

**13.3.2 CDS – Notice and Request for Comments – Material Amendments to CDS Rules – Delegation of Board Authority to Management**

**CDS CLEARING AND DEPOSITORY SERVICES INC. (CDS®)**

**MATERIAL AMENDMENTS TO CDS RULES**

**DELEGATION OF BOARD AUTHORITY TO MANAGEMENT**

**NOTICE AND REQUEST FOR COMMENTS**

**A. DESCRIPTION OF THE PROPOSED CDS RULE AMENDMENTS**

The proposed Rule amendments provide that, in the event of substantial and imminent risk of material harm (to CDS Clearing, its Participants, other market participants, the Canadian capital markets, or due to a change in operation imposed by a third party providing services to CDS Clearing or its Participants) (“Emergencies”), CDS management be permitted to exercise powers normally conferred on the CDS Board of Directors (the “CDS Board”) under the CDS Participant Rules.

**B. NATURE AND PURPOSE OF THE PROPOSED CDS RULE AMENDMENTS**

The CDS Participant Rules detail the powers conferred on the CDS Board and on CDS management. The CDS Board, for example, approves new participant applications before a participant is permitted access to any of CDS Clearing’s products or services. CDS management’s role in this process is to provide a recommendation to the CDS Board for approval based on a thorough review of various aspects of the application.

CDS has recognized a deficiency in the existing governance practice for dealing - on extremely short notice and typically concerning confidential matters - with Emergencies which may pose substantial and imminent risk of material harm. CDS is of the view that codification of an alternative governance process is necessary for use in such specific situations. The proposed governance process provides CDS management with the flexibility required to address Emergencies without explicit approval from the CDS Board, and requires that the CDS Board be informed as soon as practically possible such that the CDS Board will be in a position to understand and ratify CDS management’s decision(s) on a *post-facto* basis.

In the example cited above, under the existing Rules and governance process, CDS Board consideration of an application for participation can be accomplished by:

- a. convening a CDS Board meeting, which requires a minimum of five business days’ notice and achievement of quorum, or
- b. written resolution, which requires unanimous approval of the CDS Board.

Execution of a Participation Agreement by CDS management has the legal effect of making the applicant a CDS Clearing Participant and binds the applicant to the CDS Legal Documents. Under the usual participant approval process, however, CDS management’s execution of the Participation Agreement *follows* CDS Board approval of the prospective participant’s application. In the event that neither the five business day notice period, nor unanimous CDS Board approval are possible or practical, approval of an application for participation could not be completed in exigent circumstances on extremely short notice.

The proposed Rule amendments will insert the terms “Emergency” and “Independent” into Section 1.2 – Definitions. The definition of “Emergency” mirrors CDS Rule Protocol, Section 6(a) – Criteria for Immediate Implementation. The definition of “Independent” mirrors CDS Recognition Order Terms and Conditions, Section 2.2(b). The proposed Rule amendments will specify that, in Emergency circumstances, CDS management, with the approval of two of the three Independent chairs of the committees of the CDS Board (or, due to the unavailability of such chairs, a minimum of one approval from the available chairs and the approval of the available Independent director having served the longest in such capacity on the Board), may act, and is provided with the legal right to act, in the stead of the full CDS Board.

**C. IMPACT OF THE PROPOSED CDS RULE AMENDMENTS**

(a) *CDS Clearing* – The proposed Rule amendments will enhance CDS management’s ability to respond to urgent or critical events that materially harm, or have the potential materially to harm, CDS’s systems, operations or services. The proposed Rule Amendments do not amend or remove CDS management’s obligation to seek approval from the CDS Board for all decisions properly reserved for the latter.

(b) *CDS Participants* – The proposed Rule amendments will provide further comfort to CDS Participants, as the proposed Rule amendments provide CDS management with the power to act rapidly in the event of a situation that might otherwise result in material harm to the Participant and/or the Participant's operations.

(c) & (d) *Other Market Participants and Securities and Financial Markets in General* – CDS is of the view that the only impact to other market participants will be positive; in the event of an Emergency situation, the proposed rule amendments provide CDS management with the tools, authority, and discretion to act – in the event of a disruption, or possible disruption to the Canadian Capital Markets – in the best interests of the participants in those markets.

### **C.1 Competition**

The proposed Rule amendments are not expected to have any impact on the competitive landscape of the Canadian capital markets or CDS Participants.

### **C.2 Risks and Compliance Costs**

The principal risk which the proposed amendments are intended to mitigate is a situation where, in an emergency, approval of the CDS Board is either not possible or not feasible. In an emergency, as defined in the proposed Rule amendments, CDS may be required rapidly to respond to circumstances beyond CDS's control, and the proposed Rule amendments strike a balance between effective, comprehensive oversight of CDS by the CDS Board and the ability to adapt to emergency or exigent circumstances.

