

13.1.7 Material Amendments to CDS Rules – Destruction of Non-Transferable Issues – Request for Comment

CDS CLEARING AND DEPOSITORY SERVICES INC. (“CDS”)

MATERIAL AMENDMENTS TO CDS RULES

DESTRUCTION OF NON-TRANSFERABLE ISSUES

REQUEST FOR COMMENTS

A. DESCRIPTION OF THE PROPOSED CDS RULE AMENDMENTS

The majority of security certificates currently stored in CDS’s vaults are non-transferable issues (“NTI”). Issuers of NTI securities are often inactive or insolvent and the lack of transfer agent services generally renders the certificates non-transferable. Consistent with CDS’s strategic goal of promoting dematerialization and to make efforts to reduce the number of security certificates in our vaults, CDS proposes to implement a program whereby certificates representing NTI securities are destroyed by CDS if they have been non-transferable for at least 7 years. In order to allow for destruction of NTI certificates, Rule 6.4.2 “Custody of Securities” should be amended. To evidence a certificate if an issue becomes active again, CDS will retain electronic images of destroyed certificates. Even though certificates will be destroyed, the Participant’s ledger position in CDSX and inventory position will be maintained.

B. NATURE AND PURPOSE OF THE PROPOSED CDS RULE AMENDMENTS

The amendments proposed pursuant to this Notice are considered material amendments as they are amendments required to allow CDS to destroy security certificates of non-transferable issues. CDS will enhance its insurance policy to include a bond of indemnity to replace the security certificate(s) destroyed as a result of this program. If an NTI issue becomes active in the future, and the issuer will not process the transfer when presented with the electronic image of the destroyed certificate, CDS will rely on its insurance coverage if required to replace the certificate of an NTI issue that was destroyed pursuant to the program.

C. IMPACT OF THE PROPOSED CDS RULE AMENDMENTS

As of November 30, 2008, CDS held 6,753 NTI issues (represented by 154,988 security certificates in its vaults), representing approximately 75% of its entire certificate inventory. Over an 18 month period, NTI issues increased by an average of .34% per month: using this percentage increase, if the proposed program is not approved, this would mean that by August 31, 2014, approximately 8,602 NTI issues (and therefore even greater number of security certificates) would be required to be stored in CDS’s vault. Implementation of a program for destruction of security certificates of NTI will significantly reduce the physical inventory of certificates that are held in CDS’s vaults. Because significant costs and risks are associated with ongoing maintenance of custody, control and audit of security certificates, NTI certificate destruction will reduce both CDS’s costs and risks and industry costs, and savings can then be passed on to Participants. In terms of impacts to Participants, since this is an inventory management matter, the positions of Participants in NTIs will not be altered by the program. Participants continue to have the choice to either maintaining their positions in CDSX or have the position removed and replaced by a depository acknowledgement. In addition, Participants will be offered a deposit window where they can bring certificates of eligible NTI issues that are held in their vaults to CDS for destruction. There should be no impact to other market participants or the securities and financial markets in general.

C.1 Competition

There is expected to be no impact on competition.

C.2 Risks and Compliance Costs

CDS will no longer maintain physical custody of security certificates for NTIs, thereby realizing significant cost savings associated with vaulting NTIs. CDS will maintain insurance coverage or bond of indemnity for voluntary destruction of NTI certificates. The insurance coverage will cover the risk of a financial loss to CDS in case a certificate is destroyed, requiring CDS to get the certificate replaced, or if a transfer agent refuses to recreate positions for CDS if the issue becomes active or transferable again.

CDS will acquire IBM FileNet image management software, scanners and the services of a commercial shredding company to facilitate destruction of NTI certificates. CDS will maintain controls to reconcile NTI certificates with Security Information Management System (“SIMS”) before the destruction of the NTI certificates, reconcile NTI certificates with IBM’s FileNet image capture software during the NTI destruction process, and reconcile FileNet Images with SIMS once the destruction has been completed.

