

13.3.2 Material Amendments to CDS Procedures – Change to Federally Guaranteed Class Code – Request for Comments

CDS CLEARING AND DEPOSITORY SERVICES INC. (CDS®)

MATERIAL AMENDMENTS TO CDS PROCEDURES

CHANGE TO FEDERALLY GUARANTEED CLASS CODE

REQUEST FOR COMMENTS

A. DESCRIPTION OF THE PROPOSED CDS PROCEDURE AMENDMENTSURE AMENDMENTS

The proposed change is to remove the ACV sector limit for federally guaranteed securities, and remove one of the class codes to have only one class code for federally guaranteed securities.

B. NATURE AND PURPOSE OF THE PROPOSED CDS PROCEDURE AMENDMENTS

Largely due to the systemic risk concerns that could result from a default of an extender of credit, the federated participant or a settlement agent and their associated family members, CDS applies restrictions on the amount of ACV that can be created by certain types of securities held by these participants. These restrictions are called sector limits. These limits can be distributed among family-member companies. Participants can acquire securities above their sector limits in their ledgers. However, their value is not included in the ACV for that ledger. Non-family member receivers of credit are not subject to these sector limits.

The following table provides details of the sector limits applied to different types of securities:

Sector Limits Applied to the Calculation of ACV	
Sector limit	Description
Government sector limit (GSL)	Calculated as 25% of the company cap and is made up of non-federal-government-sector-issued securities (provincial debt, federally guaranteed debt and provincially guaranteed debt).
Private sector limit (PSL)	Calculated as 15% of the company cap and is made up of private-sector-issued debt securities.
Unrated debt limit (UDL)	Set at zero and is made up of unrated public sector bonds and unrated municipal bonds.
High yield debt limit (HYL)	\$100 million or less, as elected by the participant, to be shared between the participant and their family member(s) and is made up of BBB-rated corporate debt (high yield bonds).
Federal U.S. limit (FTL)	Set at zero and made up of U.S. Treasury securities.
Equity sector limit (ESL)	\$100 million or less, as elected by the participant, to be shared between the participant and their family member(s). This amount is deducted from the participant's existing PSL.

There is no limit on the amount of ACV that can be made up of federal government securities (i.e., those issued by the Government of Canada). However, securities that have been guaranteed by the Government of Canada are subject to the Government Sector Limit (GSL). Since the federally guaranteed securities are a direct obligation of the Government of Canada, and are backed by full faith and guarantees of the Government of Canada, CDS believes that the imposition of sector limits on federally guaranteed securities unnecessarily restricts ACV for participants subject to sector limits. Although some of the federally guaranteed securities may not be as actively traded as the Government of Canada issues, the actively traded federally guaranteed securities normally trade at a very narrow and consistent spread to similar maturity Government of Canada securities. Since these securities do not present credit risk similar to Government of Canada issues, sector limits for these securities should be removed.

Since the implementation of CDSX in 2003, there have been two security class codes (XG and FG) associated with federally guaranteed securities. The vast majority of federally guaranteed securities have been given the security class code of XG. CDS believes that splitting federally guaranteed securities into different class codes does not provide value, and therefore that the security class code for federally guaranteed debt be limited to just one.

C. IMPACT OF THE PROPOSED CDS PROCEDURE AMENDMENTS

C.1 Competition

None.

C.2 Risks and Compliance Costs

There are no risk and compliance costs associated with the change. There are no adverse effects on participants' ability to collateralize their settlement activity.

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 changes are consistent with all relevant international standards.

D. DESCRIPTION OF THE PROCEDURE DRAFTING PROCESS

D.1 Development Context

The proposed amendments were developed by CDS and reviewed and recommended for approval by the Risk Advisory Committee on December 8, 2009.

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 March 24, 2011.

D.3 Issues Considered

See above.

D.4 Consultation

See above.

D.5 Alternatives Considered

See above.

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.

E. TECHNOLOGICAL SYSTEMS CHANGES

E.1 CDS

CDS will implement a system change to remove the class code FG. All issuers designated with a class code with FG will be assigned a class code XG.

E.2 CDS Participants

No changes are required.

E.3 Other Market Participants

No changes are required.

