

**COMPANION POLICY 24-101CP TO PROPOSED NATIONAL INSTRUMENT 24-101
POST-TRADE MATCHING AND SETTLEMENT**

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COMPANION POLICY 24-101CP TO NATIONAL INSTRUMENT 24-101 POST-TRADE MATCHING AND SETTLEMENT

PART 1 INTRODUCTION AND DEFINITIONS

1.1 Introduction

- (1) National Instrument 24-101 — *Post-Trade Matching and Settlement* (the Instrument) has been adopted to provide a framework in provincial securities legislation for ensuring more efficient post-trade processing for settlement of trades in publicly traded securities. In the past decade, volumes and dollar values of securities traded in Canada and globally have grown substantially. The increasing volumes mean existing back-office systems and procedures of market participants are challenged to meet post-trade processing demands, and new requirements are needed to address the increasing risks.
- (2) The Instrument is being adopted as part of the broader initiatives to implement straight-through processing (STP) in the Canadian securities markets. STP is the passing of information seamlessly and electronically among all participants involved in a securities transaction process. Implementing STP will enable the direct capture of trade details from order taking at the front-end of trading systems and complete automated processing of confirmations and settlement instructions without the need for the re-keying or re-formatting of data. STP implies electronic rather than manual interfaces between market participants, market infrastructure entities and service providers. It also implies achieving *inter-operability* in the marketplace, which refers to the ability of entities along the clearing and settlement chain to communicate and work with other entities without special effort on the part of users.

1.2 Purpose of Companion Policy — The purpose of this Companion Policy is to state the views of the Canadian securities regulatory authorities on various matters related to the Instrument, including:

- (a) a discussion of the general approach taken by the Canadian securities regulatory authorities in, and the general regulatory purpose for, the Instrument; and
- (b) the interpretation of various terms and provisions in the Instrument.

1.3 Trade Matching

- (1) A first step in settling a securities trade is to ensure that the buyer and the seller agree on the details of the transaction, a process referred to as trade confirmation and affirmation or *trade comparison and matching*. A dealer who executes trades on behalf of others is required to confirm trade details, not only with the counterparty to the trade (if the trade is not automatically matched at the marketplace), but also with the client for whom it acted. Agreement of trade details (sometimes referred to as *trade data elements*) must occur as soon as possible so that errors and discrepancies in the trades can be discovered early in the clearing and settlement process.
- (2) The typical institutional trade involves at least three parties: an investment manager or portfolio adviser (institutional client), usually acting on behalf of one or more underlying client accounts, who decides what securities to buy or sell and how the assets should be allocated among the client accounts; a dealer to execute the resulting trades; and one or more financial institutions appointed as custodian to hold the institutional client's assets. After placing an order with, and receiving a notice of execution of a trade from, a dealer, the institutional client must provide the dealer and custodian(s) with certain details to facilitate the settlement of the trade. In particular, the institutional client must provide details with respect to the underlying client accounts managed by it, and must instruct the custodian(s) to release funds and/or securities to the clearing agency. The dealer must also issue a customer trade confirmation to the institutional client containing required information pertaining to the trade pursuant to securities legislation or the rules of a self-regulatory organization (SROs).

1.4 Trade Settlement

- (1) A trade is the entering into of a contract for the purchase or sale of securities. If the facilities of a marketplace are used, the marketplace is not directly involved with the exchange of property for other property or money. The rules and customs of a marketplace or an SRO will generally set the terms of the contracts that are formed through the trading of securities.
- (2) Settlement is to be distinguished from clearance. Clearing is the process which begins immediately after the execution of a trade, and includes the process of comparing trade data elements. It also includes the calculation of the mutual obligations of market participants, usually on a net basis, for the exchange of securities and money—a process which occurs within the operations of a clearing agency. The concept of *clearing* or *clearance* is given a broad meaning to include the process of transmitting, reconciling and confirming payment orders or security transfer instructions prior to settlement. *Settlement* is, on the other hand, the moment when the property right or entitlement to the securities is transferred finally and irrevocably from one investor to another, usually in exchange for a

corresponding transfer of money. In the context of settlement of a trade through the facilities or services of a clearing agency acting as central counterparty, settlement is viewed as the discharge of obligations in respect of funds or securities, computed on a net basis, between and among the clearing agency and the participants of the clearing agency. Through the operation of novation and set-off in law or by contract, the clearing agency becomes a counterparty to each trade so that the mutual obligation to settle the trade is between the clearing agency and a participant.