CDS does not expect that the proposed Rule amendments will result in any compliance costs for CDS, its Participants, or other market participants.

### **C.3 Comparison to International Standards – (a) Committee on Payment and Settlement Systems of the Bank for International Settlements, (b) Technical Committee of the International Organization of Securities Commissions, and (c) the Group of Thirty**

CDS is of the view that the proposed amendments are consistent with, and are in accordance with, the key risks and recommendations relating to financial market infrastructure examined in detail in the document released in April, 2012, by the Committee on Payment and Settlement Systems of the International Organization of Securities Commissions (CPSS-IOSCO). More specifically, the proposed Rule amendments dovetail with sections 2.2 & 2.3 – Systemic Risk, 2.4, – Legal Risk, 2.7 – General Business Risk, and section 2.9 – Operational Risk.

## **D. DESCRIPTION OF THE RULE DRAFTING PROCESS**

### **D.1 Development Context**

CDS developed the proposed Rule amendments in response, and subsequent, to a proposed transaction between a CDS Participant and a non-Participant. An application for participation, under the existing Participant Rules, requires Board approval. The timing and nature of the transaction, however, were such that CDS's current Rules and governance processes would have resulted in both a substantial delay, and the risk of material and imminent harm, to CDS, CDS Participants, and the Canadian capital markets.

### **D.2 Rule Drafting Process**

Each amendment to the CDS Participant Rules is reviewed by CDS's Legal Drafting Group ("LDG"). The LDG is a committee that includes members of Participants' legal and business groups. The LDG's mandate is to advise CDS management and its Board of Directors on rule amendments and other legal matters relating to centralized securities depository and clearing services in order to ensure that they meet the needs of CDS, its Participants and the securities industry.

These amendments were reviewed and approved by the Board of Directors<sup>1</sup> of CDS Ltd. on June 19<sup>th</sup>. 2012.

### **D.3 Issues Considered**

CDS is cognizant of the fact that the proposed Rule amendments have the effect of limiting the power(s) of the CDS Board in certain circumstances, and considered the possible consequences of the exercise of such power(s) by CDS management in exigent circumstances. CDS management believes, however, that the benefit of avoiding material risk

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<sup>1</sup> Pursuant to a unanimous shareholder agreement between The Canadian Depository for Securities Limited ("CDS Ltd.") and CDS, effective as of November 01, 2006, CDS Ltd., which acts under the supervision of its Board of Directors, assumed all rights, powers, and duties of the CDS Board of Directors.

or harm to CDS, to CDS Participants, or to the Canadian capital markets outweighs the risk or risks that such delegation of authority presents.

#### **D.4 Consultation**

Due to the critical nature of the proposed amendments, and due to the potential impact that the exercise of the powers and discretion of the CDS Board by CDS management, CDS consulted directly with the members of the CDS Board.

#### **D.5 Alternatives Considered**

CDS considered three options with respect to the current Rules and governance process:

1. CDS considered the option of making no amendments to the CDS Rules, the effect of which would be to leave all powers and discretion of the CDS Board and CDS management unchanged.
2. CDS considered the option of amending the Rules such that the Rules will define an “Emergency” and, with respect to certain specifically cross-referenced powers and discretion ordinarily reserved for the CDS Board, would allow CDS management to exercise such power and discretion without prior approval of the CDS Board but with subsequent ratification by the CDS Board.
3. CDS considered the option of amending the Rules such that where the Rules specify that a power or discretion rests with the CDS Board, each individual Rule will permit CDS management to exercise the power and discretion of the CDS Board in certain Emergency circumstances.

CDS determined that option two was the most appropriate and efficient. Option one was rejected as being insufficiently robust, particularly where immediate response and reaction of and by CDS and the CDS Board is required. Option three was rejected as being both too cumbersome and complex to maintain within the CDS Participant Rules.

#### **D.6 Implementation Plan**

CDS is recognized as a clearing agency by the Ontario Securities Commission pursuant to section 21.2 of the Ontario *Securities Act*. The *Autorité des marchés financiers* has authorized CDS to carry on clearing activities in Québec pursuant to sections 169 and 170 of the Québec *Securities Act*. In addition CDS is deemed to be the clearing house for CDSX<sup>®</sup>, a clearing and settlement system designated by the Bank of Canada pursuant to section 4 of the *Payment Clearing and Settlement Act*. The Ontario Securities Commission, the *Autorité des marchés financiers* and the Bank of Canada will hereafter be collectively referred to as the “Recognizing Regulators”.

The amendments to Participant Rules may become effective upon approval of the amendments by the Recognizing Regulators following public notice and comment.

### **E. TECHNOLOGICAL SYSTEMS CHANGES (E.1, E.2, E.3)**

The proposed Rule amendments are not expected to have any impact on technological systems, or require any changes to such systems, either for CDS, for CDS Participants, or for other market participants.

