Canada T+1 Settlement Cycle FAQ

The following Q&A will help you understand changes required to support the T+1 Settlement Cycle transition and facilitate meaningful conversations with your service providers, brokers and internal staff. We will continue to update the document as more information becomes available. If you have any questions, please email them to T1_Settlement_Initiative@ntrs.com or your relationship manager.

What is happening?

On December 1, 2021, the Canadian Capital Markets Association (CCMA) announced plans to shorten the trade settlement cycle from trade date plus 2 (T+2) to trade date plus one (T+1). The CCMA has been working with industry participants, U.S. (United States) Securities Industry and Financial Markets Association (SIFMA), Investment Company Institute (ICI) and Depository Trust & Clearing Corporation (DTCC) in coordinating efforts for the transition. CCMA has been discussing T+1 settlement cycle since the market moved from T+3 to T+2 in September 2017, which will align the Canadian settlements for equities and corporate debit for when the U.S. transitions to T+1 on May 28, 2024. On May 14, 2024, the **CCMA announced the first T+1 settlement date will start on May 27, 2024**.

CCMA highlighted key benefits for a shorter trade settlement cycle:

- Reduce risk for investors and industry participants
- Lower collateral cost associated with trades
- Maintain alignment with the U.S. markets

In July 2022, the CCMA published recommendations for amending the Canadian Depository for Securities Ltd. (CDS) timeframes for trades and on December 15, 2022, the Canadian Securities Administration (CSA) proposed amendments to National Instrument (NI) 24-101-instutotional Trade Matching and Settlement and companion policy and to CSA Staff Notice 81-335- Investment Fund Settlement.

- Amend subsections 3.1(1) and 3.3(1) of Part 3 Trade Matching Requirements to require registered dealers and registered advisers to have policies and procedures in place designed to achieve institutional trade matching by 9:00 PM EST on trade date (T), as opposed to the current requirement of 12:00 PM EST on T+1.
- Matching Service Utility Quarterly Operations Report of Institutional Trade Reporting and Matching will change the institutional trade matching (ITM) data reporting requirements to T at 12 PM, T at 9 PM, T+1 at 12 PM, T+1 at 3 PM, T+1 at 11:59 PM, and after T+1; all times are EST.
- Repeals the exemption reporting requirements and other amendments.

- Comment period ended March 17, 2023.

The primary goal of the changes is to make it easier to eventually shorten the settlement cycle to trade date plus zero (T+0) for institutional equities and long-term debt market trading in Canada to align with the Securities Exchange Commission's (SEC) future goals. The U.S. industry has requested a Labor Day weekend conversion (August 31 – September 2). However, the SEC's final rule, approved on February 15, 2024, calls for a May 28, 2024 compliance date. The CSA proposed changes:

1. Offer a standard settlement term that is in line with U.S. policy for T+1 settlements.

2. Reduce outstanding settlements and the related replacement cost risks, mitigating counterparty risk market risk and liquidity risk.

3. Improve an organization's capacity to automate business operations, particularly in the following areas: dematerialization, same-day affirmation (SDA), alignment with linked markets and streamlined trade corrections.

The CSA is not recommending changes to sections 9.4 and 10.4 of NI 81-102 to require mutual funds to convert to a T+1 settlement. The CSA acknowledged that doing so would cause operational challenges for funds that have a sizable share of their portfolio assets that settle at T+2 or longer.

In addition, the CCMA has recommended a 3:59am EST on T+1 deadline to match, while the CSA has published 9pm EST on trade date. The CSA will base its decision on the feedback received by members.

What operational areas will be impacted?

All operational teams are impacted by this change and industry participants must update their procedures and systems to adopt the shorter settlement cycle.

- Trade Processing
- Middle Office
- Settlement Systems
- Securities Lending
- Asset Servicing
- Broker-Dealers
- Client Onboarding
- Collateral Management
- Funding & Treasury
- Foreign Exchange

- Staff Operating Hours
- Regulatory Reporting
- Enterprise

How will trading procedures be impacted?

The trade life cycle will be compressed from T+2 to T+1. This means financial institutions will have less time to process trade confirmations, allocations and affirmations. All trade affirmations will need to be sent to CDS by 9:00 PM EST on trade date (T). Registered firms and other capital market participants must evaluate their current clearing and settlements method, internal operations and processes to successfully transition to T+1 settlement. Additionally, market participants and clearing agencies would need to update their policies and procedures that: require a specific settlement cycle, are timed to the settlement date, call for pre-settlement activities or in any other way make deals easier to clear and settle.

As a result, Northern Trust will amend its current cut-off times to align with the shorter settlement time. Northern Trust will announce the new cut-off times in due course through the Atlas Bulletin and on its website.

As described by CSA notice, the proposed revisions eliminate the requirement for registered firms to complete and submit exception reports on Form 24-101F1 if they fall short of meeting the institutional trade matching (ITM) threshold of 90% of trades by value and volume matched by the ITM deadline during a calendar quarter regarding their institutional trades (Exception Reporting Requirement).

