

6.1.2 Adoption of a T+2 Settlement Cycle for Conventional Mutual Funds – Proposed Amendments to National Instrument 81-102 Investment Funds



Canadian Securities
Administrators

Autorités canadiennes
en valeurs mobilières

Notice and Request for Comment

Adoption of a T+2 Settlement Cycle
for Conventional Mutual Funds

Proposed Amendments to
National Instrument 81-102 *Investment Funds*

April 27, 2017

Introduction

The Canadian Securities Administrators, other than the British Columbia Securities Commission¹, (the **CSA** or **we**) are publishing for a 90-day comment period proposed 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 funds² from three days after the date of a trade (**T+3**) to two days after the date of a trade (**T+2**) (the **Proposed Amendments**).

We are also providing 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.

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 is publishing, concurrently with this Notice, a Notice of Amendments that would harmonize settlement cycles to T+2 in Canada for equity and long-term debt markets and amend National Instrument 24-101 *Institutional Trade Matching and Settlement* (**NI 24-101**) (the **NI 24-101 Amendments**) 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 24-101 Institutional Trade Matching and Settlement*.

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 would 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

¹ While the British Columbia Securities Commission is not an authority publishing the Proposed Amendments under this Notice, it anticipates that, subject to receiving the necessary approvals, it will, in the near future, publish for comment proposed amendments that will be consistent with the Proposed Amendments described in this Notice.

² 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*.

- 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.

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 the requirement for a dealer or principal distributor to forward the cash or securities received for payment of the issue price of securities of a mutual fund to the mutual fund as soon as practicable would require conventional mutual funds to adopt a T+2 settlement cycle on the coming into force of the NI 24-101 Amendments, currently expected on September 5, 2017.

Additionally, with the Proposed Amendments, we wish to codify the expectation that conventional mutual funds will settle on T+2 to remove any possibility of confusion.

Summary of the Proposed Amendments

The Proposed Amendments amend sections 9.4 and 10.4 of NI 81-102 so as to remove references to a T+3 settlement cycle and replace them with references to a T+2 settlement cycle. The Proposed Amendments also amend paragraph 9.4(4)(a) of NI 81-102 so as 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, rather than on the fourth. Furthermore, a consequential amendment will be made to section 6.3 of NI 81-104 to harmonize it with the new proposed wording of section 10.4 of NI 81-102.

Transition

Subject to the rule approval process, we anticipate publishing final rules aimed at implementing the Proposed Amendments in the late Summer of 2017 (**Publication Date**). We anticipate the Proposed Amendments will be proclaimed into force expeditiously after the Publication Date (**In Force Date**). After the In Force Date, the T+3 settlement cycle for conventional mutual funds will be replaced by a T+2 settlement cycle.

Local Matters

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

Annexes

This Notice includes the following Annexes:

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

Deadline for Comments

Please submit your comments to the Proposed Amendments, in writing, on or before July 26, 2017. If you are not sending your comments by email, please send a CD containing the submissions (in Microsoft Word format).

Where to Send Your Comments

Address your submission to the CSA as follows:

Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Please send your comments only to the addresses listed below. Your comments will be forwarded to the other CSA member jurisdictions.

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, Ontario M5H 3S8
Fax: 416-593-2318
comments@osc.gov.on.ca

Madame Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, rue du square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, Québec H4Z 1G3
Fax: 514-864-6381
Consultation-en-cours@lautorite.qc.ca

We would like your input on the proposed amendments. Please include a prominent reference to the subject matter of your comments. For example, please include a subject line similar to the following: "RE: Mutual Fund T+2 Settlement Amendments".

Comments Received will be Publicly Available

Please note that we cannot keep submissions confidential because securities legislation in certain provinces requires publication of a summary of written comments received during the comment period. In this context, you should be aware that some information which is personal to you, such as your email and address, may appear on certain CSA web sites. It is important that you state on whose behalf you are making the submission.

All comments will be posted on the Ontario Securities Commission web site at www.osc.gov.on.ca and on the Autorité des marchés financiers web site at www.lautorite.qc.ca.

