

### 13.3 Clearing Agencies

#### 13.3.1 CDS – Notice and Request for Comment – Material Amendments to CDS Procedures – CDCC INTERFACE

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

##### NOTICE AND REQUEST FOR COMMENT

##### MATERIAL AMENDMENTS TO CDS PROCEDURES

##### CDCC INTERFACE

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

##### *Withdrawal of previous procedure amendment submission*

On November 2, 2010, CDS submitted a Notice and Request for Comment – Material Amendments to CDS Rules and Procedures Relating to the CDCC Interface for regulatory review.

The procedure amendments identified changes related to two phases of the CDCC Interface project: Phase 1 was intended to address repurchase agreement transactions, while phase 2 would address cash trades. Implementation of phase 1 was initially scheduled for January 10, 2011, with the implementation of phase 2 following closely thereafter.

The Notice and the proposed amendments were published on November 5, 2010 by the Ontario Securities Commission (OSC Bulletin (2010) 33 OSCB 10317), and by the Autorité des marchés financiers du Québec (AMF Bulletin 2010-11-05 Vol. 7, n° 44).

Since CDS's original submission, the industry steering committee has amended the effective dates of the implementations as follows:

- Phase 1 implementation has been deferred to October 24, 2011
- Phase 2 implementation has tentatively been scheduled for the end of February, 2012 (no firm date has been set, however)

In addition to the deferral of implementation, and subsequent to the publication of CDS's Notice, the industry steering committee has identified functional enhancements to the initial proposal that impact the previously published proposed amendments.

As a result of these changes to implementation timing and the functional enhancements noted above, the proposed procedure amendments are being withdrawn.

The proposed CDS Rule amendments set out in Appendix A of the previous Notice for Request and Comment remain in effect.

##### *Summary of new proposed amendments to procedures*

The proposed amendments outlined in this Notice for Request and Comment are intended to reflect *only* those amendments related to phase 1 of the CDCC Interface project.

The CDS procedure amendments for phase 1 impact the following functionality:

- Participant service eligibility (new service - SOLA netting system)
- Non-exchange trade: new mode of settlement (SNS), new trade type (USR) and addition of the repo tag number field
- Participant merge does not occur for trades with mode of settlement equal to SNS and trades submitted by CDCC
- Modifying trades with mode of settlement equal to SNS
- Modifying trades submitted by CDCC

- CDCC cutoff time and update of mode of settlement from SNS to TFT for current value dated trades entered or modified after the cutoff time
- Neither the participants nor CDCC are permitted to place a hold on a trade involving CDCC as the CCP

Previously submitted procedure amendments relating to the implementation of phase 2 have been redacted, and relate to the following functional changes:

- Cash trades with mode of settlement equal to SNS
- CDSX ISIN eligibility for CDCC novation and netting
- Inter-dealer broker reporting of blind repo trades with mode of settlement equal to SNS
- SOLA zero net matching process for cash trades
- Partial settlement process

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

The procedure amendments are considered material. The proposed amendments implement a new process flow and connectivity with the CDCC's fixed income clearing facility and redefine CDS's role in the transmission of information from its participants to third parties, while minimizing changes to participants' in-house and back-office vendors' systems.

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

Under the new process, confirmed trades that are reported to CDS with a mode of settlement equal to SNS will be reported to CDCC for novation and subsequent netting and clearing if the participant subscribes to CDCC's fixed income clearing facility. Trades with a mode of settlement equal to SNS will not be eligible for settlement in CDSX. CDS will be acting only in the capacity of an intermediary which communicates transactional information between participants and CDCC. Trades novated and netted by CDCC will be reported to CDS by CDCC for subsequent settlement within the CDSX TFT trade settlement process. These Trades will be reported to CDSX in a pre-confirmed status and with a mode of settlement equal to TFT using the CDSX Non-Exchange Trade entry process. The parties to these trades will be CDCC and a CDSX participant

If CDCC rejects a trade transmitted to CDCC by CDSX, the submitter of the trade will be notified of the rejection using existing processes and procedures. The submitter of the trade will be required either to adjust the trade for resubmission to CDCC, or to clear and settle the trade within CDSX either on a Trade-for-Trade basis or through CDS's existing FINet<sup>®</sup> service.

