

13.3.3 CDS Clearing and Depository Services Inc. – Material Amendments to CDS Procedures – Amendments to Buy-In Messaging – Request for Comments

CDS CLEARING AND DEPOSITORY SERVICES INC. (CDS®)

MATERIAL AMENDMENTS TO CDS PROCEDURES

AMENDMENTS TO BUY-IN MESSAGING

REQUEST FOR COMMENTS

A. DESCRIPTION OF THE PROPOSED CDS PROCEDURE AMENDMENTS

The proposed amendments to the CDS Participant Procedures will amend the buy-in messages related to the buy-in process in the Continuous Net Settlement Service (CNS). The amendments are being proposed at the request of the Debt and Equity Subcommittee of the CDS Strategic Development Review Committee (SDRC). The CNS buy-in process is used by CDSX® participants to expedite settlement of outstanding CNS positions. Currently, a buy-in transaction can only be created or modified through the manual entry of information into CDSX.

Background

CNS is a central counterparty service designed to clear and settle primarily, but not exclusively, equity trades transacted on a Canadian exchange, a quotation and trade reporting system (QTRS) or an alternative trading system (ATS). The CNS buy-in process enables the buyer on the transaction to accelerate settlement of outstanding CNS positions identified in the relevant procedures as 'to-receive'. An outstanding 'to-receive' CNS position is a quantity of shares that failed to settle on value date. The buyer and seller are referred to as the receiver and deliverer respectively for the purposes of buy-in activity.

The lifecycle of the buy-in process is initiated when the receiver enters an "intent to buy-in" transaction in CDSX against an outstanding quantity of shares owed to the receiver. When the buy-in is manually entered, all participants who are in an owing CNS position (deliverers) for the specified security are identified and are provided with 48 hours notice that they may be held liable to deliver on some or all of their portion of the buy-in quantity. This notice is provided via CDSX screens, reports and messages. Priority settlement is applied to the buy-in; any subsequent settlement to the receiver's account reduces the amount of the buy-in quantity and related liabilities.

Two days after the buy-in is initiated, the receiver may choose to execute on the remaining unsettled portion of a buy-in by manually updating the status of the transaction in CDSX. If the receiver chooses to execute the transaction, CDSX determines which deliverers will be required to satisfy the buy-in and identifies these deliverers to the receiver on the CDSX Buy-in Details screens. A message is also sent to the identified deliverers to advise them that the buy-in has been executed.

The identified deliverers then have the option of requesting an extension from the receiver, but only during the time frame when extension requests are permitted. An extension request is accomplished by manually updating the extension request field in CDSX. Extensions remove the deliverer as a party to the buy-in. If a deliverer requests an extension and the receiver grants the request by updating the response field in CDSX, or does not respond to the request by the pre-determined cut off time, then the buy-in execution time for the identified deliverer is extended. If the extension request is denied, then the execution of the buy-in proceeds against the identified deliverer.

Identified deliverers have until the delivery cut-off time to satisfy the executed buy-in. If the identified deliverers fail to settle their outstanding positions against an executed buy-in by the delivery cut off time, CDS will attempt to purchase the shares on a Canadian exchange on behalf of the receiver. Once CDS acquires the shares on a Canadian exchange, both the receiver's and deliverer's outstanding CNS and funds positions are adjusted to reflect this acquisition.

A buy-in that has reached the execution date is cancelled and purged at the end of the day whether the buy-in was executed or not. Once cancelled, related liabilities are also extinguished. The repeat buy-in function is a facility that allows the receiver to maintain uninterrupted settlement priority until a buy-in is fully satisfied. A repeat buy-in is an extension of the original buy-in. Like a new buy-in, repeat buy-ins are entered manually on the CDSX Buy-in Intent Entry screen and confirmed on the Confirm Intent to Buy-in screen. Alternatively, the receiver may indicate that repeat buy-ins be entered and confirmed automatically, on a daily basis, by manually updating an auto repeat feature on the buy-in input screens. Once a repeat buy-in is confirmed in CDSX, deliverers with outstanding CNS positions are identified and provided with a 48 hour notice period advising them that they may be held liable if the buy-in is executed.

The repeat transaction effectively extends the execution date of the buy-in allowing the receiver to maintain settlement priority while also providing the deliverer with their requisite 48 hour notice.

Currently, when a buy-in is entered, or modified, by either the receiver or deliverer in CDSX, a notification message that provides the details of the activity is sent to the addresses specified by the participant.

