

Chapter 13

SRO Notices and Disciplinary Proceedings

13.1.1 CDS Notice and Request for Comments – Material Amendments to CDS Procedures Relating to Exchange Trades

CDS CLEARING AND DEPOSITORY SERVICES INC. (CDS)

MATERIAL AMENDMENTS TO CDS PROCEDURES

EXCHANGE TRADES

REQUEST FOR COMMENTS

A. DESCRIPTION OF THE PROPOSED AMENDMENTS

The proposed amendments to the CDS User Guide entitled *Trade and Settlement Procedures* set out the criteria which CDS uses to determine whether a trade originating from one of several sources (exchanges, quotation and trade reporting systems (QTRS), or alternative trading systems (ATS)) can properly be described as an exchange or non-exchange trade for the purposes of settlement in CDS's clearing and settlement system, CDSX. For the purposes of CDS's operations, an entity may only qualify as an eligible source of exchange trades if, among other requirements, it is subject to securities regulation by virtue of National Instrument 21-101 – *Marketplace Operation*.

With the introduction of several new marketplaces, CDS has been requested to clarify its position and eligibility criteria with respect to the acceptance of exchange trades in CDSX and, consequently, the criteria which a supplying organization must meet in order to qualify as an eligible source for such trades. The proposed amendments are intended to ensure that CDS has sufficient confidence in the source of the exchange trades and in the enforceability of the trades that such a source submits to CDS. This confidence is necessary because CDS considers such exchange trades as being matched for confirmation and settlement.

B. NATURE AND PURPOSE OF THE PROPOSED AMENDMENTS

The purposes of the proposed amendments are twofold. First, the proposed amendments outline the specific criteria and requirements under which, and according to which, CDS will treat a trade submitted to CDSX as an exchange trade for the purposes of settlement in CDS's system; and second, the proposed amendments incorporate the process through which a potential source of exchange trades (possible sources being those enumerated in section A, above) must apply to CDS in order to be considered a source of exchange trades. In addition the proposed amendments outline CDS's requirements in respect of the documentation required in order for an entity to be permitted to submit exchange trades to CDSX.

First, the proposed amendments set out the two principal criteria for eligibility as an exchange trade for the purposes of settlement in CDSX. They are:

- i) that a trade be executed on an exchange or QTRS that is regulated by a Canadian securities regulator; and
- ii) that a trade be executed on an ATS which is a member of, and recognized as an Acceptable Trade Matching Utility by, the Investment Dealers Association of Canada (IDA).

The proposed amendments also incorporate the specific requirement that, in order to ensure that they are confirmed for settlement within CDSX, such trades *must* be matched prior to delivery to the system and cannot be modified by the Participants prior to settlement.

Second, the proposed amendments detail the procedure by which a prospective source of exchange trades applies to become such a source and imposes the following restriction: in the event that a source of exchange trades no longer meets the criteria required to qualify as an eligible source, CDS may, at its discretion, suspend the marketplace as a source of exchange trades until such time as the criteria are fully met.

The proposed amendments, therefore, impose restrictions on which trades qualify as exchange trades and, in so doing, impose the same restrictions on an entity which submits, or proposes to submit, exchange trades to the CDSX system.

C. IMPACT OF PROPOSED AMENDMENTS

The proposed amendments are made in order to facilitate, and render more transparent, the process by which exchanges, QTRS' and ATS' become sources of eligible exchange trades for the CDSX system. The proposed amendments introduce the evaluation criteria and requirements for such eligibility. Whereas in the past, new marketplaces applied to CDS to become a source of such trades on an *ad hoc* basis, the proposed amendments clearly define CDS's requirements in this regard.

CDS expects the clarifications that the proposed amendments represent to contribute to a more streamlined approach to establishing sources of exchange trades for the purposes of settlement within the CDSX system. Further, the establishment of a principles-based approach to assessing the suitability of a marketplace as a source of exchange trades - rather than the specific iteration of eligible sources of exchange trades, as is currently the case in CDS's Participant Procedures - will promote the twin goals of regulatory consistency and efficiency.

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' 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 proposed amendments will have only the following minimal impacts on the technological systems of CDS, its participants, and/or the securities market as a whole:

- Following the application process and the acceptance of a marketplace as an eligible source of exchange trades, the CDSX list of source identifiers for exchange trades will be updated by CDS personnel. In reports originating from CDSX to its Participants, the new source identifier will appear and, in the event that such reports segregate trades by source, the new source will also be so segregated.
- To the extent that a CDS Participant, service bureau, or other user of CDSX or its reports manipulates data provided within CDSX reports, and in which a new source identifier could appear, such manipulation may have to account for the addition of the new source identifier. CSDX users will be informed of any such addition.

