

13.1.4 CDS Notice and Request for Comments – Material Amendments to CDS Rules Relating to Failure-to-Receive in CCP Services

CLEARING AND DEPOSITORY SERVICES INC. (CDS®)

MATERIAL AMENDMENTS TO CDS RULES

FAILURE-TO-RECEIVE IN CCP SERVICES

REQUEST FOR COMMENTS

A. DESCRIPTION OF THE PROPOSED AMENDMENTS

CDS proposes to amend the CDS Participant Rules to permit participants to make an automatic interest claim when a trade in the Central Counterparty (“CCP”) Services does not settle on value date due to a “fail-to-receive” situation.

B. NATURE AND PURPOSE OF THE PROPOSED AMENDMENTS

In the CCP Services, trades in the same securities with the same value date between participants are novated and netted to outstanding obligations between each participant and CDS as CCP. Each CCP participant then has a CCP obligation “to deliver” (the participant is required to deliver securities and in turn receives payment) or a CCP obligation “to receive” (the participant is required to receive securities and in turn makes payment). The total CCP obligations for all participants offset one another. If a participant fails to settle its CCP obligation, then CDS will be unable to settle a corresponding obligation to one or more participants. For instance, if a participant due to receive securities fails to do so, then CDS will not have the funds to enable it to settle with one or more participants who have an obligation to deliver securities.

A “fail-to-receive” occurs when the delivering participant has the required securities available for delivery but the receiving participant is unable to settle on value date [because the participant has insufficient funds, line of credit or aggregated collateral value (“ACV”)]. In a trade-for-trade situation, the delivering participant can make an interest claim against the receiving participant, as compensation for the loss of the use of funds. In the CCP services, there is no direct relationship between the delivering participant and the receiving participant so a direct interest claim by the delivering participant cannot be made against the receiving participant. The proposed Rule amendments will permit an automatic interest claim to be made for a CCP “fail-to-receive”.

The CDSX® system will automatically identify each CCP “fail-to-receive” and will calculate the applicable fail mark. A fail mark is an amount that is collected by CDS from the fail-to-receive participant and distributed to the corresponding delivering participant. The formula for calculating the fail mark will be set out in the operating procedures of CDS, and will reflect the cost of funds by reference to a published interest rate used in the industry. The current Rules describe the use of a fail mark and have been revised to provide that the formula will reflect the financing cost of the failure to settle on value date [Rule 7.3.6(b) and 7.4.6(b)].

In making these amendments, it was determined that it was appropriate to amend the Rules describing delayed and partial settlements to provide a clear and fuller description of the situations [Rule 7.3.8(a) and 7.4.8(b)]. These amendments impose no further obligations on participants but simply better describe the circumstances in which settlement of CCP obligations may be delayed or completed for less than the full amount outstanding.

CDS is also considering the imposition of a fee for participants in a fail-to-receive situation. Rule 3.5.2 currently permits CDS to charge fees for services, including “fees for the failure to comply with the Legal Documents”. Any fee imposed by CDS for a participant who fails to receive securities on value date will be imposed in accordance with this existing Rule 3.5.2; the possibility of imposing such fees is also referred to in Rules 7.3.8 and 7.4.8. Both the fail mark and the fee are inducements to improve the consistency of settlement and to ensure that participants in a position to deliver are not subject to a financial penalty. Review of the relatively infrequent occurrence of “fail-to-receive” situations has indicated that the fail marks will be a relatively small amount. The fail marks are not considered to be a matter of risk management in the CCP services. Risk management in the CCP services is adequately covered by the existing risk control mechanism, such as the daily mark-to-the-market mark, collateral requirements and credit rings.

The Rules require participants in CCP services to settle on value date (Rule 7.3.7 and 7.4.7). CDS may consider a failure to settle as one of the factors in determining whether or not to exercise its discretionary power to suspend a participant: failure to settle on value date is not automatically grounds for suspension, but may indicate that the participant “is in such financial or operating condition that its continuation as a Participant would cause material disruption to the Services or would jeopardize the interests of CDS or other Participants” (Rule 9.1.2). The current Rules are inconsistent, in that the CCP Rules include a statement that a failure to deliver in a CCP Service is not grounds for suspension [Rules 7.3.8(a) and 7.4.8(a)]; this

inconsistency should have been removed when Rule 9 was revised. The inconsistency is eliminated by the proposed amendments.

C. IMPACT OF PROPOSED AMENDMENTS

The proposed amendments encourage participants to settle outstanding CCP positions on value date, and ensure that participants that are able to deliver securities do not suffer a financial penalty when the corresponding participant fails to receive those securities.

