

Chapter 13

SROs, Marketplaces and Clearing Agencies

13.3 Clearing Agencies

13.3.1 CDS – Request for Comments – Material Amendments to CDS Procedures – Elimination of ACV to Entitlement Processors for Security Submit Events

CDS CLEARING AND DEPOSITORY SERVICES INC. (CDS®)

MATERIAL AMENDMENTS TO CDS PROCEDURES

ELIMINATION OF ACV TO ENTITLEMENT PROCESSORS FOR SECURITY SUBMIT EVENTS

REQUEST FOR COMMENTS

A. DESCRIPTION OF THE PROPOSED CDS PROCEDURE AMENDMENTS

In February 2011, CDS implemented changes to address the risks associated with providing aggregate collateral value (ACV) to Entitlement Processors when acting as Paying Agents in CDSX for maturing securities (see Notice distributed December 16, 2010, entitled “ELIMINATION OF ACV TO ENTITLMENT PROCESSORS FOR MATURING SECURITIES”).

Currently, ACV is given to Entitlement Processors for securities that have been submitted by holding participants in other, non maturity-type events. Upon release of the payment item by the Entitlement Processor to the receiving participants, the securities being submitted for payment are moved from the holding participant ledgers into a CDS entitlement account. If the Entitlement Processor leaves the submitted securities in the CDS entitlement account intraday on the day of payment, they receive an ACV credit for those paid-for securities. If the Entitlement Processor releases the securities from the CDS entitlement account to themselves intraday on day of payment, they lose that credit. If the securities remain in the CDS entitlement account until the end of day on the day of payment, CDSX functionality automatically moves the securities to the Entitlement Processor’s account overnight (at this point, the intraday ACV credit will have expired).

In order for securities to provide ACV in CDSX, there needs to be certainty that the collateral can be used to provide the necessary liquidity for survivors in the credit ring of a defaulting Entitlement Processor. After completion of their related corporate action events, these securities have no market value, and will subsequently be removed from CDSX and cancelled by the issuer. Continuing with the existing practice of giving ACV for these submitted securities exposes surviving participants to significant liquidity and credit risk.

Based on the above, CDS proposes to implement system and procedure changes to eliminate the practice of providing intraday ACV to Entitlement Processors in CDSX for the following security-submit type events:

Mandatory Events

Consolidation	Merger
Liquidation	Partial Call Lottery
Mandatory Change	Partial Call Pro Rata
Mandatory Conversion	Plan of Arrangement
Mandatory Exchange	Push Out
Mandatory Extension	Subscription Installment Receipt
Mandatory Redemption	Unit Separation
Mandatory Acquisition with Option	Mandatory Merger with Option
Mandatory Change with Option	Plan of Arrangement with Option

Voluntary Events

Debenture Buy-Back	Voluntary Conversion
Odd Lot Offer	Voluntary Exchange
Retraction	Voluntary Extension
Subscription	Voluntary Redemption
Tender Offer	

The movement of the submitted securities will not change - the Entitlements Processor can leave the securities in CDS's entitlement account intraday and the CDSX functionality will move them automatically in the overnight batch process, or they can release the securities to themselves intraday in order to complete their internal processing. There will no longer be an advantage to leaving the submitted securities in the CDS entitlement account intraday on the event's payable date.

B. NATURE AND PURPOSE OF THE PROPOSED CDS PROCEDURE AMENDMENTS

CDS will implement system and procedure changes so Entitlement Processors acting as Paying Agents will not receive ACV for securities submitted to entitlement events in CDSX. The proposed amendments to CDS's external procedures (i) remove the references to the ACV that was previously credited to the Paying Agent, and (ii) describe the automated movement of the submitted securities during overnight CDSX processing.

C. IMPACT OF THE PROPOSED CDS PROCEDURE AMENDMENTS

The elimination of ACV on submitted securities may require Paying Agents to collateralize their entitlement payments with other securities. Not receiving ACV for submitted securities could cause Paying Agents to fail the ACV edit checks resulting in payments to participants holding the submitted securities to fail. The settlement flow for the Paying Agent and participants that are depending on the proceeds from the submitted securities could be slowed down until all ACV edit checks are satisfied.

During the analysis of historical payment data conducted by CDS in 2011 prior to the removal of ACV on maturing securities, it was determined that the impact for that change would not create a significant processing or financial impact to participants. As the 2011 change involved the highest volume event types (maturities, final asset-back payments and final mortgage-backed payments), it has further been determined that the impacts of removing ACV on the remaining security-submit type events will be minor.

C.1 Competition

The change in process and procedures will not have a competitive impact on CDS, its participants or any other interested parties.

C.2 Risks and Compliance Costs

There is a potential increase in cost to Paying Agents in CDSX if they are required to provide additional ACV to ensure that the settlement process is not affected by this change. The cost is not expected to be material based on the analysis conducted.

There is no compliance costs associated with this change.

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

This recommendation is consistent with "Recommendation 9" made by CPSS-IOSCO, regarding the risk controls of CSDs, to address participant's failure to settle. The recommendation states that, CSDs that extend intraday credit to participants, including CSDs that operate net settlement systems, should institute risk controls that, at a minimum, ensure timely settlement in the event that the participant with the largest payment obligation is unable to settle. The most reliable set of controls is a combination of collateral requirements and limits.

D. DESCRIPTION OF THE PROCEDURE DRAFTING PROCESS

D.1 Development Context

The amendments have been proposed to remove the references to the crediting of ACV to Entitlements Processors acting as Paying Agents in CDSX, and to better describe the automated movement of the submitted securities during CDSX processing.

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.

These amendments were reviewed and approved by the SDRC on February 23, 2012.

D.3 Issues Considered

CDS considered that the implementation of this change could impact the flow of settlements and possibly cause a settlement gridlock within CDSX. A settlement gridlock could occur if the lack of ACV prevented a Paying Agent from releasing entitlement proceeds to CDS and downstream processing to participants holding the submitted securities. While a settlement gridlock is possible, the analysis based on historic data indicates that such a gridlock is unlikely as it relates to the amount of ACV currently provided to Paying Agents for submitted securities.

D.4 Consultation

CDS has communicated the proposed change to all Entitlement Processors/Paying Agents and participants through the SDRC subcommittees, and the CDS Development Plan, published monthly on CDS's website (www.cds.ca). CDS also plans to distribute a bulletin to all participants notifying them of the upcoming changes.

D.5 Alternatives Considered

No other alternatives were considered.

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[®], 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

CDS will need to implement a system change to eliminate the practice of providing ACV for securities submitted in entitlement and corporate action events within CDSX to Entitlement Processors, acting as Paying Agents, that are participants of CDS.

E.2 CDS Participants

There are no anticipated system changes to be made by participants.

E.3 Other Market Participants

There is no anticipated impact to other market participants.

F. COMPARISON TO OTHER CLEARING AGENCIES

All CSDs are required to ensure that credit exposures are fully collateralized according to CPSS-IOSCO recommendation 9, point #5. There is no information available from other CSDs in order to conduct a further comparable 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:

Laura Ellick
Manager, Business Systems
CDS Clearing and Depository Services Inc.
85 Richmond Street West
Toronto, Ontario M5H 2C9

Phone: 416-365-3872
Fax: 416-365-0842
Email: lellick@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^e Anne-Marie Beaudoin
Secrétaire del'Autorité
Autorité des marchés financiers
800, square Victoria, 22^e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3

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

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

Fax: 416-595-8940
e-mail: marketregulation@osc.gov.on.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 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.