

13.1.3 CDS Notice and Request for Comments – Material Amendments to CDS Procedures Relating to Maximum Debt Trade Amount

CDS CLEARING AND DEPOSITORY SERVICES INC. (CDS)

MATERIAL AMENDMENTS TO CDS PROCEDURES

MAXIMUM DEBT TRADE AMOUNT

REQUEST FOR COMMENTS

A. DESCRIPTION OF THE PROPOSED AMENDMENTS

At the request of its participants and the Investment Industry Association of Canada, CDS is proposing amendments to its procedures providing that trades in debt securities with a par value greater than CAD 50 million be split into CAD 50 million or smaller increments. This would apply to, but not be limited to, all Government of Canada Bonds, Government of Canada T-Bills, Canada Housing Trust Securities, and all Provincial Bonds and T-Bills. The proposed amendments will reduce delays in settlement and failed settlement of large value trades of debt securities.

B. NATURE AND PURPOSE OF THE PROPOSED AMENDMENTS

The purpose of the proposed amendments is to reduce (1) market inefficiency and (2) the potential for financial loss and/or liquidity issues. More specifically, without a maximum split rule, some participants have been required to settle very large transactions or opt to consolidate and deliver such positions very late in the trading day. This practice has resulted in the failure to settle of large transactions where the participant lacks sufficient credit or a sufficient position on CDS's ledger and where it is too late to initiate corrective action. In order to avoid the failure of such large value transactions, participants have been required to either request a delay in CDS's payment exchange or resort to splitting the transaction into multiple settlement blocks, each of which falls within a participant's available credit limit or available securities position.

The proposed amendments will not, however, affect delivery of large value debt trades in CDSX where they are submitted for delivery versus payment to Her Majesty the Queen in right of Canada, as represented by the Minister of Finance, for Tri-Party Repo Transactions. These trades must be submitted exactly as executed. In addition, certain transaction types internal to CDS will be exempt from the cap for operational reasons.

C. IMPACT OF PROPOSED AMENDMENTS

The proposed amendments, which limit the maximum delivery size of a debt trade to CAD 50 million, require CDS participants to break trades in excess of that limit in multiple trades. The effect of this maximum delivery size will be to reduce the risk of settlement delays and/or failures involving large positions and settlement value.

In order for the implementation of the maximum delivery size to be successful, both CDS participants and the clients for whom they execute such large value trades in debt securities, must report the trade splits to their custodian in exactly the same way. Unless this reporting is done, securities custodians will be unable to match their institutional trades in a timely fashion and will not be in compliance with National Instrument 24-101 – *Institutional Trade Matching and Settlement*, which is intended to come into force on April 1st, 2007.

A further advantage of the proposed amendments may include a decrease in the inventory required to be segregated for clearing purposes, which will reduce costs for CDS participants and market participants.

D. DESCRIPTION OF THE PROCEDURE DRAFTING PROCESS

CDS is recognized as a clearing agency by the Ontario Securities Commission pursuant to Section 21.2 of the Ontario *Securities Act* and as a self-regulatory organization by the Autorité des marchés financiers pursuant to Section 169 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".

CDS Procedure Amendments originate from a number of sources, both internal and external, and may be standalone or consequential amendments. Standalone amendments are most often necessitated by internal systems changes or service enhancements, while consequential amendments stem from amendments to CDS Participant Rules and/or other regulatory requirements. CDS Procedure Amendments are reviewed and approved by CDS's Strategic Development Review Committee.

The amendments to Participant Procedures 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

The immediate impact of the proposed amendments will be that participants will be required to submit large value debt trades in CAD 50 million maximum increments with a single "tail" for the remainder. For example, where a trade of CAD 325 million was previously submitted as a single trade, it will now be six trades of CAD 50 million and one trade of CAD 25 million. The proposed mandatory split may result in an increase in the number, but not the value, of trades submitted.

In the longer term, the clearly defined maximum debt trade value in the proposed amendments will be of significant value to the Canadian debt marketplace in the following ways:

- The establishment of a clear definition will offer participants the opportunity further to automate their trading and clearing systems and will increase the potential for straight-through-processing.
- The establishment of a clear definition will result in less time, and less processing resources being expended by trading and operations staff in order to calculate the required splits.

