

13.1.5 Material Amendments to CDS Procedures – FINet Intraday Netting – Request for Comments

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

**MATERIAL AMENDMENTS TO CDS PROCEDURES**

**FINET INTRADAY NETTING**

**REQUEST FOR COMMENTS**

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

The proposed amendments to the CDS procedures are designed to illustrate the differences between the eligible trades that are considered for the FINet intraday and end-of-day netting processes.

The CDS Procedures marked for the amendments may be accessed at the CDS website at:

<http://www.cds.ca/cdsclearinghome.nsf/Pages/-EN-blacklined?Open>.

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

The proposed amendments to the CDS procedures, relative to the change being made to the intraday netting process, is based on a request from participants that subscribe to the FINet service. This request was made during the May 14, 2009 FINet Working Group meeting. Some FINet participants are currently not allowing some of their FINet eligible trades to be netted by FINet, because the intraday netting process nets eligible trades regardless of their value dates. When the FINet intraday netting process runs at approximately 2:00 p.m. ET, some participants need to have the ability to modify their eligible future value-dated trades but, once a trade is netted, many of its details can no longer be modified. As such, some participants have requested that CDS exclude FINet eligible trades with a future value date, from the 2:00 PM intraday netting cycle and to net these trades at the end of day (approximately 5:30 PM) instead. Members of the FINet working group have concurred with this change. Modifying the intraday netting process so that it will only net eligible current or past value-dated trades (i.e. not new eligible future value-dated trades), will address this problem and facilitate the inclusion of more eligible trades in FINet which will benefit all of the participants that subscribe to FINet.

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

Participants will need to be aware that eligible future value-dated trades will no longer be netted during the FINet intraday netting process. Eligible future value-dated trades will continue to be netted as part of the FINet end-of-day netting process.

FINet participant fund requirements may be impacted (i.e. increased/decreased) as fewer eligible trades may be netted during the FINet intraday netting process and more eligible trades may be netted during the FINet end-of-day netting process.

**C.1 Competition**

There is no impact to competition as CDS is the sole provider of a fixed income netting and settlement service in Canada.

**C.2 Risks and Compliance Costs**

No known risks or compliance costs will be introduced to CDS or its participants because of the change to the FINet intraday netting process.

**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**

FINet exceeds the standards in terms of credit exposures. Mark-to-market occurs twice a day using current prices. CDS also back-tests FINet participant fund collateral requirements to ensure that they are sufficient and potential losses are limited through documented default procedures and a loss allocation mechanism.

Furthermore, FINet has its own participant fund designed to contain the losses resulting from the default of a participant (who subscribes to FINet) without spill-over to other services. Participants who subscribe to FINet provide collateral to the participant fund and each participant's collateral requirement represents an estimate of the potential loss that their default could create.

## **D. DESCRIPTION OF THE PROCEDURE DRAFTING PROCESS**

### **D.1 Development Context**

Development/testing is required in order to modify the FINet intraday netting process so that only eligible current or past value-dated trades are considered:

- The existing procedure (Section 5.6 – FINet netting of Chapter 5 – FINet within the Trade and Settlement Procedures) describes the FINet netting processes. Text has been added that describes the difference between the intraday and end-of-day netting processes.
- The existing procedure (Section 18.4.1 – Settlement today marks of Chapter 17 – FINet Participant Fund within Participating in CDS services) describes the intraday and end-of-day marking processes. Text related to extracted eligible non-exchange trades has been removed.

### **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.

The proposed amendments were reviewed and approved by the SDRC on August 27, 2009.

### **D.3 Issues Considered**

No issues related to the procedural amendments associated with FINet intraday netting and/or new instrument types were identified/considered.

In addition, all of the FINet participants were asked to comment on the proposed change to the FINet intraday netting process and no potential issues were brought to CDS's attention.

### **D.4 Consultation**

Input to the proposed amendments to the procedures was provided by participants, as well as, staff from CDS's Customer Service & Product Development and Risk Management divisions.

### **D.5 Alternatives Considered**

Running the FINet intraday netting process later in the day (i.e. the FINet intraday netting process currently runs at approximately 2:00 p.m. ET) was considered. This alternative was rejected as insufficient time would be available for participants to satisfy their intraday collateral requirements.