Institutions with investment exposure held outside of Canada will need to consider the funding ramifications from a move to T+1. When planning for their settlement needs, such firms may need to purchase or sell CAD (Canadian Dollar) earlier or change the settlement cycle of the foreign exchange they execute.

What are the matching requirements for brokers?

The CSA proposal for National Instrument 24-101 requires registered broker-dealers and registered advisors to amend their current policies and procedures designed to achieve institutional trade matching by 9 PM EST on trade date.

Brokers are expected to follow the new industry standard, and the asset managers or their delegated middle office must ensure their brokers issue confirmations and match the trades on trade date.

Canada has some regulatory requirements now for trades to match ahead of settlement. Does the U.S. have any regulatory requirements on matching or is it just best practice?

On February 15, 2023, the Securities Exchange Commission (SEC) approved changes to modify Rule 15c6, *Shortening the Securities Transaction Settlement Cycle,* from trade date plus two (T+2) to trade date plus one (T+1). The final rule requires brokers to submit trade allocations and match trades by the end of day on trade date, which is a change from the proposed 9 PM EST deadline. This new standard is considered a market best practice.

Why should I review my standing settlement instructions?

Maintaining and updating Standing Settlement Instructions (SSI) are key components for timely affirmations and settlements. Clients should review their existing SSIs and validate they have the correct counterparty SSIs. Incorrect SSIs will result in late trade matching and could result in unnecessary fails. All trades will need to be matched on T+0, which means less time to resolve settlement issues. Trades must be submitted to CDS before their 9:00PM EST cut-off time.

How will securities lending be impacted by the move to T+1?

The industry is changing the "best practice" securities lending recall cutoff time from 3:00PM EST on T+1 to 9:30PM EST on trade date. Firms that manage their own direct lending programs will need to work with their service providers to align to this earlier recall process.

The T+1 settlement cycle will impact trading practices around the expiration dates of voluntary corporate actions. In many instances, the issuer may often provide a Guarantee of Delivery feature that allows investors to purchase securities on the offer's expiration date and still participate in the offer while their securities are in the process of settling. This is referred to as the cover/protect period where unsettled purchases are instructed as a protect and then covered once they settle, which is aligned with the standard settlement cycle. In a T+2 settlement cycle, the cover/protect period is often expiration date plus two (2) trading days. In a T+1 settlement cycle, the cover/protect period will be the expiration date plus one (1) trading day.

The current timing for issuing a securities recall from the borrower must be changed to align with the new T+1 settlement, which cannot begin until the trade execution is received by Northern Trust.

Will there be any changes for corporate actions?

In a T+1 environment, ex-date and record date will be the same, commonly referred to as "regular way ex-date." With regular way ex-date, due bills are not necessary as any trade entitled to the dividend will settle on the record date. However, due bills are required for any ex-date that is not a regular way ex-date. The exchanges set ex-dates and typically will set a later ex-date (e.g., day after payment date) for stock or large cash dividends that exceed 25% of the value of the stock. This practice helps to maintain market values because in a regular way ex-date, the price will typically drop by the value of the dividend on ex-date; however, the proceeds would not be paid until later. This undervalues the stock and impacts portfolio modeling and purchasing power. Any irregular ex-date will still require a due bill. Organizations must adjust the ex-date period for regular way ex-date and modify the due bill period calculation for regular way and irregular ex-dates.

To prepare for the migration to T+1 settlement, CDS needs to review and modify the interim accounting process to account for the shortened period and verify that income entitlement and tracking processes (e.g., due bill fails tracking, stock loan income tracking and repo income tracking) are adjusted and functioning properly. Firms should review their entitlements process.

Will there be any changes to the FX process?

Currently there are no anticipated changes to FX systems since the applications currently support same day FX. However, Northern Trust is reviewing the current cut-off times and any changes will be announced through Atlas Bulletins and updated on our website.

Are there any currency pairs that are causing you concern regarding equities settling on T+1?

Currently there are no concerns about currency parings. However, institutions that are domiciled outside of the U.S. will need to consider the funding requirements for their trading activity and they must adjust to the shorter settlement period. This would mean that some institutions may need to prefund their trading activity if their current operations cannot support same day FX on trade date or FX settlement in the U.S. on T+1 to align with the equities market.

Will Northern Trust still accept third party FX?

Yes, Northern Trust will still accept third party FX for accepted currencies. All third-party FX for funding trade activity must adopt to the shorter settlement cycle and counterparties will need to update their procedures.

Will T+1 trades still be able to settle through Continuous Link Settlement (CLS)?

Yes, they will need to be instructed to Northern Trust and matched by the counterparty promptly on T+0.

Will Canada's move to T+1 cause any additional issues?

No. The change program has identified enhancements to securities lending and trade processes, which were expected.

Do you believe either the U.S. or Canada will introduce penalties for late settlement?

No, there has not been any indication from the regulators that penalties will be introduced.