F. COMPARISON TO OTHER CLEARING AGENCIES

The proposed amendments are similar to the rules governing the settlement of debt trades in the United States. The Rules of the Government Securities Division of the Fixed Income Clearing Corporation ("FICC"), a subsidiary of the Depository Trust and Clearing Corporation, addresses the issue of large value debt trades at Section 4 of Rule 5 – *Comparison System*. The text of the rule is as follows:

"The following requirements shall apply to all trades that are submitted to the Corporation by a Member, including all trades that are submitted on behalf of any Affiliate or Executing Firm.

A trade with a par value of \$50 million or less must be submitted to the Corporation in the full size and in the exact amount in which the trade was executed. Trades for over \$50 million must be submitted in an equivalent number of \$50 million trades and a single tail for the remaining amount.

Notwithstanding the above: (i) GCF Repo Transactions must be submitted exactly as executed, and (ii) when the Corporation deems it appropriate and advises Members of such, Members using the Interactive Submission Method may submit Full-Sized trades exactly as executed, for amounts over \$50 million. The Corporation shall establish procedures governing the manner in which the Corporation shall compare Full-Sized Trades to trades submitted in pieces and the order in which such comparison shall occur. The Corporation shall inform Members of these procedures by notice prior to their implementation.

The Corporation may discipline a Member for a violation of this section..."

The proposed amendments to CDS procedures are intended to mirror the restrictions imposed by the FICC Rules.

G. PUBLIC INTEREST ASSESSMENT

An analysis of the impact of the proposed amendments on the Participant Procedures and CDS technological systems has determined that the implementation of these amendments would not be contrary to the public interest.

H. COMMENTS

Comments on the proposed amendments should be in writing and delivered by April 9, 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

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
Tour de la Bourse
800, square Victoria, C.P. 246, 22^e étage
Montréal, Québec H4Z 1G3

Télécopieur: 514-864-6381
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Cindy Petlock
Manager, Market Regulation
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Ontario Securities Commission
Suite 1903, Box 55,
20 Queen Street West
Toronto, Ontario M5H 3S8

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

I. PROPOSED PROCEDURE AMENDMENTS

Appendix "A" contains text of current CDS Participant Procedure marked to reflect proposed amendments as well as text of these procedures reflecting the adoption of the proposed amendments.

J. QUESTIONS

Questions regarding this notice may be directed to:

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

Fax: 416-365-1984
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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>CHAPTER 4 Non-exchange trades ... <u>Maximum debt trade amount</u></p> <p><u>Debt trades entered directly into CDS by a CDSX participant with a delivery versus payment par value of \$50 million or less must be submitted in the par value and net amount in which the trade was executed. A debt trade with a delivery versus payment par value in excess of \$50 million must be submitted in par value increments of \$50 million and a single tail for any remaining amount.</u></p> <p><u>The following is exempt from the \$50 million maximum amount:</u></p> <ul style="list-style-type: none"> • <u>Receiver General of Canada tri-party repo transactions (i.e., tri-party repo trades). These trades are identified by the CUID RBCC and the internal account T13055391.</u> • <u>Trades automatically generated as a result of processing by CDSX, ATON, IMHub, cross border moves with DTC and any other CDS system.</u> 	<p>CHAPTER 4 Non-exchange trades ... Maximum debt trade amount</p> <p>Debt trades entered directly into CDS by a CDSX participant with a delivery versus payment par value of \$50 million or less must be submitted in the par value and net amount in which the trade was executed. A debt trade with a delivery versus payment par value in excess of \$50 million must be submitted in par value increments of \$50 million and a single tail for any remaining amount.</p> <p>The following is exempt from the \$50 million maximum amount:</p> <ul style="list-style-type: none"> • Receiver General of Canada tri-party repo transactions (i.e., tri-party repo trades). These trades are identified by the CUID RBCC and the internal account T13055391. • Trades automatically generated as a result of processing by CDSX, ATON, IMHub, cross border moves with DTC and any other CDS system.