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 Committee on Payment and Settlement Systems of the Bank of International Settlements, the Technical Committee of the International Organization of Securities Commissions and the Group of Thirty all advocate moving to a dematerialized or at a minimum, an immobilized environment. Although these groups do not refer to the destruction of physical certificates for NTI specifically, the proposed program is in-line with a move to a dematerialized environment and, given the numbers of NTI that in the future become active and transferable, there is low risk involved in this program.

D. DESCRIPTION OF THE RULE DRAFTING PROCESS

D.1 Development Context

CDS Rules do not expressly permit CDS destroying security certificates. Rule 6.4.2 gives CDS discretion to make certain determinations in respect of the custody of securities held in the Depository Service. Accordingly, it is proposed that Rule 6.4.2 be amended to add an additional subsection (f) to allow CDS to determine in its discretion whether or not to destroy any Security Certificate in respect to which transfers have not been available from a Transfer Agent for at least 7 years. CDS determined that 7 years is a reasonable amount of time to wait until the likelihood of an issuer coming back to life. Furthermore, although security certificates are not "data and records", Rule 3.4.6 contemplates CDS archiving data and records and states that CDS is not obliged to retain records for longer than 7 years. This is another reason why 7 years is specifically mentioned in proposed Rule 6.4.2(f). Destruction of NTI certificates is an inventory management process that will be managed by CDS in accordance with its internal procedures.

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.

These amendments were reviewed and approved by the Board of Directors of CDS Ltd. on April 22, 2009.

D.3 Issues Considered

CDS investigated possible solutions that would both achieve the overall objective and benefits of eliminating NTI certificates while continuing to provide Participants with the choice of maintaining their positions or having their positions removed and replaced with a depository acknowledgement. CDS also considered solutions implemented by others. CDS's current lease at 85 Richmond Street West in Toronto will expire in August 2014 and while the costs associated with a new location cannot be projected now, it is possible that the new location will not have a vault or that a custody arrangement with an external party could be put in place. Implementation of an NTI destruction program now will significantly impact the number of certificates in CDS's vaults by 2014 and beyond.

D.4 Consultation

CDS consulted with the transfer agents, custodians and DTC on possible alternatives to deal with the growing number of NTI certificates held in CDS's vaults, as part of CDS's dematerialization strategy, which was approved by CDS's Strategy Group and the CDS Board of Directors.

D.5 Alternatives Considered

CDS considered 4 alternatives before deciding on the proposed program:

1. Destruction of NTI certificates using DTC's model or a variation of DTC's model

DTC's program is described below under Section F of this Notice. A variation of DTC's model was selected: CDS can destroy NTI certificates and CDS Participants do not have to make a choice of either maintaining their positions or removing those positions.

2. Last known Transfer Agent agrees to hold NTI certificates and report those positions to CDS using a daily reconciliation process

This alternative was not selected because there would be a number of NTI issues where the appropriate transfer agent could not be identified. In addition, identification of the last transfer agent would be a manually intensive process since each certificate would have to be reviewed to determine the appropriate transfer agent. The transfer agent community was not in favour of this alternative.

3. One Transfer Agent agrees to hold all NTI issues and report those positions to CDS using a daily reconciliation process

Discussions were held with the two largest transfer agents and they did not have interest in this initiative.

4. A third party custodian is contracted to hold NTI issues on CDS's behalf and report those positions to CDS using a daily reconciliation process

One custodian was approached and provided CDS with a high level proposal which was very expensive, especially given that these costs would be on-going.

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. The target date for implementation is September 21, 2009.

E. TECHNOLOGICAL SYSTEMS CHANGES

E.1 CDS

CDS will create a new process workflow which will identify eligible NTI issues for destruction, which is based on the issue being NTI for 7 years. The certificates identified will be scanned using IBM FileNet image capture software and the image saved in a new database. There will be processes established which will ensure that a certificate cannot be destroyed until the image is taken and stored and that the image cannot be altered or deleted once saved in the FileNet database. CDS's inventory systems will be modified to recognize an image as a valid inventory type.