Is Northern Trust considering implementing new technologies to handle T+1 settlement?

New technology will not be required. Rather, opportunities to improve current technology and operational efficiencies are in focus.

Are other markets considering a move to T+1 settlement cycle?

Yes, other markets are considering moving to T+1. India has completed the last of their transition to T+1 in Q1 2023, which we have highlighted in Northern Trust's Atlas Bulletins. In Europe, the Association for Financial Markets in Europe (AFME) published a white paper that covers the key considerations, like those outlined in the U.S. AFME has called for an industry task force to assess the risk, benefits, cost and challenges for moving to a shorter settlement cycle. AFME are partnering with The Value Exchange (TVE) on a new campaign called "**Operationalizing T+1 in the US and Canada**". The initiative is being led by DTCC and the Toronto Stock Exchange (TMX) and will be focused on mapping out the practical steps that market participants would need to take or are currently taking to be ready for the US/Canada move to T+1. TVE have launched a survey and are asking participants to contribute to the initiative by responding.

In the UK (United Kingdom) HM Treasury has set up a taskforce to assess the case for transitioning to T+1. However, they have until December 2023 to publish a public report on their findings. In addition, Mexico is in discussions with market participants about converting to T+1. However, no formal announcement has been made. Other markets are considering the move as well. Northern Trust is closely monitoring this globally and anticipates formal announcements. We are working closely with our sub-custodians to ensure a smooth transition to any global settlement changes.

How has Northern Trust engaged with the industry in its efforts to prepare for the move to T+1?

There is regular engagement with industry groups at the Northern Trust enterprise and Asset Servicing business unit levels. Northern Trust plays an active role in several industry forums and working groups addressing T+1, including the Association of Global Custodians (in which Northern Trust serves as a co-chair of its T+1 Working Group), the Investment Company Institute (ICI) and the Securities Industry and Financial Markets Association (SIFMA). The Asset Servicing transition program is evaluating the outcomes of the industry forums to align Northern Trust's program with best practices for converting to T+1 settlement. In Canada, Northern Trust participates in various CCMA working groups, including the Operations Working Group which it also co-chairs. Also, the CCMA has created a Buy Side Task Force to address any potential processing delays at the start of the trade lifecycle, specifically looking to address trade instruction delivery to their applicable custodian.

How will the program keep clients and relationship staffed informed?

The program has established an active communication strategy with stakeholders across our business and our clients, which will be distributed through our established communication channels: Our website, nt.com, regulatory forums, client meetings, Atlas Bulletins and other distribution channels.

What is Northern Trust doing?

Northern Trust has established an enterprise change program, reviewed the IWG playbook, detail testing framework and has incorporated the industry considerations and the test approach in our program. A summary of the components of the playbook are as follows:

Overview of the T+1 transition: Contains timelines, milestones, and guidelines for market participants to assist in the planning, development, testing, and migration to a T+1 settlement cycle.

- Primary areas of focus: Provides suggested activities across several business areas, including trade processing, asset servicing, documentation, securities lending, prime brokerage, and funding and liquidity.

- Next steps: Details considerations for firms in the planning and execution of these impact assessments and implementation considerations, including response to regulatory changes: industry testing and business readiness for migration.

What should I be doing?

The CCMA references the efforts underway with DTCC (Depository Trust & Clearing Corporation) in the U.S. and suggest market participants leverage the U.S. Industry Working Group (IWG) documentation, T+1 Securities Settlement Industry Implementation Playbook published in August 2022, and DTCC T+1 Test Approach: Detailed Framework, published on February 15, 2023, to help participants prepare for the conversion. The documents highlight some key considerations:

- Organizations should test with their data providers to ensure continuity with downstream processing.
- Organizations should review standardization with settlements on the underlying CDRs (Canadian Depository Receipts) on global markets and cross-currency funding. Eligible positions must be established based on T+1 ex-dates for mandatory events and income, including dividend reinvestment processes.
- Organizations must update client notifications for voluntary events. Ex-date calculations must be shortened to record date minus one. Mandatory warrants and rights distributions must be based on a T+1 ex-date.
- Changes to client messaging and reporting requirements should be considered.

Organizations should start their own change program and start an impact assessment to determine which, if any, of their internal processes will need to be changed, which include but are not limited to:

- review existing batch and manual processes
- trade confirmation, allocation and affirmation processes
- SSI (Standing Settlement Instructions) review to ensure accuracy
- engaging with your brokers and other service providers to assess any downstream impacts
- leverage industry testing approach
- review existing industry best practices and reference materials

Northern Trust will provide ongoing communications, which will be sent through our normal distribution channels. If you have any questions, please reach out to your relationship staff at Northern Trust or send your question to T1_Settlement_Initiative@ntrs.com.

REFERENCE MATERIALS:

CDS Migration to T+1

Information and Tools – CCMA-ACMC

Let's Talk T+1 (January 2023)

DTCC T+1 Test Approach: Detailed Framework

U.S. T1 Settlement Cycle FAQ