

## Chapter 13

# SROs, Marketplaces and Clearing Agencies

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### 13.3 Clearing Agencies

#### 13.3.1 CDS Notice and Request for Comments – Material Amendments to CDS Procedures – Issue and Entitlement Procedures – Other Securities

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

##### MATERIAL AMENDMENTS TO CDS PROCEDURES

##### ISSUE AND ENTITLEMENT PROCEDURES – OTHER SECURITIES

##### REQUEST FOR COMMENTS

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

The amendments being proposed will provide qualified CDS participants with the ability to issue and maintain security positions in CDSX in an uncertificated format. These changes will provide another option for issuers to issue their securities and is a further step supporting the Canadian capital markets' move towards a dematerialized environment.

On August 3, 2010, CDS will be implementing new eligibility fees to discourage the issuance of new securities in certificated form and to cover the costs and risks to CDS involved in receiving and processing physical certificates for custody. The new fees will be applied at the time that CDS is requested to make an issue eligible for its clearing and depository services and will be based on whether a certificate is held by CDS. The new fees are as follows:

- \$1,000 for an issue where CDS receives one or more definitive certificates for custody
- \$500 for a book-entry-only (BEO) issue where CDS receives one or more global certificates for custody
- \$0 for issues received by CDS to be held in an uncertificated format, either by CDS, a transfer agent or a qualified participant

At the time that the new eligibility fees were announced, CDS began discussions with some of its participants who are also issuing agents for their clients. Those discussions centered on the options that an issuer had for issuing their securities and the impact the new fees would have on them. In the current environment the issues managed by the participants are typically issued in the BEO format and are represented by one or more global certificates held in CDS's vaults. Examples of the type of security issued in this manner are the medium-term note (MTN) issues. Once the new fee is implemented, this type of issuance would attract the \$500 fee for each security issued.

At the same time as these discussions were taking place CDS was also undertaking a project to review money market processes. As a result of the money market project a number of rules and procedures were revised to provide clarity to the roles and responsibilities of a money market issuing agent. Those rules and procedures came into effect on April 5, 2010. In a review of those rules and procedures CDS concluded that they also would accommodate non-money market securities and therefore provide an option for participants to issue other securities in an uncertificated format.

Under CDS's rules there are clear definitions for the roles that a participant can perform when acting as an issuing agent, with specific qualification criteria for each of the roles. The roles that participants could undertake are: ISIN Activator, Security Validator, Entitlement Processor and Custodian. For money market securities a participant must assume three of those roles: ISIN Activator, Security Validator and Custodian, with the Entitlement Processor as an option. For other types of securities, a participant may fulfill one or more of these roles, except the ISIN Activator role, which would remain a CDS activity. All participants must submit an application if they want to perform any of the roles of ISIN Activator, Security Validator or Custodian.

If a qualified participant were to undertake the role of Security Validator they could issue the non-money market securities in an uncertificated format and therefore would not attract the new eligibility fee for those issues. In performing the Security Validator role a participant confirms all deposit and withdrawal requests in CDSX and must reconcile the issuer's register with CDS's records.

Participants also may decide to assume the roles of Entitlement Processor or Custodian, if the qualifications are met. The Custodian role would only be required if that participant was to hold one or more physical certificates for the issue. In the event that the participant holds the certificate(s) as custodian, CDS would consider this to be a case of dealing with an uncertificated security for the purpose of deciding the applicable eligibility fee, provided that CDS is not charged a custody fee.

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

For money market securities there are procedures in place that detail the processes and controls that must be followed for participants to comply with the applicable rules associated with those securities. Since non-money market issuing agents would be assuming most of the same roles and responsibilities, CDS determined that a new set of procedures comparable to the procedures applicable for money market securities should be created to accommodate these types of securities.

The new procedures document the roles and responsibilities of Security Validator, Custodian and Entitlement Processor and the standards and controls to be applied for each of those roles. The application for participants has been amended to include the non-money market processes so that a single application may be used by interested participants. Schedule A has been amended to allow participants to select the option of acting as security validator or custodian for non-money market securities. In addition, two changes have been made to respond to problems identified when the initial participants completed the applications: (i) section 3 now requires a participant to insert the name of its parent when the participant's qualification relies on that parent's status; (ii) the execution format has been clarified. Also, standards and an annual certification have been created to accommodate other securities.

