

CSA Notice

Adoption of a T+2 Settlement Cycle
for Conventional Mutual FundsAmendments to
National Instrument 81-102 *Investment Funds*

August 31, 2017

Introduction

The Canadian Securities Administrators, other than the British Columbia Securities Commission¹ and the Financial and Consumer Affairs Authority of Saskatchewan², (the **CSA** or **we**) are adopting amendments to National Instrument 81-102 *Investment Funds* (**NI 81-102**) and a consequential amendment to National Instrument 81-104 *Commodity Pools* (**NI 81-104**) to shorten the standard settlement cycle for conventional mutual funds³ from three days after the date of a trade (**T+3**) to two days after the date of a trade (**T+2**) (the **Amendments**).

This notice also provides guidance to conventional mutual funds regarding their expected adoption of a T+2 settlement cycle in light of the adoption of a T+2 settlement cycle in equity and long-term debt markets.

In some jurisdictions, government ministerial approvals are required for the implementation of the Amendments. Provided all necessary approvals are obtained, we expect the amendments will come into force on November 14, 2017 (see *Effective Date of the Amendments* below).

Background

On April 27, 2017, we published proposed amendments to NI 81-102 and a consequential amendment to NI 81-104 for a 90-day public comment period (collectively, the **Proposed Amendments**).

¹ The British Columbia Securities Commission did not publish the Proposed Amendments for comment, although staff anticipates doing so in the near future, after obtaining necessary approval.

² The Financial and Consumer Affairs Authority of Saskatchewan will advise of their approach in this matter after the provincial by-election in Saskatchewan on September 7, 2017.

³ A conventional mutual fund is a mutual fund that offers securities in continuous distribution under a simplified prospectus in accordance with National Instrument 81-101 *Mutual Fund Prospectus Disclosure*.

We received two comment letters on the Proposed Amendments. The list of the commenters is attached in Annex A to this Notice. We have considered the comments received, and thank all commenters for their submissions. We provide a summary of the comments on the Proposed Amendments, together with the CSA's responses, in Annex B to this Notice.

The Amendments are substantially the same as the Proposed Amendments.

Substance and Purpose

On September 5, 2017, markets in the United States are expected to move to a T+2 settlement cycle. As it is in the public interest for Canadian market participants to match U.S. settlement cycles, the CSA published on April 27, 2017 a Notice of Amendments to National Instrument 24-101 *Institutional Trade Matching and Settlement* (**NI 24-101**) (the **NI 24-101 Amendments**) that will harmonize settlement cycles to T+2 in Canada for equity and long-term debt markets to coincide with the adoption of a T+2 settlement cycle in the United States. Please see *CSA Notice Amendments to National Instrument 24-101 Institutional Trade Matching and Settlement and Changes to Companion Policy 24-101CP to National Instrument Institutional Trade Matching and Settlement* published on April 27, 2017.

A trade in a security of a conventional mutual fund is not subject to NI 24-101. However, the underlying equity and long-term debt securities owned by conventional mutual funds are subject to NI 24-101 and will settle at T+2.

Under NI 81-102, conventional mutual fund settlement must follow the requirements below (the **Current Requirements**):

- cash received by a dealer or principal distributor for payment of a mutual fund security must be forwarded to the order receipt office of the mutual fund *as soon as practicable* and in any event no later than the third business day after the pricing date (subsection 9.4(1) of NI 81-102);
- payment of the issue price of a security must be made on or before the third business day after the pricing date (subsection 9.4(2) of NI 81-102);
- in the event that payment is not received by the third business day after the pricing date of the security, the mutual fund must redeem the securities to which the purchase order pertains as if it had received an order for the redemption of the securities on the fourth business day after the pricing date or on the date the mutual fund first knows that the method of payment will not be honoured (subsection 9.4(4) of NI 81-102); and
- a mutual fund must pay the redemption proceeds for securities once a redemption order has been received within three business days after the date of calculation of the net asset value per security used in establishing the redemption price (subsection 10.4(1) of NI 81-102).

We note that this language is broad enough to permit conventional mutual funds to adopt a T+2 settlement cycle as of September 5, 2017 and prior to the coming into force of the Amendments.

Guidance on the transition to a T+2 settlement cycle

Given that the standard settlement cycle for equity and long-term debt market trades in Canada is being shortened from T+3 to T+2, we are of the view that conventional mutual funds must adopt a T+2 settlement cycle on the coming into force of the NI 24-101 Amendments, currently expected on September 5, 2017.