F. COMPARISON TO OTHER CLEARING AGENCIES

Information is not available from other CSDs in order to conduct a 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 [•Autorité des marchés financiers Bulletin if this is the translated version•] to:

David Stanton
Chief Risk Officer
CDS Clearing and Depository Services Inc.
85 Richmond Street West
Toronto, Ontario M5H 2C9

Phone: (416) 365-8489
Email: dstanton@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 de l'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.gc.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

Attached at Appendix A are the clean and blacklined versions of the proposed procedural amendments.

Access to the proposed amendments to the CDS Procedures is also provided on the User documentation revisions web page (<http://www.cds.ca/cdsclearinghome.nsf/Pages/-EN-blacklined?Open>) and to the CDS Forms (if applicable) on Forms online (Click View by Form Category and in the Select a Form Category list, click External review) on the CDS Services web page (www.cdsservices.ca).

"APPENDIX A"

CHAPTER 10 AGGREGATE COLLATERAL VALUE
Sector limits

Security type	Term to maturity				
	0 to 1 year	1 to 3 years	3 to 5 years	5 to 10 years	Greater than 10 years
Corporate BB	100.0%				
Corporate B	100.0%				
Corporate C	100.0%				
U.S. Treasury bills, notes and bonds (interest-bearing and zero-coupon bonds) ¹	2.0%			5.0%	

¹ The value of U.S. Treasury securities is determined using NSCC haircuts that apply to zero-coupon bonds.

Haircut rates for new issues

A standard haircut rate of 25 per cent is applied to all new equity issues, unless the haircut rate is not appropriate for the particular new issue. The standard haircut rate is reviewed and validated on a regular basis, and CDS reserves the right to adjust the rate. After the initial 20-day period has elapsed, the haircut rate is calculated by the Internal Risk Management System (IRMS) at the next haircut calculation run, subject to the minimum haircut rate of 15 per cent for the first year.

Haircut rates for equities with static prices

For equities with no price change for a period of 20 or more consecutive days in the most recent 260-day price history, CDS applies a default haircut rate of 75 per cent.

10.6 Sector limits

Sector limits are applicable to extenders of credit, federated participants and settlement agents, and their family members. The sector limits indicated in the table below ensure that a participant's ACV is not concentrated in certain types of securities.

Sector limit	Field	Description
Government sector limit	GSL	Calculated as 25 per cent of the company cap and is made up of non-federal-government-sector-issued securities (provincial debt, federally-guaranteed debt and provincially-guaranteed debt)
Private sector limit	PSL	Calculated as 15 per cent of the company cap and is made up of private-sector-issued debt securities
Unrated debt limit	UDL	Set at 0 and is made up of unrated public sector bonds and unrated municipal bonds

CHAPTER 10 AGGREGATE COLLATERAL VALUE
CDSX issuer ratings

Sector limit	Field	Description
High yield debt limit	HYL	\$100 million or less, as elected by the participant, to be shared between the participant and their family member(s) and is made up of BBB-rated corporate debt (high yield bonds)
Federal U.S. limit	FTL	Set at 0 and made up of U.S. Treasury securities
Equity sector limit	ESL	\$100 million or less, as elected by the participant, to be shared between the participant and their family member(s). This amount is deducted from the participant's existing PSL

Receivers of credit are given the maximum amount (i.e., 99,999,999,999) for each sector limit.

There is no limit on the amount of ACV that can be made up of federal government securities (i.e., those issued by the Government of Canada) or federally-guaranteed securities. However, limits are placed at the family level on the amount of sector limit securities that may be counted towards that ledger's ACV. Like the initial ACV, these limits are distributed among family-member companies. Participants can acquire securities above their sector limits, however, their value will not be included in the ACV for that ledger.

10.7 CDSX issuer ratings

A CDSX issuer rating is applied to every debt issue deposit and is used to assess the quality of an issuer's securities. The rating is used in determining the haircut percentage applied by the ACV edit. Issuers rated BB, B or C are not used in the ACV edit. For more information, see [Haircuts](#) on page 109.

CDS uses the lowest available rating from the Dominion Bond Rating Service (DBRS) and Standard & Poor's Corp. (S&P) to assign the CDSX issuer rating. The table below compares each agency's rating scale with the CDSX ratings.

