

### 13.3 Clearing Agencies

#### 13.3.1 CDS – Notice and Request for Comment – Material Amendments to CDS Procedures – GIC Funds-Only Trade Service in CDSX

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

##### MATERIAL AMENDMENTS TO CDS PROCEDURES

##### GIC FUNDS-ONLY TRADE SERVICE IN CDSX

##### REQUEST FOR COMMENTS

#### A. DESCRIPTION OF THE PROPOSED CDS PROCEDURE AMENDMENTS

The proposed amendments to CDS Participant Procedures will introduce a new service – the GIC Funds-Only Trade Service – into CDS's CDSX settlement system. This new participant-requested service will automate the process for the exchange of funds between Guaranteed Investment Certificate (GIC) issuers and GIC purchasers in the Canadian capital markets.

CANNEX Financial Exchanges Limited (CANNEX) is a service provider that compiles interest rate and calculation value information for a variety of financial products (e.g. GICs, term deposits and Guaranteed Interest Annuities) from 49 Canadian issuing institutions (of which 20 are CDS participants) and redistributes that information to subscribing agents, brokers and dealers. Through the CANNEX Financial Network system, subscribing clients are able to transmit purchase order files to participating financial institutions to electronically confirm their purchases of offered financial products. Through the same system, the financial institutions are also able to transmit order confirmation files back to the agents, brokers, and dealers verifying the details of their purchases.

The current process for the completion of these purchases involves an exchange of funds between the issuing financial institution and the purchasing agent, broker or dealer via the issuance of physical cheques, and the manual delivery and deposit of those cheques. Throughout the day, various cheque payments may be exchanged between these parties for daily money settlement of new purchases, and payments of maturity amounts, interest payments, commissions and early redemptions. Security positions are held electronically by the issuing institution and require no physical exchange. A regular reconciliation is performed by issuers and purchasers to verify their electronic positions.

CDS was asked by some of its participants through the Debt & Equity Subcommittee of the Strategic Development Review Committee (SDRC) to introduce a facility within CDSX whereby daily payments specific to GICs could be exchanged. This request is in line with a continuing effort by the financial community to reduce the exchange of non-electronic funds.

To accommodate this request, CDS, the SDRC and CANNEX agreed to a process whereby CANNEX will deliver a daily payments file related to GIC activity between eligible clients to CDS for funds-only settlement in CDSX. The payments file will be transmitted to CDS daily at approximately 2:00 p.m. ET, with additional files containing late delivery information sent up to 3:00 p.m. ET, as required. With the introduction of seven new trade types in CDSX, CANNEX will be able to instruct on payments that represent the netted exchange of funds on purchases, maturities, interest payments, commissions, early redemptions, other miscellaneous payments such as correction amounts, as well as a single total netted settlement amount. Each individual payment will be instructed as a non-exchange trade with a designated trade type. Trades reported by CANNEX will be identified by a unique source ID. The payment types and related non-exchange trade types are described on page 12 of CDS's *Trade and Settlement Procedures* manual, in the proposed documentation changes.

CDS participants that are also clients of CANNEX will be required to instruct both CANNEX and CDS of their wish to participate in this service. Participants will be required to advise CDS to accept transactions from CANNEX by subscribing to this service within CDSX. CDS will control inbound activity and subsequent non-exchange trade activity by insuring that both parties to the transaction provided by CANNEX have subscribed to the service and that the transactions reflect one of the seven acceptable trade types.

CANNEX clients that are not CDS participants (primarily credit unions and municipalities that issue GICs) may arrange for a CDSX participant to act as their settlement agent in order to exchange owing funds electronically within CDSX, replacing the current manual delivery of cheques. This relationship is arranged outside of CDS.

Upon receipt of the payments file from CANNEX, the non-exchange trade transactions will be uploaded into the CDSX settlement system in a confirmed status. The generic Canadian or U.S. funds ISINs will be reported on the non-exchange trade record (CA99997Z1099 or US99997Z2083), depending on the currency identified on the payment. The submitter/acceptor and buyer/seller roles on the trade will be determined based on which counterparty owes/is owed funds, with the submitter being deemed as the seller who will be credited with the netted funds at settlement, and the acceptor being deemed as the buyer who

is being debited. The settlement control indicators for each party will be set to 'N'o. Both the submitter and acceptor will be required to confirm their agreement with the funds amount of each trade by re-setting their own settlement control indicator to 'Y'es. Current non-exchange trade functionality applies. Once both settlement control indicators on a trade have been updated, the transaction will be considered for settlement. The settlement of these trades will be subject to the existing funds and aggregate collateral value (ACV) edits, ensuring that the acceptor has sufficient funds and collateral to allow settlement.

CANNEX will provide their clients with a daily report that will provide a breakdown of each payment record, allowing easier reconciliation of settlement amounts. It is expected that if both parties disagree with the funds amount reported, they will delete the incorrect trade in CDSX and manually setup a replacement one.

