Preparing for Canada's move to a T+2 Settlement Cycle

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As global markets continue to move – or have already moved – to a T+2 settlement cycle (two days following the trade date, or "T"), Canadian market stakeholders and participants are likewise preparing to shorten the settlement cycle from the current T+3 standard to T+2. Given the substantial volume of cross-border trading activity between Canada and the United States, Canadian regulators and the Canadian Capital Markets Association (CCMA) have aligned the Canadian market timelines to those of the U.S., targeting the third quarter (Q3) of 2017.

Canada has been operating on a T+3 settlement cycle since 1995, when both Canada and the U.S. shortened the settlement cycle for most debt and equities from T+5. Shortening the settlement cycle produces a number of benefits, including mitigating operational and systemic risk by reducing exposure between the parties to a trade, between the counterparties and central clearinghouses, and in terms of harmonization among various markets.

WHY NOW? T+2 GLOBALLY

Across the globe, markets have been making the move to T+2 – Asia-Pacific and Europe have already made the move and Australia and New Zealand successfully converted on March 7, 2016.[1] Joining other global markets in a shorter trade cycle will support a more efficient marketplace with reduced operational risk. As investors' horizons and investment activity become increasingly global, opportunities to simplify and unify cross-border trading help to support efficient markets and position investors in Canada to navigate the environment.

T+2 TIMING: Q3 2017, IN LINE WITH THE U.S. AND SUBJECT TO REGULATORY APPROVAL

The Canadian Securities Administrators (CSA) have affirmed that Canada will move to T+2 settlement at the same time as U.S. markets. Decisions remain to be finalized, but U.S. market stakeholders on March 7, 2016 announced[2] a recommended target date of September 5, 2017. The U.S. implementation date is contingent upon the U.S. T+2 Industry Steering Committee obtaining U.S. regulators' support in amending applicable rules in a timely manner, and upon the successful completion of industry-wide testing during Q2 and Q3 of 2017. Though Canadian regulators and stakeholders anticipate alignment to these U.S. dates, the shortening of Canada's cycle likewise remains subject to regulatory review and direction.

Given complex regulations and market structure in Canada and the U.S., planning well in advance gives stakeholders the needed time to assess and test their preparations for shortening the settlement cycle. Every firm in the securities industry in Canada and the U.S. will be (or already is) involved in the transition, directly or indirectly.

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Benefits to Clients and Securities Firms

Of the range of benefits of the shortened cycle, arguably the most important are the certainty, safety and increased soundness of Canadian capital markets for participants. T+2 will promote reduced counterparty risk, reduced margin requirements, decreased clearing capital requirements and increased global settlement harmonization. The Canadian and U.S. market structure will also work to improve safety and efficiency for investors.

In summary, the benefits to market participants active in Canada include:

- Aligning with U.S. and various global markets
- Mitigating operational and systemic risk
- Reducing exposure between trade counterparties
- Reducing exposures between participants and clearinghouses
- Reduced margin requirements
- Decreased clearing capital requirements
- Increased global settlement harmonization.
- Improved safety and efficiency for investors

IMPACTED SECURITIES WILL SETTLE ON T+2

Securities impacted by the settlement switch to T+2 include:

- Stocks/equities
- Corporate bonds
- Federal, provincial and municipal government bonds with a remaining term to maturity of 3+ years[3]
- Mutual funds
- Exchange-traded funds (ETFs)
- Hedge funds
- Segregated funds
- Principal-protected notes

The final list has been posted to the CCMA website.

T+2 PREPAREDNESSS

The U.S. T+2 schedule continues its execution stage, awaiting regulatory review, approval and publication of final rule changes and implementation dates. Q1 2017 will see the U.S. complete the internal build in order to accommodate the new cycle, and Q3 2017 will see the finalization of industry-wide testing and the beginning of T+2 implementation.

