

**13.1.5 Notice and Request for Comment – Material Amendments to CDS Procedures Relating to Issuer Buy-Back Procedures**

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

**MATERIAL AMENDMENTS TO CDS PROCEDURES**

**ISSUER BUY-BACK PROCEDURES**

**REQUEST FOR COMMENTS**

**A. DESCRIPTION OF THE PROPOSED AMENDMENTS**

CDS proposes to amend the CDS Participant procedures to require participants to submit securities for cancellation, on a timely basis, purchased under an issuer buy-back programme.

The proposed amendments to the *CDSX Procedures and User Guide* clarify the procedure to be followed when a security to be withdrawn is for the purpose of a buy-back (s. 7.3). Further the proposed amendments add subsections 8.16 and 8.16.1 to the same guide. These sections outline the procedures by which Participants report issuer buy-backs through CDSX® and the subsequent withdrawal of securities. These transactions are reported to CDSX on a non-exchange transaction basis.

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

CDS, through its nominee CDS & Co., is the registered shareholder of securities deposited at CDS. As the registered owner of such securities, CDS receives entitlement payments on certain corporate action events. CDS in turn distributes these entitlement payments to its participants and the participants distribute the entitlements to their clients who are the beneficial holders of the securities.

Unfortunately, CDS continues to experience a significant number of occurrences where the entitlement payment it receives is less than the expected payment calculated on the basis of its registered holding of securities. This typically occurs when an issuer has undertaken a buy-back programme and the issuer has elected to treat purchased securities as having been cancelled (notionally on its books) even though these securities have not been officially cancelled in the share register.

Under an issuer buy-back programme, a participant reports purchases made to the issuer on trade date. These trades do not settle until settlement date (i.e. trade date plus three business days). Even after the trade has settled, the securities generally remain in the participant's account at CDS, as the common practice is for participants to wait until the end of the week or month to bulk up the purchases in order to reduce associated fees. The participant then processes a withdrawal of the securities from CDSX, and the securities are cancelled by the issuer's agent, reducing the total number of outstanding securities.

However, an issuer may treat the securities as effectively cancelled on trade date, even though the CDS account ledgers and the records maintained by the issuer's transfer agent continue to show that the securities are outstanding. In many instances the transfer agent may not be aware that a buy-back programme is in place, and is not notified that securities have been repurchased. If the issuer declares an entitlement in the time period between trade date and the withdrawal of the securities, the issuer often calculates the entitlement payment on the assumption that the repurchased securities are cancelled. However, the transfer agent's register of securities, and the CDSX ledgers which are daily reconciled with the register, show all of the securities as outstanding and do not reflect the buy-back securities as cancelled.

Therefore the amount of the entitlement actually paid does not reflect the entitlement due for all of the outstanding securities held by CDS as the registered holder. Thus if the issuer pays the entitlement calculated on the basis of the reduced number of securities, CDS receives an entitlement payment that cannot be reconciled with its total holdings. The transfer agent does not have the information needed to enable a speedy reconciliation of the discrepancy. CDS must expend considerable time and effort to reconcile the discrepancy between its own records and the entitlement payment. If CDS delays the payment of the entitlement while attempting to reconcile the discrepancy, this causes disruptions to all participants and their clients. If circumstances arose in which the discrepancy could not be resolved on the payable date, then it is possible that the payment to all participants could be delayed, resulting in interest and other costs to the industry. To minimize disruption to the industry, the distribution of entitlements must take place quickly and efficiently on payable date.

To ensure proper processing of entitlements, the transfer agent's records must reflect the cancellation of the repurchased securities as soon as possible, and CDS ledgers must balance with the transfer agent records. The issuer should not adjust entitlement payments until the repurchased securities have been cancelled.

Furthermore, the inaccurate depiction of the total number of outstanding securities for a particular issuer skews holders of record reports. This would have a negative impact on the financial community at large. For example, making a determination of rights under a class action lawsuit would be complicated by overstatement of securities within the system.

To address this problem, CDS proposes procedures to require participants acting for an issuer on a buy-back programme to ensure that such securities are cancelled on a timely basis. Participants that postpone the process to effect timely cancellation of bought-back shares will be considered in breach of the CDS Rules. CDS intends to impose a fee to encourage compliance with the new procedures. The fee would be comparable to the late payment exchange fee, currently set at \$500.

