

**CANADIAN SECURITIES ADMINISTRATORS' NOTICE 24-302**  
**ENTITLEMENT PAYMENTS TO**  
**THE CANADIAN DEPOSITORY FOR SECURITIES LIMITED (CDS)**

**1 Purpose of Notice**

The *Canadian Securities Administrators* (CSA or we) are asking all issuers and offerors<sup>1</sup> that pay entitlements in Canadian dollars to CDS,<sup>2</sup> for distribution to CDS' participants, to make such payments using the Large Value Transfer System (LVTS) operated by the *Canadian Payments Association* (CPA). While the rules of the CPA already effectively require issuers and offerors to make payments that exceed \$25 million in LVTS funds, we encourage issuers and offerors (and their agents<sup>3</sup>) to arrange with their financial institutions to pay entitlements of \$25 million or less in LVTS funds instead of cheques or other forms of payment that do not provide immediately final and irrevocable funds upon receipt.<sup>4</sup>

**2. What are entitlement payments?**

An entitlement payment is any money payment made in respect of issued and outstanding securities to holders of such securities. Entitlement payments include interest payments made on debt securities, cash dividend payments or other similar distributions made on equity securities, payments made upon redemptions, repurchases, or maturities of securities, and payments made in a transaction whereby securities are acquired in exchange for cash, or for both cash and other securities, under an offer to acquire, take-over bid, issuer bid, plan of arrangement or other form of business reorganization.

**3. What is the Large Value Transfer System (LVTS)?**

The LVTS, launched in 1999 by the CPA, is an electronic wire payment system that allows financial institutions and their customers to send large payments securely in real time. Through LVTS, funds can be transferred between participating financial institutions almost instantaneously, and the money can thus be credited to the recipient's account on a timely basis. All LVTS payments are immediately final and irrevocable. The recipient may withdraw the money, invest it or use it to make another payment. According to the CPA, more than \$130 billion in payments daily, representing approximately 88 per cent of the total value flowing through Canada's payments system, are being settled through the LVTS.<sup>5</sup>

**4. What is CDS' role in processing entitlement payments?**

CDS is Canada's national securities depository, clearing and settlement organization that holds over \$2.6 trillion of securities on deposit and handles over 65 million securities trades annually. Most publicly-traded Canadian equity, corporate and government debt and money market

---

<sup>1</sup> For the purposes of this Notice, an *offeror* is a person or company that acquires securities in exchange for funds, or for both funds and other securities, pursuant to an offer to acquire, take-over bid, issuer bid, plan of arrangement or other form of business reorganization.

<sup>2</sup> Or, alternatively, its nominee, CDS & Co.

<sup>3</sup> Generally, *transfer agents* act for issuers and *depository agents* act for offerors.

<sup>4</sup> The CPA rule limits the use of cheques, bank drafts and other paper-based payment items that can be processed through the CPA's older Automated Clearing Settlement System (ACSS) to payments of \$25 million or less. See Section 14 of CPA Rule A1 — *General Rules Pertaining to Items Acceptable for Exchange, for the Purpose of Clearing and Settlement*. The CPA's rules can be found on its web site at: <http://www.cdnpay.ca/>.

<sup>5</sup> For more information on the LVTS and the CPA, visit the CPA's web site at <http://www.cdnpay.ca/> and the web site of the Bank of Canada at <http://www.bank-banque-canada.ca/>.

securities, and many U.S. securities owned by Canadian investors, are held through CDS. When making entitlement payments to its registered or bearer securities holders, an issuer in Canada will usually make, by far, the largest entitlement payment to CDS or its nominee. CDS then processes the entitlement payment it receives from the issuer and credits the funds to its participants' accounts. Participants in turn make payments to their customers.

CDS' records show that, during its fiscal year ended October 31, 2004, it processed the following entitlement payments:

- interest: \$59.4 billion
- dividends: \$22.4 billion
- corporate actions: \$135 billion
- money market maturities: \$2.1 trillion

Of the total number of entitlement payments paid directly to CDS, 65.12 per cent were made by cheque (representing 21.49 per cent of the total value of such payments).<sup>6</sup> In the United States, apparently 99.5 per cent of the value of entitlement payments to the U.S. central securities depository are made by means of FedWire, a real-time gross settlement payment system operated by the U.S. Federal Reserve Board.<sup>7</sup>