Summary of the Amendments

The Amendments amend sections 9.4 and 10.4 of NI 81-102 to remove references to a T+3 settlement cycle and replace them with references to a T+2 settlement cycle. The Amendments also amend paragraph 9.4(4)(a) of NI 81-102 to require a mutual fund, in the case where payment of the issue price of the securities has not been received, to redeem the securities on the third business day after the pricing date, instead of the fourth. Furthermore, a consequential amendment is made to section 6.3 of NI 81-104 to harmonize it with the amended section 10.4 of NI 81-102.

Effective date of the Amendments

We expect the Amendments will come into force on November 14, 2017, subject to obtaining ministerial approvals in certain CSA jurisdictions. Given prescribed timelines necessary to obtain ministerial approval, November 14, 2017 is the earliest date on which the Amendments can come into force.

Markets in Canada and the United States are expected to transition from a T+3 settlement cycle to a T+2 settlement cycle on September 5, 2017. The NI 24-101 Amendments will come into force concurrently with the date the United States transitions to a T+2 settlement cycle. However, while remote, it is possible that this target date may be deferred if certain regulatory and industry contingencies are not covered on time, which would delay the market transition to a T+2 settlement cycle and postpone the coming into force of the NI 24-101 Amendments. As a result, while we have specified November 14, 2017 as the earliest date when the Amendments will become effective, the Amendments contain language that will allow for the effective date to be postponed in order to match any delay of the coming into force of the NI 24-101 Amendments should it happen after November 14, 2017.

Local Matters

Certain jurisdictions are publishing other information required by local securities legislation. In Ontario, this information is contained in Annex G of this Notice.

Annexes

This Notice includes the following Annexes:

- Annex A: List of Commenters
- Annex B: Summary of comments on the Proposed Amendments and CSA responses

- Annex C: Amending Instrument for National Instrument 81-102 *Investment Funds*
- Annex D: Amending Instrument for National Instrument 81-104 *Commodity Pools*
- Annex E: Blackline of Select Provisions of National Instrument 81-102 *Investment Funds*
- Annex F: Blackline of Select Provisions of National Instrument 81-104 *Commodity Pools*
- Annex G: Local Matters

Questions

Please refer your questions to any of the following CSA staff:

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Where to find more information

The text of the Amendments follow after this Notice in Annexes C and D and will also be available on websites of CSA jurisdictions, including:

www.albertasecurities.com
www.mbsecurities.ca
www.osc.gov.on.ca
www.lautorite.qc.ca
www.fcnb.ca
nssc.novascotia.ca

ANNEX A

LIST OF COMMENTERS

1. Canadian Capital Markets Association
2. Osler, Hoskin & Harcourt LLP

ANNEX B

SUMMARY OF COMMENTS ON THE PROPOSED AMENDMENTS AND CSA RESPONSES

1. Theme/question	2. Summary of comments	3. General responses
<i>General</i>		
<i>Support for T+2 amendments</i>	<p>One Commenter expressed support for the rule amendments to confirm two-day settlement for conventional mutual funds.</p> <p>The Commenter also expressed appreciation for the CSA’s work to support the adoption of the transition to T+2 and for providing guidance to those manufacturing and distributing conventional mutual funds on the regulatory expectation that these entities will adopt a T+2 settlement cycle.</p>	<p>We acknowledge and thank the Commenter for its remarks.</p>
<i>Implementation</i>	<p>One Commenter recommended that the amendments to NI 81-102 relating to the transition to a T+2 settlement cycle by conventional mutual funds be implemented as quickly as possible and ideally before September 5, 2017.</p> <p>If this is not possible, the Commenter advised that it should be as soon as possible thereafter, with the clear understanding that the guidance communicates the regulatory expectation that conventional mutual funds transition to a T+2 settlement cycle on September 5, 2017.</p>	<p>Staff included guidance in the Notice and Request for Comment published on April 27, 2017 that the regulatory expectation was that conventional mutual funds adopt a T+2 settlement cycle on September 5, 2017 and have reiterated that guidance in this Notice.</p> <p>The amendments will come into force on November 14, 2017 or, in the event that the amendments made to NI 24-101 come into force after November 14, 2017, the date on which such amendments come into force.</p>

