

CDS Clearing and Depository Services Inc. (CDS®)
MATERIAL AMENDMENTS TO CDS PROCEDURES
CANADIAN DOLLAR CASH COLLATERAL MANAGEMENT
REQUEST FOR COMMENTS

A. DESCRIPTION OF THE PROPOSED AMENDMENTS

The Canadian Depository for Securities (CDS) is considered a critical infrastructure to the Canadian marketplace and, as a result of that designation and other financial market regulations to which we are subject, CDS must adhere to the Principals for Financial Market Infrastructures (PFMIs) as defined by the Committee on Payments and Market Infrastructures of the International Organization of Securities Commission (CPMI-IOSCO)¹. Where warranted, CDS's standards must ensure that external parties do not pose undue operational risks to CDS or to our stakeholders, through their use of our systems.

Background

As reviewed at several recent meetings of CDS's Risk Advisory Committee (RAC), CDS intends to make changes to certain risk management practices to ensure we are in compliance with the global PFMI regulatory standards. Specifically, CDS's Continuous Net Settlement service (CNS) is impacted by PFMI Principle 4, Credit Risk, a principle which requires central counterparties to ensure that they have sufficient financial resources on hand to withstand the default of its largest exposure (including affiliates). This coverage level is commonly referred to as the "Cover 1" standard.

Principle 4 – Credit Risk – *"a Central Counterparty (CCP) should maintain additional financial resources sufficient to cover a wide range of potential stress scenarios that should include, but not be limited to, the default of a participant and its affiliates that would potentially cause the largest aggregate credit exposure for the CCP in extreme but plausible market conditions."*²

In order to meet the Cover 1 standard, CDS intends to introduce changes to the CNS Default Fund methodology by the end of 2017, in line with regulatory expectations. As a result, CDS expects changes in the size and variability of the CNS Default Fund. In order to address size volatility and the variability associated with the collateral calls, CDS has reviewed its procedures for the management of cash collateral provided by its Participants and has determined that changes to CDS's cash management policy are required.

Proposed Amendments

Participants are currently required to maintain an amount of collateral with CDS at least equal to their respective and required CNS Participant Fund and CNS Default Fund contributions. CDS collateral requirements are made available to the Participants on a same business day basis (T+0) by 9 a.m. ET. Participants are subsequently obligated to meet their requirement, without any threshold limitations, by pledging acceptable securities or cash by 10 a.m. ET, per the existing *Participating in CDS Services Procedures*.³

¹ <http://www.bis.org/cpmi/index.htm>

² <http://www.cds.ca/resource/en/180>

³ <https://www.cds.ca/resource/en/65>

However, CDS's banking arrangements in respect of cash collateral are subject to certain withdrawal and deposit thresholds, notice periods, and restrictions. As a result of the recently implemented changes to the timing of novation of CNS transactions (on Value Date - 1), and in contemplation of the proposed changes to the Default Fund methodology⁴, the aforementioned withdrawal and deposit thresholds may, in certain limited circumstances, result in CDS being unable to provide same day value for withdrawals or deposits of cash collateral.

In order to mitigate the risk of the above occurring, the following thresholds will apply to withdrawal and deposit requests for all Canadian Dollar cash collateral supporting both the CNS Participant Fund and the CNS Default Fund:

Cash Collateral Withdrawals

If a request for a cash collateral withdrawal is received by 10 a.m. ET (T+0):

- Amounts less than or equal to \$10 million may be withdrawn after 10 a.m. ET on the following business day (T+1).*
- Amounts greater than \$10 million may be withdrawn after 10 a.m. ET two business days after the request is made (T+2).

*Subject to CDS's own banking restrictions, CDS will confirm by 10:30 a.m. ET to any participant with a withdrawal request if that request cannot be fulfilled by the T+1 timeline.

Cash Collateral Deposits

CDS will continue to accept cash collateral deposits of any size. If a request for a cash collateral deposit is received by 10 a.m. ET (T+0), the participant has met their collateral requirements and is considered compliant.

However, due to CDS's banking arrangements and constraints relating to cash deposits, CDS requests that Participants substitute securities for cash for collateral amounts greater than \$10 million by 1 pm ET on the day of deposit, with the residual cash balance to be less than or equal to \$10 million.

Collateral deposited in the form of securities is not subject to any notice requirements for either deposit or withdrawal. Participants depositing collateral in the form of securities are not affected by these thresholds.

B. NATURE AND PURPOSE OF THE PROPOSED CDS PROCEDURE AMENDMENTS

The proposed amendments to the CDS Procedures are to (i) align CDS's cash management policies with the expected changes in the size volatility and variability associated with collateral calls as a result of upcoming amendments to the CNS Default Fund methodology, and (ii) enable CDS to comply with their banking arrangements with respect to certain withdrawal and deposit thresholds, notice periods and restrictions.