1.5 The Process of Comparing Trade Data

- (1) The process of comparing trade data relating to a trade executed on behalf of an institutional client is explained in Section 1.2 of the Instrument. It includes the following activities:
 - (a) The dealer notifies the institutional client of the execution of the trade.
 - (b) The institutional client advises the dealer and custodian or custodians how the securities in the trade are to be allocated among the underlying client accounts managed by the institutional client. For so-called *block settlement trades*, the dealer may not necessarily need such allocation information, or may receive allocation information from the institutional client based solely on the number of custodians used by the institutional client instead of on the actual underlying client accounts managed by the institutional client.
 - (c) The dealer confirms to the institutional client the trade details, and submits trade data details to the clearing agency.
 - (d) The custodian or custodians of the assets of the institutional client verify the trade details and settlement instructions against available securities or funds held for the institutional client.
- (2) There is a difference between the process of comparing trade data, as described in Section 1.2 of the Instrument, and the moment an institutional trade is *matched*, as indicated in Section 1.3 of the Instrument (see also Section 3.5 of the Instrument). Comparing trade data is a necessary process to achieve the matching of a trade executed on behalf of an institutional client. Matching occurs when the relevant parties to a trade executed on behalf of an institutional client have, after comparing trade data, reconciled or agreed to the details of the trade. Matching also requires that the custodian holding the institutional client's assets be in a position to report the trade to a recognized clearing agency. At that point, the trade is ready for the clearing and settlement process through the facilities of the clearing agency.
- (3) The distinction between the process of comparing trade data and matching is made partly because of the scope of the trade matching requirement in Section 3.1 of the Instrument. A dealer is required *to take all necessary steps* to match the trade as

soon as practicable after its execution, and in any event no later than the close of business on T, irrespective of whether the trade was executed on behalf of an institutional client. This implies that, in the context of an institutional trade, the dealer must promptly complete the process of comparing trade data so as to enable trade matching no later than the close of business on T. However, if there is an error with respect to a detail of a trade or the details of the trade are incomplete, the relevant parties involved in settling the trade may not be in a position to match the trade by T. In that case, exception processing will apply, but the parties nevertheless have an obligation *to take all necessary steps* to correct the details of the trade and match the trade as soon as practicable thereafter and in any event no later than the close of business on T+1. See Sections 1.4 and 3.5 of the Instrument and Section 3.4 of this Policy.

- (4) Trade data elements that must be compared and agreed upon are those identified in the best practices and standards for institutional trade processing established and generally accepted by the industry as a whole. See Section 3.5 of this Policy. They include those trade data elements required to be included in customer trade confirmations pursuant to securities legislation¹ and the rules of the marketplace or SRO.² Thus, trade data elements that must be transmitted, compared and agreed upon may include the following, where applicable:
- (a) Security identification: ISIN, currency, strike date, issuer, type/ class/series, strike price, market ID.
 - (b) Order and trade information: dealer ID, account ID, account type, buy/sell indicator, order status, order type, unit price/face amount, number of securities/quantity, message date time, trade transaction type, commission, accrued interest (fixed income), broker settlement location, block reference, net amount, settlement type, allocation sender reference, custodian, payment indicator, IM portfolio/account ID, quantity allocated, and settlement conditions.

1.6 Definitions of *Depository Eligible Security* and *Recognized Clearing Agency*—
The trade matching and settlement requirements of the Instrument are limited to trades in depository eligible securities. Section 1.1 of the Instrument defines *depository eligible security* as 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. Thus, securities that are not eligible for deposit at The Canadian Depository for Securities Limited (CDS) are not securities that would be covered by the Instrument. Generally, most publicly traded securities in Canada are eligible for deposit in, and are cleared and settled through the

¹ See, for example, section 36 of the *Securities Act* (Ontario).

