

13.3 Clearing Agencies

13.3.1 CDS – Request for Comments – Material Amendments to CDS Rules – Electronic Payment of Entitlements

CDS CLEARING AND DEPOSITORY SERVICES INC. (CDS®)

MATERIAL AMENDMENTS TO CDS RULES

ELECTRONIC PAYMENT OF ENTITLEMENTS

REQUEST FOR COMMENTS

A. DESCRIPTION OF THE PROPOSED CDS RULE AMENDMENTS

This report proposes amendments to the CDS Rules to permit CDS to establish certain limited exemptions to the requirement (scheduled to become effective on November 1, 2011) that all entitlements on eligible securities be paid by an acceptable electronic means.

B. NATURE AND PURPOSE OF THE PROPOSED CDS RULE AMENDMENTS

B.1 Proposed Amendment

In November 2008, CDS published notice of Rule amendments intended to ensure that entitlements on securities held in CDSX® are paid in electronic format. This requirement is scheduled to become effective on November 1, 2011, and states that a security will not be eligible for deposit into CDSX unless entitlements on that security are paid in certain defined formats (essentially electronic payments with assurance of final and irrevocable funds). The three year lead time was intended to provide an opportunity for market participants (including in particular issuers, paying agents and their bankers) to make the system and process changes necessary to comply with this eligibility criterion. However, not all issuers or their agents are able to comply with the requirement at the present time. The proposed amendments to the CDSX Rules will authorize CDS to establish certain limited exemptions to the requirement.

B.2 Paperless Processing of Securities Transactions

For many years, CDS has pursued the objective of paperless processing of securities transactions, holdings and entitlement payments. One means to this objective is the reduction in the use of cheques. In the absence of Canadian legislation or regulations mandating that issuers pay securities entitlements to the clearing agency in final electronic funds, progress requires changes to the practices of individual issuers and their agents.

Entitlement payments include dividends, interest, payments upon redemption or maturity of securities, and other events involving payments or distributions to holders of securities. Eliminating the use of cheques for entitlement payments provides greater efficiency and cost reduction to CDS (and therefore to the financial services industry as a whole). From a risk perspective, the use of acceptable payments or fund transfers (the requirement to be imposed as of November 1, 2011) ensures that the entitlements credited into CDSX funds accounts are received by CDS as immediate, final and irrevocable credit.

A number of CDS initiatives have significantly reduced the number of cheques received for entitlements. The implementation of the Book Entry Only Securities Services Agreement in 2009 has had a very positive impact on the type of payments received for these issues, as the agreement requires all entitlement payments to be made in electronic form. In addition, CDS has implemented system enhancements to support participants acting as paying agents, and thus the payment of entitlements by funds transfers. CDS is continuing to work with participants to extend this functionality to additional institutions and to a wider range of corporate action events.

In the three years since the eligibility requirements were announced, considerable progress has been made in achieving CDS's objective. In 2008, cheques were used for 70% of payment events, representing 10% of the value of entitlements received; today, cheques are used for 25% of payment events, representing 3% of the value of entitlements received.¹

While progress has been substantial, and is continuing, it has not been possible to achieve 100% compliance with the eligibility requirement. A considerable number of issuers continue to use alternative means of entitlement payment, including cheques and electronic payments such as pre-authorized debits. This includes significant categories of issuers, such as the Quebec municipalities². As issuers are not CDS participants, they are not themselves bound by the CDSX Rules, and therefore they

¹ Note that these figures exclude entitlements on money market securities; these entitlements, which represent by far the highest value of entitlement payments in CDSX, have been paid by funds transfers for some considerable time.

² CDS is actively working with representatives of the Province of Quebec to enhance the entitlement payment process for a range of securities.

cannot be directly required to comply with the Rules. To make the securities of these issuers ineligible would cause considerable disruption to participants, to their customers and to the issuers in question. CDS is actively working to resolve the remaining issues, but this is not expected to be achieved by the November 1, 2011 deadline imposed under the current version of the CDSX Rules. It is therefore proposed that CDS will establish limited exemptions to the eligibility requirement. Exemptions will be based on the amount of the payment (a *de minimis* exemption for small payments), the means of payment (such as pre-authorized debits) or the classification of the issuer (such as Quebec municipalities). The proposed Rule amendments authorize CDS to establish such exemptions.