Questions

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

Jason Alcorn
Senior Legal Counsel
Financial and Consumer Services Commission (New Brunswick)
Tel: (506) 643-7857
Email: jason.alcorn@fcb.ca

Heather Kuchuran
Senior Securities Analyst
Financial and Consumer Affairs Authority of Saskatchewan
Tel: (306) 787-1009
Email: heather.kuchuran@gov.sk.ca

Request for Comments

Wayne Bridgeman
Deputy Director, Corporate Finance
The Manitoba Securities Commission, Securities Division
Tel: (204) 945-4905
Email: wayne.bridgeman@gov.mb.ca

Donna Gouthro
Senior Securities Analyst
Nova Scotia Securities Commission
Tel: (902) 424-7077
Email: Donna.Gouthro@novascotia.ca

Nick Hawkins
Legal Counsel, Investment Funds & Structured Products
Branch
Ontario Securities Commission
Tel: (416) 596-4267
Email: nhawkins@osc.gov.on.ca

M^e Chantal Leclerc
Senior Policy Advisor, Investment Funds Branch
Autorité des marchés financiers
Tel: (514) 395-0337, ext. 4463
Email: chantal.leclerc@lautorite.qc.ca

Danielle Mayhew
Legal Counsel
Alberta Securities Commission
Tel: (403) 592-3059
Email: Danielle.Mayhew@asc.ca

Where to find more information

We are publishing the proposed amendments with this Notice, as well as blackline version of select provisions of NI 81-102. The Proposed Amendments are also available on websites of CSA members, including:

www.albertasecurities.com

www.fcaa.gov.sk.ca

www.mbsecurities.ca

www.osc.gov.on.ca

www.lautorite.qc.ca

www.fcnb.ca

nssc.novascotia.ca

ANNEX A

PROPOSED 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. This Instrument comes into force ●.

ANNEX B

**PROPOSED 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. This Instrument comes into force ●.

ANNEX C

Blackline of Select Provisions of National Instrument 81-102 *Investment Funds*

This blackline shows the proposed changes in Annex A to this Instrument.

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 D

Blackline of Select Provisions of National Instrument 81-104 *Commodity Pools*

This blackline shows the proposed changes in Annex B to this Instrument.

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 E
Local Matters

The Ontario Securities Commission (the **Commission**) is publishing this Annex to supplement the CSA Notice.

Alternatives considered to the Proposed Amendments

The alternative to the Proposed Amendments would be not to proceed with making the Proposed Amendments to require conventional mutual funds to adopt a T+2 settlement cycle. Not proceeding with the Proposed Amendments would generally be inconsistent with the desire to facilitate the move to a T+2 settlement cycle, the industry support for the adoption of a T+2 settlement cycle, and any amendments made to NI 24-101 concerning ETF, equity and long-term debt markets that facilitate the adoption of a T+2 settlement cycle in those markets. Without the adoption of the Proposed Amendments, the industry led shift from a T+3 settlement cycle to a T+2 settlement cycle could result in some conventional mutual funds remaining on a T+3 settlement cycle. This situation would create investor confusion regarding the settlement cycle of securities of a particular conventional mutual fund.

Anticipated costs and benefits

As noted above, not proceeding with the Proposed Amendments would generally be inconsistent with the desire to facilitate the adoption of a T+2 settlement cycle. As the adoption of a T+2 settlement cycle is an industry led initiative, the costs of the adoption of a T+2 settlement cycle will, for the most part, be incurred regardless of the adoption of the Proposed Amendments. The Proposed Amendments will cause conventional funds to trade on the same settlement cycle as equity and long-term debt, and ETFs. The Proposed Amendments will require all conventional mutual funds to adopt a T+2 settlement cycle, thus avoiding investor confusion regarding the settlement cycle of securities of a particular conventional mutual fund.

Unpublished materials

In developing the Proposed Amendments, we have not relied on any significant unpublished study, report, or other written material.

Authority of the Proposed Amendments

The Proposed Amendments are being made under paragraph 143(1)31 of the *Securities Act* (Ontario). It authorizes the Commission to make rules regulating investment funds and the distribution and trading of the securities of investment funds including prescribing procedures applicable to investment funds, registrants and any other person or company in respect of sales and redemption of investment fund securities and payments for sales and redemptions.