² See, for example, TSX Rule 2-405 and Investment Dealers Association of Canada (IDA) Regulation 200.1(h).

facilities and services of, CDS. The definition of *recognized clearing agency* takes into account the fact that only the provinces of Ontario and Quebec have recognized or otherwise regulate clearing agencies under provincial securities legislation.³ The term *clearing agency* is defined in the securities legislation of certain jurisdictions (see, for example, s. 1(1) of the *Securities Act* (Ontario)).

- 1.7 Definitions of DVP and RVP** — Section 1.1 of the Instrument defines *delivery-versus-payment* (DVP) as a service available to a buyer of a security which allows the buyer to pay for the security when the security is delivered at settlement. The definition of *receive-versus-payment* (RVP) is essentially the mirror image of DVP. RVP means, in relation to a sale of a security, a service available to the seller which allows it to deliver the security when payment is received at settlement.
- 1.8 Definitions of Custodian, Institutional Client and Portfolio Adviser** — The definition of custodian in Section 1.1 of the Instrument expressly excludes a dealer, and is an important component of the definition of *institutional client*. This latter term is defined as a person or company that appoints a custodian to hold securities on his, her or its behalf. It expressly includes a *portfolio adviser*, which, in turn, is defined as an adviser registered under securities legislation for the purpose of managing the investment assets of one or more clients of the adviser through discretionary authority granted to the adviser by the clients. While most institutional clients are investment, pension or other types of funds or entities, an individual can be an institutional client. Some individuals, usually *high net-worth* individuals, hold their investment assets through securities accounts maintained with a custodian rather than with a dealer.
- 1.9 Trade-Matching Compliance Agreement** — This term is described in detail in Section 1.4 of the Instrument. A trade-matching compliance agreement contractually binds all institutional clients, even those that the Canadian securities regulatory authorities do not regulate, such as pension and insurance funds. Institutional clients are required by agreement to *take all necessary steps* to complete the process of comparing trade data and matching a trade as soon as practicable after the trade is executed and in any event no later than the close of business on T.
- 1.10 Trade Matching and Trade Settlement** — Sections 1.3 of the Instrument describes when a trade executed on behalf of an institutional client is *matched*. The term *settlement* is defined in Section 1.1 of the Instrument and means the completion of a trade, whereby the seller transfers the security to the buyer and the buyer transfers the payment to the seller. The term also includes, in the context of completion of a

³ CDS is also regulated by the Bank of Canada pursuant to the *Payment Clearing and Settlement Act* (Canada).

trade through the facilities or services of a clearing agency acting as central counterparty, the discharge of obligations in respect of funds or securities, computed on a net basis, between and among the clearing agency and the participants of the clearing agency. The Instrument does not describe when an institutional trade is executed.

PART 2 APPLICATION OF INSTRUMENT

2.1 Application of Instrument — Part 2 of the Instrument largely defines the scope of the Instrument. It will not apply to certain types of trades, such as a trade that is a distribution of a security and a trade in a security of a mutual fund to which National Instrument 81-102 Mutual Funds applies. Nor will the Instrument apply to a trade in a security where the parties expressly agreed from the outset to *special settlement terms*. In addition, a trade in a security to be *settled outside Canada* is not subject to the Instrument.

PART 3 TRADE MATCHING REQUIREMENTS

3.1 Trade Matching Compliance by Dealer — Pursuant to Section 3.1 of the Instrument, a dealer who executes a trade in depository eligible securities must *take all necessary steps* to match the trade as soon as practicable after the trade has been executed and in any event no later than the close of business on T. This requirement is not necessarily limited to trades executed on behalf of institutional clients. However, the obligation to take all necessary steps to match trades by T for non-institutional trades, such as retail equity trades listed or traded on a marketplace, is not particularly onerous, as most non-institutional trades are usually automatically matched, or locked-in, or can easily be confirmed and affirmed on T through the facilities of a marketplace or CDS.⁴ With respect to institutional trades, however, a dealer's obligation to take all necessary steps to match a trade as soon as practicable, but no later than the close of business on T, will necessarily imply an obligation to promptly complete the process of comparing trade data. See the interpretation rules in Sections 1.2 and 1.3 of the Instrument, which describe the process of comparing trade data and when a trade executed on behalf of an institutional client is matched.