No other internal or external impacts are anticipated as a result of the proposed amendments.

F. COMPARISON TO OTHER CLEARING AGENCIES

Due to the significant differences inherent in both the regulatory environments and market structures within which other clearing agencies operate, a direct comparison to the operations of such other clearing agencies is not possible.

The principle of a clearing agency accepting trades the details of which have been verified and the enforceability of which can be relied upon for the purposes of settlement, however, remains. CDS and its closest comparable system, the National Securities Clearing Corporation (NSCC), both accept trades which each clearing agency considers to be legally binding contracts; these exchange trades are known as "matched" trades in Canada and "locked-in" trades in the United States. Prior to their submission to the clearing agency, these trades have been compared such that the details of the trade have been confirmed with the parties to the trade.

In the Canadian context, marketplaces are distinct and independent of their regulators. In the United States, however, the exchanges from which the NSCC receives its 'locked-in' trades are considered to be Self-Regulatory Organizations (SROs) in and of themselves, and have been recognized as such by the United States Securities and Exchange Commission (SEC). NSCC Rule 7, Section 1, for example, states that when a marketplace or exchange assumes responsibility for trade comparison for transactions subject to the rules of such an entity, NSCC will no longer provide comparison services for those transactions.

The rules of these SROs, and the recognition of the SROs by the SEC, create a similar legal obligation, and a similar level of legal comfort and contractual enforceability, to the process that CDS is seeking to codify with the proposed amendments.

An exchange or QTRS shown to be regulated by National Instrument 21-101, or an ATS which meets the requirements of IDA Regulation 800.49, and which, respectively, provide CDS with a representation with respect to the enforceability of transactions made on that marketplace, will permit CDS to accept such organizations as eligible *sources* of exchange trades and, therefore, the trades they submit as exchange trades.

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 March 12, 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
Courriel :
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 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
e-mail: attention@cds.ca

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 1 - Introduction to trade and settlement</p> <p>CDSX provides clearing, depository and entitlement services for eligible instruments. CDS identifies trades as either exchange or non-exchange trades. Exchange trades are always pre-matched trades. They are made up of, but not limited to, of trades originating from an accepted exchange marketplace, which includes exchanges, quotation and trade reporting systems (QTRS) and alternative trading systems (e.g., the TSXATS). Exchange trades are created in CDSX with a confirmed status and are ready for settlement. Pre-matched non-exchange trades include northbound cross-border activity as well as trades originating from an authorized VMU. CDS determines if trades should be classified as exchange or non-exchange. For more information, see Exchange trades on page 19 and Non-exchange trades on page 25.</p> <p>1.1 Life cycle of a trade</p> <p>Trades may be reported to CDSX:</p> <ul style="list-style-type: none"> • Directly by the participant (or their service bureau) • By an authorized third party (e.g., exchange, VMU) • By a CDSX subsystem (e.g., NCS, broker-to-broker matching utilityTrade Matching Service). <p>In a trade, there are two parties, the submitter and the acceptor, and two roles, the buyer and the seller. There is no restriction on which participant, the buyer or the seller, enters the trade details. Whoever enters the trade details becomes the submitter; the other participant becomes the acceptor. A participant's role, in conjunction with the source of the trade, determines the extent to which each party can modify the trade.</p> <p>In the simplest life cycle, the submitter inputs the trade and the acceptor confirms. When the trade is confirmed, CDSX performs a settlement check and settles the trade on value date if positions are available in the appropriate accounts. The positions move immediately.</p> <p>The trade functions in CDSX enable the buyer and the seller of a security to process the transaction online. Alternatively, participants may also submit batch and InterLink messages. For file and message layouts, refer to <i>CDS Batch and Interactive Services – Technical Information</i>.</p> <p>Trade ID</p> <p>Each trade is assigned a transaction ID (for example, T02045-17357) when the request is saved. In this example, the T identifies the transaction as a trade and 02045 is the Julian date when the request was entered (February 14,</p>	<p>Chapter 1 - Introduction to trade and settlement</p> <p>CDSX provides clearing, depository and entitlement services for eligible instruments. CDS identifies trades as either exchange or non-exchange trades. Exchange trades are always pre-matched trades. They are made up of trades originating from an accepted marketplace, which includes exchanges, quotation and trade reporting systems (QTRS) and alternative trading systems (ATS). Exchange trades are created in CDSX with a confirmed status and are ready for settlement. Pre-matched non-exchange trades include northbound cross-border activity as well as trades originating from an authorized VMU. CDS determines if trades should be classified as exchange or non-exchange. For more information, see Exchange trades on page 19 and Non-exchange trades on page 25.</p> <p>1.1 Life cycle of a trade</p> <p>Trades may be reported to CDSX:</p> <ul style="list-style-type: none"> • Directly by the participant (or their service bureau) • By an authorized third party (e.g., exchange, VMU) • By a CDSX subsystem (e.g., NCS, Trade Matching Service). <p>In a trade, there are two parties, the submitter and the acceptor, and two roles, the buyer and the seller. There is no restriction on which participant, the buyer or the seller, enters the trade details. Whoever enters the trade details becomes the submitter; the other participant becomes the acceptor. A participant's role, in conjunction with the source of the trade, determines the extent to which each party can modify the trade.</p> <p>In the simplest life cycle, the submitter inputs the trade and the acceptor confirms. When the trade is confirmed, CDSX performs a settlement check and settles the trade on value date if positions are available in the appropriate accounts. The positions move immediately.</p> <p>The trade functions in CDSX enable the buyer and the seller of a security to process the transaction online. Alternatively, participants may also submit batch and InterLink messages. For file and message layouts, refer to <i>CDS Batch and Interactive Services – Technical Information</i>.</p> <p>Trade ID</p> <p>Each trade is assigned a transaction ID (for example, T02045-17357) when the request is saved. In this example, the T identifies the transaction as a trade and 02045 is the Julian date when the request was entered (February 14,</p>