B.3 New Standards Established by Bank for International Settlements

The Canadian financial services industry is subject to developing international standards. In March of 2011, the Bank for International Settlements, through its committees the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO), issued a draft report for public consultation. The report, *Principles for Financial Market Infrastructures*, proposes new international standards for payment, clearing and settlement systems.³ After a consultation period, CPSS and IOSCO will review all comments received and publish a final report in early 2012. It is proposed that the new principles will be implemented in legal and regulatory frameworks by the end of 2012. The report states that the new principles “are designed to ensure that the essential infrastructure supporting global financial markets is even more robust and thus even better placed to withstand financial shocks than at present”. Financial market infrastructures or “FMIs”, including central securities depositories and securities settlement systems such as CDS, will be expected to take “appropriate and swift action” to comply with the new standards. CDS is following these developments closely, and will take the necessary steps to ensure that it complies with the new standards when they are implemented. Principle #9 - Money Settlements states: “An FMI should conduct its money settlements in central bank money where practical and available. If central bank money is not used, an FMI should minimise and strictly control the credit and liquidity risk arising from the use of commercial bank money.” The provisions of the CDSX Rules requiring entitlements to be paid in electronic format are in line with this principle. The Board of Directors, in considering the proposed Rule amendments, determined that a sunset provision should be imposed on the exemptions to the entitlement payment requirement for eligible securities. The exemptions will be of limited duration, and further Rule amendments to dispense with such exemptions will be brought forward at a later date. CDS anticipates that the exemptions, provided for by the proposed Rule amendments, will be withdrawn in the timeframes established by CPSS/IOSCO when the new international standards are implemented. CDS will continue to work with the financial services industry, including issuers and their agents, to achieve compliance with the new international standards.

B.4 Technical Amendments to French Version

It is noted that the French version of the Rule amendments includes technical amendments not in the English version, to correct minor typographical errors that occur only in the French version.

C. IMPACT OF THE PROPOSED CDS RULE AMENDMENTS

C.1 Competition

The Rule amendments ensure that there will not be a competitive disadvantage to issuers who are not yet in a position to use the Rule mandated electronic means of paying entitlements.

C.2 Risks and Compliance Costs

The Rule amendments do not impose any compliance costs on 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

CDS’s eligibility Rule, and the proposed exception to it, are adapted to the Canadian financial market and there is no direct comparison to other clearing agencies. CDS is closely following the development of new international standards for payment, clearing and settlement systems set out in the CPSS/IOSCO report *Principles for Financial Market Infrastructures*, and will continue to work with the financial services industry, including issuers and their agents, to achieve compliance with the new international standards for the processing of entitlements.

³ The report can be found at <http://www.bis.org/publ/cpss94.htm>

D. DESCRIPTION OF THE RULE DRAFTING PROCESS

D.1 Development Context

CDS consulted with issuers and their agents to understand the barriers to compliance with the existing requirements for electronic payment of entitlements, and to design exceptions responsive to the circumstances of these issuers and their agents.

D.2 Rule Drafting Process

Each amendment to the CDS Participant Rules is reviewed by CDS's Legal Drafting Group ("LDG"). The LDG is a committee that includes members of Participants' legal and business groups. The LDG's mandate is to advise CDS management and its Board of Directors on rule amendments and other legal matters relating to centralized securities depository and clearing services in order to ensure that they meet the needs of CDS, its Participants and the securities industry. The LDG had no comments on the proposed Rule amendments.

These amendments were reviewed and approved by the Board of Directors of CDS Ltd. on April 22, 2011.

D.3 Issues Considered

CDS balanced the importance of electronic payment of entitlements against the market disruption that would be caused by making a number of securities ineligible for CDS. Substantial progress has been made towards the objective, and issuers and their agents continue to actively work with CDS to resolve the remaining issues. It was determined that imposing a firm deadline without exceptions would be counterproductive to the overall objective, as well as causing disruption to the issuers and to the financial industry in general.

D.4 Consultation

CDS has consulted widely with the financial services sector on this objective, primarily through the SDRC committee structure (CDS's Strategic Development Review Committee) and IIROC committees. CDS has worked closely with issuers and their agents to increase the use of electronic payments for entitlements. Most recently, CDS gave a presentation to the March 31 annual general meeting of STAC (the Stock Transfer Association of Canada), which included a discussion of the eligibility requirement.

Many Canadian transfer agents are not participants of CDS; as such transfer agents are not bound by the CDSX Rules, they do not routinely receive notice of changes to the CDSX Rules. CDS will provide a copy of this Notice to all transfer agents for CDSX eligible securities, to ensure that they are fully informed of the CDS policy with respect to the electronic payment of entitlements, and the anticipated implementation of the new CPSS/IOSCO standards.

