, the SIA said that it would consider returning to that objective in 2004, and work continued – on both sides of the border – with the knowledge that advances made would contribute significantly to achievement of T+1

settlement if and when announced. The direct benefits of STP made continuing the work in a very tough cost environment easier for the industry to accept.

Support for STP continues in the U.S., and the SEC's request for comments earlier this year included reference to shortening the settlement cycle. However, we are aware of no significant expressions of current industry support for this possibility. In its response of June 16, 2004 to the SEC's request, the SIA proposed a "phased-in approach" to trade matching, based on "current capabilities." The example given suggested that affirmation of trades by noon on T+1 might be possible (and thus could be required) within 24 months, with further tightening of the allowed time period after that.[3] In this situation we believe that there is little likelihood that the U.S. will move to requiring T+1 settlement prior to the middle of 2007 at the very earliest.

We also believe there is little likelihood that a T+1 settlement objective in the U.S. would be established in future without significant prior notice (whether of a formal or informal nature) to the CCMA. Among other things, the CCMA has, and will maintain, a "watching brief" over events in the U.S., through its relationships with the SIA and with important U.S. industry participants. As noted above, in the CCMA's letter to the SEC we strongly recommended that the U.S. and Canada should work together on any shortening of the settlement cycle which the U.S. might decide to impose, to allow time for testing and implementation, and avoid any market disruptions.

In this context, looking at STP decoupled from T+1, and recognizing that the consequences of failing to affirm are quite different from the consequences of failing to settle, there is no reason why the Canadian market needs to achieve detailed STP objectives at the same time as the U.S. Should new timelines for achievement of T+1 in the U.S. be proposed or established, our views might change. Some STP activities might not be affected even then, but we acknowledge that the area of CCMA focus, institutional trade matching, would in all likelihood have to be closely coordinated in that context with the U.S. schedule.

In relation to unique Canadian factors or challenges, we would only note that the Canadian marketplace is generally somewhat better positioned to move forward on STP than is the U.S. market, due to its smaller size, including in volumes but perhaps especially in terms of number of participants in the various sectors. Canada also has advantages in its payments mechanisms, and in its lower reliance on certificates. We deal with the area where Canada is at the most significant disadvantage – institutional trade matching – in our responses below, but note here that the Canadian practice of block settlement will facilitate closing the gap in this area.

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?

Yes – but, as discussed in the introduction to this letter, the environment for STP has evolved to the point where it is clear that the key STP initiative, on which the CCMA must focus at least for the present, is institutional trade matching. The CCMA's Institutional Trade Processing Advisory Committee (ITPAC) is undertaking a study (the ITPAC

[3] See pages 9-10 of the SIA's letter.

Study) to identify bottlenecks in trade matching processes. The results of that study will be important as we set new critical path items. The CCMA is committed to identifying appropriate objectives and timelines for pursuing this goal by no later than December 31, 2004, and will be communicating those conclusions to the CSA as well as to the industry.

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?

[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?]

We reiterate our support for the mandating of institutional trade matching on trade date. However, we believe that it will be more appropriate, at least for the time being, to facilitate improvements in trade matching processes on a more gradual basis than is contemplated by the Proposed Instrument. As a related matter, we also think it is important to use the existing framework of SROs to the maximum extent possible, to minimize changes to the existing regulatory framework and avoid jurisdictional questions where possible. The CCMA is committed to continuing to discuss and develop arrangements within which all participants, including brokers, custodians and investment managers, can satisfactorily be accommodated. We anticipate that the CSA and the Investment Dealers Association of Canada (IDA) will both be involved in this process, but also that other participant groups and regulators (for example, the Office of the Superintendent of Financial Institutions) will need to be involved.

We believe the ITPAC Study will provide important information to assist these discussions and developments. Our proposed phased-in approach is at least generally similar to the SIA's proposal to the SEC in its June letter. In both cases requirements would be set in relation to existing and projected market capabilities, in anticipation that those requirements would be tightened (by shortening the time within which trade matching is required) as matching capabilities improve. If it becomes apparent that appropriate progress is not being made in Canada – and/or that a problematic timeline for achievement of settlement by T+1 has been resurrected in the U.S. – we believe there will be sufficient time to discuss any alternative arrangements that may be required.