3.2 Trade-Matching Compliance Agreement — Section 3.2 of the Instrument prohibits a dealer from accepting instructions to open an account or an order to trade in a

⁴ Non-institutional trades in non-exchange traded securities, including government debt securities, by direct participants of CDS can be matched through the facilities of CDS' trade confirmation and affirmation system. The IDA is proposing a rule that will require their members to confirm and affirm *broker-to-broker* trades in non-exchange traded securities within one hour of the execution of the trade through CDS' trade confirmation and affirmation system. See proposed IDA Regulation 800.49, February 13, 2004, 27 OSCB 2038.

depository eligible security from an institutional client pursuant to an arrangement under which (a) the payment for the security purchased is to be made on a DVP or RVP basis by a custodian, or (b) the delivery of the security sold is to be made on a DVP or RVP basis by a custodian, unless the dealer has entered into a trade-matching compliance agreement with the institutional client. A dealer and institutional client need only enter into one trade-matching compliance agreement at the time of opening one or more trading accounts with a dealer for all future trades in relation to such accounts. A trade-matching compliance agreement should form part of the dealer's institutional account opening documentation. Moreover, a dealer should use reasonable efforts to monitor and enforce compliance with a trade-matching compliance agreement. It should, for example, suspend any DVP or RVP trading privileges of an institutional client that materially breaches a trade-matching compliance agreement until such time as the breach has been remedied.

- 3.3 Trade Matching Compliance by Adviser** — Pursuant to Section 3.3 of the Instrument, a portfolio adviser who gives an order to a dealer to trade in a depository eligible security on behalf of one or more clients of the portfolio adviser must take all necessary steps to match the trade as soon as practicable after the trade has been executed and in any event no later than the close of business on T. Section 3.4 of the Instrument further prohibits a portfolio adviser from opening an account with or giving an order to a dealer to trade in a depository eligible security on behalf of one or more underlying clients pursuant to an arrangement under which (a) the payment for the security purchased is to be made on a DVP or RVP basis by a custodian, or (b) the delivery of the security sold is to be made on a DVP or RVP basis by a custodian, unless the portfolio adviser has entered into a trade-matching compliance agreement with the dealer. These requirements are the mirror image of the combined provisions of Sections 3.1 and 3.2 of the Instrument in relation to dealers. Because the Canadian securities regulatory authorities regulate portfolio advisers, Section 3.3 directly requires portfolio advisers to take all necessary steps to match trades as soon as practicable. It is not necessary, in this case, to rely only on the terms of a trade-matching compliance agreement and the enforcement of contract law by a dealer.
- 3.4 Exception Processing** — As mentioned in subsection 1.5(3) of this Policy, a person or company subject to Section 3.1 or 3.3 of the Instrument or bound by a trade-matching compliance agreement is relieved from the requirement to match on T if, after comparing trade data, the details of the trade are found to be incorrect or incomplete and the person or company, acting reasonably, is unable to agree on the details of the trade with another relevant party before the close of business on T. However, the terms of a trade matching compliance agreement (see subsections 1.4(2) and (3) of the Instrument) and Section 3.5 of the Instrument require the person or company to nevertheless take all necessary steps to correct the details of the trade and match the trade as soon as practicable thereafter, but no later than the close of business on T+1.

3.5 Trade Data — The description of a trade-matching compliance agreement in Section 1.4 and the provisions of Sections 3.1, 3.3 and 3.5 of the Instrument use the expression *take all necessary steps* (or a variation of such expression). These provisions describe the obligation of a person or company to complete the process of trade-matching as quickly as possible—by the close of business on T as a general rule or by the close of business on T+1 where exception processing is required to correct the details of a trade. The Canadian securities regulatory authorities are of the view that a person or company will be presumed to have taken all necessary steps to match a trade as soon as practicable after a trade has been executed if the person or company has complied with the best practices and standards for institutional trade processing established and generally accepted by the industry as a whole.⁵ Current industry best practices and standards contemplate two future state scenarios for the Canadian marketplaces:

- (a) where institutional trade comparison and matching is achieved through connectivity to centralized facilities of a matching service utility, and
- (b) where institutional trade comparison and matching is achieved without connectivity to centralized facilities of a matching service utility.⁶

See subsection 1.5(4) of this Companion Policy for a brief discussion of some of the trade data elements that must be compared and agreed upon by the relevant parties to process a trade executed on behalf of an institutional client. Current industry best practices and standards contemplate confirmation and affirmation of up to 26 trade data elements.

