INVESTMENT DEALERS ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DES COURTIERS EN VALEURS MOBILIÈRES

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President and Chief Executive Officer

July 16, 2004

British Columbia Securities Commission
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 / Madame Beaudoin:

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

We are writing to provide the views of the Investment Dealers Association (the Association) in relation to the questions posed in Discussion Paper 24-401 (the Discussion Paper) and the related materials, including Proposed National Instrument 24-101 and Companion Policy 24-101CP

(collectively the Proposed Rules). We believe that the Discussion Paper is a very useful summary of the trade settlement and processing issues. We hope our responses to the questions that have been posed will contribute to the development of regulatory policy in this area, at both the CSA and SRO levels.

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

The value provided by requiring the filing of readiness certificates for STP is not as easy to demonstrate as it was for Y2K. In the case of Y2K, these certificates provided assurance to investors that their investments would still be available to them on and after January 1, 2000. In the case of STP, there is no similar need to provide this investment safety assurance to investors.

The objectives of the STP initiative are twofold: (i) to reduce settlement risk through more timely trade affirmation / confirmation and (ii) to reduce the cost of the trade affirmation / confirmation process to ensure that the Canadian capital markets remain competitive internationally. While these are important objectives, they are not of the same acute importance to the investor as investment safety was in the case of Y2K.

Nevertheless, financial intermediaries may wish to obtain STP readiness assurance from the counterparties with which they transact, if only to ascertain that the likely costs associated with transacting with their counterparties that are not STP ready are minimal.

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?

As the discussion paper points out, the Charles River study performed in 2000 indicated that if the United States were to move to T+1 settlement without the same move in Canada there would be a significant impact on competitiveness. If the U.S. was able to move to T+1 more quickly than Canada, there would be migration of inter-listed securities trading activity to the U.S. because of the reduced settlement risk in the U.S. Further, since CDS has a direct cross border link to DTCC, the efficiency of the clearing and settlement of securities transactions through CDS may be affected if one set of settlement requirements is followed for Canadian transactions (T+3) and another for U.S. transactions (T+1).

While the same competitiveness concerns do not necessarily arise if the U.S. was to become STP ready before Canada, while both countries retained T+3 settlement requirements, we do believe that it is important that Canada not lag too far behind the U.S. in STP readiness. Relative delays in Canadian STP readiness increase the risk of the U.S. moving to T+1 settlement in advance of Canada. This risk may not be high at this point, since it is our understanding that the move to T+1 is to be significantly delayed in the U.S., but the risk is there and steps need to be taken to ensure that Canada catches up on the STP readiness front prior to any move, in either country, to T+1 settlement.

Factors unique to Canada are the relative lack of available STP utilities and the unique trading / account types that exist. Canada at the moment has neither an institutional trade matching utility (CDS's Trade Matching Service which commenced operations in June 14, 2004 is available only to brokers) nor an ID confirmation utility, both of which are either under development or currently available in the U.S.

With respect to trading / account types, both block trading and accumulation accounts are present in Canada. The U.S. has neither and therefore Canada specific STP solutions must be developed to address these unique trading / account types.

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. It is the Association's understanding that the CCMA had already identified in November 2002 the critical paths for the core STP objectives through the establishment of Canadian securities industry STP milestones. The CCMA is also monitoring progress in achieving these milestones at both the working group and board levels and a study has been commissioned to evaluate Canadian STP preparedness vis-à-vis the United States. It is fair to say the progress to date in achieving these milestones has been slow, but without the discipline achieved through the establishment of regulatory requirements, the CCMA has a limited ability to mandate change.

We believe the primary concern at this point is not the establishment of a critical path for each core objective but rather to identify what the regulators (the CSA, the OSFI and the SROs) can do from a rulemaking standpoint to assist in achieving these milestones. Our responses to the remaining questions you have posed will detail the Association's views on what can be done by regulators to assist with STP.

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 market participants should be required to match institutional trades on a timelier basis to allow all institutional market participants to manage their settlement risks more effectively. As a result, in our view, only the following remaining questions need to be answered:

1. What should the institutional trading requirements be?
2. Which regulator should establish the requirements?
3. When should the requirements become effective?