The specific work plan tasks will be quite different for the U.S. and for Canada, since current data from the Canadian Depository for Securities Limited (CDS) shows that only 48 per cent of domestic institutional trades are confirmed/affirmed by T+1,[4] compared with the at least roughly comparable figure of 80 per cent which the SIA provides in its letter to the SEC.[5]

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[4] As reported in the CCMA Institutional Trade Processing Report Card for March, 2004, filed on the CCMA's web site, www.ccma-acmc.ca. This percentage has been recently confirmed to apply also to processing of the May transactions.

[5] See page 10 of the SIA's letter.

[Is the effective date of July 1, 2005 achievable?]

In terms of timing, many aspects of the situation affecting matching have changed and are continuing to change, including available technologies and service providers. We anticipate that the CSA will hear a variety of views from individual industry participants, but that most will conclude that the effective date of July 1, 2005 is not achievable on an industry-wide basis. Coordination with the U.S. in relation to Canada's institutional trade matching objectives is appropriate, but the main focus of that coordination should be ensuring that the final state – from which T+1 settlement becomes an easy transition – is reached at approximately the same time.

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

We should not use "close of business" terminology, since many enterprises operate today on a 24/7 basis. However, there are cut-off times for operational processes, and it is probably helpful to ensure that all processes are targeted against a common objective. One such possible time would be 7:30 p.m. Eastern Time, when CDS – as the effective link between all parties – begins processing the day's trades. However, that time was originally determined by the requirements of the service bureaus that serviced many CDS participants. It must be recognized that whatever timeline is chosen will leave individual participants with a variety of earlier deadlines to meet according to infrastructure processing deadlines and CCMA industry institutional best practices and standards. We suggest there is a need for further discussion of this issue, and those impacts, with key infrastructure providers and industry participants.

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?

As indicated above,[6] we do not believe the Proposed Instrument is appropriate at this time. However, were the CSA to proceed with the Proposed Instrument, we do not believe that expressly identifying in the Proposed Instrument each trade data element to be matched would be advisable. It is highly likely that these elements will change over time, and they may also differ by product. We believe it is more flexible and practical to rely on industry best practices and standards, supplemented by the requirements of infrastructure providers such as CDS.

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

To the extent that the CSA is to be involved in these matters, our answer is yes, it should rely on the Institutional Trade Processing Best Practices and Standards. These were

[6] See especially the introduction to our letter, and our response to Question 4.

developed with broad input from brokers, investment managers, custodians, depositories, transfer agents (TAs) and other Canadian market participants.

Question 8: The CSA seeks 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 reiterate our belief that the Proposed Instrument is inappropriate at this time. However, we do believe that the CSA has captured the appropriate transactions and types of securities that should be subject to institutional trade matching, and that any requirements being developed should be limited to public secondary market trades.

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?

We anticipate that you may receive a significant range of opinion from industry participants in relation to use of contracts to enforce standards on the investment management segment of the industry. We are not recommending a CSA rule at this time, and believe that it is preferable wherever possible to establish requirements directly through an appropriate regulator. Not only do contractual requirements operate indirectly, but their implementation could impose costly burdens on everyone, and generate additional paperwork of the very type the CCMA is trying to reduce (as well as presumably generate related audit requirements). We anticipate that any contracts which would be required would need to include all three parties involved (dealer, investment manager and custodian). It would also be important to standardize any proposed documentation to the maximum degree possible, and otherwise to minimize additional processing. We are optimistic, and believe that there will be sufficient time for the industry and its various regulators to develop an efficient approach that includes all necessary participants.

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?

Exceptions to matching requirements on trade date are necessary when trade details have not been agreed to, and these are provided for in the CCMA's Institutional Trade Processing Best Practices and Standards.

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)?

There is no need for registrants to report exceptions, but it is anticipated that the industry will work with CDS to report in aggregate to the IDA on broker-to-broker and institutional trade matching, and individually against the aggregate to the relevant CDS participant.

