

13.1.5 Notice and Request for Comments – Material Amendments to CDS Rules Relating to Issuer Electronic Payments

CDS CLEARING AND DEPOSITORY SERVICES INC. (CDS®)

MATERIAL AMENDMENTS TO CDS RULES

ISSUER ELECTRONIC PAYMENTS

REQUEST FOR COMMENTS

A. DESCRIPTION OF THE PROPOSED CDS RULE AMENDMENTS

Since the implementations of CDSX® and the Large Value Transfer System (“LVTS”), considerable progress has been made in having entitlement payments for CDSX eligible securities made in electronic form. As long as there are still some entitlement payments which are made by cheque, however, inefficient manual processes will continue to be necessary. CDS has decided to require all entitlement payments made by issuers of CDSX eligible securities or their agents to be made by an electronic means that meets the definition of an Acceptable Payment (as defined in the Rules and required for all settlement payments) or Funds Transfer in CDSX. Acceptable Payments are made by LVTS for Canadian funds, Fedwire for U.S. funds or by another transaction which results in immediate, final and irrevocable credit to CDS’s account at the Bank of Canada.

B. NATURE AND PURPOSE OF THE PROPOSED CDS RULE AMENDMENTS

Currently, CDS receives entitlement payments via the LVTS for Canadian dollar entitlements,¹ Fedwire for US dollar entitlements, and cheques. In terms of value of the entitlement payments, the large majority are made in acceptable electronic form. In terms of the volume of the payment items, however, most of the payments are in the form of cheques. Processing cheques is manually intensive, time consuming, and does not provide an immediate, final and irrevocable credit to CDS’s account with Bank of Canada, or, in the case of US dollar entitlement payments, CDS’s account with a financial institution that CDS has designated as its banker. LVTS and Fedwire payments are Acceptable Payments and as such are preferred to the receipt of cheques. Notwithstanding such preference, LVTS and Fedwire payments also cause logistical issues for CDS because of the lack of event information received on the related payment message. Another acceptable method of electronic entitlement payment is a Funds Transfer made in CDSX.

Commencing on November 1, 2011, CDS will require all CDSX eligible securities issuers and their agents to make entitlement payments in electronic format. Entitlement payments include dividends, interest, payments upon redemption or maturity of Securities and other events involving payments or distributions to holders of Securities, as outlined in CDS Participant Rule 6.6.1. Many payments are already required to be made electronically: The LVTS Rules require payments in excess of \$25 million to be made by LVTS; the future Book Entry Only Securities Services Agreement will require all BEO securities entitlements to be paid electronically.

This initiative will provide greater efficiency and cost reduction to the investment community by eliminating the use of cheques for entitlement payments.

C. IMPACT OF THE PROPOSED CDS RULE AMENDMENTS

Failure to make an Acceptable Payment (CDS Participant Rule 8.2.5) or Funds Transfer in CDSX (CDS Participant Rule 1.2.1) for entitlements will render the Securities with which the payment is associated ineligible for the CDS Depository Service. Acceptable Payments for entitlements denominated in Canadian dollars include LVTS payments, or transactions resulting in immediate, final and irrevocable credit to CDS’s account with Bank of Canada. Payments for entitlements denominated in US dollars include Fedwire payments or transactions resulting in immediate, final and irrevocable credit in CDS’s account with a financial institution that CDS has designated as its banker.

The proposed solution will reduce the collection and handling of cheques by CDS staff and will promote the straight-through processing of entitlement payments. CDS is expected to save approximately \$500,000 per year from not having to process cheques. CDS also expects to save approximately \$240,000 per year in collateral costs that will no longer be required to collateralize the conversion of cheques to LVTS, which is a service that CDS’s banker currently provides. It is expected that the number of events requiring reconciliation with transfer agents will be reduced and that the resulting ledger adjustments to balance events will also be reduced.

¹ See http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part2/csa_20060303_24-302_not-entitlement-pay.pdf.

Although the Rules are scheduled to be implemented following regulatory approvals, by their terms the Rules will not become effective until November 1, 2011. Participants, issuers and their agents are being given a long lead time to make any arrangements which they find necessary to enable all entitlement payments to be made electronically.

C.1 Competition

There is expected to be no impact on competition. Financial institutions will no longer have to convert cheques into LVTS funds. Issuers and their agents will have the flexibility to make an entitlement payment by LVTS or by Funds Transfer in CDSX. All CDSX eligible securities will be subject to the same entitlement payments requirements.

C.2 Risks and Compliance Costs

Issuers and their agents will no longer issue cheques to CDS for entitlement payments. Lost and missing cheques, and operational risk associated with cheque handling will no longer be a risk.

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 entitlement payments specifically, the elimination of cheques is in-line with a move to a dematerialized environment. One of the main recommendations from these groups is to also have finality of payment, which also fits in well with the elimination of cheques.