D.5 Alternatives Considered

The alternative would be to have the eligibility requirement become effective on November 1, 2011 without exceptions. However, it was determined that to make the securities of these issuers ineligible would cause considerable disruption to participants, to their customers and to the issuers in question. For this reason, it was determined that exceptions should be made, as set out in the proposed Rule amendments.

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 Rules may become effective upon approval of the amendments by the Recognizing Regulators following public notice and comment.

E. TECHNOLOGICAL SYSTEMS CHANGES

The proposed exceptions to the entitlement payment requirement will not require any system changes for CDS, participants or other financial institutions.

F. COMPARISON TO OTHER CLEARING AGENCIES

CDS's eligibility Rule, and the proposed exception to it, are adapted to the Canadian financial market and there is no direct comparison to other clearing agencies.

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:

Legal Department
CDS Clearing and Depository Services Inc.
85 Richmond Street West
Toronto, Ontario M5H 2C9

Fax: 416-365-1984
e-mail: attention@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
Market Regulation Branch
Ontario Securities Commission
Suite 1903, Box 55,
20 Queen Street West
Toronto, Ontario, M5H 3S8

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

Télécopieur: (514) 864-6381

Courrier électronique: consultation-en-cours@lautorite.qc.ca

CDS will make available to the public, upon request, all comments received during the comment period.

I. PROPOSED CDS RULE AMENDMENTS

Appendix "A" contains text of current CDS Participant Rules marked to reflect proposed amendments as well as text of these rules reflecting the adoption of the proposed amendments.

APPENDIX "A"

PROPOSED CDS RULE AMENDMENTS

[NOTE – for marked text of rules, additions are underlined; deletions are strikethrough text]

Text of CDS Participant Rules marked to reflect proposed amendments	Text CDS Participant Rules reflecting the adoption of proposed amendments
<p>Rule 1 DOCUMENTATION 1.6 OVERVIEW OF CDSX SERVICES 1.6.2 Eligibility of Securities and Currencies</p> <p>Only Securities that CDS has determined are eligible may be deposited into or held in the Depository Service. CDS may determine from time to time the currencies in which Funds Accounts of Ledgers may be denominated and the classes of Securities for which Transactions may be processed in a particular Service or Function. CDS may determine from time to time that a particular Security shall be ineligible for the Depository Service or for any Service or Function. Securities may be made eligible for the Depository Service only if there is competent legislation providing that transactions in Securities of that class may be effected by entries made on the records of CDS. Notwithstanding the foregoing, the fact that no such legislation is found to be applicable to a Security shall not limit the effect and finality of the transfer of such Security to CDS on deposit into the Depository Service, nor of any Transaction or Settlement effected through the Services in respect of such Security. On November 1, 2011, those Securities in respect of which entitlement payments are not made by Acceptable Payments or Funds Transfer will be made ineligible for the Depository Service, <u>subject to exceptions established by CDS based on criteria including the amount of the entitlement payment, the means by which the entitlement payment is made or the classification of the issuer making the entitlement payment.</u></p>	<p>Rule 1 DOCUMENTATION 1.6 OVERVIEW OF CDSX SERVICES 1.6.2 Eligibility of Securities and Currencies</p> <p>Only Securities that CDS has determined are eligible may be deposited into or held in the Depository Service. CDS may determine from time to time the currencies in which Funds Accounts of Ledgers may be denominated and the classes of Securities for which Transactions may be processed in a particular Service or Function. CDS may determine from time to time that a particular Security shall be ineligible for the Depository Service or for any Service or Function. Securities may be made eligible for the Depository Service only if there is competent legislation providing that transactions in Securities of that class may be effected by entries made on the records of CDS. Notwithstanding the foregoing, the fact that no such legislation is found to be applicable to a Security shall not limit the effect and finality of the transfer of such Security to CDS on deposit into the Depository Service, nor of any Transaction or Settlement effected through the Services in respect of such Security. On November 1, 2011, those Securities in respect of which entitlement payments are not made by Acceptable Payments or Funds Transfer will be made ineligible for the Depository Service, subject to exceptions established by CDS based on criteria including the amount of the entitlement payment, the means by which the entitlement payment is made or the classification of the issuer making the entitlement payment.</p>
<p>RULE 6 DEPOSITORY SERVICE 6.2 DEPOSIT OF SECURITIES 6.2.1 Eligibility</p> <p>Only Securities that CDS has determined are eligible may be deposited into or held in the Depository Service. CDS may determine from time to time the classes of Securities for which Transactions may be processed in a particular Service or Function. CDS may determine from time to time that a particular Security shall be ineligible for the Depository Service or for any Service or Function. Securities may be made eligible for the Depository Service only if there is competent legislation providing that transactions in Securities of that class may be effected by entries made on the records of CDS. The Procedures and User Guides describe the types of Securities that CDS has determined are eligible for the Depository Service. For each eligible Security, facilities for deposit (and, if applicable, withdrawal) are provided by one of CDS, Bank of Canada, the Transfer Agent for the Issuer, the Issuer acting as its own registrar, a Security Validator or a Custodian. On November 1, 2011, those Securities in respect of which entitlement payments are not made by Acceptable Payments or Funds Transfer will be made ineligible for the</p>	<p>RULE 6 DEPOSITORY SERVICE 6.2 DEPOSIT OF SECURITIES 6.2.1 Eligibility</p> <p>Only Securities that CDS has determined are eligible may be deposited into or held in the Depository Service. CDS may determine from time to time the classes of Securities for which Transactions may be processed in a particular Service or Function. CDS may determine from time to time that a particular Security shall be ineligible for the Depository Service or for any Service or Function. Securities may be made eligible for the Depository Service only if there is competent legislation providing that transactions in Securities of that class may be effected by entries made on the records of CDS. The Procedures and User Guides describe the types of Securities that CDS has determined are eligible for the Depository Service. For each eligible Security, facilities for deposit (and, if applicable, withdrawal) are provided by one of CDS, Bank of Canada, the Transfer Agent for the Issuer, the Issuer acting as its own registrar, a Security Validator or a Custodian. On November 1, 2011, those Securities in respect of which entitlement payments are not made by Acceptable Payments or Funds Transfer will be made ineligible for the Depository Service, subject to</p>