Canadian regulators and securities firms recognize the necessity of properly preparing Canadian stakeholders for the new cycle. The CCMA is working to promote industry awareness and prepare Canada for T+2. The CCMA is coordinating key securities infrastructure including the Canadian Depository of Securities (CDS), Fundserv, and exchanges along with the CCMA's dealer, custodian, asset manager and other industry stakeholders to prepare them for the transition. The CCMA has established a T+2 Steering Committee (T2SC) to support a smooth transition to a T+2 settlement. The T2SC has also established four working group committees:

- T+2 Operations Working Group (OWG)
- T+2 Legal and Regulatory Working Group (LRWG)
- T+2 Communication and Education Working Group (CEWG)
- T+2 Mutual Funds Working Group (MFWG)

The Canadian Depository for Securities Limited (CDS) is participating in the T2SC and in addition to coordinating activities with stakeholders to position Canada for a smooth transition, has conducted its own analysis[4] on the move to T+2. It has determined that its systems will be minimally impacted, "are T+2 compatible, and are unaffected by a shortened settlement period as processes are based on trade date, value date, ex-date and due bill redemption date values as received from exchanges and service bureaus." [5]

KEY CONSIDERATIONS FOR MARKET PARTICIPANTS

The CCMA OWG has analyzed and identified what they consider to be high priority

Notes

1 http://www.asx.com.au/services/t2.htm
2 http://www.ust2.com/pdfs/T2-ISC-recommends-shorter-settlement-030716.pdf
3 Federal Bonds which currently trade on a T+1 basis (e.g. those with a shorter maturity date) are expected to continue to trade on the same T+1 settlement basis following the conversion to T+2
4 https://www.cds.ca/resource/en/174
5 https://www.cds.ca/resource/en/174

Firms are not only responsible for satisfying themselves regarding their own systems, but to take steps to confirm that their linkages with other stakeholders in the settlement chain are prepared for the move.

operational issues and processes for corporations, Canadian investors and investors into Canada regarding the move to T+2. These focus areas include:

- National Instrument (NI) 24–101 rule amendments
- Holiday processing
- Corporate Actions (ex and record date calculations, due bill processing, etc.)
- Industry testing
- Buy-side client readiness

Firms preparing for T+2 may want to consider the adjustments and changes that may be necessary for their relevant securities system(s). Securities firms may decide to take into consideration whether they need to:

- Review downstream and upstream processes, reports, files and databases.
- Make any changes to prospectus or other agreements.
- Make any changes to trading platforms.
- Make any changes to portfolio valuation systems.

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CIBC MELLON AND T+2

CIBC Mellon is playing an active role in the readiness and consultations taking place across the industry leading up to the 2017 implementation. Our company is represented on the T2SC, OWG and CEWG. CIBC Mellon also participates on the CIBC T+2 working group and is plugged into the U.S. BNY Mellon DTCC working group.

CIBC Mellon's custody system is currently settling trading activities across a wide range of settlement cycles in support of clients' cross-border activities – with cycles ranging from same-day settlement on T through T+2 and T+3, to T+5 and beyond. CIBC Mellon is ready and able to handle T+2 settlement in Canada.

We bring considerable settlement experience – in addition to our daily settlement activities, a number of CIBC Mellon employees have the experience of having been active participants during Canada's previous, successful shortening of the settlement cycle to T+3 from T+5 in 1995. We will continue to provide clients updates as they relate to the T+2 settlement in Canada and CIBC Mellon's supportive efforts.

T+2 TIMELINE – CANADA / U.S. SCHEDULE

U.S.	Canada
• Oct. 2012: DTCC-commissioned report by the Boston Consulting Group showed positive benefit-to-cost ratio from shortening settlement cycles • Apr. 2014: All major U.S. industry organizations commit to move to T+2	The CCMA continues to review matching requirements set out under NI 24-101 and expects it will provide recommendations to Canadian regulators later in 2016.
• June 2015: Updated U.S. T+2 white paper	• July 15, 2015: CCMA formally "re-activated" for T+2 • Sept. 2015: CDS white paper on T+2 issued
• Dec. 2015: industry implementation plan proposal to SEC	• Dec. 2015: CCMA relaunched and staffed; milestones ready; industry awareness builds
• 2016: DTCC and other market infrastructure entities to develop and test system changes, conduct cross-industry testing; firms start changes	• 2016/Q1 2017: CDS and key infrastructure to develop and test systems changes and complete cross-industry test plan; firm start changes
• Q1-Q3 2017: Firms complete changes; U.S. industry testing; readiness confirmation	• Q1-Q3 2017: Canadian preparatory industry testing, confirmation of readiness
• Sept. 5, 2017: Expected implementation	• Sept. 5, 2017: Expected implementation

Questions

To learn more or discuss any questions related to CIBC Mellon's preparations for the shortening settlement cycle, contact your service director or account manager.

About CIBC Mellon

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