CDS cannot impose compliance requirements on issuers via CDS Rules as the Rules only apply to participants. Notwithstanding that limitation, CDS hopes its participants and other market participants will explain the need for rapid and accurate processing of entitlements to issuers. If the new procedures do not achieve the objective of receiving accurate entitlement payments, CDS will need to consider other remedies. For instance, CDS may have a claim against an issuer when CDS is shown as the registered holder of a certain number of securities, but the entitlement is paid on only part of those securities.

## **C. IMPACT OF THE PROPOSED AMENDMENTS**

### **C.1 Competition**

All industry participants using CDSX will be subject to consistent requirements, so that there will be no competitive advantage or disadvantage.

### **C.2 Risks and Compliance Costs**

This proposal will assist issuers in meeting their own statutory obligations. As a matter of corporate law, issuers should not hold their own securities. Therefore, securities purchased for the account of the issuer must be cancelled immediately on receipt, to ensure compliance with respective corporate legislation. Adherence to the new procedures will enhance compliance with statutory obligations.

### **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**

There is no indication that these international organizations have addressed the matter of reconciling entitlement distributions during an issuer buy-back programme.

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

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

The Toronto Stock Exchange issued a staff notice on August 29, 2006 reminding issuers of the need to ensure that bought-back securities are cancelled in a timely manner. Notwithstanding such notice, the issuer buy-back problem continues to negatively affect the financial community. As such, additional measures are required.

### **D.2 Procedure Drafting Process**

CDS Procedures are drafted by CDS personnel based on direction from CDS business units. Where a request for a systems change, update, or new service is initiated by CDS's Strategic Development Review Committee (the "SDRC" - a committee comprised of CDS product development personnel and members of the Participant community), these procedural changes are made in consultation with the SDRC and other interested Participants. Once drafted, CDS Procedure amendments are reviewed and approved by CDS's Strategic Development Review Committee.

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

The primary issues addressed have been (i) the importance of reconciling issuers' registers of securities, (ii) the growing problem of delay and expense in reconciling entitlement payments with CDS and transfer agent records, and (iii) the disruption that any delay in entitlement processing would cause to all industry participants and their clients. It is recognized that the new procedure will require some additional back office processing, and potentially a slight increase in the fees paid for withdrawals, by the participants acting for issuers on a buy-back programme. It was determined that these costs would be minor, would affect all participants engaged in that business in a similar fashion, and are minor in comparison to the disruption to all industry participants and to CDS caused by the problem of reconciling entitlement payments with securities registers that have not been updated on a current basis. CDS has requested that transfer agents assess their fee structure in regards to processing the cancellations of securities.

**D.4 Consultation**

Within CDS, the issue of reconciling entitlement payments to the register, and the proposed procedures, have been reviewed by the Debt and Equity Sub-Committee of CDS's SDRC as well as by the SDRC itself. The SDRC is a committee comprised of CDS participant representatives and determines or reviews, prioritizes and oversees CDS-related systems development and other changes proposed by participants and CDS.

Transfer agents have also expressed concerns about the problems of reconciling registers during buy-back of securities by issuers. Transfer agents have stressed the importance of ensuring that the records they maintain for the issuer are as current and accurate as possible.

**D.5 Alternatives Considered**

As an alternative to the present proposed amendments to CDS Procedures, changes to the CDS Participant Rules were also considered. The proposal to amend the CDS Participant Rules involved introducing a requirement that Participants who are acting on behalf of an issuer in a buy-back scenario immediately submit any securities received in this context for cancellation. Participants would be required to submit a withdrawal transaction for this purpose. It was determined that the buy-back process as outlined in the procedures would be more cost effective, as they permit the bulking of withdrawals in the CDS CUID.

As noted, the Toronto Stock Exchange has reminded issuers of their obligations in respect of cancellation of securities involved in a normal course buy-back. Transfer agents have also indicated their concerns about the process. CDS has worked with industry committees to request voluntary compliance with the need for timely cancellation of such securities. The introduction of mandatory requirements under the procedures has been proposed due to the failure of such voluntary measures to achieve a sufficient level of compliance to avoid disruptions to the entitlement distribution system.

**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.

**E. TECHNOLOGICAL SYSTEMS CHANGES**

**E.1 CDS**

With the exception of the creation of a dedicated CUID to allow for the buy-back process, the proposed procedural amendments do not require any change to CDSX or to any CDS systems.

**E.2 CDS Participants**

The proposed procedural amendments should not require changes to participants' technological systems. Participants will need to implement new back office practices to ensure submissions for cancellations are made on an immediate rather than a delayed basis.

**E.3 Other Market Participants**

Other market participants will not be affected by the proposed amendments. Transfer agents will process cancellations in the normal course.