Proposed Amendments

The Debt and Equity Subcommittee of the SDRC requested that CDS make the necessary changes in CDSX to support inbound buy-in messaging. The request entailed making the following three changes to messaging related to the CNS buy-in process: (i) introducing a new Intent to buy-in entry message to allow the receiver to establish a buy-in (either a new or repeat type) on CDSX; (ii) introducing a new buy-in modification message to allow a receiver to modify an existing buy-in; and (iii) introducing a new buy-in modification message to allow a deliverer to modify an existing buy-in.

The proposed amendments will allow CDS's participants to extend their straight through processing capabilities to include CNS buy-in activities.

B. NATURE AND PURPOSE OF THE PROPOSED CDS PROCEDURE AMENDMENTS

The proposed procedure amendments are enhancements to the procedure used to enter or modify buy-in information on CDSX and will allow for full or partial automation of tasks currently performed manually; such automation allows for processing efficiencies.

The following new messages, enabling the entry of information in CDSX using the messaging process, are proposed:

Intent to buy-in entry – receiver message: This message will allow the receiver to enter either a new or a repeat buy-in directly in CDSX. A separate message will be sent for each buy-in transaction required.

Buy-in modification – receiver message: This message will allow the receiver to modify the status (i.e. execute or cancel), auto repeat indicator, extension granted and memo fields on an existing buy-in.

Buy-in modification – deliverer message: This message will allow the deliverer to modify the extension request and memo fields on an existing buy-in.

Once CDSX has successfully been updated with the information contained in the inbound message, a confirmation message will be sent to the originator of the message providing the details of the buy-in established or modified.

C. IMPACT OF THE PROPOSED CDS PROCEDURE AMENDMENTS

The proposed procedure amendments will provide straight through processing capabilities for those participants that choose to subscribe to the entire suite of buy-in messages. The impact of these changes is limited to those CDS participants that use the CNS service.

C.1 Competition

The proposed procedure amendments apply to all CDS participants who currently use, or may choose in the future to use, the CNS service and the InterLink messaging service. No CDS participant will be disadvantaged with the introduction of these enhancements.

C.2 Risks and Compliance Costs

CDS Risk Management has determined that the proposed modifications to buy-in messaging will not change the risk profile of CDS or its participants.

The proposed modifications to buy-in messaging will not result in any changes to the existing CDSX settlement process. The method of applying settlements to buy-in transactions and their impact on executable amounts remains unchanged. The prioritization of settlements related to buy-ins is also not impacted by the proposed modifications to buy-in messaging.

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 continues to monitor the development of new international standards for payment, clearing and settlement systems set out in the CPSS/IOSCO report *Principles for Financial Market Infrastructures*¹, and will work with the financial services industry to achieve compliance with the new standards.

The proposed amendments are within the scope of Principle #21 – Efficiency and effectiveness. Principle #21 states that financial market infrastructure such as CDS “should be designed to meet the needs of its participants and the markets it serves, in particular, with regard to choice of a clearing and settlement arrangement; operating structure; scope of products cleared, settled, or recorded; and use of technology and procedures”.

This development, which was requested by CDS’s participants, provides greater flexibility by supporting an additional method for entering new buy-ins and buy-in modifications. In addition, updating CDSX using a messaging service is expected to result in operational efficiency by automating or semi automating the input of buy-in data.

D. DESCRIPTION OF THE PROCEDURE DRAFTING PROCESS

D.1 Development Context

The development request was tabled at the SDRC Debt and Equity Subcommittee as an opportunity to increase efficiencies by reducing or eliminating the manual entry of buy-in related data on CDSX. Once approved by the SDRC for further analysis, CDS prepared a document outlining the messages requiring development which was subsequently reviewed with the SDRC Debt and Equity Subcommittee.

D.2 Procedure Drafting Process

The CDS procedure amendments were drafted by CDS’s Product Development group, and subsequently reviewed and approved by CDS’s Strategic Development Review Committee (SDRC). The SDRC determines or reviews, prioritizes and oversees CDS-related systems development and other changes proposed by participants and CDS. The SDRC’s membership includes representatives from a cross-section of the CDS participant community and it meets on a monthly basis.

These amendments were reviewed and approved by the SDRC on February 28, 2013.

D.3 Issues Considered

Currently, when manually entering a buy-in into CDSX, a list is displayed of the potential new buy-in plus repeats for any existing buy-ins for that security (i.e. multiple transactions). The participant then selects from the list which of these buy-ins they wish to confirm and have created in CDSX.