### **F. COMPARISON TO OTHER CLEARING AGENCIES**

The Rules of the Canadian Derivatives Clearing Corporation (“CDCC”) define the term “Emergency” and allow CDCC to exercise broad discretion in the event of the declaration of an Emergency or *force majeure* event, including settlement restrictions and any other situation where such an Emergency makes completion of a CDCC obligation (under the CDCC Rules) impossible or impracticable. (Available at: [http://www.cdcc.ca/f\\_rules\\_en/cdcc\\_rules\\_en.pdf](http://www.cdcc.ca/f_rules_en/cdcc_rules_en.pdf))

### **G. PUBLIC INTEREST ASSESSMENT**

CDS has determined that the proposed amendments are not contrary to the public interest.

**H. COMMENTS**

**Comments on the proposed amendments should be in writing and submitted within 30 calendar days following the date of publication of this notice in the Ontario Securities Commission Bulletin to:**

Legal Department  
CDS Clearing and Depository Services Inc.  
85 Richmond Street West  
Toronto, Ontario M5H 2C9

Fax: 416-365-1984  
e-mail: [attention@cds.ca](mailto:attention@cds.ca)

Copies should also be provided to the Autorité des marchés financiers and the Ontario Securities Commission by forwarding a copy to each of the following individuals:

M<sup>e</sup> Anne-Marie Beaudoin  
Secrétaire générale  
Autorité des marchés financiers  
800, square Victoria, 22<sup>e</sup> étage  
C.P. 246, tour de la Bourse  
Montréal (Québec) H4Z 1G3

Télécopieur: (514) 864-6381  
Courrier électronique: [consultation-en-cours@lautorite.qc.ca](mailto:consultation-en-cours@lautorite.qc.ca)

Manager, Market Regulation  
Market Regulation Branch  
Ontario Securities Commission  
Suite 1903, Box 55,  
20 Queen Street West  
Toronto, Ontario, M5H 3S8

Fax: 416-595-8940  
e-mail: [marketregulation@osc.gov.on.ca](mailto:marketregulation@osc.gov.on.ca)

**CDS will make available to the public, upon request, all comments received during the comment period.**

**I. PROPOSED CDS RULE AMENDMENTS**

Appendix "A" contains text of current CDS Participant Rules marked to reflect proposed amendments as well as text of these rules reflecting the adoption of the proposed amendments.

APPENDIX "A"

PROPOSED CDS RULE AMENDMENTS

Text of CDS Participant Rules marked to reflect proposed amendments	Text CDS Participant Rules reflecting the adoption of proposed amendments
<p>[marked text of rules – additions are underlined; deletions are strikethrough text]</p> <p><b>1.2.1 Definitions</b></p> <p>...</p> <p><u>“Emergency” means a situation which is determined by CDS to pose a substantial and imminent risk of material harm to CDS, CDS participants, other market participants, or the Canadian capital markets.</u></p> <p>...</p> <p><u>“Independent” means a person who is not:</u></p> <p>(i) <u>an associate, partner, director, officer or employee of a shareholder of CDS,</u></p> <p>(ii) <u>an associate, partner, director, officer or employee of a participant of CDS or its affiliates or an associate of such director, partner, officer or employee, or</u></p> <p>(iii) <u>an officer or employee of CDS or its affiliates or an associate of such officer or employee.</u></p> <p>...</p> <p><b>1.3.16 Action by CDS and Board</b></p> <p>a) <u>Action by Board</u></p> <p>The powers conferred by these Rules on the Board and <del>on CDS</del> may be exercised at any time and from time to time.</p> <p>b) <u>Action by CDS</u></p> <p><u>The powers conferred by these Rules on CDS may be exercised at any time and from time to time.</u></p> <p>c) <u>Board Powers delegated to CDS</u></p> <p>i. <u>In the event of an Emergency CDS may exercise such powers as are conferred on the Board in this Rule 1.3.16 and as are exclusively specified in Rule 1.3.16(d), provided that such exercise shall require, in the first instance, a minimum of two approvals from the three Independent chairs of the committees of the Board, or in the second instance, due to the unavailability of such chairs, a minimum of one approval from the available chairs and the approval of the available Independent director having served the longest in such capacity on the Board.</u></p> <p>ii. <u>In the event of an Emergency that requires that CDS exercise the powers of the Board in Rule 1.3.16(d), the decisions pursuant, and results consequent, to any such exercise will be presented to the Board for review and ratification as soon as practicable thereafter.</u></p>	<p><b>1.2.1 Definitions</b></p> <p>...</p> <p>“Emergency” means a situation which is determined by CDS to pose a substantial and imminent risk of material harm to CDS, CDS participants, other market participants, or the Canadian capital markets.</p> <p>...</p> <p>“Independent” means a person who is not:</p> <p>(i) an associate, partner, director, officer or employee of a shareholder of CDS,</p> <p>(ii) an associate, partner, director, officer or employee of a participant of CDS or its affiliates or an associate of such director, partner, officer or employee, or</p> <p>(iii) an officer or employee of CDS or its affiliates or an associate of such officer or employee.</p> <p>...</p> <p><b>1.3.16 Action by CDS and Board</b></p> <p>a) Action by Board</p> <p>The powers conferred by these Rules on the Board may be exercised at any time and from time to time.</p> <p>b) Action by CDS</p> <p>The powers conferred by these Rules on CDS may be exercised at any time and from time to time.</p> <p>c) Board Powers delegated to CDS</p> <p>i. In the event of an Emergency CDS may exercise such powers as are conferred on the Board in this Rule 1.3.16 and as are exclusively specified in Rule 1.3.16(d), provided that such exercise shall require, in the first instance, a minimum of two approvals from the three Independent chairs of the committees of the Board, or in the second instance, due to the unavailability of such chairs, a minimum of one approval from the available chairs and the approval of the available Independent director having served the longest in such capacity on the Board.</p> <p>ii. In the event of an Emergency that requires that CDS exercise the powers of the Board in Rule 1.3.16(d), the decisions pursuant, and results consequent, to any such exercise will be presented to the Board for review and ratification as soon as practicable thereafter.</p>

