

SECURITIES & PUBLIC MARKETS BULLETIN

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CANADIAN SECURITIES ADMINISTRATORS IMPLEMENT RULES TO ENHANCE INSTITUTIONAL TRADE MATCHING AND SETTLEMENT

Earlier this year, the Canadian Securities Administrators (the “CSA”) adopted National Instrument 24-101 – Institutional Trade Matching and Settlement (“NI 24-101” or the “Rule”). Although the Rule came into force on April 1, compliance with certain important substantive provisions was delayed until October 1 and dealers and advisers should now be preparing for that deadline.

BACKGROUND

Since 2000, the CSA and the Canadian Capital Markets Association (“CCMA”) have been discussing the steps that need to be taken to achieve straight-through processing (“STP”) of all securities trading in Canada. STP is seen as critical to lowering operational, market and settlement risks and maintain the global competitiveness of Canadian capital markets.¹

The CCMA formed six committees, each of which was charged with examining a different element of STP and each of which published a white paper upon completion of its work. Following the publication of the white papers, the CCMA identified what it believed were the key legal and regulatory changes necessary to achieve STP and made a number of submissions to the CSA, federal and provincial governments and government agencies in this respect.

In 2004, the CSA and CCMA jointly determined that the most urgently required regulatory change was one mandating market participants to complete the process of confirming and affirming (“trade matching”) certain information (“trade data elements”) regarding institutional trades by the end of the day on which the trade occurs (“T”).

NI 24-101 is the culmination of a three-year rule-making process and, when fully implemented, will require the parties involved on the same side of an institutional trade to complete the trade matching process by the end of T.²

WHAT AND TO WHOM THE RULE APPLIES

NI 24-101 applies to some degree to each of the parties (the “trade-matching parties”) involved in respect of trades effected by or on behalf of an “institutional investor”³ in a “delivery against payment/receipt against payment” account (a “DAP/RAP account”).⁴

The Rule contemplates that trading in a DAP/RAP account involves three trade-matching parties: (1) the institutional investor itself, (2) the Canadian-registered dealer through which the trade is executed and (3) the Canadian custodian or sub-custodian with which the trade is settled.⁵

After October 1, Canadian-registered dealers and advisers will not be permitted to open a DAP/RAP account or to execute trades in a DAP/RAP account unless each of the other trade-matching parties has provided assurances that they

¹ CSA Request for Comment – Discussion Paper 24-401 on Straight Through Processing, (2004) 27 OSCB 3977 at 3988.

² NI 24-101 only mandates deadlines for the confirmation and affirmation of trade data elements; it does not mandate deadlines for the subsequent clearance and settlement of trades.

³ The definition is circular in the sense that an “institutional investor” is anyone (including an individual, corporation or fund of any kind) for whom a dealer has agreed to open a DAP/RAP account.

⁴ The Rule also contains certain provisions applicable to clearing agencies and matching service utilities, which are not discussed in this Bulletin.

⁵ If a trade is settled directly with the dealer through whom the trade is executed or with a custodian outside of Canada, it is not considered a DAP/RAP trade covered by the Rule.

have adopted and implement policies and procedures designed to achieve trade-matching as soon as practical after a trade is executed⁶. Those assurances can be given by way of either a “trade-matching agreement” or a “trade-matching statement”.

The CSA have only given general guidance as to the trade data elements that will need to be matched and as to the content of the policies and procedures necessary to achieve matching of trade data elements. They have specifically decided to leave it to self-regulatory organizations and industry best practices to determine the appropriate trade data elements that should be matched, have indicated that they expect trade-matching parties to take into consideration industry best practices when developing their policies and procedure and that they expect that different sizes and types of trade-matching parties may have very different policies and procedures.

APPLICATION TO NON-CANADIAN DEALERS AND ADVISERS

Non-Canadian dealers and advisers who trade on behalf of or advise non-Canadian institutional investors and who execute and settle trades in Canada are themselves considered to be the “institutional investor” and will be expected to provide trade-matching statements to (or enter into trade-matching agreements with) the Canadian-registered dealers through which they place trades.

Unregistered, non-Canadian dealers and advisers will not be required to comply with the reporting obligations the Rule imposes on Canadian-registered advisers and dealers.

TIMING REQUIREMENTS AND REPORTING OBLIGATIONS

From October 1, 2007 until June 30, 2008, Canadian-registered dealers’ and advisers’ policies and procedures must be designed to achieve matching as soon as practical, but not later than noon on the day following the execution of the trade (“T+1”). From July 1, 2008, the policies and procedures must be designed to achieve matching by not later than the end of T.

If, in any quarter, a Canadian-registered dealer or adviser determines that less than a specified percentage of its DAP/RAP trades were matched by the end of T+1 (before July 1, 2008) or T (after June 30, 2008), it will be required to file an exception report with the CSA. The specified percentage is staged, so that by January 1, 2010, Canadian-registered dealers and advisers will have to report if fewer than 95% of trades are matched by the end of T.

Exception reports will need to explain why the specified percentage of matches was not achieved and what steps the dealer or adviser has taken to remedy the situation. Since the CSA expect Canadian-registered dealers and advisers to monitor the other trade-matching parties’ adherence to the undertakings given in trade-matching agreements or trade-matching statements, exception reports may need to contain fairly detailed descriptions of discussions had or steps taken with respect to those parties.

CURRENT PREPARATIONS

We are aware that many Canadian-registered dealers who operated DAP/RAP accounts are currently corresponding with institutional investors (including non-Canadian dealers and advisers) and custodians. Canadian-registered dealers and advisers who have not yet done so should be reviewing their back-office policies and procedures to ensure that they are able to comply with the Rule’s trade-matching deadlines and should be contacting other trade-matching parties associated with DAP/RAP accounts in order to obtain the necessary trade-matching agreements or trade-matching statements by October 1.

Non-Canadian dealers and advisers who execute trades for non-Canadian institutional investor clients through Canadian-registered dealers should be confirming with their Canadian-dealers what trade data elements they expect to be matched. They should also be reviewing their back-office policies and procedures to ensure that they are able to give the assurances or undertakings contemplated in any trade-matching agreement or trade-matching statement.

⁶ Canadian-registered dealers’ and advisers’ own policies must be designed to achieving matching “as soon as practical after such trade is executed and in any event no later than the end of T”, as described further under the heading “Timing Requirements and Reporting Obligations”.

We expect that most trade-matching parties will want to exchange trade-matching statements rather than enter into trade-matching agreements. The CCMA has created a web page onto which trade-matching parties can post their trade-matching statements. This is designed to help speed up the account opening process for parties opening DAP/RAP accounts with each other for the first time, by allowing them to quickly obtain a copy of the other parties' trade-matching statements.

Finally, the CSA has established a working group comprising representatives of each of the groups of trade-matching parties and representatives of the CSA and which is charged with identifying and resolving issues that arise under the Rule. The members of the working group are identified on the Ontario Securities Commission's Website.

Written by Mark Pratt.

The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

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