D. DESCRIPTION OF THE RULE DRAFTING PROCESS

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".

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.

The amendments to Participant Rules may become effective upon approval of the amendments by the Recognizing Regulators following public notice and comment.

E. IMPACT OF PROPOSED AMENDMENTS ON TECHNOLOGICAL SYSTEMS

CDS will undertake minor system modifications so that the CDSX system will automatically identify "fail-to-receive" situations in CCP Services, and will calculate, collect and distribute the fail mark together with the daily mark.

F. COMPARISON TO OTHER CLEARING AGENCIES

Other clearing agencies have similar measure to encourage settlement of central counterparty positions on value date.

CRESTCo, a member of the Euroclear group, is the central securities depository for the United Kingdom market and Irish equities, and operates the CREST system. CRESTCo offers central counterparty services to clear and settle certain trades on the London Stock Exchange and the Irish Stock Exchange. CRESTCo has a Settlement Discipline Regime with a mandate "to ensure that the sustained efforts made by many firms to improve their matching and settlement performance is not undermined by the actions of a minority" (Euroclear/CRESTCo White Book – CREST Settlement Discipline). CRESTCo sets standards relating to matching and settlement, and imposes sanctions for breaches of those standards, including interest payments for fails-to-receive and fines for fails-to-deliver (White Book, Chapter 1 – Overview).

National Securities Clearing Corporation ("NSCC"), one of the clearing corporations subsidiaries of The Depository Trust & Clearing Corporation ("DTCC"), clears and settles trades in a continuous net settlement environment similar to the Continuous Net Settlement ("CNS") Service of CDSX. NSCC does not have an automatic process to make interest claims on either side of a CNS position that fails to settle on value date. However, NSCC has several charges intended to provide an incentive for the settlement of CNS positions on value date. Each NSCC member makes a collateral contribution to a clearing fund; the formula for calculating that contribution includes a percentage (between 5% and 10%) of each outstanding CNS position, that is for each fail-to-deliver and each fail-to-receive (NSCC Procedures, Procedure XV – Clearing Fund, Section I.(A) - Clearing Fund Formula for Members, Section 1 – For CNS Transactions). NSCC charges a fee for each fail-to-deliver position in CNS (NSCC Procedures, Addendum A – Fee Schedule, Section II Trade Clearance Fees, subsection B – Fails to Deliver to CNS).

G. PUBLIC INTEREST ASSESSMENT

In analysing the impact of the proposed amendments to the CDS Participant Rules, CDS has determined that the implementation of these amendments would not be contrary to the public interest. The proposed amendments will ensure that CCP obligations are subject to the same industry standards as are direct trade-for-trade obligations.

H. COMMENTS

Comments on the proposed amendments should be in writing and delivered by May 14, 2007 to:

Jamie Anderson
Managing Director, Legal
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
Directrice du secrétariat
Autorité des marchés financiers
800, square Victoria, 22nd floor
PO box 246, tour de la Bourse
Montréal (Québec) H4Z 1G3

Fax: (514) 873-7455
e-mail: consultation-en-cours@lautorite.qc.ca

Cindy Petlock
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: cpetlock@osc.gov.on.ca

CDS will make available to the public, upon request, copies of comments received during the comment period.

I. PROPOSED 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.

J. QUESTIONS

Questions regarding this notice may be directed to:

Jamie Anderson
Managing Director, Legal
CDS Clearing and Depository Services Inc.
85 Richmond Street West
Toronto, Ontario M5H 2C9

