

B.6

Request for Comments

B.6.1 CSA Notice and Request for Comment – Proposed Amendments to National Instrument 81-102 Investment Funds



Canadian Securities
Administrators

Autorités canadiennes
en valeurs mobilières

CSA NOTICE AND REQUEST FOR COMMENT

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

October 19, 2023

Introduction

The Canadian Securities Administrators (**CSA** or **we**) are proposing amendments to facilitate a voluntary decision by a mutual fund to shorten the settlement cycle for purchases and redemptions of its securities from two days after the date of a trade (**T+2**) to one day after the date of a trade (**T+1**) in anticipation of a reduction of the settlement cycle for equity and long-term debt market trades in Canada to T+1.

We are publishing for a 90-day comment period proposed amendments (the **Proposed Amendments**) to National Instrument 81-102 *Investment Funds* (**NI 81-102**).

The text of the Proposed Amendments is contained in Annex A of this Notice and will also be available on the websites of the following CSA jurisdictions:

www.lautorite.qc.ca
www.asc.ca
www.bcsc.bc.ca
nssc.novascotia.ca
www.fcmb.ca
www.osc.gov.on.ca
www.fcaa.gov.sk.ca
www.msc.gov.mb.ca

Summary, Substance and Purpose

The purpose of the Proposed Amendments is to accommodate a range of settlement cycles and particularly for those mutual funds that voluntarily decide to shorten the settlement cycle for purchases and redemptions of their securities from T+2 to T+1 when the underlying assets held by the fund move to a T+1 settlement cycle.

The Proposed Amendments introduce drafting changes to clarify that payments must be made no later than the reference settlement date of the purchase order. The reference settlement date of the purchase order is the business day determined by the mutual fund and disclosed in writing to the principal distributor, the participating dealer, or the person or company providing services to the principal distributor or participating dealer, which must be on or before the second business day after the pricing date.

The Proposed Amendments also introduce a change to paragraph 9.4(4)(a) of NI 81-102 to require a mutual fund that voluntarily decides to shorten the settlement cycle for purchase or redemption of its securities from T+2 to T+1 to redeem its securities for non-payment on the next business day after the reference settlement date of the purchase order, which would be on T+2 rather than T+3 as currently required.

Background

On December 15, 2022, the CSA published for comment proposed amendments (the **NI 24-101 Amendments**) to National Instrument 24-101 *Institutional Trade Matching and Settlements*. Among other things, the NI 24-101 Amendments focus on facilitating the shortening of the standard settlement cycle for equity and long-term debt market trades in Canada from T+2 to T+1.

B.6: Request for Comments

Concurrent with the publication of the NI 24-101 Amendments, CSA staff published CSA Staff Notice 81-335 *Investment Fund Settlement Cycles (Staff Notice 81-335)*. Staff Notice 81-335 explained that CSA staff did not propose to amend sections 9.4 and 10.4 of NI 81-102 to mandate the shortening of the settlement cycle for primary distributions and redemptions of mutual fund securities from T+2 to T+1. However, it was CSA staff's view that mutual funds should settle primary distributions and redemptions of their securities on T+1 voluntarily if the standard settlement cycle for listed securities moves from two days to one day in Canada.

The comment period for the NI 24-101 Amendments closed on March 17, 2023, and we received one comment letter regarding Staff Notice 81-335. The commenter stated that, to facilitate a voluntary decision by a mutual fund to shorten the settlement cycle for purchase or redemption of its securities from T+2 to T+1, a technical amendment to the forced redemption for non-payment requirement in paragraph 9.4(4)(a) of NI 81-102 should be made. The commenter noted that the intent of paragraph 9.4(4)(a) of NI 81-102 is that a mutual fund must redeem its securities that were issued to a purchaser if the purchaser fails to pay for those securities the day after settlement. Because settlement is currently required on T+2, current paragraph 9.4(4)(a) of NI 81-102 effectively mandates redemption three days after the date of the trade (**T+3**). If a mutual fund voluntarily shortens its settlement cycle for a sale of its securities to T+1, the mutual fund should be required to redeem for non-payment on the date after settlement, which would be on T+2 rather than T+3.