In the most recent review of CDS by Thomas Murray, under the Asset Servicing section, Thomas Murray highlights that CDS does receive the majority of entitlement payments by cheque; however they note that those payments make up only 10% of the value, but 70% of the volume. They did not identify this as a major risk but a factor that reduced CDS's overall rating on asset servicing risk.

D. DESCRIPTION OF THE RULE DRAFTING PROCESS

D.1 Development Context

Over a period of years, efforts have been undertaken by a broad cross-section of the financial community to increase the efficiency of payment of entitlements. Unfortunately, none of the efforts have been successful in eliminating cheques to pay entitlements. The proposed amendments will bring desired efficiency to the Canadian capital markets.

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 Directors² 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 November 26, 2008.

D.3 Issues Considered

When this change was first proposed there were a number of issues that were reviewed. One issue, mentioned earlier in section B of this report, related to LVTS payments not having the event information required to readily identify the payments. Although this is an issue, the savings associated with the elimination of cheques outweighs any negative impact from LVTS payments.

CDS will not pay a fee to the issuers or their agents for submitting entitlement payments to CDS. Any costs associated with preparing and submitting entitlement payments in electronic form to CDS should be borne by the issuer in negotiations with their agent as part of supporting their public issues and making their issues eligible at CDS.

² Pursuant to a unanimous shareholder agreement between The Canadian Depository for Securities Limited ("CDS Ltd.") and CDS, effective as of November 01, 2006, CDS Ltd., which acts under the supervision of its Board of Directors, assumed all rights, powers, and duties of the CDS Board of Directors.

D.4 Consultation

Various proposals for mandating electronic entitlement payments have been considered by CDS, the securities industry and regulatory authorities for a number of years.³

The Governance Committee/Human Resources of the Board of Directors of CDS Ltd. directed CDS at its meeting on September 23, 2008 to prepare Rule amendments to give effect to the proposal requiring all entitlement payments to be made to CDS electronically, failing which the Securities will be made ineligible for CDSX.

CDS's Risk Advisory Committee ("RAC") was presented with the proposal for informational purposes on October 28, 2008. Membership in RAC is open to representatives from the following CDSX participant groups: Extenders of Credit, Settlement Agents, Federated Participant, and Receivers of Credit. Representatives of CDS's regulators (Ontario Securities Commission, Quebec Autorité des marchés financiers and the Bank of Canada) and of the Investment Industry Regulatory Organization of Canada are permitted to participate on RAC as observers. The RAC's terms of reference are to review and recommend to CDS enhancements to the CDSX risk model, risk controls for the cross-border services and any related measures required to mitigate financial risk to CDS and its participants. It also is responsible for reviewing the adequacy of the model's coverage of the risks related to CDSX and the relative costs to CDS and its participants, for recommendation to the Audit/Risk Committee of the CDS Ltd. Board of Directors. RAC may be called upon to provide input regarding operational risk issues from time-to-time.

D.5 Alternatives Considered

The current proposed rule amendments are the result of several efforts by CDS and other regulatory bodies (including the CSA) over many years to consider various options (the streamlining entitlements proposal being the most recent) to have issuers and their agents make electronic entitlement payments. These efforts are even more relevant since Canadian financial markets are behind the best practices of other financial markets in this regard. Throughout these efforts, working groups involving representatives from the banks, transfer agents, the Bank of Canada and the Ontario Securities Commission have been involved.

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 will become effective upon approval of the amendments by the Recognizing Regulators following public notice and comment.

E. TECHNOLOGICAL SYSTEMS CHANGES

E.1 CDS

There will be no changes required for CDS's systems.

E.2 CDS Participants

The majority of CDS's participants will not require any development to accommodate this change; however, some of the paying agents who are participants may require some changes within their systems. This is because it is the paying agents that receive the funds from issuers and then direct the funds to CDS.

E.3 Other Market Participants

Some transfer agents may need to modify their internal systems, such as automated cheque production routines, in order to shift to electronic payments. Additionally, depending on the transfer agent, this may mean amending procedures for manually based processes.

³ See footnote 1.

F. COMPARISON TO OTHER CLEARING AGENCIES

In support of the recommendations made in 1988 by the Group of Thirty (“G-30”) and as part of the U.S. Working Committee’s G-30 Clearance and Settlement Project, U.S. financial industry guidelines were published in 1993 requiring, as of January 1995, that all new issues be made depository eligible and structured so that all associated payments of principal and income to depositories (consisting of dividends, interest, reorganization and redemption payments) be paid in same day funds on payment date. Implementation of this recommendation was delayed until February 22, 1996 due to the industry shift from five to three day settlement.⁴

To facilitate these changes The Depository Trust Company (“DTC”) has implemented cut-off times for the receipt of payments on payable date and has also required paying agents or transfer agents to provide DTC with the details of the payments, also on payable date. In this way DTC is able to determine what the funds were for. The payments must be received by DTC by no later than 2:30 p.m. on payable date.

