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ACCOVAM – Association professionnelle

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Saskatchewan Financial Services Commission (SFSC)
Manitoba Securities Commission (MSC)
Ontario Securities Commission (OSC)
New Brunswick Securities Commission (NBSC)
Office of the Attorney General, Prince Edward Island
Nova Scotia Securities Commission (NSSC)
Securities Commission of Newfoundland & Labrador
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Dear Sirs and Madams:

Re: Response to Canadian Securities Administrators' (CSA's) National Instrument 24-101 – Institutional Trade Matching and Settlement

Below are comments by the IDA – Industry Association on the CSA's Notice and Request for Comment on Proposed National Instrument (NI) 24-101, Institutional Trade Matching and Settlement, and Proposed Companion Policy (CP) 24-101CP to National Instrument 24-101 – Institutional Trade Matching and Settlement (the draft institutional trade-matching rule). The IDA – Industry Association is the national professional association of the Canadian investment industry, representing industry positions on

regulatory and public policy issues to promote efficient, fair and competitive capital markets for Canada. Many of our members have direct involvement in the institutional market and all have a clear interest in the efficient and cost-effective operations of Canada's capital markets.

We appreciate the changes that the CSA has made to the 2004 version of the proposed institutional trade-matching rule, notably, the addition of a written statement alternative to the proposed contractual obligation among the parties involved in the institutional trade process; providing for oversight involvement of self-regulatory organizations (SROs) and changes to the implementation timeframe.

This said, we believe that dealers appears to be the trade-matching parties that carry the heaviest burden as regards to compliance with the matching requirements. To the extent that all parts of the market are to benefit from earlier trade matching to reduce risk, the costs should be borne more evenly by all trade-matching parties through simplification of the responsibilities to be borne by dealers. Our comments therefore focus on amendments to make the national instrument more practical from a dealer operational perspective.[1] Key among our recommendations are:

1. **Ensuring greater clarity, simplicity and/or flexibility in the definition of an institutional investor, trade-matching party and institutional trade**
2. **Promoting greater efficiency in the establishment of compliance documentation through a standard industry-wide template that trade-matching parties could post on their websites**
3. **Extending implementation deadlines and allowing for the re-assessment in a year's time before reducing the matching timeline from noon on T+1 to the end of the day on T.**

Question 1: Should the definition of "institutional investor" be broader or narrower?

The purpose of NI 24-101 is to improve market efficiency and reduce risk, goals that we support fully. Risks associated with institutional trades are greater than in retail trades generally due to the size and nature of the transactions. The draft institutional trade processing rule excludes an individual under subsection (a) of the "institutional investor" definition but includes an individual under subsection (b) if the person holds securities through a custodian. While the IDA – SRO's Policy 4 – Minimum Standards for Institutional Account Opening, Operation and Supervision, excludes individuals from the definition of institutional investor, the trades of individuals with securities held with custodians are likely to be processed through the regulated clearing agency along with trades of institutional investors as defined in Policy 4. To include or exclude individuals universally may present unnecessary systems development and monitoring costs for some firms and the effect of their inclusion or exclusion would likely be immaterial on overall market efficiency and risk.

Furthermore, CDS, which will play a key part in the compliance monitoring framework, will be basing reporting on trades reported in its CDSX platform as "client trades" by brokers and affirmed as such by custodians or brokers acting in a custodial capacity. A CDS client trade is defined as a non-exchange trade between a broker and a settlement agent (custodian) who have the same client, which, in usual circumstances, would be viewed as trades of an institutional investor but include trades of individuals. Form 24-101F2, *Regulated Clearing Agency Quarterly Operations Report of Institutional Trade Matching Reporting and Matching* refers specifically to client trades, linking client trades to trades of institutional investors.

[1] We do not address a number of technical matters that have been raised by other commenters (e.g., policies and procedures should be "*designed* to achieve matching" rather than simply "achieve matching"); also, the comments assume that The Canadian Depository for Securities Limited (CDS) is the only regulated clearing agency and that there will shortly be one or two matching utilities in the Canadian marketplace.

Recommendation: Ensure that the definition of institutional investor provides appropriate flexibility to reflect existing trade clearing and settlement practices, that is, neither broadening nor narrowing the definition *per se*, but considering what is most practical operationally and from a compliance monitoring perspective.

Defining an institutional investor as one with "net investment assets of at least $10,000,000 as shown on its most recently prepared financial statements" adds unnecessary complexity as net investment assets fluctuate. Moreover, reporting by the registered clearing agency will not be able to distinguish such parties when it reports.

