

13.1.2 CDS Clearing and Depository Services Inc. (CDS®) - Material Amendments to CDS Procedures - CDS Rule 7.3 - Finet Function - 7.3.2 – Eligibility - Request for Comments

CDS CLEARING AND DEPOSITORY SERVICES INC. (CDS®)

MATERIAL AMENDMENTS TO CDS PROCEDURES

CDS Rule 7.3 - FINET FUNCTION

7.3.2 - Eligibility

REQUEST FOR COMMENTS

A. DESCRIPTION OF THE PROPOSED CDS PROCEDURE AMENDMENTS

FINet procedures replaced DetNet procedures when FINet was implemented on April 27, 2009. The proposed amendment consists of the inclusion of Canada Mortgage Bonds, issued by Canada Housing Trust (CMB's) on the list of FINet-eligible securities. CDS's original intent was to include federally guaranteed corporate bonds as an eligible security type; however, when the procedures were finalized, federally guaranteed corporate bonds were not included on the list of eligible securities (Please see section D3 for further detail regarding FINet eligibility of federally guaranteed securities). The proposed amendment is intended to bring CDS Procedures into line with the intended list of eligible securities.

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

FINet's ability to net more fixed income trading obligations by CDS Participants will increase market efficiency in a number of ways. These efficiencies include better regulatory capital deployment, reduction of counterparty credit limits and risk, greater participation in the netting service and enhanced risk reduction in the fixed income trading markets.

To facilitate making CMB's eligible for FINet (at the request of participants) and to align the external procedure with the related CDS Rule, the CMB instrument type (Other Asset-backed – federally guaranteed) is to be added to section 5.3 – Security eligibility of Chapter 5 – FINet within the Trade and Settlement Procedures.

C. IMPACT OF THE PROPOSED CDS PROCEDURE AMENDMENTS

The eligibility parameters associated with CMB's (federally guaranteed - Other Asset-backed securities) need to be entered into the FINet security eligibility function before these securities will be netted by FINet. No changes are required to FINet in order to allow CMB's to be netted.

The addition of federally guaranteed - Other Asset-backed securities as an eligible instrument type (to section 5.3 – Security eligibility of Chapter 5 – FINet within the Trade and Settlement Procedures) will clearly identify these securities as being eligible for FINet.

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

The netting of CMB's will not introduce any new risk to CDS or its participants.

No known additional compliance costs to participants will result from making CMB's eligible for FINet.

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

The existing procedure (section 5.3 – Security eligibility of Chapter 5 – FINet within the Trade and Settlement Procedures) lists the instrument types that are eligible for FINet. The CMB instrument type (Other Asset-backed – federally guaranteed) has been added to this list.

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 May 28, 2009.

D.3 Issues Considered

- Corporate Actions (e.g. takeovers, mergers and consolidations) – As is the case with provincial and Government of Canada securities, CMB's are not subject to corporate actions and, as such, can be made FINet-eligible.

CDS had originally planned to make federally guaranteed corporate bonds eligible for FINet. However, the reference to the eligibility of federally guaranteed corporate bonds was removed from the related external procedures, as further analysis/development was required in order to address the processing of corporate actions that might occur with these securities.

At the time FINet was brought online, CDS Product Development determined that while extremely unlikely, it is possible for corporate events (i.e. name changes, takeovers, mergers, consolidations, etc.) that involve federally-guaranteed corporate bonds to occur. CDS did not, and does not, have procedures/processes in place to handle these events (and CDS was not prepared to accept the risk of such an event occurring without these procedures/processes being in place), the FINet team decided not to make federally guaranteed corporate bonds eligible for FINet.

The securities that were DetNet eligible (i.e. Government of Canada bonds/t-bills) are not subject to corporate actions such as name changes, mergers, consolidations, etc. As such, we don't need to worry about dealing with the future value-dated netted trades if one of these corporate actions occurs.

The FINet Working Group (which comprises all FINet stakeholders) was advised of the decision *not* to make federally-guaranteed corporate bonds eligible on February 13th, 2009.

A proposal to make CMB's eligible for FINet was tabled and accepted at the May 13, 2009 Risk Advisory Committee (RAC) meeting.

- Availability of current market prices – CDS's price vendor has confirmed that they are able to provide current market prices for the CMBs.
- No other potential issues were identified/considered.

D.4 Consultation

Input to the proposed amendment to the procedures was provided by staff from CDS's Customer Service & Product Development and Risk Management divisions.

D.5 Alternatives Considered

No alternatives to making CMB's eligible for FINet were considered.

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.

A related CDS Bulletin will also be released prior to making CMB’s eligible for FINet.

E. TECHNOLOGICAL SYSTEMS CHANGES

No technological systems changes are required by CDS, CDS’s participants or other market participants.

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:

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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:

M^e Anne-Marie Beaudoin
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Autorité des marchés financiers
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Manager, Market Regulation
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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

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>5.3 Security eligibility</p> <p>The following instrument types are eligible for FINet:</p> <ul style="list-style-type: none"> • Government of Canada bonds • Government of Canada treasury bills • <u>Other asset-backed securities (federally-guaranteed)</u> • Provincial bonds • Provincial notes • Provincial treasury bills. | <p>5.3 Security eligibility</p> <p>The following instrument types are eligible for FINet:</p> <ul style="list-style-type: none"> • Government of Canada bonds • Government of Canada treasury bills • Other asset-backed securities (federally-guaranteed) • Provincial bonds • Provincial notes • Provincial treasury bills. |