1. Theme/question	2. Summary of comments	3. General responses
<p><i>Exposure to markets remaining on a T+3 settlement cycle</i></p>	<p>One Commenter expressed concern that the proposed amendments could create compliance and liquidity challenges for Funds that have exposure to markets remaining on a T+3 settlement cycle, such as Japan, Brazil, the Philippines, Indonesia, and Singapore, once the proposed amendments come into force.</p> <p>The Commenter submitted that if a fund with significant investments in markets remaining on a T+3 settlement cycle were to receive a redemption request requiring it to liquidate securities in order to satisfy the redemption request, it may not be possible to raise sufficient cash to pay out the redemption proceeds by T+2. The Commenter also commented that index funds must generally trade in proportion to the index being tracked and therefore cannot raise cash by simply liquidating securities in other markets that settle within T+2. The Commenter suggested that this would result in funds maintaining higher cash balances than would otherwise be required in order to satisfy redemption requests and, in the case of index funds, will result in increased tracking error to the fund's index.</p> <p>The Commenter recommended that the proposed amendments be revised to include transition relief to permit a fund to continue to complete redemption transaction</p>	<p>Staff note that in accordance with section 2.6 of NI 81-102, a conventional mutual fund may borrow up to 5 percent of its net asset value in order to accommodate requests for the redemption of securities of the mutual fund.</p> <p>Furthermore, Staff would be prepared to consider appropriate exemptive relief in cases where conventional mutual funds hold a large portion of their net assets in jurisdictions in which securities will trade on a T+3 settlement cycle.</p> <p>We note that the global trend is towards T+2 settlement. Staff is also of the view that investors will find it very difficult to manage a portfolio of mutual funds that could have differing settlement periods.</p>

1. Theme/question	2. Summary of comments	3. General responses
	on a T+3 basis if the fund invests a substantial portion of its assets in securities traded only in markets that continue to remain on a T+3 settlement cycle.	

ANNEX C

**AMENDMENTS TO
NATIONAL INSTRUMENT 81-102 INVESTMENT FUNDS**

- 1. *National Instrument 81-102 Investment Funds is amended by this Instrument.***
- 2. *Section 9.4 is amended by***
 - (a) *replacing “third” wherever it occurs with “second”, and***
 - (b) *in paragraph (4)(a), replacing “fourth” with “third”.***
- 3. *Section 10.4 is amended by replacing “three” wherever it occurs with “two”.***
- 4. (a) Except in British Columbia and Saskatchewan, this Instrument comes into force on the later of November 14, 2017 or, in the event that the amendments made to National Instrument 24-101 *Institutional Trade Matching and Settlement* come into force after November 14, 2017, the date on which such amendments come into force.**
 - (b) For the purposes of paragraph (a), "amendments to National Instrument 24-101 *Institutional Trade Matching and Settlement*" means amendments made to National Instrument 24-101 *Institutional Trade Matching and Settlement* published on April 27, 2017 to facilitate the shortening the standard settlement cycle for equity and long-term debt market trades in Canada from 3 days after the date of a trade to 2 days after the date of a trade.**

ANNEX D

**AMENDMENTS TO
NATIONAL INSTRUMENT 81-104 *COMMODITY POOLS***

- 1. *National Instrument 81-104 Commodity Pools is amended by this Instrument.***
- 2. *Section 6.3 is amended by replacing “three” with “two”.***
3. (a) Except in British Columbia and Saskatchewan, this Instrument comes into force on the later of November 14, 2017 or, in the event that the amendments made to National Instrument 24-101 *Institutional Trade Matching and Settlement* come into force after November 14, 2017, the date on which such amendments come into force.

(b) For the purposes of paragraph (a), "amendments to National Instrument 24-101 *Institutional Trade Matching and Settlement*" means amendments made to National Instrument 24-101 *Institutional Trade Matching and Settlement* published on April 27, 2017 to facilitate the shortening the standard settlement cycle for equity and long-term debt market trades in Canada from 3 days after the date of a trade to 2 days after the date of a trade.