3.6 Matching Service Utility - The Instrument takes a neutral position on whether market participants should use the facilities of a matching service utility to accomplish comparison of trade data and trade matching. Section 3.6 of the Instrument stipulates that a person or company subject to Section 3.1, 3.3 or 3.5 of the Instrument or bound by a trade-matching compliance agreement may use the facilities or services of a recognized clearing agency, a recognized exchange, a recognized quotation and trade reporting system, or a matching service utility to comply with the Section or the trade-matching compliance agreement if the facilities or services are reasonably designed to accomplish the matching of trades by the close of business on T.

⁵ The Canadian Capital Markets Association (CCMA) released on June 9, 2003 for public comment a document entitled *Canadian Securities Marketplace Best Practices and Standards: Institutional Trade Processing, Entitlements and Securities Lending* (“CCMA Best Practices and Standards White Paper”) that sets out best practices and standards for the processing for settlement of institutional trades, the processing of entitlements (corporate actions), and the processing of securities lending transactions. The final version of the CCMA Best Practices and Standards White Paper dated December 2003 can be found on the CCMA website at www.ccma-acmc.ca.

⁶ See the CCMA Best Practices and Standards White Paper, at 12.

PART 4 REQUIREMENTS FOR A MATCHING SERVICE UTILITY

4.1 Matching Service Utility

- (1) Part 4 of the Instrument sets out filing, reporting, systems capacity, and other requirements of a matching service utility. Section 1.1 of the Instrument defines a “matching service utility” as a person or company that provides centralized facilities for the comparison of trade data and has filed Form 24-101 F1. The term expressly excludes a recognized clearing agency, a recognized exchange, or a recognized quotation and trade reporting system (see definitions of these terms in Section 1.1 of the Instrument). Thus a recognized clearing agency, a recognized exchange, or a recognized quotation and trade reporting system are not subject to the requirements of Part 4 of the Instrument because, as a matter of policy, they are generally subject to similar requirements under the terms of their recognition. A matching service utility is a system operated by an entity that provides the services of a post-trade central comparison and matching facility for dealers, institutional investors, and custodians that clear and settle institutional trades. The entity uses technology to match in real-time trade data elements throughout a trade’s processing lifecycle. A matching service utility is not meant to include a dealer who offers “local” matching services to its institutional clients.

- (2) A matching service utility would be viewed as a critical infrastructure system involved in the clearing and settlement of securities transactions and the safeguarding of securities. The securities regulatory authorities believe that, while a matching service utility operating in Canada would largely enhance operational efficiency in the capital markets, it would raise certain regulatory concerns. Comparing and matching trade data are complex processes that are inextricably linked to the clearance and settlement process. A central matching utility concentrates processing risk in the entity that performs matching instead of dispersing that risk more to the dealers and their institutional clients. Accordingly, we believe that the breakdown of a matching service utility’s ability to accurately compare trade information from multiple market participants involving large numbers of securities transactions and sums of money could have adverse consequences for the efficiency of the Canadian securities clearing and settlement system.

4.2 Initial Filing Requirements for a Matching Service Utility

- (1) Section 4.1 of the Instrument requires any person or company that intends to carry on business as a matching service utility to file Form 24-101F1 at least 90 days before the person or company begins to carry on business as a matching service utility. Form 24-101F1 is attached to the Instrument.