What should the institutional trading requirements be?

The Proposed Rules seek to require trade matching by the close of business on trade date, effective July 1, 2005. We agree that trade matching on trade date (T) is an appropriate ultimate goal. Achieving this matching standard would significantly reduce settlement risk without shortening the existing settlement period from 3 days to 1 day. However, implementing such a requirement without first requiring all parties to the trade to report the trade as soon as possible may be too disruptive a change. While it is true that many institutional market participants are or could be prepared to trade match on T by the proposed date of July 1, 2005, many others will be hard pressed[1] to be able to trade report on T by this deadline.

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[1] This view is supported by the preparedness concerns we heard from the broker dealer community relating to the commencement of CDS's Trade Matching Service, a broker-to-broker trade matching utility for non exchange trades, which resulted in the Association deferring the effective date of the one hour trade reporting requirement until June 14, 2005. Refer to IDA Bulletin No. 3296 for details of the Association's broker to broker trade matching requirements.

An alternative approach would be to require the institutional market to first move to trade reporting by the close of business on T (possibly combined with a trade matching requirement by the end of T+1) and then subsequently move to trade matching by the close of business on T. One benefit of this two-stage approach would be to incrementally raise the bar for institutional market participants to facilitate a smoother transition to trade date matching. Another benefit would be to provide market participants, once they start reporting trades on T, the necessary information/experience to determine the types of trading that will benefit from a trade matching utility prior to trade matching on T becoming a regulatory requirement.

Which regulator should establish the requirements?

It is our understanding that for the broker dealers, enforcement of the requirements (whether it is the requirements set out in the Proposed Rules or possible SRO rules) will be left to the SROs. As a result, from a practical viewpoint it could be argued that the net effect to the broker dealer community will be the same whether rulemaking is done by the CSA or the SROs.

There are advantages to both rulemaking alternatives. The main advantage of the CSA rule alternative is that the rule would cover a greater number of participants in the institutional market and would lead to greater overall compliance. However, the greater jurisdiction of the CSA is of little benefit if the Proposed Rules fail to fully leverage off of it through requirements to be met by all CSA registrants.

The main advantage of the SRO rule alternative is that the SROs would retain their current ability to set specific rules that are most appropriate for their Member firms, which also meet a broader capital market objective, in this case settlement risk reduction through timelier trade matching.

The Association's rulemaking approach with respect to operational issues has been to selectively mandate industry best practices and participation in necessary utilities[2] that provide better service to the investing public and/or improve efficiencies within the dealer community as a whole. Specific to trade matching, the Association recently implemented a rule change (Regulation 800.49) mandating that IDA Member firms participate in the broker-to-broker trade matching utility that has been developed by CDS. It is therefore our preference that any additional STP related rulemaking that applies specifically to our Member firms be done at the SRO level.

An alternative to exclusive CSA or SRO rulemaking is the development of complementary CSA and SRO rules where the CSA rules would be less prescriptive than the Proposed Rules and the SRO rules would provide the necessary specifics to enforce SRO Member firm compliance. It is likely the CSA is already considering this alternative but we did not want to assume this was the case.

The scope of the questions set out as part of Question #4 and the specific Rule Proposals assume that the only alternatives for rulemaking are the CSA and the SROs. We believe there is an important role for other regulators, such as the OSFI, to assist in STP readiness that should not

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Further, a study performed by the CCMA as at March 2004 indicates that only 48% of domestic institutional trades were confirmed by T+1.

[2] Examples include the adoption of the good delivery rule (IDA Regs. 800.30 through 800.30E) and mandating participation in ATON to enable timely account transfer (IDA Regs. 2300.1 through 2300.11).

be overlooked. Adoption of the Proposed Rules or similar rules without the adoption of equivalent rules by other regulators will likely hinder progress towards STP readiness.

When should the requirements become effective?