E.2 CDS Participants

There are no external development impacts to CDS Participants.

E.3 Other Market Participants

There are no external development impacts to other market participants within the Canadian environment.

F. COMPARISON TO OTHER CLEARING AGENCIES

DTC first proposed a program for disposal of worthless warrants, rights and put options in 1990, and over the years, this program has been amended, most recently, receiving approval of the SEC for implementing the current version of NTI destruction program in 2005. DTC's program allows for the destruction of NTI certificates where a participant requests DTC to remove their position in a specified NTI security. This is done by the participant entering the relevant quantity into a DTC function called Position REMoval or "PREM". DTC's analysis showed that most issues that become active again did so within six years of being identified as NTI. This six year timeframe is used within the DTC system to determine when the issue's certificates are eligible for destruction. If an issue has reached the six year time frame and a participant has PREMEd their position, the quantity that was PREMEd can then be destroyed. Once a participant PREMEd a position, they no longer pay custody fees for that position. DTC has procedures in place to take and maintain images of all certificates that are deposited into their system, including NTI issues and to oversee the actual shredding.

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 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
Market Regulation 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.qc.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 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.

Resa Sitzer
Managing Director, Legal

APPENDIX "A"
PROPOSED CDS RULE AMENDMENTS

Text of CDS Participant Rules marked to reflect proposed amendments	Text CDS Participant Rules reflecting the adoption of proposed amendments
<p>6.4.2 Custody of Securities With respect to any Security held in the Depository Service, CDS shall determine how such Securities shall be handled and in particular CDS in its discretion may determine whether or not:</p> <p>(a) to require the issuance of a Security Certificate;</p> <p>(b) to cause any Security Certificate to be issued in bearer form, order form or registered form;</p> <p>(c) to cause any Security Certificate in registered form to be registered in the name of CDS, a Nominee, a Custodian or a nominee of a Custodian;</p> <p>(d) to hold any Security Certificate itself or to appoint another Person to hold any Security Certificate in its behalf; or</p> <p>(e) to appoint a Custodian for any Security; <u>or</u></p> <p><u>(f) to destroy any Security Certificate in respect of which transfers have not been available from a Transfer Agent for at least 7 years.</u></p> <p>In exercising or determining whether to exercise any of the foregoing powers, CDS shall take reasonable care in what it, in good faith, considers to be in the best interests of all Participants.</p> <p>In certain circumstances, including the maturity of a Security or a re-organization of the Issuer or a process involving the Tender of a Security, CDS may release certificates or other instruments evidencing a Security held in the Depository Service to the Issuer, its Transfer Agent, its paying agent, or a Depository Agent, in order to complete the procedure and receive any entitlements or payments owing in respect of the Security.</p>	<p>6.4.2 Custody of Securities With respect to any Security held in the Depository Service, CDS shall determine how such Securities shall be handled and in particular CDS in its discretion may determine whether or not:</p> <p>(a) to require the issuance of a Security Certificate;</p> <p>(b) to cause any Security Certificate to be issued in bearer form, order form or registered form;</p> <p>(c) to cause any Security Certificate in registered form to be registered in the name of CDS, a Nominee, a Custodian or a nominee of a Custodian;</p> <p>(d) to hold any Security Certificate itself or to appoint another Person to hold any Security Certificate in its behalf;</p> <p>(e) to appoint a Custodian for any Security; <u>or</u></p> <p>(f) to destroy any Security Certificate in respect of which transfers have not been available from a Transfer Agent for at least 7 years.</p> <p>In exercising or determining whether to exercise any of the foregoing powers, CDS shall take reasonable care in what it, in good faith, considers to be in the best interests of all Participants.</p> <p>In certain circumstances, including the maturity of a Security or a re-organization of the Issuer or a process involving the Tender of a Security, CDS may release certificates or other instruments evidencing a Security held in the Depository Service to the Issuer, its Transfer Agent, its paying agent, or a Depository Agent, in order to complete the procedure and receive any entitlements or payments owing in respect of the Security.</p>