

Chapter 13

SROs, Marketplaces and Clearing Agencies

13.3 Clearing Agencies

13.3.1 CDS - Notice and Request for Comment – Material Amendments to CDS Procedures – Modification to the CDSX interface to the CDCC fixed income CCP

NOTICE AND REQUEST FOR COMMENT – MATERIAL AMENDMENTS TO CDS PROCEDURES

MODIFICATION TO THE CDSX INTERFACE TO THE CDCC FIXED INCOME CCP

A. DESCRIPTION OF THE PROPOSED CDS PROCEDURE AMENDMENTS

Description of the proposed amendments

The proposed amendment addresses the industry requirement to amend the way in which trades destined to CDCC's fixed income central counterparty service (SOLA) are handled by CDSX after the SOLA cut-off time. The request for this amendment to CDSX procedure was submitted to CDS by the IIAC Fixed Income CCP Steering Committee.

The current business rule is - If both parties to a trade are eligible to clear at CDCC and the trade has a value date equal to the current business day and the mode of settlement is equal to SNS and the trade is received in CDSX after the SOLA cut-off time, the mode of settlement is automatically changed to TFT and is immediately eligible to settle in CDSX. This rule satisfies the requirement that if a repo transaction targeted to clear at CDCC misses the last netting opportunity at CDCC (at 3:30 PM) the front leg still has an opportunity to settle in CDSX that same business day.

The new requirement being satisfied by this amendment is to allow the Participant an option to automatically set the settlement control indicator from "Y" (Yes) to "N" (No) in the scenario noted above. This option allows the Participant the ability to choose whether trades missing the netting cut-off at CDCC settle automatically in CDSX or provide the opportunity to resubmit them to CDCC for novation and netting the following day. Participants will have the ability to exercise this option by requesting CDS to adjust their CDSX profile accordingly.

B. NATURE AND PURPOSE OF THE PROPOSED CDS PROCEDURE AMENDMENTS

This process change would enhance Participants' ability to manage those of their repo trades that did not reach CDCC prior to the cut-off time for same day novation and netting. The business purpose is to allow the parties to the repo transactions submitted after the cut-off time the opportunity to intervene and prevent those trades from settling in CDSX. This change will allow the Participant the opportunity to review, and adjust if necessary the terms of the trade, and resubmit it to CDCC for netting and novation the following day. By holding the trade from settling, the Participant has the opportunity to deal with the trade in a manner consistent with the original intent of the trade when it was originally entered in CDSX.

C. IMPACT OF THE PROPOSED CDS PROCEDURE AMENDMENTS

In the new process Participants will have the ability to choose whether the front leg of a repo transaction reported after the SOLA cut-off is released for settlement in CDSX. Currently, the trade will settle bilaterally before either party to the transactions has the opportunity to react to it. In the case where these trades do settle in CDSX the parties to the original repo deal would also have to deal with far leg of that repo transaction. When this change is implemented Participants will be able to more effectively control how their repo deals are cleared and subsequently settled.

Participants will be required to modify their internal procedures in order to adjust to this change in process. However, because these trades will now be held, Participants will be able to more effectively identify these exceptional situations and to address them in a manner that best meets their needs.

C.1 Competition

The procedure amendment is being proposed to support system changes that will allow our Participants to more effectively manage their repo activity that is targeted to clear in a competing fixed income central counterparty clearing

solution. The proposed changes will have no impact on existing or new participants having or being granted access to CDS's systems.

C.2 Risks and Compliance Costs

The proposed amendments do not introduce additional risks or compliance costs to CDS or its participants.

For trades that are received by CDS after the SOLA cut-off time, the mode of settlement is changed to TFT. As such, this amendment is to treat these trades in a more consistent fashion to all other TFT trades in CDSX. That is, the risk exposure associated with these trades being able to be put on hold is no different than other TFT trades being managed through the use of the settlement control indicator. This change will allow participants to more effectively manage the settlement of all of their TFT trades.

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

The proposed system change and procedure amendments are consistent with international standards and recommendations previously set forth by the International Organization of Securities Commissions and the Committee on Payment and Settlement Systems of the Bank for International Settlements.

While the change being introduced is specific in scope it is being implemented in the broader context of usability, risk containment and efficiency. Recommendation 5 regarding securities lending suggests that barriers that inhibit the practice of lending securities should be removed. This proposal addresses the question about the efficacy of risk management procedures used to monitor and/or limit risks stemming from such activities. In this case, a more effective tool (a trade hold) is being implemented to monitor trade activities. Essentially, this change is intended to reduce the risk of unintended bilateral settlements which will potentially increase the number of transactions clearing in a central counterparty clearing solution, an accepted means for reducing financial risk. In the context of repo activity it also allows for the greater possibility of balance sheet relief.