Recommendation: Delete the reference to $10 million from the proposed institutional trade-matching rule.

The 2004 proposed version of the institutional trade-matching rule limited the trades to "depository-eligible securities." Also, the draft rule refers to regulated clearing agency reporting for "client trades with a T+3 settlement period" – there are transactions that currently trade on a T+2 or other settlement cycle (certain forms of debt).

Recommendation: Re-instate the 2004 draft institutional trade-matching rule reference limiting the rule to "depository-eligible securities" for greater clarity. Consider clarifying in section 2.1 that the matching requirements and reporting apply only to T+3-settling trades (except those excluded under subsection 7.1(2)) and not to, for example, institutional trades settling on T+2 or to trades in money market instruments.

Question 2: Does the definition of "trade-matching party" capture all the relevant entities involved in the institutional trade-matching process?

Yes, however, either the definition of "custodian" in section 1.1 should not exclude a registered dealer or subsection (d) in the definition of "trade-matching party" should be expanded to capture dealers that act as custodians. Registered dealers acting as custodians (e.g., in prime brokerage arrangements) are currently captured in data provided by the registered clearing agency.

Question 3: The scope of the matching requirements of the Instrument is limited to DAP or RAP trades. Should the requirements be expanded to include other trades executed on behalf of an institutional investor? Should the requirements capture trades executed with or on behalf of an institutional investor settled without the involvement of a custodian?

See also answers to both question 1 regarding trades to be included and question 2. We believe that the scope of the draft institutional trade-matching rule should:

- Not be expanded to include other types of trades executed on behalf of an institutional investor with a custodian or other party performing a custodial role
- Be limited to delivery-against-payment (DAP) or receive-against-payment (RAP) trades, including trades in cash-on-delivery (COD) accounts that involve a custodian other than the dealer executing the trade, but including other dealers – this will capture both DAP/RAP and prime brokerage account trades where the dealer executing the trade is different from the prime broker that is acting as a custodian.

Question 4: Are each of these methods (compliance agreement and signed written statement) equally effective to ensure that the trade-matching parties will match their trades by the end of T? Should trade-matching parties be given a choice of which method to use?

A choice should be provided to the extent that both compliance documentation methods are enforceable and apply to all trade-matching parties. It should be recognized, however, that whichever mode is used, it will be difficult for one party to force another party to meet the target deadlines and that there is, therefore, an expectation that regulators and SROs will follow up as appropriate with counterparties that persist in not meeting the established deadlines.

This said, we note that the draft institutional trade-matching rule prohibits a registered dealer/adviser from opening an account to execute a DAP or RAP trade for an institutional investor, or from accepting an order to execute a DAP or RAP trade for the account of an institutional investor, unless each trade-matching party has either entered into a compliance agreement or signed a written statement. Custodians are trade-matching parties, but are party to neither account-opening nor trade execution and thus do not sign documentation with both broker and institutional investor.

Recommendation: Implement industry-wide standard wording to be used by all trade-matching parties for greater certainty and to simplify negotiation and implementation.

The time provided to dealers to execute the compliance agreements or the signed written statements should be extended as the rule is unlikely to have been finalized (expected in August, 2006 at the earliest) by the ostensible effective date of the agreements – July 1, 2006. Also, given the thousands of clients that some trade-matching parties may have, a longer lead time will allow for the reasonable development of industry standard forms for compliance agreements/signed written statements. The IDA – Industry Association intends to undertake work in this regard.

Recommendation: Allow trade-matching parties until January 1, 2007 to obtain signed versions of either of the two forms of compliance documentation or, ideally, commitment to abiding by an industry standard to reduce both the compliance burden for firms and the resources required by regulators to review agreements. Registrants and custodians could be required to post their documentation on their website.

Question 5: Will exception reports enable practical compliance monitoring and assessment of the trade-matching requirements?

We appreciate that reporting by registrants is limited to registrants, regulated clearing agencies and matching service utilities that do *not* meet the target matching thresholds, however, registrants may believe that they need to incur the expense of establishing reporting systems that they may not ultimately be required to use if they meet the matching deadlines.

Results of the regulated clearing agency reports will be indicative in many cases rather than substantive, as some trade-matching parties will submit trades to CDSX directly and others to CDSX through a clearing broker. In either case, there will likely be some disputes and confusion as a trade-matching party's inability to meet deadlines may relate less to its operational inefficiency and more to delays on the part of another trade-matching party.[2]

[2] Note that the number of trades entered and reflected in Table 1 – Entered in Form 24-101F5 will likely not equal trades affirmed in Table 2 – Matched as trades that contain errors are frequently re-input for matching rather than DK-ed or cancelled.