- (2) The securities regulatory authorities will review Form 24-101F1 to determine whether it is contrary to the public interest for the person or company who filed the form to act as a matching service utility. The Canadian securities regulatory

authorities will consider a number of factors when reviewing the form filed, including,

- (a) the performance capability, standards and procedures for the transmission, processing and distribution of details of trades in securities executed on behalf of institutional clients;
 - (b) whether market participants generally may obtain access to the facilities and services of the matching service utility on fair and reasonable terms which are not unreasonably discriminatory;
 - (c) personnel qualifications;
 - (d) whether the matching service utility has sufficient financial resources for the proper performance of its functions;
 - (e) the existence of another entity performing the proposed function for the same type of security;
 - (f) the systems report referred to in subsection 4.5(b) of the Instrument.
- (3) The securities regulatory authorities request that the forms and exhibits be filed in electronic format, where possible.

4.3 Change to Material Information - Under subsection 4.2 of the Instrument, a matching service utility is required to file an amendment to the information provided in Form 24-101F1 at least 45 days before implementing a material change involving a matter set out in Form 24-101F1. In the view of the Canadian securities regulatory authorities, a material change includes a change to the information contained in the General Information items 1-11 and Exhibits I and O of the Form 24-101F1.

4.4 Ongoing Filing and Other Requirements Applicable to a Matching Service Utility

- (1) Ongoing quarterly filing requirements will allow regulators to monitor a matching service utility's operational performance and management of risk, the progress of inter-operability in the market, and any negative impact on access to the markets. A matching service utility will also provide trade matching data (e.g., number of trades matched on T) and other information to the securities regulatory authorities so that they can monitor industry compliance.
- (2) The Form 24-101F3 completed by a matching service utility will provide information on whether it is:
 - (a) developing fair and reasonable linkages between its systems and the systems of any other matching service utility in Canada that, at a minimum,

allow parties to executed trades that are processed through the systems of both matching service utilities to communicate through appropriate effective interfaces;

- (b) negotiating with other matching service utilities in Canada fair and reasonable charges and terms of payment for the use of interface services with respect to the sharing of trade and account information; and
- (c) unreasonably charging its customers more for use of its facilities and services when one or more counterparties to trades are customers of other matching service utilities than the matching service utility would normally charge its customers for use of its facilities and services when all counterparties to trades are customers of the matching service utility.

4.5 Capacity, Integrity and Security System Requirements

- (1) Subsection (a) of section 4.5 of the Instrument requires a matching service utility to meet certain systems, capacity, integrity and security standards. Subsections (b) and (c) of section 4.5 of the Instrument require a matching service utility to meet certain additional systems, capacity, integrity and security standards.
- (2) The activities in subsection (a) of section 4.5 of the Instrument must be carried out at least once a year. The Canadian securities regulatory authorities would expect these activities to be carried out even more frequently if there is a material change to trading volumes that necessitates that these functions be carried out more frequently in order to ensure that the matching service utility can appropriately service its clients.
- (3) The independent review contemplated by subsection (b) of section 4.5 of the Instrument should be performed by competent, independent audit personnel, following established system audit procedures and standards.

PART 5 TRADE SETTLEMENT REQUIREMENTS

5.1 Trade Settlement by Dealer — Section 5.1 of the Instrument sets out a basic rule that, to some extent, already exists through market practices and the rules of marketplaces and SROs. A dealer who executes trades in depository eligible securities must *take all necessary steps* to settle the trades no later than the end of T+3. Like Section 3.1 of the Instrument, this requirement is not necessarily limited to trades executed on behalf of institutional clients. Although current SRO rules already mandate a minimum T+3 settlement cycle period for most equity and long term debt securities,⁷ the Canadian securities regulatory authorities believe a general T+3

⁷ See IDA Regulation 800.27.

settlement cycle requirement in provincial securities legislation will strengthen the clearing and settlement system in Canada.

5.2 Good Delivery Rule — Section 5.2 of the Instrument sets out a *good delivery* rule that, to some extent, already exists in SRO rules.⁸ The rule provides that a dealer is not permitted to grant DVP or RVP trading privileges to a client in respect of trades in depository eligible securities unless settlement of the trade is effected through the facilities of a recognized clearing agency. Like the T+3 rule, the Canadian securities regulatory authorities believe a *good delivery* rule enshrined in provincial securities legislation will strengthen the clearing and settlement system in Canada.

⁸ See IDA Regulations 800.30C and 800.31.