D. DESCRIPTION OF THE PROCEDURE DRAFTING PROCESS

D.1 Development Context

On February 18, 2012 CDS implemented changes to CDSX that delivers eligible repurchase agreement transactions in debt securities to CDCC's fixed income central counterparty service (SOLA) for clearing. During community testing, industry participants requested the project management office of the Fixed Income project to consider a change that would automatically hold current-value trades delivered to CDSX after the SOLA cutoff time from settling in CDSX. CDS was presented with a change request in September, 2011. In January 2012, the IIAC Fixed Income CCP Steering Committee agreed to defer the change post implementation in order to avoid additional delays to the implementation date. Subsequent to the implementation in February, CDS was asked to complete the change request.

D.2 Procedure Drafting Process

CDS procedure amendments are 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 the CDS participant community and it meets on a monthly basis. The SDRC membership includes participants of CDCC's fixed income central counterparty service.

These amendments were reviewed and approved by the SDRC on March 29, 2012.

D.3 Issues Considered

Only two options were considered. The first was to leave the process unchanged; the second was to give Participants the ability to resubmit trades to CDCC the following day that, due to late submission, would not be considered eligible for clearing at CDCC. The latter option was chosen for the reasons cited in section B. The primary issue was whether the thirty minute timeframe between the CDCC cut-off time and the start of CDSX payment exchange would be sufficient to resolve any outstanding issues. Acknowledging a strong desire by some firms to have the ability to resubmit late trades to the CCP it was agreed to implement this option to automatically flip the settlement control on late trades to the discretion of each participant.

D.4 Consultation

The proposed requirement was reviewed and discussed with the IIAC Fixed Income Repo Committee, a consultation process which is consistent with the CDCC Fixed Income Central Counterparty Service project management process. The change in requirement was identified through the project change request process and reviewed by both front-office and back-office stakeholders. CDS was consulted and was asked to propose a technical solution that was consistent with both general CDSX functionality and current CDSX risk containment practices. The agreed solution was presented to the IIAC Fixed Income CCP Steering Committee for approval.

D.5 Alternatives Considered

The proposed solution is the only alternative that is consistent with general CDSX functionality and with the general flow of repo activity between CDSX and SOLA; consequently, no alternatives were considered.

D.6 Implementation Plan

CDS received sign-off on the requirement from the IIAC Fixed Income CCP Steering Committee in January 2012. Development will be completed on March 23, 2012. The code will be introduced into the CDSX/CDCC testing region for participant acceptance testing on April 9, 2012. The change will be implemented on June 25, 2012.

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[®], 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 Procedures may become effective upon approval of the amendments by the Recognizing Regulators following public notice and comment.

E. TECHNOLOGICAL SYSTEMS CHANGES

E.1 CDS

System changes are required in CDSX to automatically update the settlement control indicator of a trade from "Y" to "N" if both parties to a trade are eligible to clear at CDCC and the trade has a value date equal to the current business day and the mode of settlement is equal to SNS and the trade is received in CDSX after the SOLA cut-off and at least one party to the trade has indicated that it wishes these trades be held from settlement.

The Participant's choice to systematically hold late trades will be captured in a CDSX SOLA profile. This profile will be populated by CDS if requested to do so. In the second phase of the fixed income project, CDS will make this profile available to participants using online functionality to manage this option without CDS intervention.

There are no other changes or impacts to trade or settlement processing in CDSX.

E.2 CDS Participants

Changes are not required to Participant systems to benefit from this change.

E.3 Other Market Participants

Changes are not required to third-party vendor systems to benefit from this change.

F. COMPARISON TO OTHER CLEARING AGENCIES

Netting and novation of fixed income repo trades in the U.S. market occur through the Fixed Income Clearing Corporation (FICC); a subsidiary of the Depository Trust & Clearing Corporation (DTCC). FICC nets and novates transactions on a near real-time basis and provides counterparties with net outstanding obligations on a current and forward-dated basis. Repo transactions with a "start" or "on" leg of the current day are novated by FICC. The "end" or "off" legs are future dated and are novated and netted, with settlement taking place on the net obligation on the value date. In each case the security obligation settles through the Federal Reserve and the funds component is settled through Fedwire.

The model developed by CDCC follows roughly that of LCH.Clearnet, an independent clearing house that is based in London, U.K. LCH.Clearnet operates RepoClear, a market utility that nets and novates bond and repo transactions between industry participants in 13 European markets. Settlement of these net obligations that have reached their value date is done at the depository in each market.

In the current CDCC model, CDS delivers eligible repo transactions (eligible CDSX trades) to CDCC for netting and novation. Those trades that are not eligible are settled in CDSX trade-for-trade. Like both of the repo models described above, the CDCC model assumes that the terms of the transactions delivered for clearing are agreed.

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:

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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:

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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 and CDS Forms (if applicable) on the User documentation revisions web page (<http://www.cds.ca/cdsclearinghome.nsf/Pages/-EN-UserDocumentation?Open>). The revision portfolio contains text of CDS Procedures marked to reflect proposed amendments, as well as text of these procedures reflecting the adoption of the proposed amendments.