

13.3.2 CDS Clearing and Depository Services Inc. (CDS) – Notice and Request for Comment – Proposed Amendments to CDS Participant Rules related to Post-Trade Modernization

CDS CLEARING AND DEPOSITORY SERVICES INC. (“CDS”)

PROPOSED AMENDMENTS TO
CDS PARTICIPANT RULES
(the “RULES”)

RELATED TO
POST-TRADE MODERNIZATION

REQUEST FOR COMMENTS

A. BACKGROUND, NATURE, AND PURPOSE OF THE PROPOSED CDS RULE AMENDMENTS

The CDS Post-Trade Modernization project (“**PTM Initiative**”) was initiated in 2017 and is expected to take effect in Q4 2021. The objective of the project is the wholesale upgrade of the CDS clearing, settlement, and depository platform; modern software and infrastructure will permit additional flexibility for future changes and will ease future support activities. In the planning and execution of the PTM Initiative, CDS undertook to minimize the systemic and documentary impact on CDS’s Participants. A large-scale initiative such as the PTM Initiative, and the consequential changes to the CDS systems and related processes, result in corresponding amendments to the Rules. A detailed internal review of the Rules for the proposed amendments, followed by an extended review process involving CDS Participants and stakeholders, has identified both certain material changes to the Rules and some additional housekeeping amendments (collectively, “**Proposed PTM Amendments**”).

B. DESCRIPTION OF THE PROPOSED AMENDMENTS

Material Rules

Appendix 1 provides specific description(s) of the amendments (“**Proposed Material Amendments**”) to the Rules that fall within the meaning of material rules (“**Material Rules**”), as defined under Appendix A of the Recognition Order issued by the Ontario Securities Commission on July 4, 2012, as amended (the “**Recognition Order**”).

Technical Rules

Appendix 2 provides specific description(s) of the amendments (“**Proposed Technical Amendments**”) to the Rules that are:

- (a) matters of a technical nature in routine operating procedures and administrative practices relating to the CDS services;
- (b) consequential amendments intended to implement a material rule that has been published for comment which only contain material aspects already contained in the material rule or disclosed in the notice accompanying the material rule;
- (c) the correction of spelling, punctuation, typographical or grammatical mistakes or inaccurate cross-referencing; and
- (d) stylistic formatting, including changes to headings or paragraph numbers.

The Proposed Technical Amendments fall within the meaning of technical rules (“**Technical Rules**”), as defined in the Recognition Order.

Materials Available for Review

1. The clean versions of Rules 1 to 12, which have incorporated all the Proposed PTM Amendments, as well as all the Clean-up Changes that were published for comment on June 11, 2020 (the “**Revised Rules**”)¹; and
2. The blacklined versions of the Revised Rules, which track all the Proposed PTM Amendments;

are made available by CDS for review at the following link to CDS’s website:

<https://www.cds.ca/bulletins-and-resources/user-resources/publications/proposed-ptm-related-amendments-to-cds-participant-rules?lang=en>

¹ CDS anticipates receiving regulatory decisions in Q4 2020 regarding all the Clean-up Changes to the Rules that were published for comment on June 11, 2020.

C. IMPACT OF THE PROPOSED CDS RULE AMENDMENTS ON CDS AND CDS PARTICIPANTS

Please refer to Appendix 1, which summarizes the material impact, if any, of the Proposed Material Amendment on CDS, Participants and other stakeholders. Other than those set out in Appendix 1, CDS is not aware of any other material impact on CDS, Participants, other market participants or the securities and financial markets in general.

C.1 Competition & Conflict of Interest Analysis

The Proposed Material Amendments result from changes to CDS clearing, settlement, and depository systems. As concerns fair access and conflict of interest issues, CDS does not believe any individual, or subset of, Participants will be disadvantaged or otherwise prejudiced by the introduction of the Proposed Material Amendments.

C.2 Risks and Compliance Costs

While CDS acknowledges that the PTM Initiative will impact Participants and stakeholders, the Proposed Material Amendments are not expected to result in any direct compliance costs for CDS, Participants, or other market participants.

C.3 Comparison to International Standards

Observance of PFMI standards is a requirement under CDS's Recognition Order as well as under National Instrument 24-102 (Clearing Agency Requirements) and related Companion Policy 24-102CP. The Proposed Material Amendments have been evaluated against, and do not affect, CDS's observance of, and compliance with, these standards.

D. DESCRIPTION OF THE RULE DRAFTING PROCESS

D.1 Development Context

The Proposed PTM Amendments are drafted by CDS legal personnel, in consultation and collaboration with all relevant CDS departments and project management personnel, including, without limitation, subject matter experts from CDS Risk Management, Integrated Operations, Tax Processing, and Relationship Management areas. Draft Rules are subsequently reviewed by the CDS Legal Drafting Group, one of several CDS Participant Advisory Committees provided for under CDS's regulatory oversight framework.

D.2 Rule Drafting Process

The proposed changes to CDSX and related processes resulting from the PTM Initiative are captured in the Change Assessment Documents², which had been reviewed and discussed with Participants. The Proposed Material Amendments have been drafted to reflect the changes that are detailed in the Change Assessment Documents, to the extent such changes impact the Rules.

The Proposed PTM Amendments were circulated to CDS's Legal Drafting Group (the "LDG") in mid-June 2020.³ Three (3) LDG meetings were subsequently convened to review the proposed amendments. The LDG was requested to provide their feedback by August 4, 2020. LDG did not raise any objection to the proposed amendments.

D.3 Issues Considered

In drafting the Proposed PTM Amendments, CDS's primary objective is to ensure that the Rules will accurately capture the changes to CDSX and related processes under PTM, which are expected to take effect in Q4 2021.