## **5. Why is the ongoing use of cheques to pay entitlements to CDS a growing concern to regulators?**

Many issuers and offerors currently pay their entitlements by uncertified cheque or other forms of paper-based payment items. This method of payment of entitlements is inefficient, costly and poses certain risks to CDS and its participants. The main risk is that there is no finality of payment with paper-based items, as they can be reversed if there are insufficient funds in the account on which the cheque or other paper-based item is drawn. If an entitlement payment is reversed, participant recipients would be required to return such reversed payments to CDS. Risk is created where a participant is unable to return reversed payments. There is also the risk of loss or theft of such paper-based items. In addition, CDS is required to maintain costly manual processes to receive and handle large quantities of cheques, including data entry, reconciliation, safekeeping, and cheque conversion.<sup>8</sup>

International best practices and standards require payment arrangements that enable market participants to retransfer the proceeds of securities transactions as soon as possible—ideally intraday or at a minimum before the end of business on the same day—so as to limit their liquidity risk and any credit risks associated with the assets used.<sup>9</sup> International benchmarking studies suggest that current entitlement management processes in the Canadian capital markets are likely adversely affecting our country's otherwise high standing in global custody service rankings.<sup>10</sup>

---

<sup>6</sup> Entitlement payments paid by means of a debit to a CDS participant's funds account are not included in these numbers.

<sup>7</sup> See letter of the Canadian Capital Markets Association (CCMA) dated May 12, 2003—*Letter to CSA Responding to Questions on Mandating Use of LVTS for Entitlement Payments*—available on the CCMA's web site at: <http://www.ccma-acmc.ca/ccmahome.nsf/Splash?OpenPage>

<sup>8</sup> *Ibid.*

<sup>9</sup> See par. 3.52 of *Recommendations for securities settlement systems*—November 2001 report of the joint Task Force on Securities Settlement Systems of the Committee on Payment and Settlement Systems (CPSS) of the central banks of the Group of Ten countries and the Technical Committee of the International Organization of Securities Commissions (IOSCO). The CPSS-IOSCO report is available at:

<http://www.iosco.org/pubdocs/pdf/IOSCOPD123-English.pdf>, or <http://www.bis.org/publ/cpps46.pdf>.

<sup>10</sup> An October 22, 2002 CCMA White Paper—*Corporate Actions and Other Entitlements White Paper*—makes

Led by the Canadian Capital Markets Association (CCMA), the securities industry in Canada has raised this issue as an impediment to the industry's move towards straight-through processing (STP) and eventual move to a standard T+1 settlement cycle. From an STP perspective, LVTS entitlement payments will eliminate the current reliance on manual intervention to process payments, thus reducing the potential for errors and delays associated with payments by cheque. According to the CCMA, these are features that investors, and in particular foreign investors, consider when selecting markets in which to invest.<sup>11</sup>

The CSA agree that this issue impacts the efficiency of our capital markets, and that the use of LVTS funds for all entitlement payments will improve market efficiency and reduce risk. The CSA share the industry's view that the payment of entitlements using LVTS funds will ensure that:

- all payments within the securities clearing and settlement system are final and irrevocable,
- beneficiaries receive entitlement payments that are immediately available to them on an unconditional basis,
- Canada is better prepared to achieve STP and an eventual standard T+1 settlement period.

#### **6. What are the potential costs to issuers and offerors in making LVTS entitlement payments to CDS?**

In a letter to the CSA dated May 12, 2003, the CCMA described the potential costs to issuers and offerors of making an LVTS payment. The costs will vary depending on the size of the issuer or offeror, the nature of its commercial relationship with its financial institution,<sup>12</sup> how the entitlement payments are funded and other factors. The CCMA suggested that, depending on the size of the overall financial-institution relationship, the explicit cost of a particular LVTS payment could be nil.<sup>13</sup>

The CSA are cognizant of concerns about higher fees and costs to change banking practices and convert cheque payments to LVTS payments. This Notice is asking issuers and offerors to voluntarily change their payment practices.

#### **7. What have the industry and CSA said about this issue in the past?**

Numerous industry submissions and white papers on the LVTS issue have been made since 2000.<sup>14</sup> For example, in a written submission dated July 17, 2002 to the CSA, the CCMA requested that we mandate as quickly as possible the use of LVTS funds when payment of corporate entitlements are made to recognized depositories. The industry provided various reasons for this request, including that, even without any move to a standard T+1 settlement

---

reference to a 1997-1999 GSCS *Benchmarks* annual survey, which suggested that Canada's "undisciplined" entitlement-management process contributes to lowering Canada's standing in world rankings, citing Canadian custody client criticisms regarding corporate action handling. The CCMA White Paper is available on the CCMA's web site at: <http://www.ccma-acmc.ca/ccmahome.nsf/Main-E?OpenFrameSet>. The latest *Thomas Murray* capital market infrastructure risk assessment on Canada seems to echo these concerns. See *Thomas Murray Capital Markets Infrastructure Risk Ratings—Canada*, 2005 Report; Thomas Murray, London, U.K. The Thomas Murray web site is at [www.thomasmurray.com](http://www.thomasmurray.com).