### **C.1 Competition**

The procedure amendments are being proposed to support the CDS system changes that will allow CDCC to implement a competing solution to FINet as a result of the IIAC RFP process and the requirements of industry participants.

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

The proposed amendments are not expected to change the risk profile of CDS or its participants. It is expected that CDCC will settle its fixed income central counterparty trades as a receiver of credit in CDSX and that no changes to the risk model will be required. The payment obligations of CDCC resulting from fixed income settlement will be supported by an extender of credit providing an adequate line of credit to CDCC. Further, the proposed amendments are not expected to result in changes or increases to compliance costs for CDS, its participants, or other market participants.

### **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 changes 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. The process is intended to increase securities repurchase agreement volumes and enhance market liquidity through a more efficient use of such securities.

## D. DESCRIPTION OF THE PROCEDURE DRAFTING PROCESS

### D.1 Development Context

The industry's desire for an alternative, additional fixed income clearing facility, currently being developed by the CDCC on behalf of the IIAC, is the impetus for the proposed procedure amendments and the systems changes which the proposed amendments will implement. The systems changes and procedure amendments are intended to minimize the impact to the current roles, practices, and systems of all affected market participants.

### 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 membership includes representatives from the CDS participant community and the committee meets on a monthly basis.

The proposed procedure amendments were reviewed and approved by the SDRC on April 21, 2011.

### D.3 Issues Considered

The primary consideration in the development of the procedures in response to the industry initiative was development of the process and the legal framework which was intended to minimize effects on market participants' processes, practices, and systems.

### D.4 Consultation

The process, and the procedures, were developed with direct consultation with market participants at the IIAC.

### D.5 Alternatives Considered

As the fixed income clearing facility is an industry initiative, alternatives to the new fixed income clearing facility process were considered at the outset of that initiative. In respect of the proposed amendments, CDS was asked only to develop a solution that would implement the CDCC fixed income clearing facility with a minimum of development required by CDS's participants and other affected market participants.

### 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<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 the participant procedures may become effective on or after date of approval of the amendments by the Recognizing Regulators following public notice and comment.

## E. TECHNOLOGICAL SYSTEMS CHANGES

### E.1 CDS

CDS's systems will be modified to accommodate the interface such that the system will support trade submission and confirmation through CDSX. CDSX will perform edits as described in the procedures. CDS will also be receiving information from CDCC, which will communicate net position details and settlement instructions using (modified) CDSX trade functionality.

In particular, new functions within CDSX include:

**Service eligibility (SOLA netting system)**, enables participants to direct trades to CDCC for subsequent processing by entering SNS as the mode of settlement on the non-exchange trade.

A new field will be added to a non-exchange trade (**Repo tag number**). This field will link the near and far legs of a repurchase agreement transaction and is required when a mode of settlement equal to SNS is entered.

and,

**Mode of Settlement Conversion**, whereby an eligible trade may be modified by CDSX such that the mode of settlement will be changed from SNS to TFT for settlement.

## **E.2 CDS Participants**

CDS participants' systems will be required to determine which transactions should be reported to a Third Party Clearing System (TPCS), and will be required to assign a TPCS mode of settlement in order to instruct CDS accordingly. Further, participants' systems will be required to identify the short and long legs of a repurchase transaction through the use of an identification link assigned to the individual leg transactions. Finally, participants' systems will be required to recognize a new label indicating that the transaction had been novated by a TPCS, a process similar to the current "Deleted by FINet" label in the FINet process.

## **E.3 Other Market Participants**

Where a CDS participant's systems are operated by a third-party vendor, the vendor will be required to make substantially similar modifications to systems as appear in section E.2, above.

## **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 being 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.

## **G. PUBLIC INTEREST ASSESSMENT**

CDS has determined that the proposed amendments to the CDS procedures 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:

Me Anne-Marie Beaudoin  
Secrétaire de l'Autorité  
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**

The proposed procedure amendments are available for review and download on the [User Documentation](#) page on the CDS website.