CDSX participants will have the ability to report non-exchange trades with these new trade types directly. They may choose to do so if (i) they are not clients of CANNEX, but the issuing GIC institution is able to settle funds through CDSX, or (ii) they are now able to accept a previously rejected payment. If directly entered, these non-exchange trades will follow the current non-exchange trade lifecycle from trade entry through to settlement.

In addition to the above mentioned changes to the non-exchange trade function, a new EAS Alert will be implemented advising participants that the current day's transactions have been received from CANNEX and loaded into CDSX. Multiple alerts may be received by participants in a single day, depending on the number of files CANNEX provides, and if another GIC service provider joins the new service.

Based on the above, CDS proposes to implement system and procedure changes to accommodate the electronic settlement of funds movements related to GIC transactions.

## **B. NATURE AND PURPOSE OF THE PROPOSED CDS PROCEDURE AMENDMENTS**

The proposed procedure amendments support the financial industry's objective of straight-through electronic processing. The amendments facilitate a reduction in the physical creation, certification and delivery of cheques and bank drafts as payment for various GIC transactions.

CDS participants will benefit from the introduction of funds settlements in CDSX for GIC payment activities through (i) improved delivery efficiency of payments (electronic exchange of funds versus manual delivery by messenger), (ii) lowered processing and staffing costs, (iii) settlement process efficiencies (by keeping funds inside CDSX that may be used for other investment activities), and (iv) reduced risk through finality of payment.

## **C. IMPACT OF THE PROPOSED CDS PROCEDURE AMENDMENTS**

The elimination of physical cheques, and the associated delivery and handling of those payments, will allow CDS participants to securely settle the funds related to their GIC investment activities within CDSX.

### **C.1 Competition**

The proposed procedure amendments will have no impact on the ability of eligible market players, both CDS participants and non-CDS participants, to use the new service. All information service providers that facilitate transactions between GIC issuers and purchasers will be able to provide CDS with settlement details to enable the exchange of the funds related to those transactions within CDSX.

No CDS participant will be at a disadvantage if they chose not to subscribe to the GIC Funds-Only Trade service. All CDS participants may use the new trade types to settle funds movements related to GIC transactions. Institutions that are clients of both CANNEX and CDS may elect to have their netted transaction details uploaded electronically into the CDSX settlement system, but are not required to do so. CANNEX clients that are not CDSX participants may arrange to have an existing CDS participant act as their agent to effect settlement of these transactions.

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

The development of the new service was undertaken at the request of some of CDS's participants, and is intended to reduce both the risk and costs associated with GIC investment activities. There are no compliance costs or issues for participants vis-à-vis CDS with regard to the new service.

The reduced costs and increased efficiencies in the processing of funds related to GIC transactions will benefit those participants that use the new trade types. The settlement of these funds trades will be subject to the existing funds and ACV edits, ensuring that the acceptor has sufficient funds and aggregate collateral value to allow settlement.

As with all other transactions, GIC related delivery of funds transactions expose CDS to payment risk. CDSX addresses this payment risk by ensuring that the corresponding participants are appropriately funded and collateralized at all points of time.

Settlements of free deliveries of funds are subject to the existing risk edits. Payment risk is mitigated by ensuring that the purchasing participant has sufficient funds and aggregate collateral value to allow settlement.

In order for a free delivery of funds to settle, the following payment risk edits are applied:

- The buyer must have sufficient available funds, unused cap and/or unused lines of credit to cover their funds obligation after the settlement (the Funds edit)
- The buyer and the seller must have sufficient ACV after the settlement to cover the resulting funds obligation (the ACV edit)

The Funds edit ensures that the GIC related transactions do not exceed the corresponding participant's limit as calculated by the sum of cap and line of credit.

**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*<sup>1</sup>, and will work with the financial services industry to achieve compliance with the new standards.

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

The development requested by some of CDS’s participants will support timely delivery of funds related to GIC investment activities. While the exchange and custody of the GIC security will continue to occur outside of CDSX, the delivery of funds for purchases and entitlements will be accomplished within the secure processing environment of CDSX, where finality of payment is ensured.

No other comparison is available in respect of the proposed amendments.

**D. DESCRIPTION OF THE PROCEDURE DRAFTING PROCESS**

**D.1 Development Context**

The development request was tabled at the SDRC Debt & Equity subcommittee, as an opportunity to streamline GIC related payment activities. Once approved by the SDRC for further analysis, CDS was requested to consult with CANNEX to understand their financial products information service, and to determine how best to integrate their clients GIC payment transaction details with the CDSX settlement system. The resulting straw-man approach was reviewed in detail with the SDRC and any additional participant requirements were incorporated into the final approved design.

**D.2 Procedure Drafting Process**

The CDS Procedure Amendments were drafted by CDS’s Business Systems Development and Support 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 March 16, 2012.