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?

We reiterate our view that mandating use of a matching service utility is not required, or appropriate. As noted in the Discussion Paper, the industry best practices and standards have been developed both with and without use of such a utility. We also note that STP trade matching can be achieved without a matching service utility. We believe the market will naturally gravitate to the most cost-effective solution (or solutions).

Questions 13 (Should the scope of functions of a matching service utility be broader?) and 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 have nothing to add to our response to the previous question.

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

We think market forces will determine the appropriate number of service providers, and the nature of their offerings. We do think that matching utilities should be required to be able to communicate with each other – the requirement would be as general as possible, requiring consistency with other markets and seamless operation across utilities in Canada.

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?

We would be concerned with imposing a T+3 requirement on the Canadian marketplace, which is operating quite well within that general parameter without such a requirement. Imposition of new rules in that circumstance would only divert attention from achieving higher standards, create confusion and increase costs and uncertainty. In addition, any rule would be complex, in view of the number of securities that currently settle on other than a T+3 basis. Similarly, we suggest that in moving from T+3 to T+1 we should proceed cautiously, remembering that in the move from T+5 to T+3 no CSA rule was

required. In this situation any rule changes that are required can probably be accommodated at the SRO level and/or at CDS.

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?

[Should the CSA require the reporting of corporate actions into a centralized hub?]

Yes, but we do not think this is a priority area for either the CCMA or for the CSA at this time. The CCMA's priorities are discussed above.[7] In relation to the CSA, we see continued difficulties in breaking out of the impasse created by the need for a regulatory requirement as the basis for building the hub and the concurrent difficulty of establishing such a requirement in the absence of an expressed appetite to build the hub. We believe that in this context it makes sense to allow the industry to work further on the issue and establish its objectives and interests more clearly. If and when that effort is successful, then appropriate regulators can consider whether they wish to cooperate in next steps. Among other things, we believe that continued work on a hub must confront the reality that securities issued by foreign companies – which are probably generally outside the jurisdiction of the CSA – are an important aspect of the current difficulties experienced in relation to corporate actions.

[If not (appropriate for CSA to require the reporting of corporate actions into a centralized hub), is it more appropriate for exchanges and other marketplaces to impose this requirement through listing or other requirements?]

As indicated above, we believe the next steps should be taken by interested industry groups. Corporate actions are one part of a larger fabric of investor communication issues that require more industry discussion. Once it becomes useful for regulators to be involved with industry, it seems to us likely that such involvement would extend beyond Exchanges. Not all securities are subject to Exchange requirements, and even for listed securities there remains the possibility of multiple and possibly conflicting standards. While a CSA rule will reach the broadest number of these instruments, it would not reach government issues, so consultation with government representatives would also be required.

[Who should pay for the development and maintenance of the central hub?]

This would be a matter to be confirmed in the further industry discussions we are suggesting.

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

[7] See especially the introduction to our letter, and our response to Question 4.

We believe this is something that would be addressed as industry deliberations develop proposals for a hub further, in relation to funding and the regulatory support that will be required.

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

Industry participants have recently made progress in increasing the amount of entitlement payments made in LVTS funds (now approximately 25 per cent of such payments). However, close to $3 billion in entitlement payments were received by cheque in June, 2004, and there is still a substantial gap between the amount of entitlement payments made in immediately available funds in Canada as opposed to the U.S.[8] On balance, we believe that a CSA requirement is not appropriate, assuming progress continues. We expect that there will be further progress in this area by individual participants in the system, and perhaps at some point through further action by the Canadian Payments Association (CPA).

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?

We have nothing to add to our response to the previous question (if there is to be any consideration of these matters, it should involve consultation with the CPA and CDS, and coordination with CPA Rules).

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 are encouraged by the CSA's stated commitment to make changes in National Instrument 81-102, and also to the Ontario Securities Commission and Alberta Securities Commission Policies dealing with certain unincorporated closed-end investment funds. The changes we requested in those areas, as described in the current Detailed Required Amendments List published by the CCMA's Legal and Regulatory Working Group, are important to the industry.