Based on our previous comments in response to the questions raised as part of Question #4, we do not believe that the CSA's effective date of July 1, 2005 is achievable. That being said, we do think progress needs to be achieved by July 1, 2005 (i.e., a lesser requirement should be imposed such as trade reporting by the close of business on T or trade matching by the close of business on T+1 or both) so progress is being made towards being able to trade match by the end of T by a later date.

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

While we agree that a common deadline for matching trades is desirable, the unique systems issues that each of the institutional market participants face may make a common definition unachievable and, at least in the near term, requiring matching by the close of business of T may not be realistic.

In the case of the broker-to-broker matching engine (which commenced operations on June 14th) the cut-off time for trade reporting into M1 (the "near real time" trade matching process) is 7:30 PM on T. This is not a trade matching cut-off time but rather a cut-off time for reporting trades into M1 within the matching utility. Two matching processes are run (M1 and M2) and a lock-in process is run (L1) before all trades reported to the utility can be reported as being matched. These processes finish at approximately 3:00 PM on T+1.

Given the timelines detailed for the broker-to-broker matching utility, establishing a "close of business" matching requirement for trades in the near term does not appear to be realistic, particularly if the use of a trade matching utility is not to be mandated.

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 current trade matching process takes place without regulatory requirements that expressly identify the trade data elements that must be passed between and matched by counterparties. We are not convinced that specifying the trade data elements to be passed between counterparties will assist in achieving timelier trade matching. We therefore believe that relying on industry best practices as well as the requirements of CDS, Canada's central securities depository, continues to be the most appropriate approach.

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

We believe the CCMA ITPWG best practices and standards are reflective of industry best practices and standards. As a result, consistent with our response to Question #6, the CSA should rely on the CCMA ITPWG best practices and standards as well as the requirements of CDS.

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 believe the scope of the proposed National Instrument is appropriate in terms of transactions and types of securities covered, including limiting the rule 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?

To the extent participants in the institutional market are not subject to regulation, the contractual method seems to be the most feasible approach. However, the Proposed Rules do not consider the role to be played by other regulated institutions (i.e., the custodians) in bringing the buy side of the industry on side with the need to match trades on a timelier basis. We do not believe that application of the contractual method should be limited to the dealer / client relationship when it could also be used effectively in governing the client / settlement agent relationship. We therefore recommend that to that the extent settlement agents are regulated by OSFI (or others) they should be policing their relationships with their buy side clients in the same manner as proposed for IDA Member firms. This could be achieved by developing a separate client / settlement agent trade matching compliance agreement or amending the compliance agreement concept in the Proposed Rules to include settlement agents.

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?

Disputed trades[3] should not be subject to a requirement to match (either by close of business on T or by some other time standard). That being said, disputed trades that are exempt from a trade matching requirement should be subject to a reporting requirement; otherwise trades not reported on a timely basis by one or both parties to the trade that ultimately result in a disputed trade would also be exempt from a matching requirement. If this view is accepted, then the question "Is it practical to expect that all disputed trades can be identified by the close of business on T?" arises. We believe the answer to this question is no, particularly for trading that takes place immediately prior to the end of the trading 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, registrants should not be required to report exception trades on a trade-by-trade basis. Exception trade information should be retained and made available upon request to the SROs and/or securities regulatory authorities by either the registrant or, where a trade matching utility is being used, by the recognized clearing agency or the trade matching facility operator. Where a trade matching utility is being used, a more efficient approach to monitoring compliance would

[3] For the purposes of this response we consider a disputed trade to be the portion of a trade (either part or all) on which both parties have reported that has not been agreed to by one of the parties to the trade.

be for the regulator to receive a dealer compliance summary report from the recognized clearing agency or the trade matching facility operator.

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?

The Association is generally supportive of the use of trade matching utilities as an effective means of reducing settlement risk. We recently demonstrated this support by mandating IDA Member firm participation in CDS's Trade Matching Service. That being said, we do not understand the need to define the "matching service utility" and subject it to regulation when the user of the service would continue to be responsible for meeting any trade matching standard that is set.

We are also concerned that, based on the proposed definition of a "matching service utility", any move to mandate the use of such utility might be anti-competitive. Specifically, if the use of such utility were mandated any similar matching services offered by any of the CDS, the Toronto Stock Exchange or the Bourse de Montreal[4] would be immediately placed at a competitive disadvantage.