Without the Proposed Amendments, current paragraph 9.4(4)(a) of NI 81-102 would make a voluntary movement to a T+1 settlement cycle by a mutual fund administratively challenging because it could not redeem its securities for non-payment until two days after the settlement date.

Content of Annexes

This Notice contains the following annexes:

- Annex A – Proposed Amendments to National Instrument 81-102 *Investment Funds*
- Annex B – Local Matters

How to Provide Your Comments

Please provide your comments in writing by **January 17, 2024**.

We cannot keep submissions confidential because securities legislation requires publication of a summary of written comments received during the comment period. All comments received will be posted on the website of each of the Alberta Securities Commission at www.asc.ca, the Ontario Securities Commission at www.osc.ca and the Autorité des marchés financiers at www.lautorite.qc.ca. Therefore, you should not include personal information directly in comments to be published. It is important you state on whose behalf you are making the submissions.

Thank you in advance for your comments.

Please address your submission to all of the CSA as follows:

British Columbia Securities Commission
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
Office of the Superintendent of Securities, Service NL
Northwest Territories Office of the Superintendent of Securities
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Nunavut

B.6: Request for Comments

Please send your comments only to the following addresses. Your comments will be forwarded to the remaining jurisdictions:

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor, Box 55
Toronto, Ontario
M5H 3S8
Fax: 416-593-2318
Email: comments@osc.gov.on.ca

Me Philippe Lebel
Corporate Secretary and Executive Director, Legal Affairs
Autorité des marchés financiers
Place de la Cité, tour Cominar
2640, boulevard Laurier, bureau 400
Québec (Québec) G1V 5C1
Fax: 514-864-8381
Email: consultation-en-cours@lautorite.qc.ca

Questions

Please refer your questions to any of the following:

British Columbia Securities Commission
James Leong
Senior Legal Counsel, Corporate Finance
Tel : 604-899-6681
Email: jleong@bcsc.bc.ca

Alberta Securities Commission
Chad Conrad
Senior Legal Counsel, Investment Funds
Tel: 403-297-4295
Email: Chad.Conrad@asc.ca

Financial and Consumer Affairs Authority of Saskatchewan
Heather Kuchuran
Director, Corporate Finance
Tel: 306-787-1009
Email: heather.kuchuran@gov.sk.ca

Manitoba Securities Commission
Patrick Weeks
Deputy Director – Corporate Finance
Tel: 204-945-3326
Email: Patrick.weeks@gov.mb.ca

Ontario Securities Commission
Michael Tang
Senior Legal Counsel, Investment Funds and Structured Products Branch
Tel: 416-593-2330
Email: mtang@osc.gov.on.ca

Autorité des marchés financiers
Philippe Lessard
Securities Analyst, Investment Products Oversight
Tel: 514-395-0337 # 4364
Email: Philippe.Lessard@lautorite.qc.ca

Financial and Consumer Services Commission (New Brunswick)
Joe Adair, Senior Securities Analyst
Tel: 506-643-7435
Email: joe.adair@fcnbc.ca

Nova Scotia Securities Commission
Abel Lazarus
Director, Corporate Finance Branch
Tel: 902-424-6859
Email: abel.lazarus@novascotia.ca

Peter Lamey
Legal Analyst, Corporate Finance Branch
Tel: 902-424-7630
Email: peter.lamey@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***
 - (a) ***by adding the following subsection:***
 - (0.1) In subsections (1), (2), and (4), “reference settlement date” means the earlier of:
 - (a) the business day determined by the mutual fund and disclosed in writing to the principal distributor or participating dealer referred to in subsection (1), or to the person or company referred to in subsection (1) providing services to the principal distributor or participating dealer, and
 - (b) the second business day after the pricing date.,
 - (b) ***in subsections (1), (2) and (4), by replacing “second business day after the pricing date” with “reference settlement date”, and***
 - (c) ***by replacing in paragraph 4(a) “third business day after the pricing date” with “next business day after the reference settlement date”.***

Effective Date

3. (1) This Instrument comes into force on [DATE].
- (2) In Saskatchewan, despite subsection (1), if this Instrument is filed with the Registrar of Regulations after [DATE], this Instrument comes into force on the day on which it is filed with the Registrar of Regulations.