During the analysis phase of the initiative, consideration was given as to whether a single message would create multiple buy-ins or a single buy-in. It was determined that as a buy-in being submitted using the new message would be automatically created in CDSX, there would be no additional mechanism for participants to select a specific buy-in to be created, thereby accepting the costs associated with buy-in entry. For this reason, only a single buy-in transaction will be created in CDSX for each message sent, based on the information contained in the message.

D.4 Consultation

This development was requested by the SDRC Debt and Equity Subcommittee. CDS reviewed the requirements document with the SDRC Buy-in Working Group and received final approval for the proposal from the SDRC Debt and Equity Subcommittee.

CDS’s Customer Service account managers provide continuous communication and status updates of all proposed changes to their clients, as well as soliciting input on those changes.

CDS facilitates consultation through a variety of means, including regularly scheduled SDRC subcommittee meetings, which provide a forum for detailed requirement review, and monthly meetings with service bureaus to discuss development impacts to them. All development initiatives are also presented to the Investment Industry Regulatory Organization of Canada’s (IIROC) Financial Administrators Section (FAS) working group.

¹ The report can be found at <http://www.bis.org/pub/cpss101.htm>

D.5 Alternatives Considered

Due to the specific nature of the request from the SDRC, alternatives were not considered for this initiative.

D.6 Implementation Plan

The proposed procedure amendments and the scheduled date of implementation have been communicated regularly to CDS participants through the SDRC and its subcommittees, as well as through Customer Service relationship meetings. The Customer Service account managers will provide their clients with details of the upcoming changes, and provide customer-related training during the month of April 2013. In addition, message testing with CDS participants and service bureaus will be performed following the successful completion of internal testing. CDS will distribute a bulletin to all CDS participants the week before implementation reminding them of the upcoming changes and confirming the effective date of those changes.

CDS is recognized as a clearing agency by the Ontario Securities Commission pursuant to section 21.2 of the Ontario *Securities Act* and by the British Columbia Securities Commission pursuant to Section 24(d) of the British Columbia *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[®], 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 British Columbia 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 Procedures may become effective upon approval of the amendments by the Recognizing Regulators following public notice and comment. Implementation of this initiative is planned for June 8, 2013.

E. TECHNOLOGICAL SYSTEM CHANGES

E.1 CDS

Buy-in entry and modification on CDSX will be impacted by these changes as follows:

- a) Allow for participants to subscribe to new buy-in related entry, modification and confirmation messages
- b) Allow for the entry of a new or repeat buy-in by the receiver using a new 'Intent to buy-in entry' message.
- c) Allow for the entry of a buy-in modification by the receiver using a new 'Buy-in modification – receiver' message. This message may update the status, auto repeat, extension granted and memo fields
- d) Update the 'Intent to buy-in entry' and 'Buy-in modification – receiver' notification messages to include the auto repeat field
- e) Allow for the entry of a buy-in modification by the deliverer using a new 'Buy-in modification – deliverer' message. This message may update the extension requested and memo fields
- f) Trigger an outbound confirmation or rejection message to the submitter of the inbound message if the entry or modification is accepted or rejected respectively by CDSX

E.2 CDS Participants

CDS participants will need to make changes to their internal systems in order to submit the new inbound messages and process the data contained in the new outbound confirmation and rejection messages if they choose to use the messaging facility to enter or modify buy-ins. Such changes will not be mandatory.

E.3 Other Market Participants

Service bureaus will need to make changes to their internal systems in order to submit the new inbound messages and process the data contained the new outbound confirmation and rejection messages if they, or their clients, choose to use the messaging facility to enter or modify buy-ins. Such changes will not be mandatory.

F. COMPARISON TO OTHER CLEARING AGENCIES

A similar CNS buy-in messaging process is provided by the National Securities Clearing Corporation (NSCC) as outlined in the NSCC Rules and Procedures dated January 1, 2013 (Procedure VII, Section J: Recording of CNS Buy-ins and Procedure X, Execution of Buy-ins, Section A: CNS System).

No comparable or similar procedures were available for other clearing agencies in order to conduct an analysis.

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, the British Columbia Securities Commission Bulletin or the Autorité des marchés financiers Bulletin to:

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

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

I. PROPOSED CDS PROCEDURE AMENDMENTS

Access the proposed amendments to the CDS Procedures on the User documentation revisions web page (<http://www.cds.ca/cdsclearinghome.nsf/Pages/-EN-UserDocumentation?Open>).

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