In addition to the above, DTC also arranged for a line of credit (“LoC”) that they are able to draw on if funds are not received for an expected payment by the prescribed cut-off time. If the LoC is used the participants who have been allocated the entitlement payment are debited for the cost of the LoC.

DTC also has a “claw back” arrangement which enables them to reverse payments if a paying agent does not receive the expected funds from the issuer. DTC has advised CDS that they are currently receiving “good funds” 99.9% of the time.

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 60 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^o 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.

⁴ http://findarticles.com/p/articles/mi_hb6642/is_ /ai_n28709180

APPENDIX "A"
PROPOSED RULE AMENDMENT

Text of CDS Participant Rules marked to reflect proposed amendments	Text of CDS Participant Rules reflecting the adoption of proposed amendments
<p>1.6.2 Eligibility of Securities and Currencies</p> <p>The Board of Directors (but not the executive committee of the Board of Directors) shall determine from time to time the classes of Securities that may be made eligible for the Depository Service, the currencies in which Funds Accounts of Ledgers may be denominated and the classes of Securities for which Transactions may be processed in particular Services or Functions. Securities may be made eligible for the Depository Service only if there is competent legislation providing that transactions in Securities of that class may be effected by entries made on the records of CDS. Notwithstanding the foregoing, the fact that no such legislation is found to be applicable to a Security shall not limit the effect and finality of the transfer of such Security to CDS on deposit into the Depository Service, nor of any Transaction or Settlement effected through the Services in respect of such Security. <u>On November 1, 2011, those Securities in respect of which entitlement payments are not made by Acceptable Payments or Funds Transfer will be made ineligible for the Depository Service.</u></p> <p>6.2 DEPOSIT OF SECURITIES</p> <p>6.2.1 Eligibility</p> <p>Only eligible Securities may be deposited into or held in the Depository Service. The Board of Directors (but not the executive committee of the Board of Directors) shall determine from time to time the classes of Securities that may be made eligible for the Depository Service and the classes of Securities for which Transactions may be processed in particular Services or Functions. The Procedures and User Guides describe the types of Securities that are eligible for the Depository Service. For each eligible Security, facilities for deposit (and, if applicable, withdrawal) are provided by one of CDS, Bank of Canada, the Transfer Agent for the Issuer, the Issuer acting as its own registrar, a Security Validator or a Custodian. <u>On November 1, 2011, those Securities in respect of which entitlement payments are not made by Acceptable Payments or Funds Transfer will be made ineligible for the Depository Service.</u></p> <p>6.6.3 Eligible Entitlement Payment</p> <p>A Participant, acting in its capacity as the Issuer of the Security, the agent of the Issuer or the Entitlements Processor, may distribute an entitlement to CDS in the form of a payment of money. A Participant other than a TA Participant who distributes such an entitlement to CDS shall pay the entitlement by means of an Acceptable Payment or by debiting the amount of the entitlement from the Funds Account of the Participant. A TA Participant is required to pay an entitlement by such means only if it is acting as an Entitlements Processor pursuant to <u>in accordance with</u> Rule 11.6.</p>	<p>1.6.2 Eligibility of Securities and Currencies</p> <p>The Board of Directors (but not the executive committee of the Board of Directors) shall determine from time to time the classes of Securities that may be made eligible for the Depository Service, the currencies in which Funds Accounts of Ledgers may be denominated and the classes of Securities for which Transactions may be processed in particular Services or Functions. Securities may be made eligible for the Depository Service only if there is competent legislation providing that transactions in Securities of that class may be effected by entries made on the records of CDS. Notwithstanding the foregoing, the fact that no such legislation is found to be applicable to a Security shall not limit the effect and finality of the transfer of such Security to CDS on deposit into the Depository Service, nor of any Transaction or Settlement effected through the Services in respect of such Security. On November 1, 2011, those Securities in respect of which entitlement payments are not made by Acceptable Payments or Funds Transfer will be made ineligible for the Depository Service.</p> <p>6.2 DEPOSIT OF SECURITIES</p> <p>6.2.1 Eligibility</p> <p>Only eligible Securities may be deposited into or held in the Depository Service. The Board of Directors (but not the executive committee of the Board of Directors) shall determine from time to time the classes of Securities that may be made eligible for the Depository Service and the classes of Securities for which Transactions may be processed in particular Services or Functions. The Procedures and User Guides describe the types of Securities that are eligible for the Depository Service. For each eligible Security, facilities for deposit (and, if applicable, withdrawal) are provided by one of CDS, Bank of Canada, the Transfer Agent for the Issuer, the Issuer acting as its own registrar, a Security Validator or a Custodian. On November 1, 2011, those Securities in respect of which entitlement payments are not made by Acceptable Payments or Funds Transfer will be made ineligible for the Depository Service.</p> <p>6.6.3 Eligible Entitlement Payment</p> <p>A Participant, acting in its capacity as the Issuer of the Security, the agent of the Issuer or the Entitlements Processor, may distribute an entitlement to CDS in the form of a payment of money. A Participant other than a TA Participant who distributes such an entitlement to CDS shall pay the entitlement by means of an Acceptable Payment or by debiting the amount of the entitlement from the Funds Account of the Participant. A TA Participant is required to pay an entitlement in accordance with Rule 11.6.</p>