**F. COMPARISON TO OTHER CLEARING AGENCIES**

There is no indication that other clearing agencies have addressed the matter of reconciling entitlement distributions during an issuer buy-back programme.

**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 delivered by **December 3, 2007** to:

Tony Hoffmann  
Legal Counsel  
CDS Clearing and Depository Services Inc.  
85 Richmond Street West  
Toronto, Ontario M5H 2C9

Fax: 416-365-1984  
e-mail: [attention@cds.ca](mailto: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<sup>e</sup> Anne-Marie Beaudoin  
Directrice du secrétariat  
Autorité des marchés financiers  
800, square Victoria, 22<sup>nd</sup> floor  
PO box 246, tour de la Bourse  
Montréal (Québec) H4Z 1G3

Fax: (514) 873-7455  
e-mail: [consultation-en-cours@lautorite.gc.ca](mailto:consultation-en-cours@lautorite.gc.ca)

Cindy Petlock  
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CDS will make available to the public, upon request, all comments received during the comment period.

## I. PROPOSED 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.

JAMIE ANDERSON  
Managing Director, Legal

APPENDIX "A"

PROPOSED PROCEDURE AMENDMENT

Text of CDS Participant Procedures marked to reflect proposed amendments	Text CDS Participant Procedures reflecting the adoption of proposed amendments
<p><b>7.3 Requesting security withdrawals</b></p> <p>...</p> <p><u>For issuer buy-back securities, the participant may enter a withdrawal request or a trade transaction to report their issuer buy-back positions to the transfer agent and CDS. This will cancel the shares in the transfer agent register. For more information on trade transactions, see Issuer buy-backs on page 190.</u></p> <p><u>To request a security withdrawal for issuer buy-backs, the participant must enter PURCHASED FOR CANCELLATION in the MEMO field of the withdrawal. This entry identifies to the transfer agent that the participant wishes to remove the participant security position in CDSX and subsequently cancel the shares in the transfer agent register. The transfer agent will not issue a certificate for release to the participant for these requests, and the shares will be cancelled immediately. If PURCHASED FOR CANCELLATION is not entered in the MEMO field, then a certificate will be issued. For BEO issues, the trade process must be followed. For more information, see Issuer buy-backs on page 190.</u></p> <p><u>If a withdrawal or trade transaction is not processed prior to record date, CDS will, upon reconciliation with the transfer agent, charge the non-reporting participant a fee of \$500 (issuer buy-backs not reported).</u></p> <p><u>[**NOTE**: The following text will be added to the instructions related to the 'MEMO' field in section 7.3 on page 120 of the CDSX Procedures and User Guide].</u></p> <p><u>For issuer buy-back security withdrawals, enter PURCHASED FOR CANCELLATION (CDS transfer agent requirement). A certificate is not returned to the participant. Entries for issuer buy-back security withdrawals cannot be completed for BEO issues</u></p> <p>...</p>	<p><b>7.3 Requesting security withdrawals</b></p> <p>...</p> <p>For issuer buy-back securities, the participant may enter a withdrawal request or a trade transaction to report their issuer buy-back positions to the transfer agent and CDS. This will cancel the shares in the transfer agent register. For more information on trade transactions, see Issuer buy-backs on page 190.</p> <p>To request a security withdrawal for issuer buy-backs, the participant must enter PURCHASED FOR CANCELLATION in the MEMO field of the withdrawal. This entry identifies to the transfer agent that the participant wishes to remove the participant security position in CDSX and subsequently cancel the shares in the transfer agent register. The transfer agent will not issue a certificate for release to the participant for these requests, and the shares will be cancelled immediately. If PURCHASED FOR CANCELLATION is not entered in the MEMO field, then a certificate will be issued. For BEO issues, the trade process must be followed. For more information, see Issuer buy-backs on page 190.</p> <p>If a withdrawal or trade transaction is not processed prior to record date, CDS will, upon reconciliation with the transfer agent, charge the non-reporting participant a fee of \$500 (issuer buy-backs not reported).</p> <p>[**NOTE**: The following text will be added to the instructions related to the 'MEMO' field in section 7.3 on page 120 of the CDSX Procedures and User Guide].</p> <p>For issuer buy-back security withdrawals, enter PURCHASED FOR CANCELLATION (CDS transfer agent requirement). A certificate is not returned to the participant. Entries for issuer buy-back security withdrawals cannot be completed for BEO issues</p> <p>...</p>
<p><b>8.16 Issuer buy-backs</b></p> <p><u>Non-exchange trade transactions for issuer buy-back positions are reported to CDS through a CDS-controlled internal CUID, the CDS issuer buy-back positions account (XDSP). CDS and the transfer agent use this CUID to account for the buy-back transactions and to assist in the reconciliation of entitlement events set up in CDSX.</u></p> <p><u>Once a dealer has reported a buy-back to the issuer, the dealer delivers the trade to the XDSP CUID within CDSX using a non-exchange trade transaction. CDS confirms the trade and then processes the withdrawal prior to the corresponding record date.</u></p>	<p><b>8.16 Issuer buy-backs</b></p> <p>Non-exchange trade transactions for issuer buy-back positions are reported to CDS through a CDS-controlled internal CUID, the CDS issuer buy-back positions account (XDSP). CDS and the transfer agent use this CUID to account for the buy-back transactions and to assist in the reconciliation of entitlement events set up in CDSX.</p> <p>Once a dealer has reported a buy-back to the issuer, the dealer delivers the trade to the XDSP CUID within CDSX using a non-exchange trade transaction. CDS confirms the trade and then processes the withdrawal prior to the corresponding record date.</p>