### **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.

A CDS Bulletin will also be released prior to implementing the changes to the FINet intraday netting process.

**E. TECHNOLOGICAL SYSTEMS CHANGES**

No technological systems changes are required by CDS's participants or other market participants however, development/testing will be required by CDS in order to change the FINet intraday netting extraction process.

The FINet intraday netting extraction process will be modified so that eligible future value-dated trades are not netted (only eligible current or past value-dated trades will be netted).

**F. COMPARISON TO OTHER CLEARING AGENCIES**

The Depository Trust Clearing Corporation, through its subsidiary, the Fixed Income Clearing Corporation ("FICC") provides a fixed income netting service in the U.S. CDS's previous fixed income netting service (DetNet) was modeled after DTCC's Government Securities Clearing Corporation ("GSCC"), the predecessor of the FICC. CDS's new fixed income netting service (FINet) is an enhancement to DetNet and is similar to FICC's Government Securities Division (GSD).

**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:

Rob Argue  
Senior Product Manager, Product Development  
CDS Clearing and Depository Services Inc.  
85 Richmond Street West  
Toronto, Ontario M5H 2C9  
Telephone: 416-365-3887  
Fax: 416-365-0842  
Email: [rargue@cds.ca](mailto:rargue@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  
C.P. 246, tour de la Bourse  
Montréal, Québec, H4Z 1G3  
Télécopieur: (514) 864-6381

Courrier électronique: [consultation-en-cours@lautorite.qc.ca](mailto:consultation-en-cours@lautorite.qc.ca)

Manager, Market Regulation  
Capital Markets 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](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**

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

APPENDIX “A” – PROPOSED CDS PROCEDURE AMENDMENTS

Text of CDS Participant Procedures marked to reflect proposed amendments	Text CDS Participant Procedures reflecting the adoption of proposed amendments												
<p><b>5.6 FINet netting</b></p> <p>FINet-eligible trades are entered and confirmed in CDSX following the same process as all other non-exchange trades; however, when the FINet netting process (intraday and end-of-day) is running, netted trades cannot be modified by online interface, InterLink messages or files. For more information, see Trade eligibility on page 44.</p> <p><u>The FINet intraday netting process only nets eligible trades with value dates that are equal to or less than the current business date, while the FINet end-of-day netting process nets eligible trades regardless of their value dates.</u></p> <p>As part of the FINet netting process (intraday and end-of-day), trades are reviewed for FINet eligibility and are then netted as follows:</p> <p>Individual trades are deleted from CDSX and replaced with a single net trade. The net trade is either a buy or sell transaction between CDS’s CUID (ZNET) and each applicable FINet participant for each security and value date combination.</p> <p>As more trades are netted for each ISIN and value date combination, the details of an existing net trade (if one already exists) are changed or a new net trade is created (if one does not already exist).</p> <p>FINet performs all necessary trade entry and modifications for FINet net trades. Participants are not required to perform any activity on FINet net trades.</p>	<p><b>5.6 FINet netting</b></p> <p>FINet-eligible trades are entered and confirmed in CDSX following the same process as all other non-exchange trades; however, when the FINet netting process (intraday and end-of-day) is running, netted trades cannot be modified by online interface, InterLink messages or files. For more information, see <u>Trade eligibility</u> on page 44.</p> <p>The FINet intraday netting process only nets eligible trades with value dates that are equal to or less than the current business date, while the FINet end-of-day netting process nets eligible trades regardless of their value dates.</p> <p>As part of the FINet netting process (intraday and end-of-day), trades are reviewed for FINet eligibility and are then netted as follows:</p> <p>Individual trades are deleted from CDSX and replaced with a single net trade. The net trade is either a buy or sell transaction between CDS’s CUID (ZNET) and each applicable FINet participant for each security and value date combination.</p> <p>As more trades are netted for each ISIN and value date combination, the details of an existing net trade (if one already exists) are changed or a new net trade is created (if one does not already exist).</p> <p>FINet performs all necessary trade entry and modifications for FINet net trades. Participants are not required to perform any activity on FINet net trades.</p>												
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