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<p>2002, the 45th day of the year). The remaining numbers are generated by CDSX to ensure a unique identifier. The trade ID displays online, on reports and in messages in CDSX.</p>	<p>2002, the 45th day of the year). The remaining numbers are generated by CDSX to ensure a unique identifier. The trade ID displays online, on reports and in messages in CDSX.</p>
<p>1.2 Trade functions</p>	<p>1.2 Trade functions</p>
<p>The trade functions are:</p>	<p>The trade functions are:</p>
<ul style="list-style-type: none"> • Enter Non-Exchange Trade – The submitter enters the trade details for regular non-exchange trades. For trade matching of non-exchange trades, both parties enter the trade details. For more information, see Entering non-exchange trades on page 27. • Modify Non-Exchange Trade – Both parties use this function to change non-exchange trade details. For more information, see Modifying non-exchange trades on page 31. • Inquire Non-Exchange Trade – Both parties can display information on their non-exchange trades. For more information, see Inquiring on non-exchange trades on page 29. • Inquire Exchange Trade – Both parties in an exchange trade can display information on their trades. For more information, see Inquiring on exchange trades on page 20. • Modify Exchange Trade – Both parties use this function to change their settlement control indicator for their exchange trades. For more information, see Requesting modifications to exchange trades on page 22. • Maintain Default Settlement Accounts – Participants can establish the settlement account against which CDSX should default their trades. For more information, see Maintaining default settlement accounts on page 15 and Maintaining alternate settlement accounts on page 16. • Inquire Default Settlement Accounts – Participants can display information on their default accounts. For more information, see Inquiring on default and alternate settlement accounts on page 17. 	<ul style="list-style-type: none"> • Enter Non-Exchange Trade – The submitter enters the trade details for regular non-exchange trades. For trade matching of non-exchange trades, both parties enter the trade details. For more information, see Entering non-exchange trades on page 27. • Modify Non-Exchange Trade – Both parties use this function to change non-exchange trade details. For more information, see Modifying non-exchange trades on page 31. • Inquire Non-Exchange Trade – Both parties can display information on their non-exchange trades. For more information, see Inquiring on non-exchange trades on page 29. • Inquire Exchange Trade – Both parties in an exchange trade can display information on their trades. For more information, see Inquiring on exchange trades on page 20. • Modify Exchange Trade – Both parties use this function to change their settlement control indicator for their exchange trades. For more information, see Requesting modifications to exchange trades on page 22. • Maintain Default Settlement Accounts – Participants can establish the settlement account against which CDSX should default their trades. For more information, see Maintaining default settlement accounts on page 15 and Maintaining alternate settlement accounts on page 16. • Inquire Default Settlement Accounts – Participants can display information on their default accounts. For more information, see Inquiring on default and alternate settlement accounts on page 17.
<p>Chapter 3 - Exchange trades</p>	<p>Chapter 3 - Exchange trades</p>
<p>Exchange trades are delivered to CDS directly from an exchange, another external clearing organization or a third party. In all cases, exchange trades are delivered to CDS with a matched status and cannot be modified by the participant. These trades are reported to participants with a confirmed status.</p>	<p>Exchange trades are reported as between two CDS participants and are delivered to CDS directly from a source of exchange trades. Eligible sources of exchange trades are certain marketplaces, as defined by the Canadian Securities Administrators' National Instrument 21-101 - Marketplace Operation, and may be either an exchange, quotation and trade reporting system (QTRS) or alternative trading system (ATS).</p>
<p>GDS identifies the source of all exchange trades, which is reported in file transmissions and InterLink messages. Currently, CDS identifies the following sources:</p>	<p>To be eligible as an exchange trade, the trade must be:</p>
<ul style="list-style-type: none"> • CDCC for exercised options delivered to CDS by the Canadian Derivatives Clearing Corporation (CDCC) 	<ul style="list-style-type: none"> (i) a trade executed on an exchange or QTRS that is regulated by a Canadian securities regulatory authority;