**D.3 Issues Considered**

The original design of this initiative involved the creation of a single new trade type that would identify a trade as being the total netted amount of all funds settlements between a GIC issuer and purchaser on a given day (i.e. all new purchases, maturing

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<sup>1</sup> The report can be found at <http://www.bis.org/publ/cpss94.pdf>

amounts, interest payments, commissions, early redemptions, and payment corrections). After an initial review with the SDRC Debt & Equity subcommittee, it was identified that some participants would have difficulty reconciling this single amount as various types of payments are handled in different departments (i.e. interest payments may be reconciled in an entitlement area, while new purchases are handled in a settlement area). As a result, the number of new trade types was expanded to seven to identify each type of payment that would be exchanged.

CANNEX requested an end of day file that would identify whether the original payment amounts submitted by them were completed, outstanding or deleted by the counterparties. In order to maintain the scope of the project and control costs, the SDRC Debt & Equity subcommittee rejected this item, for consideration at a later time.

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

This development initiative was requested by the SDRC Debt & Equity subcommittee. CDS has reviewed the related requirements documentation with that group, and received their final approval of the proposal.

CDS has regular consultations with CANNEX to better understand their financial service offerings, to determine how best to receive their client's GIC funds-related information, and to exchange project status updates. CDS and CANNEX have met frequently to arrive at a mutually acceptable electronic communications protocol. Business requirements and the business relationships required to make this project successful have also been discussed, and will be reflected in a formal agreement, which will be in place prior to the implementation of this initiative.

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. They will provide customer-related training prior to implementation, as required. As per usual practice, CDS will distribute a bulletin to all participants the week before implementation reminding them of the upcoming changes.

CANNEX has reviewed the details of this project with their clients at their scheduled user group meetings, and are working with their "non-CDS participant" clients to assist them in establishing settlement agent relationships with existing CDS participants.

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 presented to IIROC's FAS working groups.

This initiative was discussed at the CDS Risk Advisory Committee, and CDS Risk Management will be providing an analysis for their review.

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

Preliminary analysis by CDS to introduce GIC securities into CDSX concluded that a system constraint within the Security Master File function prevents multiple securities from having the same description and maturity date (i.e. CDS's entitlement system could not calculate the appropriate accrued interest on a GIC issued on many different days, but with the same maturity date and rate). CDS concluded that the alternative of introducing funds-only GIC transactions would allow participants to exchange settlement funds with issuing financial institutions in an electronic and secure manner. The exchange and custody of the GIC security will continue to occur outside of CDSX.

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

The proposed changes 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. As per usual practice, the Customer Service account managers will provide their clients with details of the upcoming changes, and provide training as required. CDS will distribute a bulletin to all participants the week before implementation reminding them of the upcoming changes, and confirming the effective date of those changes.

Prior to implementation, CDS and CANNEX will perform file transmission and settlement process testing. CDS participants will be required to advise CDS that details of their GIC funds settlements are to be accepted electronically from CANNEX. CANNEX will maintain similar eligibility criteria where their clients instruct CANNEX to send their GIC fund settlement details to CDS.

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 Procedures may become effective upon approval of the amendments by the Recognizing Regulators following public notice and comment. Implementation of this change is planned for May 28, 2012.

**E. TECHNOLOGICAL SYSTEMS CHANGES**

**E.1 CDS**

CDSX functionality will be impacted by these changes, as follows:

- a) Accept daily files of payment transaction details from GIC service providers
- b) Implement a new service transmission code for GIC funds settlements from CANNEX
- c) Modify the trade entry function such that the non-exchange trades delivered to CDSX:
  - are from an acceptable GIC service provider
  - identify the GIC service provider in the Source ID field
  - both parties have agreed to allow the service provider to send settlement details on their behalf
  - are accepted in a confirmed status
  - are accepted with both the submitter's and acceptor's settlement control indicators set to 'N'o
  - instruct one of the seven agreed trade types
- d) Report these trades in the existing transaction reports
- e) Exclude these trades from non-exchange trade statistics

In addition, a new EAS alert will be available to subscribing participants advising when the current day's file for a given service provider has been received and processed.

**E.2 CDS Participants**

CDS participants may need to make changes to their internal systems to recognize (i) a new trade source ID, and (ii) the new funds-only GIC trade types. If a participant chooses to process these types of non-exchange trades differently from their other trade activity, they may need to make appropriate system changes. No one has indicated this to be the case.

**E.3 Other Market Participants**

Service bureaus may be required to make changes to their internal systems on behalf of their clients to recognize (i) a new source ID, and (ii) the new funds-only GIC trade types. If a service bureau chooses to process these types of non-exchange trades differently from their other trade activity, they may need to make related system changes. No one has indicated this to be the case.

CANNEX is making the necessary arrangements to update their systems and/or communicate any necessary changes to their clients' systems to benefit from this implementation.

**F. COMPARISON TO OTHER CLEARING AGENCIES**

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 to:

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Email: [lelick@cds.ca](mailto:lelick@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  
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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.