Recommendation: Rely on regulated clearing agency and matching service utility reports on trade reporting and matching to cost-effectively achieve the target reporting and focus oversight efforts on those individual firms with the highest values and/or volumes of trades that do not meet the deadlines, following up with, on a risk-evaluated basis, the trade-matching parties that appear to be causing delays.

As a comment only, we note that registrant reporting appears to be on the basis of the number of trades whereas and matching utility reporting requires volumes and values. We assume that this is deliberate on the CSA's part to facilitate risk-based examinations by regulators and self-regulatory organizations.

Question 6: Is it necessary to require custodians to do exception reporting in order to properly monitor compliance with this Instrument?

To accurately identify impediments to reaching the targets, custodians have a clear role to play. Most have established reporting programs, but these likely focus more on straight-through processing and accuracy than on the timeliness of trade matching.

Recommendation: Discuss reporting requirements with the custodian community prior to defining reporting requirements so as to achieve useful information and avoid unnecessary costs that would likely be passed on to customers.

Question 7: Is it feasible for trade-matching parties to achieve a *7:30 p.m. on T* matching rate of *98 percent* by July 1, 2008, even without the use of a matching service utility in the Canadian capital markets?

With respect to the ability for the industry to meet matching targets by July 1, 2008, with or without a matching utility, it is possible (particularly if there is increased usage of block settlement), but not certain at the present time. It should be easier with a matching utility, as such a utility allows parties to a transaction to enter details simultaneously, whereas trade entry and affirmation is by definition sequential. We continue to believe, however, that the decision to use a matching utility should be left to trade-matching parties.

The goal of achieving a high percentage of matched trades by noon on T+1 is a good step forward in reducing risk and should be achievable through behavioural changes at little further direct industry cost. To move the matching deadline from noon on T+1 to 7:30 p.m. or midnight on trade date (or even to 1:30 a.m. on T+1, understood to be the end of "trade date" at the Depository Trust Company (DTC) in the U.S.) will, however, be more costly. This is because, should trade entry take into account transactions processed until 7:30 p.m. or even midnight, custodian staff and/or systems will have to be available to affirm trades following the trade-entry cut-off time unless the custodian confirmation process is automated or matching utilities are used. Also, while matching utilities avoid the sequential nature of the trade process, at the present time, the final costs associated with matching utilities that are expected to shortly come to market are unknown to many parties.

Recommendation: Determine implications of custodians affirming trades after 7:30 p.m. or midnight on T before finalizing the final move to matching on trade date. Base matching on trade date on midnight rather than 7:30 p.m. cut-off. See also response to question 8.

With respect to the 98 percent threshold, we think that this is aggressive as actions of trade-matching parties are not completely under the control of their trade-matching counterparties. Moreover, parties that

clear through other parties by definition have to complete tasks earlier than the clearing brokers and can affect the latter's trade entry timing and therefore matching rates.

Recommendation: Consider specifying a 98 percent trade entry reporting rate for dealer trade entry to the regulated clearing agency and a separate custodian trade affirmation rate that recognizes that for the most part the process, at present, is sequential. Alternatively, consider lowering the matching rate to 95 percent. From the resultant data, determine parties that are not meeting the standards and deal with them directly on examination.

Question 8: Are the transitional percentages outlined in Part 10 of the Instrument practical? Please provide reasons for your answer.

Whereas most very large and very small firms are expected to be able to make the proposed deadlines, as noted in the answer to question 7, it is not clear to us that all other firms will be ready or find it reasonable to make the trade date match deadline. Also, even if only relatively few institutions do not comply with the trade-matching timelines, proportionally more registrants will likely be required to report exceptions, as the reporting requirements are initiated whether or not it is only one trade-matching party that is responsible for non-compliance or many.

We believe that, for the reasons noted in the answer to question 7, it will be very difficult for the industry to move from 70 per cent matched trades by noon on T+1 by December 31, 2006 to 80 percent by 7:30 p.m. on trade date six months later, by June 30, 2007.

Recommendation: Set the second target of June 30, 2007 for registrants to meet 80 percent of trades matched by noon on T+1 rather than T. Confirm the industry's ability to meet the matching-on-trade-date deadline in a year's time (July/August 2007), also evaluating impacts on western trade-matching parties and foreign financial investors, before finalizing the requirement and timeline to match by the end of trade date.

We would be pleased to discuss our comments with you. If you have any questions regarding our responses, please do not hesitate to contact me at the co-ordinates above.

Yours truly,