<sup>11</sup> See May 12, 2003 CCMA letter to the CSA, *supra*, note 7.

<sup>12</sup> For example, fees may be bundled into the overall relationship package.

<sup>13</sup> The CCMA letter goes into more detail on the cost components of making an LVTS payment. See May 12, 2003 CCMA letter to the CSA, *supra*, note 7.

<sup>14</sup> See the CCMA's Website at [www.ccma-acmc.ca](http://www.ccma-acmc.ca) for some of these submissions and white papers.

cycle, "... requiring entitlement payments to be made by LVTS is still critical to improving the efficiency of Canadian capital markets."<sup>15</sup>

In November 2002, we published *CSA Notice 51-305* encouraging market participants to comment on a CCMA white paper that recommended, among other things, a requirement that entitlements to recognized depositories be paid in LVTS funds. We also published *CSA Discussion Paper 24-401 on Straight-through Processing* in April 2004 that contained a discussion and sought comment on the LVTS entitlement payments issue. Also in April 2004, a working group (LVTS working group) comprising staff from CDS, the Bank of Canada, CPA, Ontario Securities Commission, and Autorité des marchés financiers (Québec) was struck to find ways to encourage or require the use of the LVTS when making entitlement payments to CDS. Finally, in February 2005, we published *CSA Notice 24-301*,<sup>16</sup> which summarized the comments we received on Discussion Paper 24-401. Most comments on the LVTS entitlement payments issue suggested that the CSA should require issuers and offerors to use the LVTS, regardless of the value of the entitlement to be paid to CDS. Notice 24-301 also confirmed, among other things, our support of industry and regulatory initiatives to increase the use of LVTS by issuers.

## **8. Conclusion**

The industry and LVTS working group considered a range of mandatory and non-mandatory options to achieve greater use of the LVTS when making entitlement payments of \$25 million or less to CDS. Instead of implementing a mandatory measure at this time, we have decided through this Notice to encourage the voluntary use of the LVTS. We ask all issuers and offerors (and their agents) that pay Canadian dollar entitlements to CDS or its nominee, for distribution to CDS' participants, to make such payment in LVTS funds to CDS' account at the Bank of Canada. We believe that the use of LVTS funds for all entitlement payments to CDS will contribute to market efficiency and reduce risk. We propose to assess in a year from now whether there has been any meaningful progress<sup>17</sup> towards the use of the LVTS by issuers and offerors (and their agents).

Questions may be referred to:

Maxime Paré  
Senior Legal Counsel, Market Regulation  
Capital Markets,  
Ontario Securities Commission  
Tel: (416) 593-3650  
Email: mpare@osc.gov.on.ca

---

<sup>15</sup> This CCMA written submission dated July 17, 2002—*CCMA Letter to the Canadian Securities Administrators (CSA) on the Large Value Transfer System (LVTS)*—is available on the CCMA's web site at: <http://www.ccma-acmc.ca/ccmahome.nsf/Main-E?OpenFrameSet>.

<sup>16</sup> See *CSA Notice 24-301—Responses to Comments Received on Discussion Paper 24-401 on Straight-through Processing, Proposed National Instrument 24-101 Post-trade Matching and Settlement, and Proposed Companion Policy 24-101CP to National Instrument 24-101 Post-trade Matching and Settlement*.

<sup>17</sup> As measured in terms of narrowing the gap between the use of electronic payments in Canada and in the United States.

David Coultice  
Senior Legal Counsel, Finance Team 1  
Corporate Finance  
Ontario Securities Commission  
Tel: (416) 204-8979  
Email: dcoultice@osc.gov.on.ca

Patricia Leeson  
Manager, Corporate Finance  
Alberta Securities Commission  
Tel: (403) 297-5222  
Email: patricia.leeson@seccom.ab.ca

Shaun Fluker  
Legal Counsel  
Alberta Securities Commission  
Tel: (403) 297-3308  
Email: shaun.fluker@seccom.ab.ca

Serge Boisvert  
Analyste en réglementation  
Direction de la supervision des OAR  
Autorité des marchés financiers  
Tel: (514) 395-0558, ext. 4358  
Email: serge.boisvert@lautorite.qc.ca

Sandy Jakab  
Manager, Policy  
Capital Markets Regulation  
British Columbia Securities Commission  
Tel: (604) 899-6869  
Email: sjakab@bcsc.bc.ca

March 3, 2006