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

(a) CDS Clearing

CDS Clearing will monitor all participants who qualify for any of the roles as outlined in section C.2 below.

(b) CDS Participants

CDS participants who wish to apply for any of these roles must meet the qualifications outlined in the rules and procedures. Participants will also have to review their issuer's documentation to determine if those issues can be held in an uncertificated format or if they must remain in a certificated state.

Any participants that apply for these roles must also implement the standards and controls associated with the roles.

(c) Other Market Participants

There is no impact to other market participants.

(d) Securities and Financial Markets in General

There is no impact to the securities or financial markets in general.

**C.1 Competition**

These changes are not expected to have an impact on competition, either for CDS or its participants. The participants that could benefit from the ability to perform these roles are already the issuing agents for their securities.

**C.2 Risks and Compliance Costs**

As part of the money market project CDS will be implementing a number of processes and controls to improve the system and controls and enhance CDS's ability to monitor compliance by the issuing agents. These changes include the production and review of exception reports and undertaking suitable follow-up actions and the collection and review of annual sign-offs from the participants regarding their money market holdings as custodians. Similar processes and controls will be used for non-money market issues held by qualified 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**

As these changes are unique to processing in Canada and for use with CDSX, comparisons with other jurisdictions are not applicable.

## D. DESCRIPTION OF THE PROCEDURE DRAFTING PROCESS

### D.1 Development Context

The procedures have been drafted to create a procedure guide specifically for non-money market issuing agents to provide them with the processes and standards that will apply if they assume any of the defined roles.

### 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 April 29, 2010

### D.3 Issues Considered

The impact of the fees on the ability of CDS's participants to continue to offer these services to their issuers was the issue considered.

### D.4 Consultation

The proposed changes are a consequence of discussions with issuers and their issuing agents and the impact of the new eligibility fees on those issuers. At its meeting on March 2, 2010, CDS's executive management group, the Strategy Group, reviewed and approved the approach that resulted in the amendments being proposed.

### D.5 Alternatives Considered

The alternative to making the proposed changes would be to maintain the status quo. The potential result of the status quo would be that the issuers of non-money market issues, such as MTNs, would have to look beyond their current arrangements with the participants that act as their issuing agents to other providers, such as transfer agents or CDS's registrar and paying agent (RPA) service, in order to issue and maintain their client's securities in uncertificated form. As the status quo would have limited issuers' choices, the proposed changes were considered appropriate in order to allow issuers the choice of maintaining their current relationships with their issuing agents and issue their securities in uncertificated form.

### 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 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

These changes will not result in any technological changes for CDS's systems.

### E.2 CDS Participants

CDS participants that decide to apply for any of the roles must ensure that they can provide CDS with the nightly reconciliation file that is used to balance each issue's register with CDS's records. It is likely that, in most cases, the participants that apply for these roles will also be money market issuers and therefore will have already developed the programs and processes required to provide the reconciliation file to CDS. CDS also offers an on-line version of the reconciliation file for those participants that decide not to develop the more robust file version of the reconciliation record.

**E.3 Other Market Participants**

These changes do not impact any other market participants.

**F. COMPARISON TO OTHER CLEARING AGENCIES**

Since these changes are unique to processing in Canada and for use with CDSX, comparisons with other clearing agencies are not applicable.

**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:

Mike Polak  
Director, Operations Support  
CDS Clearing and Depository Services Inc.  
85 Richmond Street West  
Toronto, Ontario M5H 2C9

Fax: 416-365-3856  
e-mail: [mpolak@cds.ca](mailto:mpolak@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 del'Autorité  
Autorité des marchés financiers  
800, square Victoria, 22<sup>e</sup> étage  
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e-mail: [marketregulation@osc.gov.on.ca](mailto: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 marked-up amendments to the CDS Procedures 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](http://www.cdsservices.ca)).