Text of CDS Participant Procedures marked to reflect proposed amendments	Text CDS Participant Procedures reflecting the adoption of proposed amendments
<p><u>Issuer buy-back transactions should be processed by participants immediately and should not be accumulated on record date periods. This ensures that the holdings for the transfer agents and CDS are in balance.</u></p> <p><u>Note: The trade transaction must be processed by the participant to the XDSP CUID prior to the record date. If it is not processed prior to this date, CDS will, upon reconciliation with the transfer agent, charge the non-reporting participant a fee of \$500 (issuer buy-backs not reported).</u></p> <p>...</p> <p><b>8.16.1 Entering issuer buy-backs</b></p> <p><u>To enter a non-exchange trade transaction for issuer buy-back positions:</u></p> <ol style="list-style-type: none"> <li><u>1. Determine the position needed to deliver buy-back positions to the XDSP CUID.</u></li> <li><u>2. Set up a free delivery trade in CDSX to deliver the quantity to the XDSP CUID. Set up the trade with the following:</u> <ul style="list-style-type: none"> <li><u>• Settlement control indicator to Y (settle)</u></li> <li><u>• Price to \$0.00.</u></li> </ul> </li> </ol> <p><u>Once the position is available in the ledger, the trade is available for settlement. CDS will then confirm the trade, and the position settles. The withdrawal transaction is entered by CDS after the trade transaction has been completed and the ledger resides in the CDS Issuer Buy-back Account.</u></p> <p><u>Participants may also use the security withdrawal function to report issuer buy-back positions to CDS. This ensures that the proper requirements for the issuer buy-back positions are identified in the withdrawal request. The security withdrawal function cannot be used on issues that are BEO at CDS. Issuer buy-backs of BEO issues must be completed using the trade process. For more information, see Requesting security withdrawals on page 118.</u></p>	<p>Issuer buy-back transactions should be processed by participants immediately and should not be accumulated on record date periods. This ensures that the holdings for the transfer agents and CDS are in balance.</p> <p>Note: The trade transaction must be processed by the participant to the XDSP CUID prior to the record date. If it is not processed prior to this date, CDS will, upon reconciliation with the transfer agent, charge the non-reporting participant a fee of \$500 (issuer buy-backs not reported).</p> <p>...</p> <p><b>8.16.1 Entering issuer buy-backs</b></p> <p>To enter a non-exchange trade transaction for issuer buy-back positions:</p> <ol style="list-style-type: none"> <li>1. Determine the position needed to deliver buy-back positions to the XDSP CUID.</li> <li>2. Set up a free delivery trade in CDSX to deliver the quantity to the XDSP CUID. Set up the trade with the following: <ul style="list-style-type: none"> <li>• Settlement control indicator to Y (settle)</li> <li>• Price to \$0.00.</li> </ul> </li> </ol> <p>Once the position is available in the ledger, the trade is available for settlement. CDS will then confirm the trade, and the position settles. The withdrawal transaction is entered by CDS after the trade transaction has been completed and the ledger resides in the CDS Issuer Buy-back Account.</p> <p>Participants may also use the security withdrawal function to report issuer buy-back positions to CDS. This ensures that the proper requirements for the issuer buy-back positions are identified in the withdrawal request. The security withdrawal function cannot be used on issues that are BEO at CDS. Issuer buy-backs of BEO issues must be completed using the trade process. For more information, see Requesting security withdrawals on page 118.</p>