In terms of additional rules required to promote industry movement to STP, we encourage continued industry work on Documentation Agreements, under which the documentation to be exchanged between a broker/distributor and a fund company in relation to client transactions would be governed. We anticipate that work may deal with a number of related issues, including in such areas as trust accounts and a possible public insurance fund. Work on the Documentation Agreements should in turn serve as the basis for further discussions with the CSA concerning any necessary new or amended rules.

[8] Entitlement payments made using LVTS funds were 31 per cent by volume and 87 per cent by value of all such payments, as compared with 99.5 per cent by value in the U.S.

We believe your Discussion Paper presents an accurate picture of the range and complexity of the retail issues with which we have been grappling. We hope your initiative will provide further incentives for all affected parties to participate in further work in this area, and encourage the CSA to continue its dialogue with the investment funds industry.

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?

We support the development of rules that encourage immobilization or dematerialization of securities, and that offer investors a choice as to how they hold or register their personal investments. We do not believe that encouragement of immobilization or dematerialization should – or needs to - deprive investors of the right to hold certificates and/or to own their securities in a direct legal relationship with the issuer.

In relation to full dematerialization specifically, we believe that moving very rapidly in this direction – which would have to include recalling existing certificates – will create unnecessary expense for shareholders. Given the small number of trades (less than one per cent) that involve certificates, a more appropriate focus for dematerialization efforts would be on new issues only. In this context we plan to encourage rule changes at the Toronto Stock Exchange (TSX), providing issuers with the option to do new issues without the need to issue certificates.

We note that the U.S. is looking at broader dematerialization objectives as part of its STP project. Assuming that Canada moves to a shortened settlement cycle at the same time as the U.S., it will be important for Canada to have established prior to that time that the default choice in the issuance of all securities is electronic, with investors being able to obtain certificates only on request. (The desire to eliminate this right to obtain certificates completely needs careful review with investor groups.) At the current time, for reasons expressed above in relation to the lack of immediacy of T+1,[9] no further initiatives in this area are planned.

As a somewhat related – and very important – matter, we also record here our continuing strong support for the earliest possible enactment of the Uniform Securities Transfer Act and consequential amendments to other legislation, such as the provincial Personal Property Security Acts.

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?

Yes, regulatory oversight of all holder of record book-based systems is appropriate. It is hoped that any additional regulatory burdens could be minimized and harmonized with U.S. regulatory requirements to which industry participants are currently adhering.

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[9] See our response to Question 2.

Consistency with minimum standards for TAs being developed with the TSX would also be appropriate. Finally, the CCMA's Dematerialization and Corporate Actions Working Groups have established best practices that apply to Direct Registration Systems (DRSs) and to entitlements reporting and payment. Any regulation should refer to or at least 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 expect there will be separate DRSs, since each transfer agent will use its own proprietary system for this purpose, in the same way that each intermediary and custodian service provider uses its own proprietary system for its client name record keeping. This is the same environment as exists in the U.S.

In that connection, we would like to clarify the parallels between current and proposed practices in Canada and the U.S. In each case, connectivity between the direct and indirect system is provided through a central utility – CDS using the CDSX system in Canada, and DTCC using the Profile System in the U.S. And in both cases each TA must have a DRS system allowing it to connect to the central utility. In the U.S., there is an established regulatory environment, and the concern relates to the large number of smaller TAs who have no DRS and who therefore cannot connect to the Profile System. In Canada all seven TAs are already connected to CDSX, using existing registration systems which will be modified to facilitate book-based DRS, and the prime concern is to establish an appropriate regulatory environment for full DRS operation.

On the other hand, these proprietary DRS systems are not currently inter-operable, nor do they need to be. The purposes for which inter-operability has been considered important do not apply in Canada as CDS through CDSX already provides the required single point of communications for the intermediary community. Educating stakeholders, including retail investors, will be a key element in the implementation of DRSs.

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?

We know of no reason why the existing segregation rules would be considered inadequate.

We thank you again for your consideration of our comments, and look forward to a continuing dialogue on the complex but very important questions involving institutional trade matching.

Sincerely,