⁴ <https://www.cds.ca/resource/en/229>

C. IMPACT OF THE PROPOSED CDS PROCEDURE AMENDMENTS

- **CDS Clearing & Depository Services** – these amendments will contribute to the observance of PFMI standards with regard to Credit Risk, and will allow compliance with CDS's banking arrangements.
- **CDS Participants** – the amendments may require some Participants to have increased reliance on securities as collateral pledged with CDS for CNS Participant Fund and CNS Default Fund contributions.

C.1 Competition

Non applicable

C.2 Risks and Compliance Costs

While these amendments will result in changes to the management of cash collateral in CDS's clearing, settlement and depository services, CDS does not foresee other risks or compliance costs accruing to CDS Participants or other stakeholders.

C.3 Comparison to International Standards – (a) Committee on Payments and Market Infrastructures of the International Organization of Securities Commissions (b) Technical Committee of the International Organization of Securities Commissions, or (c) the Group of Thirty

The CPMI-IOSCO PFMI are minimum international standards for enhancing the safety and efficiency of clearing, settlement and recording arrangements. The standards aim to limit systemic risk and foster transparency and financial stability. They apply to CCPs, central securities depositories ("CSDs") and security settlement systems ("SSS"). CDS engages in all three of these market infrastructure activities.

In accordance with the terms of CDS's recognition order requirements, CDS is reviewing its risk management practices to ensure PFMI compliance for the proposed Cover 1 standard changes. A review of PFMI Principal 4 – Credit Risk – has identified expected changes to the amounts required for Participant collateral obligations with regard to the CNS Default Fund and subsequently, amendments required to CDS's cash management policy.

D. DESCRIPTION OF THE PROCEDURE DRAFTING PROCESS

D.1 Development Context & Consultation

This Amendment was initiated by CDS as a result of its internal review of PFMI compliance related to proposed changes in the CNS Default Fund methodology, and to sustain compliance with CDS's own banking arrangements.

In May and June of this year, CDS presented the proposed changes to its Cash Collateral Management process to the SDRC Debt & Equity Subcommittee in order to solicit input. The SDRC Debt & Equity subcommittee (a subcommittee of CDS's Strategic Development Review Committee) meets monthly, and includes a cross-section of CDS's participants. CDS's Relationship Managers have also provided communication and status updates of the proposed changes to their clients.

D.2 Procedure Drafting Process

The CDS procedure amendments are drafted by CDS's Relationship Management & Product Management group, and are 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 July 27, 2017.

D.3 Issues Considered

Consideration was given to the operational impacts that the enhancements might create for CDS Participants, as outlined in section C of this Notice.

D.4 Consultation

CDS facilitates consultation through a variety of means, including regularly scheduled SDRC subcommittee meetings, which provide a forum for detailed requirement review, and 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.

D.5 Alternatives Considered

Alternatives with minor variations on the proposed timelines, and consideration of interest payable on cash collateral amounts were considered.

D.6 Implementation Plan

The proposed procedure amendments have been communicated to all affected CDS participants through the Relationship Management team, as well as through the main SDRC group and the SDRC Debt & Equity Subcommittee. CDS will distribute a bulletin to all CDS participants the week before implementation advising 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*, and as a clearing house by the *Autorité des marchés financiers* pursuant to Section 169 of the Quebec *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 *Autorité des marchés financiers*, the Bank of Canada, the British Columbia Securities Commission and the Ontario Securities Commission will hereafter be collectively referred to as the "Recognizing Regulators".

The amendments to CDS Participant Procedures are expected to become effective immediately upon approval of the amendments by the Recognizing Regulators following public notice and comment.

E. TECHNOLOGICAL SYSTEM CHANGES

E.1 CDS

There are no technological system changes required by CDS.

E.2 CDS Participants

There are no technological system changes required by CDS Participants.

E.3 Other Market Participants

There are no technological system changes required by Service Bureaus, providers or non-participants.

F. COMPARISON TO OTHER CLEARING AGENCIES

A comparison to other clearing agencies was not performed. CDS is initiating these changes to ensure PFMI compliance as a result of proposed changes in its CNS Default Fund methodology, and to sustain compliance with its banking arrangements.

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:

George Kormas
Chief Risk Officer
CDS Clearing and Depository Services Inc.
85 Richmond Street West
Toronto, Ontario M5H 2C9

Telephone: 514-871-7881
Email: George.Kormas@tmx.com

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:

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

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

Télécopieur: (514) 864-6381
Courrier électronique: consultation-encours@lautorite.qc.ca

Doug Mackay
Manager, Market and SRO Oversight
British Columbia Securities Commission
701 West Georgia Street
P.O. Box 10142, Pacific Centre
Vancouver, B.C. V7Y 1L2

Fax: 604-899-6506
Email: dmackay@bcsc.bc.ca

Fax: 416-595-8940
Email: marketregulation@osc.gov.on.ca

Bruce Sinclair
Securities Market Specialist
British Columbia Securities Commission
701 West Georgia Street
P.O. Box 10142, Pacific Centre
Vancouver, B.C., V7Y 1L2

Fax: 604-899-6506
Email: bsinclair@bcsc.bc.ca

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 at <https://www.cds.ca/newsroom/publications>