ANNEX E

**BLACKLINE OF SELECT PROVISIONS OF NATIONAL INSTRUMENT 81-102
INVESTMENT FUNDS**

9.4 Delivery of Funds and Settlement

- (1) A principal distributor, a participating dealer, or a person or company providing services to the principal distributor or participating dealer must forward any cash or securities received for payment of the issue price of securities of a mutual fund to an order receipt office of the mutual fund so that the cash or securities arrive at the order receipt office as soon as practicable and in any event no later than the ~~third~~ second business day after the pricing date.
- (2) Payment of the issue price of securities of a mutual fund must be made to the mutual fund on or before the ~~third~~ second business day after the pricing date for the securities by using any or a combination of the following methods of payment:
 - (a) by paying cash in a currency in which the net asset value per security of the mutual fund is calculated;
 - (b) by making good delivery of securities if
 - (i) the mutual fund would at the time of payment be permitted to purchase those securities,
 - (ii) the securities are acceptable to the portfolio adviser of the mutual fund and consistent with the mutual fund's investment objectives, and
 - (iii) the value of the securities is at least equal to the issue price of the securities of the mutual fund for which they are payment, valued as if the securities were portfolio assets of the mutual fund.
- (3) [Repealed]
- (4) If payment of the issue price of the securities of a mutual fund to which a purchase order pertains is not made on or before the ~~third~~ second business day after the pricing date or if the mutual fund has been paid the issue price by a cheque or method of payment that is subsequently not honoured,
 - (a) the mutual fund must redeem the securities to which the purchase order pertains as if it had received an order for the redemption of the securities on the ~~fourth~~ third business day after the pricing date or on the day on which the mutual fund first knows that the method of payment will not be honoured; and

- (b) the amount of the redemption proceeds derived from the redemption must be applied to reduce the amount owing to the mutual fund on the purchase of the securities and any banking costs incurred by the mutual fund in connection with the dishonoured cheque.
- (5) If the amount of the redemption proceeds referred to in subsection (4) exceeds the aggregate of issue price of the securities and any banking costs incurred by the mutual fund in connection with the dishonoured cheque, the difference must belong to the mutual fund.
- (6) If the amount of the redemption proceeds referred to in subsection (4) is less than the issue price of the securities and any banking costs incurred by the mutual fund in connection with the dishonoured cheque,
 - (a) if the mutual fund has a principal distributor, the principal distributor must pay, immediately upon notification by the mutual fund, to the mutual fund the amount of the deficiency; or
 - (b) if the mutual fund does not have a principal distributor, the participating dealer that delivered the relevant purchase order to the mutual fund must pay immediately, upon notification by the mutual fund, to the mutual fund the amount of the deficiency.

10.4 Payment of Redemption Proceeds

- (1) Subject to subsection 10.1(1) and to compliance with any requirements established by the mutual fund under paragraph 10.1(2)(b), a mutual fund must pay the redemption proceeds for securities that are the subject of a redemption order
 - (a) within ~~three~~ two business days after the date of calculation of the net asset value per security used in establishing the redemption price; or
 - (b) if payment of the redemption proceeds was not made at the time referred to in paragraph (a) because a requirement established under paragraph 10.1(2)(b) or a requirement of subsection 10.1(1) had not been satisfied, within ~~three~~ two business days of
 - (i) the satisfaction of the relevant requirement, or
 - (ii) the decision by the mutual fund to waive the requirement, if the requirement was a requirement established under paragraph 10.1(2)(b).
- (1.1) Despite subsection (1), an exchange-traded mutual fund that is not in continuous distribution must pay the redemption proceeds for securities that are the subject of a redemption order no later than 15 business days after the valuation date on which the redemption price was established.

- (1.2) A non-redeemable investment fund must pay the redemption proceeds for securities that are the subject of a redemption order no later than 15 business days after the valuation date on which the redemption price was established.
- (2) The redemption proceeds for a redeemed security, less any applicable investor fees, must be paid to or to the order of the securityholder of the security.
- (3) An investment fund must pay the redemption proceeds for a redeemed security by using any or a combination of the following methods of payment:
 - (a) by paying cash in the currency in which the net asset value per security of the redeemed security was calculated;
 - (b) with the prior written consent of the securityholder for a redemption other than an exchange of a manager-prescribed number of units, by making good delivery to the securityholder of portfolio assets, the value of which is equal to the amount at which those portfolio assets were valued in calculating the net asset value per security used to establish the redemption price.
- (4) [Repealed]
- (5) If the redemption proceeds for a redeemed security are paid in currency, an investment fund is deemed to have made payment
 - (a) when the investment fund, its manager or principal distributor mails a cheque or transmits funds in the required amount to or to the order of the securityholder of the securities; or
 - (b) if the securityholder has requested that redemption proceeds be delivered in a currency other than that permitted in subsection (3), when the investment fund delivers the redemption proceeds to the manager or principal distributor of the investment fund for conversion into that currency and delivery forthwith to the securityholder.

ANNEX F

**BLACKLINE OF SELECT PROVISIONS OF NATIONAL INSTRUMENT 81-104
*COMMODITY POOLS***

6.3 Payment of Redemption Proceeds

The references in subsection 10.4(1) of National Instrument 81-102 to "~~three~~ two business days" shall be read as references to "15 days" in relation to commodity pools.

ANNEX G

LOCAL MATTERS

There are no local matters in Alberta to consider at this time.