DBRS			S & P		CDSX Rating
Short-term debt	Long-term debt		Short-term debt	Long-term debt	
R-1	High	AAA	A-1+	AAA	AAA
	Middle	AA		AA	AA
	Low	A	A-1	A	A
R-2	High	BBB	A-2	BBB	BBB
	Middle	BB	A-3	BB	BB
	Low	B	B	B	B

CHAPTER 10 AGGREGATE COLLATERAL VALUE
Sector limits

Security type	Term to maturity				
	0 to 1 year	1 to 3 years	3 to 5 years	5 to 10 years	Greater than 10 years
Unrated munis	20.0%	21.0%	22.0%	23.5%	25.0%
Corporate BBB	30.0%		32.0%	33.0%	35.0%
Corporate BB	100.0%				
Corporate B	100.0%				
Corporate C	100.0%				
U.S. Treasury bills, notes and bonds (interest-bearing and zero-coupon bonds) ¹	2.0%			5.0%	

¹ The value of U.S. Treasury securities is determined using NSCC haircuts that apply to zero-coupon bonds.

Haircut rates for new issues

A standard haircut rate of 25 per cent is applied to all new equity issues, unless the haircut rate is not appropriate for the particular new issue. The standard haircut rate is reviewed and validated on a regular basis, and CDS reserves the right to adjust the rate. After the initial 20-day period has elapsed, the haircut rate is calculated by the Internal Risk Management System (IRMS) at the next haircut calculation run, subject to the minimum haircut rate of 15 per cent for the first year.

Haircut rates for equities with static prices

For equities with no price change for a period of 20 or more consecutive days in the most recent 260-day price history, CDS applies a default haircut rate of 75 per cent.

10.6 Sector limits

Sector limits are applicable to extenders of credit, federated participants and settlement agents, and their family members. The sector limits indicated in the table below ensure that a participant's ACV is not concentrated in certain types of securities.

Sector limit	Field	Description
Government sector limit	GSL	Calculated as 25 per cent of the company cap and is made up of non-federal-government-sector-issued securities (provincial debt and provincially-guaranteed debt)
Private sector limit	PSL	Calculated as 15 per cent of the company cap and is made up of private-sector-issued debt securities
Unrated debt limit	UDL	Set at 0 and is made up of unrated public sector bonds and unrated municipal bonds

CHAPTER 10 AGGREGATE COLLATERAL VALUE
CDSX issuer ratings

Sector limit	Field	Description
High yield debt limit	HYL	\$100 million or less, as elected by the participant, to be shared between the participant and their family member(s) and is made up of BBB-rated corporate debt (high yield bonds)
Federal U.S. limit	FTL	Set at 0 and made up of U.S. Treasury securities
Equity sector limit	ESL	\$100 million or less, as elected by the participant, to be shared between the participant and their family member(s). This amount is deducted from the participant's existing PSL

Receivers of credit are given the maximum amount (i.e., 99,999,999,999) for each sector limit.

There is no limit on the amount of ACV that can be made up of federal government securities (i.e., those issued by the Government of Canada) or federally-guaranteed securities. However, limits are placed at the family level on the amount of sector limit securities that may be counted towards that ledger's ACV. Like the initial ACV, these limits are distributed among family-member companies. Participants can acquire securities above their sector limits, however, their value will not be included in the ACV for that ledger.

10.7 CDSX issuer ratings

A CDSX issuer rating is applied to every debt issue deposit and is used to assess the quality of an issuer's securities. The rating is used in determining the haircut percentage applied by the ACV edit. Issuers rated BB, B or C are not used in the ACV edit. For more information, see [Haircuts](#) on page 109.

CDS uses the lowest available rating from the Dominion Bond Rating Service (DBRS) and Standard & Poor's Corp. (S&P) to assign the CDSX issuer rating. The table below compares each agency's rating scale with the CDSX ratings.

DBRS			S & P		CDSX Rating
Short-term debt		Long-term debt	Short-term debt	Long-term debt	
R-1	High	AAA	A-1+	AAA	AAA
	Middle	AA		AA	AA
	Low	A	A-1	A	A
R-2	High	BBB	A-2	BBB	BBB
	Middle	BB	A-3	BB	BB
	Low	B	B	B	B