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<p>Depository Service, <u>subject to exceptions established by CDS based on criteria including the amount of the entitlement payment, the means by which the entitlement payment is made or the classification of the issuer making the entitlement payment.</u></p> <p>RULE 11 TA PARTICIPANTS 11.3 OPERATIONS 11.3.1 Eligibility of Securities</p> <p>In accordance with Rule 1.6.2, the Board of Directors determines from time to time the classes of Securities that may be made eligible for the Depository Service and the classes of Securities for which Transactions may be processed in particular Services or Functions. The Procedures and User Guides describe the types of Securities that are eligible for the Depository Service. Not all Securities for which a Participant is the Transfer Agent of the Issuer may be eligible. A TA Participant that is the Transfer Agent for a Security that has been made eligible for CDSX shall confirm or reject the Deposit and Withdrawal of such Securities and provide a Closing Balance Report to CDS for that Security. A TA Participant is not obliged to assume the role of a CDSX Depository Agent or Entitlements Processor with respect to a particular Security by reason only that it is the agent of the offeror or the Issuer with respect to that Security. On November 1, 2011, those Securities in respect of which entitlement payments are not made by Acceptable Payments or Funds Transfer will be made ineligible for the Depository Service, <u>subject to exceptions established by CDS based on criteria including the amount of the entitlement payment, the means by which the entitlement payment is made or the classification of the issuer making the entitlement payment.</u></p> <p>11.6 ENTITLEMENTS 11.6.1 Payment of Entitlements</p> <p>An entitlement payment received by CDS with respect to Securities held for a Participant in the Depository Service is distributed to the Participant by CDS pursuant to Rule 7.</p> <p>Transition Period</p> <p>Subject to Rule 11.6.1(b) below, the TA Participant and CDS will co-operate and use their best efforts to arrange for an entitlement to be paid either (i) by an Entitlements Processor acting on behalf of the Issuer, by means of a credit to the CDS Entitlements Ledger from its Funds Account, or (ii) by the Issuer or its Entitlements Processor, by means of an LVTS or Fedwire payment to the bank account specified by CDS.</p> <p>Future Payment of Entitlements</p> <p>On November 1, 2011, the TA Participant will arrange for all entitlements to be paid by means of Acceptable Payments (as defined in Rule 8.2.5) or Funds Transfer, <u>subject to exceptions established by CDS based on criteria including the amount of the entitlement payment, the means by which the entitlement payment is made or the classification of the</u></p>	<p>exceptions established by CDS based on criteria including the amount of the entitlement payment, the means by which the entitlement payment is made or the classification of the issuer making the entitlement payment.</p> <p>RULE 11 TA PARTICIPANTS 11.3 OPERATIONS 11.3.1 Eligibility of Securities</p> <p>In accordance with Rule 1.6.2, the Board of Directors determines from time to time the classes of Securities that may be made eligible for the Depository Service and the classes of Securities for which Transactions may be processed in particular Services or Functions. 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