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<p> <ul style="list-style-type: none"> • TSE and CDNX for trades originating from TSX • CNQ for trades originating from the Canadian Trading and Quotation system • TCM for trades originating from TriAct Canada Marketplace LP • PURE for trades originating from Pure Trading. <p><u>Exchange trades are reported as between two CDS participants and are delivered to CDS directly from a source of exchange trades. Eligible sources of exchange trades are certain marketplaces, as defined by the Canadian Securities Administrators' National Instrument 21-101 - Marketplace Operation, and may be either an exchange, quotation and trade reporting system (QTRS) or alternative trading system (ATS).</u></p> <p><u>To be eligible as an exchange trade, the trade must be:</u></p> <p>(i) <u>a trade executed on an exchange or QTRS that is regulated by a Canadian securities regulatory authority;</u> <u>or</u></p> <p>(ii) <u>a trade executed on an ATS that is a member of the Investment Dealers Association of Canada (IDA) and identified by the IDA as an Acceptable Trade Matching Utility for the purposes of Regulation 800.49.</u></p> <p><u>Exchange trades may also be received on behalf of sources of exchange trades from another external clearing organization, or a CDS participant.</u></p> <p><u>A marketplace must supply CDS Customer Service with documentation that provides assurance that the responsibility for the delivery of trades rests with the marketplace or its agent.</u></p> <p><u>To ensure that exchange trades are confirmed for settlement by CDSX, they must be matched prior to delivery to CDSX and cannot be modified by the participants prior to settlement. These trades will be reported to participants as confirmed by CDSX.</u></p> <p><u>In order to qualify as a source of exchange trades in CDSX, marketplaces must submit the Application for Use by a Marketplace Requesting Designation as a Source of Exchange Trades in CDSX form (CDSX818) to confirm that the marketplace meets the above criteria. In the event that the marketplace no longer meets any one or more of the criteria required to qualify as a source of exchange trades, CDS may, at its discretion, suspend the marketplace as a source of exchange trades.</u></p> <p><u>CDS identifies the sources of all exchange trades, and reports this source in file transmissions and InterLink messages. The current list of sources is maintained on the CDS website (www.cds.ca).</u></p> </p>	<p>or</p> <p>(ii) a trade executed on an ATS that is a member of the Investment Dealers Association of Canada (IDA) and identified by the IDA as an Acceptable Trade Matching Utility for the purposes of Regulation 800.49.</p> <p>Exchange trades may also be received on behalf of sources of exchange trades from another external clearing organization, or a CDS participant.</p> <p>A marketplace must supply CDS Customer Service with documentation that provides assurance that the responsibility for the delivery of trades rests with the marketplace or its agent.</p> <p>To ensure that exchange trades are confirmed for settlement by CDSX, they must be matched prior to delivery to CDSX and cannot be modified by the participants prior to settlement. These trades will be reported to participants as confirmed by CDSX.</p> <p>In order to qualify as a source of exchange trades in CDSX, marketplaces must submit the Application for Use by a Marketplace Requesting Designation as a Source of Exchange Trades in CDSX form (CDSX818) to confirm that the marketplace meets the above criteria. In the event that the marketplace no longer meets any one or more of the criteria required to qualify as a source of exchange trades, CDS may, at its discretion, suspend the marketplace as a source of exchange trades.</p> <p>CDS identifies the sources of all exchange trades, and reports this source in file transmissions and InterLink messages. The current list of sources is maintained on the CDS website (www.cds.ca).</p> <p>CDSX applies the following rules to exchange trades reported by an eligible source:</p> <ul style="list-style-type: none"> • The seller is the submitter and the buyer is the acceptor. • Based on instructions from the source of the trade, the security eligibility and the participant's eligibility, exchange trades are targeted to settle by trade-for-trade (TFT) settlement, certificate-based settlement (CBS) or continuous net settlement (CNS). • Direct participant (DP) and mandatory cash (MC) are the only valid trade types. • Mandatory cash trades are defaulted to settle by TFT. • Exchange trades are reported with a confirmed status. • Exchange trades where the mode of settlement is CNS or CBS are defaulted to settle to the participant's GA 000.

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