ANNEX B

LOCAL MATTERS

ONTARIO SECURITIES COMMISSION

1. Introduction

The Ontario Securities Commission (the **Commission**) is publishing this Annex to supplement the CSA Notice and Request for Comment (the **CSA Notice**) and to set out matters required to be addressed by the *Securities Act* (Ontario) (the **Act**).

Unless otherwise defined in this Annex, defined terms or expressions used in this Annex share the meanings provided in the CSA Notice.

Please refer to the main body of the CSA Notice.

2. Background and Current Regulatory Framework

On December 15, 2022, the CSA published for comment the NI 24-101 Amendments. Among other things, the NI 24-101 Amendments focus on facilitating an industry led effort to shorten the standard settlement cycle for equity and long-term debt market trades in Canada from T+2 to T+1 to align with proposed changes to settlement cycles in the United States.

Concurrent with the publication of the NI 24-101 Amendments, the CSA published Staff Notice 81-335, which explained that CSA staff did not propose to amend sections 9.4 and 10.4 of NI 81-102 to mandate shortening of the settlement cycle for primary distributions and redemptions of mutual fund securities from T+2 to T+1. However, it was CSA staff's view that mutual funds should settle primary distributions and redemptions of their securities on T+1 voluntarily if the standard settlement cycle for listed securities moves from two days to one day in Canada. Staff Notice 81-335 explained that moving to T+1 settlement would present operational difficulties for funds that have a significant portion of their portfolio assets that settle at T+2 or longer and so the CSA is not proposing amendments to sections 9.4 and 10.4 of NI 81-102 to mandate a T+1 settlement cycle for all mutual fund securities.

We agree with the flexible approach set out in Staff Notice 81-335. Without the Proposed Amendments, current paragraph 9.4(4)(a) of NI 81-102 would make a voluntary movement to a T+1 settlement cycle by a mutual fund administratively challenging because they could not redeem their securities for non-payment until two days after the settlement date.

3. Rationale for Intervention

The intent of paragraph 9.4(4)(a) of NI 81-102 is that a mutual fund must redeem its securities that were issued to a purchaser if the purchaser fails to pay for those securities by the day after the settlement date. Because settlement is currently required on T+2, current paragraph 9.4(4)(a) of NI 81-102 mandates redemption for non-payment on T+3. If a mutual fund voluntarily shortens its settlement cycle for a sale of its securities to T+1, the mutual fund should be permitted to redeem for non-payment on the date after settlement, which would be on T+2 rather than T+3. Without the Proposed Amendments, current paragraph 9.4(4)(a) of NI 81-102 would be a large disincentive for mutual funds to voluntarily move to a T+1 settlement cycle because they could not redeem their securities for non-payment until two days after the settlement date.

4. Proposed Intervention

The Proposed Amendments change paragraph 9.4(4)(a) of NI 81-102 to refer to the business day after the reference settlement date rather than the third business day after the pricing date. The Proposed Amendments also make drafting changes to clarify that payments must be made no later than the reference settlement date of the purchase order. The reference settlement date of the purchase order is the business day determined by the mutual fund and disclosed in writing to the principal distributor, the participating dealer, or the person or company providing services to the principal distributor or participating dealer, which must be on or before the second business day after the pricing date.

5. Affected Stakeholders

a. Mutual Funds

The Proposed Amendments would provide the necessary flexibility to mutual funds that wish to voluntarily move to a T+1 settlement cycle and promotes CSA staff's view in Staff Notice 81-335 (outlined above). These mutual funds will be able to redeem their securities that were issued to a purchaser if the purchaser fails to pay for those securities by the business day after the reference settlement date.