Fax: 416-365-1984
e-mail: attention@cds.ca

TOOMAS MARLEY
Chief Legal Officer

Appendix "A"
Proposed Rule Amendment

| Text of CDS participant Rules marked to reflect proposed amendments | Text CDS participant Rules reflecting the adoption of proposed amendments |
|---|---|
| <p>7.3.6 Marks</p> <p>(a) Daily Mark</p> <p>For each Business Day that a DetNet Obligation is outstanding, CDS shall calculate in accordance with the Procedures the daily Mark in respect of that DetNet Obligation. The daily Mark reflects the financing element of the DetNet Obligation and the then current market price of the Securities that are to be delivered or received on Value Date by the participant in respect of that DetNet Obligation. The daily Mark is an amount that shall be paid on that Business Day either to CDS by the participant owing the DetNet Obligation, or by CDS to that participant. In addition, on that Business Day the payment component of the DetNet Obligation is adjusted by the amount of the daily Mark.</p> <p>(b) Fail Mark</p> <p>In addition, to encourage the timely Settlement of DetNet Obligations, CDS may impose a fail Mark in respect of any delayed or partial delivery of the Securities to be delivered pursuant to a DetNet Obligation <u>or in respect of any delayed or partial payment to be made pursuant to a DetNet Obligation.</u> <u>CDS shall calculate in accordance with the Procedures the fail Mark, which will reflect the financing cost of the delayed or partial Settlement.</u> If imposed, the fail Mark shall be paid to CDS by participants who failed to deliver Securities <u>or to make payment to CDS,</u> and shall be paid by CDS to participants to whom CDS failed to deliver Securities <u>or to make payment.</u> The payment component of the DetNet Obligation is not adjusted by the amount of the fail Mark.</p> <p>(c) Payment of Net Mark</p> <p>CDS calculates a net amount owing to or by each participant in respect of Marks for DetNet by netting all DetNet Marks to be paid or received by that participant and the net DetNet Mark is credited to or debited from the Funds Account of the participant. No amount shall be drawn under a Line of Credit or a System Operating Cap in respect of a DetNet Mark.</p> | <p>7.3.6 Marks</p> <p>(a) Daily Mark</p> <p>For each Business Day that a DetNet Obligation is outstanding, CDS shall calculate in accordance with the Procedures the daily Mark in respect of that DetNet Obligation. The daily Mark reflects the financing element of the DetNet Obligation and the then current market price of the Securities that are to be delivered or received on Value Date by the participant in respect of that DetNet Obligation. The daily Mark is an amount that shall be paid on that Business Day either to CDS by the participant owing the DetNet Obligation, or by CDS to that participant. In addition, on that Business Day the payment component of the DetNet Obligation is adjusted by the amount of the daily Mark.</p> <p>(b) Fail Mark</p> <p>In addition, to encourage the timely Settlement of DetNet Obligations, CDS may impose a fail Mark in respect of any delayed or partial delivery of the Securities to be delivered pursuant to a DetNet Obligation or in respect of any delayed or partial payment to be made pursuant to a DetNet Obligation. CDS shall calculate in accordance with the Procedures the fail Mark, which will reflect the financing cost of the delayed or partial Settlement. If imposed, the fail Mark shall be paid to CDS by participants who failed to deliver Securities or to make payment to CDS, and shall be paid by CDS to participants to whom CDS failed to deliver Securities or to make payment. The payment component of the DetNet Obligation is not adjusted by the amount of the fail Mark.</p> <p>(c) Payment of Net Mark</p> <p>CDS calculates a net amount owing to or by each participant in respect of Marks for DetNet by netting all DetNet Marks to be paid or received by that participant and the net DetNet Mark is credited to or debited from the Funds Account of the participant. No amount shall be drawn under a Line of Credit or a System Operating Cap in respect of a DetNet Mark.</p> |
| <p>7.3.8 Partial-Delivery and Delayed-Delivery <u>Partial Settlement and Delayed Settlement</u></p> <p>(a) Effect of Partial or Delayed Delivery <u>Settlement</u></p> <p>A partial or delayed delivery of Securities by a participant or CDS under a DetNet Obligation is not grounds for suspension under Rule 9.1.2, or a default by CDS, respectively. CDS may delay the receipt of, or take partial receipt of, Securities that it is due to receive under the securities component of a DetNet Obligation if it is unable to re-deliver all such Securities under the</p> | <p>7.3.8 <u>Partial Settlement and Delayed Settlement</u></p> <p>(a) <u>Effect of Partial or Delayed Settlement</u></p> <p>CDS may delay the receipt of, or take partial receipt of, Securities that it is due to receive under the securities component of a DetNet Obligation if it is unable to re-deliver all such Securities under the securities component of another of its DetNet Obligations with another participant, and may delay the delivery of, or make partial delivery of, Securities that is due to deliver</p> |