We believe all counterparties participating in institutional trading could benefit from the use of a trade matching utility. However, we believe it would be inappropriate to mandate the use of a single trade matching service, be it a matching service utility or a matching utility provided by a clearing agency, exchange or quotation system. Institutional market participants should be free to determine the most efficient/best cost solution for themselves.

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

As previously stated in response to Question #12, we do not understand the need to define the "matching service utility" and subject it to regulation. On this basis we cannot comment on the appropriateness to the scope of its functions.

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?

As previously stated in response to Questions #12 and #13, we do not understand the need to define the "matching service utility" and subject it to regulation. However, where a trade matching utility is being used, the regulator should be entitled to receive a counterparty compliance summary report from the recognized clearing agency or the trade matching facility's operator upon request to enable it to monitor the STP compliance of its registrants.

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[4] Recognized clearing agencies, recognized exchanges and recognized quotation and trade reporting systems would not qualify as a "trade matching utility" under the Proposed Rules

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

Competitive forces will determine the answer to this question.

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?

When the uniform settlement date was changed from T+5 to T+3 in June of 1995, it was determined that a CSA rule was unnecessary to mandate this change. SRO rules were adopted to mandate this change. It is our belief that these SRO rules, combined with voluntary compliance by unregulated capital market participants, have proven to be sufficient, as we do not believe there is any concern about compliance with the current T+3 settlement requirement. Further, any move by the CSA at this time to mandate T+3 settlement may send a false message that there are problems complying with the existing T+3 requirement.

Our experience with the change from T+5 to T+3 settlement also suggests that SRO rules would also be sufficient when the uniform settlement date is changed from T+3 to T+1.

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*?

Yes, the CSA should require the reporting of corporate actions into a centralized hub although the Association does not believe that this initiative is a priority item. Furthermore, the hub would only contain domestic corporate actions, which would be of limited benefit to the Canadian capital markets participants who have international clients, accounts and activities.

No, it is not more appropriate for the exchanges to impose this requirement, because the securities commissions are currently responsible for reviewing the information filed at SEDAR, which is initially private and then made public following its review.

The CSA should pay for the development and maintenance of a centralized hub. The costs could be funded using the same approach currently used to fund SEDAR.

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

Yes, dealers do not see the hub development as the highest priority industry project and imposing requirements prematurely would unduly add unnecessary costs to the industry at this time.

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

Yes, finality of entitlement payments is essential to reducing the risk to Canada's central clearing and settlement services.

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?

The minimum value should be the same as the CPA requirement (currently $25 million). If and when the CPA further lowers this requirement, the requirement that applies to reporting issuers should be lowered as well.

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?

The Association is generally supportive of ways that would improve trade efficiency. We support the recommendations of the CCMA Retail Trade Processing Working Group, including recommendations relating to the elimination of the forwarding of manual cheques and paperwork to the fund companies in relation to client named mutual fund transactions.

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?

CSA rulemaking is unnecessary to require immobilization, as the number of trades that involve physical certificates is small. However, those who wish to continue to hold and trade physical certificates should bear the true cost of doing so.

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?

An entity operating a DRS would not be performing the same role as a central securities depository and therefore, it would not be necessary that it be subject to the same level of regulatory oversight. To the extent that the entity is already subject to adequate regulatory oversight (i.e., OSFI), that should be sufficient.

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

There should not be a requirement that there be separate DRS systems. However, if separate DRS systems are established they should be inter-operable through CDS or by other means.

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?

Yes, there are already adequate SRO rules in place dealing with segregation. In addition, the provincial securities acts and the federal Criminal Code (OSA Section 47 and CCC Section 384) already include specific sections designed to safeguard customer fully paid for security holdings.

Why draft CSA rules unless there is an identified need to enhance SRO segregation rules? Furthermore, the OSC already directly regulates CDS, which is the largest Canadian segregation location.

Thank you for providing us with this opportunity to comment and we look forward to continuing discussions on STP readiness issues.

Yours truly,

Joseph J. Oliver