B.6: Request for Comments

As of December 2022, there were approximately 2900 mutual funds with net asset values of at least \$10 million.¹ While we do not have any estimates as to how many mutual funds will voluntarily change their settlement cycle to T+1, industry has indicated that almost half of funds have greater than 10% exposure to jurisdictions that will not be moving to a T+1 settlement cycle, highlighting the importance of the flexible approach explained in Staff Notice 81-335.²

b. Investors

Investors in a mutual fund's securities will generally benefit if the mutual fund voluntarily moves to a T+1 settlement cycle, following the adoption of the Proposed Amendments. Buyers and sellers of securities will receive their cash and securities a day earlier under a T+1 settlement cycle. While we do not have estimates on the share of investors' assets that could be affected, we note that Canadian mutual funds assets totalled \$1.9 trillion at the end of April 2023.³

c. Mutual Fund Dealers

Mutual fund dealers intermediating the purchase of mutual fund securities may incur incremental costs to track the settlement cycles of specific mutual funds as a result of any increase in the number of mutual funds voluntarily moving to a T+1 settlement cycle following the adoption of the Proposed Amendments.

6. Anticipated Benefits of the Proposed Amendments

a. Benefits to Mutual Funds

The Proposed Amendments would benefit mutual funds that wish to voluntarily move to a T+1 settlement cycle as well as investors in their funds. These mutual funds will be able to redeem its securities that were issued to a purchaser if the purchaser fails to pay for those securities by the business day after the reference settlement date rather than being forced to wait until the third business day after the pricing date. Being able to force redemption the day after non-payment will benefit the mutual fund by improving liquidity.

The Proposed Amendments provide no direct benefits to mutual funds that do not voluntarily move to a T+1 settlement cycle.

b. Benefits to Investors

Investors of a mutual fund's securities will generally benefit if the Proposed Amendments facilitate the mutual fund's voluntary move to a T+1 settlement cycle. Buyers and sellers of mutual fund securities will receive their securities or cash a day earlier under a T+1 settlement cycle.

7. Anticipated Costs of the Proposed Amendments

a. Costs to Mutual Funds

We anticipate that mutual funds will spend some time reviewing the Staff Notice 81-335 and the Proposed Amendments to determine if they should voluntarily move to a T+1 settlement cycle. We assume each fund will spend a total of 1 hour on these activities incurring a total cost of approximately \$97.50 per fund,⁴ which results in a total of around \$283,000 across the approximately 2900 funds with net asset values of more than \$10 million.⁵

The Proposed Amendments impose no other direct costs on mutual funds regardless of whether they decide to voluntarily move to a T+1 settlement cycle or retain a T+2 settlement cycle.

b. Costs to Investors

The Proposed Amendments impose no direct costs on Investors of a mutual fund's securities. Buyers of securities should have their mutual fund securities redeemed the business day after the reference settlement date if they do not pay for those securities by the reference settlement date. Buyers of securities in mutual funds that move to a T+1 settlement cycle may face a small opportunity cost from being required to pay for securities a day earlier than under the existing requirement. However, we expect the benefit to investors noted above from receiving cash earlier outweigh this.

¹ OSC Investment Fund Survey.

² <https://www.ific.ca/en/articles/investment-funds-and-the-move-to-t1/>.

³ IFIC Monthly Investment Fund Statistics – April 2023: <https://www.ific.ca/en/stats/>

⁴ Compliance Analyst for 0.75 hours at \$80 per hour and Chief Compliance Officer for 0.25 hours at \$150 per hour. Hourly rates are based on the 2021 Robert Half Accounting and Finance Salary Guide.

⁵ 2022 OSC Investment Fund Survey.

c. Costs to Mutual Fund Dealers

As noted, mutual fund dealers intermediating the purchase of mutual fund securities may incur incremental costs to track the settlement cycles of specific mutual funds as a result of any increase in the number of mutual funds voluntarily moving to a T+1 settlement cycle following the adoption of the Proposed Amendments.

8. Rule-making Authority

The Proposed Amendments are being made under paragraph 143(1)31 of the Act. 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.

9. Alternatives Considered

An alternative considered was to maintain the *status quo*, which would mean that the Proposed Amendments would not be adopted. Not proceeding with the Proposed Amendments would result in a disincentive for mutual funds to voluntarily move to a T+1 settlement cycle and a likelihood that few mutual funds would voluntarily shorten their settlement cycles.

10. Reliance on Unpublished Studies

The Commission is not relying on any unpublished study, report or other written material in proposing the Proposed Amendments.