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| <p><u>securities component of another of its DetNet Obligations with another participant, and may delay the delivery of, or make partial delivery of, Securities that is due to deliver under the securities component of a DetNet Obligation if it has not received the delivery of all such Securities under the securities component of another of its DetNet Obligations with another participant.</u> When a partial delivery of Securities is made by a participant or by CDS in Settlement of the securities component of its DetNet Obligation, the payment component of that DetNet Obligation shall be adjusted accordingly; <u>when a partial payment is made by a participant or by CDS in Settlement of the payment component of its DetNet Obligation, the securities component of that DetNet Obligation shall be adjusted accordingly.</u> If a DetNet Obligation of a participant or of CDS is not Settled in full on its Value Date because any or all of the Securities due to be delivered in respect of the DetNet Obligation are not delivered <u>or because any or all of the payments due to be made in respect of the DetNet Obligation are not made,</u> then the Value Date of the outstanding DetNet Obligation will be changed to the next Business Day, and will be netted with the like DetNet Obligations of CDS and of that participant for the new Value Date. The revision and recalculation of the DetNet Obligation will continue until it is Settled in full. <u>To encourage the timely Settlement of DetNet Obligations, CDS may impose a fee in respect of any delayed or partial delivery of the Securities to be delivered pursuant to a DetNet Obligation or in respect of any delayed or partial payment to be made pursuant to a DetNet Obligation.</u></p> | <p>under the securities component of a DetNet Obligation if it has not received the delivery of all such Securities under the securities component of another of its DetNet Obligations with another participant. When a partial delivery of Securities is made by a participant or by CDS in Settlement of the securities component of its DetNet Obligation, the payment component of that DetNet Obligation shall be adjusted accordingly; when a partial payment is made by a participant or by CDS in Settlement of the payment component of its DetNet Obligation, the securities component of that DetNet Obligation shall be adjusted accordingly. If a DetNet Obligation of a participant or of CDS is not Settled in full on its Value Date because any or all of the Securities due to be delivered in respect of the DetNet Obligation are not delivered or because any or all of the payments due to be made in respect of the DetNet Obligation are not made, then the Value Date of the outstanding DetNet Obligation will be changed to the next Business Day, and will be netted with the like DetNet Obligations of CDS and of that participant for the new Value Date. The revision and recalculation of the DetNet Obligation will continue until it is Settled in full. To encourage the timely Settlement of DetNet Obligations, CDS may impose a fee in respect of any delayed or partial delivery of the Securities to be delivered pursuant to a DetNet Obligation or in respect of any delayed or partial payment to be made pursuant to a DetNet Obligation.</p> |
| <p>7.4.6 Marks</p> | <p>7.4.6 Marks</p> |
| <p>(a) Daily Mark</p> | <p>(a) Daily Mark</p> |
| <p>For each Business Day that a CNS Obligation is outstanding, CDS shall calculate in accordance with the Procedures the daily Mark in respect of that CNS Obligation. The daily Mark reflects the then current market price of the Securities that are to be delivered or received on Value Date by the participant in respect of that CNS Obligation. The daily Mark is an amount that shall be paid on that Business Day either to CDS by the participant owing the CNS Obligation, or by CDS to that participant. In addition, on that Business Day the payment component of the CNS Obligation is adjusted by the amount of the daily Mark.</p> | <p>For each Business Day that a CNS Obligation is outstanding, CDS shall calculate in accordance with the Procedures the daily Mark in respect of that CNS Obligation. The daily Mark reflects the then current market price of the Securities that are to be delivered or received on Value Date by the participant in respect of that CNS Obligation. The daily Mark is an amount that shall be paid on that Business Day either to CDS by the participant owing the CNS Obligation, or by CDS to that participant. In addition, on that Business Day the payment component of the CNS Obligation is adjusted by the amount of the daily Mark.</p> |
| <p>(b) Fail Mark</p> | <p>(b) Fail Mark</p> |
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No amount shall be drawn under a Line of Credit or a System Operating Cap in respect of a CNS Mark.</p> <p>7.4.8 Partial Delivery and Delayed Delivery Partial Settlement and Delayed Settlement</p> <p>(a) Effect of Partial or Delayed Delivery Settlement</p> <p>A partial or delayed delivery of Securities by a participant or CDS under a CNS Obligation is not grounds for suspension under Rule 9.1.2. CDS may also delay the receipt of Securities that it is due to receive under the securities component of a CNS Obligation if it is unable to re-deliver such Securities under the securities component of another of its CNS Obligations with another participant. CDS may delay the receipt of, or take partial receipt of, Securities that it is due to receive under the securities component of a CNS Obligation if it is unable to re-deliver all such Securities under the securities component of another of its CNS Obligations with another participant, and may delay the delivery of, or make partial delivery of, Securities that is due to deliver under the securities component of a CNS Obligation if it has not received the delivery of all such Securities under the securities component of another of its CNS Obligations with another participant. When a partial delivery of Securities is made by a participant or by CDS in Settlement of the securities component of its CNS Obligation, the payment component of that CNS Obligation shall be adjusted accordingly; when a partial payment is made by a participant or by CDS in Settlement of the payment component of its CNS Obligation, the securities component of that CNS Obligation shall be adjusted accordingly. 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The payment component of the CNS Obligation is not adjusted by the amount of the fail Mark.</p> <p>(c) Payment of Net Mark</p> <p>CDS calculates a net amount owing to or by each participant in respect of Marks for CNS by netting all CNS Marks to be paid or received by that participant and the net CNS Mark is credited to or debited from the Funds Account of the participant. 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