Text of CDS Participant Rules marked to reflect proposed amendments	Text CDS Participant Rules reflecting the adoption of proposed amendments
<p>d) <u>Powers Delegated by Board</u></p> <p><u>In an Emergency, CDS may exercise the powers, otherwise reserved solely for the Board, as specified in the following Rules:</u></p> <ul style="list-style-type: none"> <li>- <u>Rule 2.1.1 – Application</u></li> <li>- <u>Rule 2.2.1 – Application for Participation</u></li> <li>- <u>Rule 2.2.10 – Waiver</u></li> <li>- <u>Rule 2.3.1. – Classification of Participants</u></li> </ul>	<p>d) Powers Delegated by Board</p> <p>In an Emergency, CDS may exercise the powers, otherwise reserved solely for the Board, as specified in the following Rules:</p> <ul style="list-style-type: none"> <li>- Rule 2.1.1 – Application</li> <li>- Rule 2.2.1 – Application for Participation</li> <li>- Rule 2.2.10 – Waiver</li> <li>- Rule 2.3.1. – Classification of Participants</li> </ul>

*For convenience, the text of the CDS Participant Rules reference in proposed Rule 1.3.16(d) is reproduced below:*

**2.1.1 Application**

A Participant's application for participation is accepted or rejected by the Board of Directors. A Participant's application to use a Service or Function is accepted or rejected by CDS. A Person is eligible to apply to participate if it fits the description in a particular category, satisfies the qualifications applicable to that category and meets the standards for participation.

**2.2.1 Application for Participation**

If an applicant is eligible for participation and meets the qualifications and standards for participation set by CDS in accordance with the Rules, it may apply to participate in one or more Services by signing and delivering to CDS an application for participation in the current form made available by CDS. The Board of Directors may approve or reject an application in its sole discretion. Upon acceptance of the application, an applicant for participation shall become a Participant and the application shall become the Participant Agreement between CDS and that Participant.

**2.2.10 Waiver**

The Board of Directors may waive any qualification, standard or classification requirement applicable to a Participant or Custodian, either unconditionally or on an appropriate temporary or other conditional basis, if the Board of Directors determines that the qualification, standard or classification requirement, as applied to the Participant, the Custodian or the applicant for participation or to act as a Custodian, is unduly severe and that it would not be against the best interests of CDS and Participants to waive the qualification, standard or classification requirement. CDS shall give notice to Participants of any waiver made pursuant to this Rule. The Board of Directors may impose limits on a Participant's right to use any Service or Function in the event that a waiver is granted pursuant to this Rule.

**2.3.1 Classification of Participants**

An applicant for participation shall specify the category in which it wishes to be classified. At the time that an applicant is accepted as a Participant, CDS shall classify it into one of the categories specified in Rule 2.3.2. At any time, a Participant may apply to the Board of Directors to be reclassified into any category for which it is qualified. CDS may reclassify a Participant if it ceases to meet any qualification, standard or classification requirement for the category into which it has been classified. Each Participant shall provide CDS with such information and assurances as may be required to classify the Participant appropriately. CDS shall give notice to a Participant of its classification or reclassification. Unless the other Extenders waive notice, CDS shall give all Extenders at least 15 Business Days' notice of a request by an applicant or a Participant to be classified as an Extender, or of a request by an Extender for reclassification into another category, before effecting the classification or reclassification.