- ² Rated R1 [low] for short-term debt by DBRS with a minimum issuer rating of A by CDS and rated AA [low] for long-term debt by DBRS with a minimum issuer rating of AA by CDS.
- ³ No more than 20 per cent of the value of collateral pledged can be the obligation of private and municipal sector issuers – subject to the additional restrictions that (i) only 10 percent of the collateral value pledged can be from LVTS and related issuers; and (ii) only 5 percent of the value of collateral pledged can be the obligation of a single private and municipal sector issuer.
- ⁴ Securities issued by members of a pool or fund, or “family” of a pool or fund member, are not eligible for collateral related to the pool or fund.
- ⁵ Rated R-1 [low] by DBRS or A-1 [mid] by S&P or P1 by Moody’s.
- ⁶ Rated R1 [mid] by DBRS or A-1 [mid] by S&P. Minimum issuer rating of AA by CDS.
- ⁷ Rated A [low] by DBRS or A- by S&P or A3 by Moody’s.
- ⁸ 100 per cent of the contribution must be made in U.S. cash.

15.1.1 Delivering Canadian dollar cash as collateral

To pledge Canadian dollar cash as collateral, initiate an LVTS payment to CDS’s cash collateral account held at the Bank of Canada using an MT205 SWIFT message. The Bank of Canada sends a confirmation to CDS that LVTS funds were deposited to CDS’s account. CDS then enters the cash value received in the Collateral Management System.

The table below indicates the information to be provided in the MT205 SWIFT message.

Field	Description
RELATED REFERENCE	Enter the collateral pool ID or participant fund ID
BANK OF CANADA TRANSIT	00006177
SWIFT ADDRESS	BCANCAW2
BENEFICIARY NAME	CDS Clearing and Depository Services Inc.
BENEFICIARY ACCOUNT	15451003 (CDS’s account number held by the Bank of Canada as CDS’s LVTS banker)
BENEFICIARY BIC	CDSLCAAT

Canadian dollar cash deposits

When using Canadian funds as collateral:

- Participants may substitute securities for collateral amounts greater than \$10 million by 1 p.m. ET on the day of deposit
- Any residual cash balance is to be less than or equal to \$10 million.

Canadian dollar cash withdrawals

If a request for a cash withdrawal is received by 10 a.m. ET:

- Amounts less than or equal to \$10 million may be withdrawn after 10 a.m. ET on the next business day following the withdrawal request
- Amounts greater than \$10 million may be withdrawn after 10 a.m. ET two business days following the withdrawal request

15.1.2 Delivering U.S. dollar cash as collateral

USD receivers of credit pool

To pledge U.S. dollar cash as collateral for the USD receivers of credit pool, initiate a Fedwire payment to the following CDS account at Harris National Association. CDS monitors the account to ensure that the funds are deposited to CDS's account. CDS then enters the cash value received in the Collateral Management System.

The table below indicates the information to be provided in the Fedwire payment.

Bank	Harris National Association
Telegraphic ID	HARRIS CHGO
Account number	203-213-4
ABA number	071000288
FAO	CDS Clearing and Depository Services Inc. (include the collateral pool ID)

NSCC participant fund for New York Link

To pledge U.S. dollar cash as collateral for the NSCC participant fund for New York Link or NSCC participant fund for New York Link special margin, initiate a Fedwire payment to the following CDS account at Harris National Association. CDS monitors the account to ensure that the funds are deposited to CDS's account. CDS then enters the cash value received in the Collateral Management System.

The table below indicates the information to be provided in the Fedwire payment.

Bank	Harris National Association
Telegraphic ID	HARRIS CHGO
Account number	203-212-6
ABA number	071000288
FAO	CDS Clearing and Depository Services Inc. (include the participant fund ID)

15.1.3 Interest rebates

Participants with cash contributions in the participant funds or collateral pools are eligible to receive interest on these funds on a semi-annual basis.

- ² Rated R1 [low] for short-term debt by DBRS with a minimum issuer rating of A by CDS and rated AA [low] for long-term debt by DBRS with a minimum issuer rating of AA by CDS.
- ³ No more than 20 per cent of the value of collateral pledged can be the obligation of private and municipal sector issuers – subject to the additional restrictions that (i) only 10 percent of the collateral value pledged can be from LVTS and related issuers; and (ii) only 5 percent of the value of collateral pledged can be the obligation of a single private and municipal sector issuer.
- ⁴ Securities issued by members of a pool or fund, or “family” of a pool or fund member, are not eligible for collateral related to the pool or fund.
- ⁵ Rated R-1 [low] by DBRS or A-1 [mid] by S&P or P1 by Moody’s.
- ⁶ Rated R1 [mid] by DBRS or A-1 [mid] by S&P. Minimum issuer rating of AA by CDS.
- ⁷ Rated A [low] by DBRS or A- by S&P or A3 by Moody’s.
- ⁸ 100 per cent of the contribution must be made in U.S. cash.

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