Text of CDS Participant Rules marked to reflect proposed amendments	Text of CDS Participant Rules reflecting the adoption of proposed amendments
<p>11.3.1 Eligibility of Securities</p> <p>In accordance with Rule 1.6.2, the Board of Directors determines from time to time the classes of Securities that may be made eligible for the Depository Service <u>and the classes of Securities for which Transactions may be processed in particular Services or Functions. The Procedures and User Guides describe the types of Securities that are eligible for the Depository Service.</u> Not all Securities for which a Participant is the Transfer Agent of the Issuer may be eligible. A TA Participant that is the Transfer Agent for a Security that has been made eligible for CDSX shall confirm or reject the Deposit and Withdrawal of such Securities and provide a Closing Balance Report to CDS for that Security. A TA Participant is not obliged to assume the role of a CDSX Depository Agent or Entitlements Processor with respect to a particular Security by reason only that it is the agent of the offeror or the Issuer with respect to that Security. <u>On November 1, 2011, those Securities in respect of which entitlement payments are not made by Acceptable Payments or Funds Transfer will be made ineligible for the Depository Service.</u></p> <p>11.6.1 Payment of Entitlements</p> <p>An entitlement payment received by CDS with respect to Securities held for a Participant in the Depository Service is distributed to the Participant by CDS pursuant to Rule 7. The</p> <p>(a) <u>Transition Period</u></p> <p>Subject to Rule 11.6.1(b) below, the TA Participant and CDS will co-operate and use their best efforts to arrange for an entitlement to be paid either (i) by an Entitlements Processor acting on behalf of the Issuer, by means of a credit to the CDS Entitlements Ledger from its Funds Account, or (ii) by the Issuer or its Entitlements Processor, by means of an LVTS or Fedwire payment to the bank account specified by CDS. This Rule 11.6 shall not be interpreted so as to require a TA Participant to make payment of an entitlement to CDS in any of the manners specified nor in a form or manner other than that in which the TA Participant receives funds from the Issuer.</p> <p>(b) <u>Future Payment of Entitlements</u></p> <p><u>On November 1, 2011, the TA Participant will arrange for all entitlements to be paid by means of Acceptable Payments (as defined in Rule 8.2.5) or Funds Transfer.</u></p>	<p>11.3.1 Eligibility of Securities</p> <p>In accordance with Rule 1.6.2, the Board of Directors determines from time to time the classes of Securities that may be made eligible for the Depository Service and the classes of Securities for which Transactions may be processed in particular Services or Functions. The Procedures and User Guides describe the types of Securities that are eligible for the Depository Service. Not all Securities for which a Participant is the Transfer Agent of the Issuer may be eligible. A TA Participant that is the Transfer Agent for a Security that has been made eligible for CDSX shall confirm or reject the Deposit and Withdrawal of such Securities and provide a Closing Balance Report to CDS for that Security. A TA Participant is not obliged to assume the role of a CDSX Depository Agent or Entitlements Processor with respect to a particular Security by reason only that it is the agent of the offeror or the Issuer with respect to that Security. On November 1, 2011, those Securities in respect of which entitlement payments are not made by Acceptable Payments become ineligible for the Depository Service.</p> <p>11.6.1 Payment of Entitlements</p> <p>An entitlement payment received by CDS with respect to Securities held for a Participant in the Depository Service is distributed to the Participant by CDS pursuant to Rule 7.</p> <p>(a) Transition Period</p> <p>Subject to Rule 11.6.1(b) below, the TA Participant and CDS will co-operate and use their best efforts to arrange for an entitlement to be paid either (i) by an Entitlements Processor acting on behalf of the Issuer, by means of a credit to the CDS Entitlements Ledger from its Funds Account, or (ii) by the Issuer or its Entitlements Processor, by means of an LVTS or Fedwire payment to the bank account specified by CDS.</p> <p>(b) Future Payment of Entitlements</p> <p>On November 1, 2011, the TA Participant will arrange for all entitlements to be paid by means of Acceptable Payments (as defined in Rule 8.2.5) or Funds Transfer.</p>