D.4 Consultation

The Proposed PTM Amendments were circulated to the LDG for review between mid-June and early August, 2020. Please refer to Section D.2 above. CDS presented the proposed amendments to the Risk Management and Audit Committee of the Board, and the CDS Board of Directors itself, (the "Board"), on September 28, 2020, subsequent to which meeting the Board approved the Proposed Amendments for filing with CDS's regulators and for publication.

D.5 Alternatives Considered

In light of the nature of and reason for the Proposed PTM Amendments, no alternatives were considered.

² The Change Assessment Documents are posted on the PTM Portal, which was set up by CDS to provide centralized access to documents related to PTM. All Participants, service providers, and Recognizing Regulators have access to the PTM Portal.

³ The LDG is an ad hoc advisory committee composed of legal and business representatives of Participants.

D.6 Implementation Plan

CDS is recognized as a clearing agency by the Ontario Securities Commission pursuant to section 21.2 of the *Securities Act* (Ontario), by the British Columbia Securities Commission pursuant to Section 24(d) of the *Securities Act* (British Columbia) and by the Autorité des marchés financiers (“AMF”) pursuant to section 169 of the *Securities Act* (Québec). 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 British Columbia Securities Commission, the Autorité des marchés financiers and the Bank of Canada will hereafter be collectively referred to as the “Recognizing Regulators”.

The Proposed PTM Amendments will come into effect on a date to be determined by CDS, such date (expected to be in Q4 2021) will be after the required public notice and comment period, approval of the Proposed Material Amendments by the Recognizing Regulators, and publication of notice of approval to Participants.

E. TECHNOLOGICAL SYSTEM CHANGES

The Proposed PTM Amendments are triggered by proposed changes to CDSX and related processes as a result of PTM. The proposed changes under PTM will impact technological systems, and require changes to such systems for CDS, Participants, or other market participants. The expected impact and required changes are under continuous discussion and review with the PTM Industry Engagement Working Group⁴ to ensure CDS’s, Participants’, and other market participants’ readiness when the new system goes live (expected to be in Q4 2021).

F. COMPARISON TO OTHER CLEARING AGENCIES

CDS is of the view that the Proposed PTM Amendments and their purpose do not deviate from the standards and practices of other international clearing agencies that are comparable to CDS, such as the Depository Trust & Clearing Corporation (“DTCC”) and its subsidiary National Securities Clearing Corporation (“NSCC”) in the United States.

G. PUBLIC INTEREST ASSESSMENT

CDS believes that the Proposed PTM Amendments are not contrary to the public interest.

H. COMMENTS

Comments on the Proposed PTM Amendments must be made in writing and submitted by January 15, 2021 to:

CDS Clearing and Depository Services Inc.
Attn: Legal Department, Tony Hoffmann, Senior Legal Counsel
100 Adelaide Street West – Suite 300
Toronto, Ontario, M5H 1S3
Email: tony.hoffmann@tmx.com

with a copy to Deanna Dobrowsky
Email: deanna.dobrowsky@tmx.com

Copies should also be provided to the Autorité des marchés financiers, British Columbia Securities Commission and the Ontario Securities Commission by forwarding a copy to each of the following individuals:

Philippe Lebel
Corporate Secretary and
Executive Director, Legal Affairs
Autorité des marchés financiers
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e-mail: marketregulation@osc.gov.on.ca

⁴ The Industry Engagement Working Group includes representatives of Participants and their service providers. All Participants, service providers and Recognizing Regulators are invited to all the working group meetings.

SROs, Marketplaces, Clearing Agencies and Trade Repositories

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

Appendix 1 – Proposed Material Amendments

| No. | Rule Amended | Description of the Amendment | Nature and Purpose of the Amendment and Material Impact |
|-----|--|--|--|
| 1 | <p>1.2.1 (definitions of Securities Account, Collateral Account, Memo Account, Pledge Account, Rehypo Given Account (new), Rehypo Balance Account (new), Pledge, Rehypotheation (new), and Trade)</p> <p>4.1.2, 4.1.4</p> <p>6.1.3(iv), (v), 6.5.1, 6.5.2(i), (ii), 6.5.3, 6.6.6</p> <p>7.2.5 (new), 7.5.4</p> | <p>Include Rehypotheation as a Trade and add related provisions</p> | <p>The introduction of the term “Rehypotheation” in the Rules is intended to:</p> <ul style="list-style-type: none"> (a) reflect the enhancement of the Pledge functionality in the new system, which gives the Pledgee Participant the right to Rehypotheate the Pledged Securities; and (b) set out the rights and obligations of CDS and of Participants to the extent Participants are using the new system to process the terms of a Rehypotheation under the bilateral agreements between them. <p>The new system will not have a Rehypotheation functionality per se. Instead, CDS will be enhancing its Pledge functionality by adding a new flag that will identify whether or not the Securities that are being Pledged may be Rehypotheated. When entering a Pledge in the new system, the Pledgor Participant will check off the new flag if the Pledgee Participant has the right to Rehypotheate the Pledged Securities. Provided the flag is checked off, the Pledgee Participant will be able to Rehypotheate the Pledged Securities by way of a new Transaction with another Participant in the system. The new Transaction can be a Pledge, loan, transfer, etc., provided it accurately reflects the terms of the bilateral agreement between the Participants.</p> <p>Pledged Securities with the right to Rehypotheate are delivered to the Securities Account of the Pledgee Participant, with such Securities reflected in the Rehypo Given Account (a new Memo Account) of the Pledgor Participant, and in the Rehypo Balance Account (a new Memo Account) of the Pledgee Participant.</p> <p>Pledged Securities without the right to Rehypotheate are delivered to the Collateral Account of the Pledgee Participant, with such Securities reflected in the Pledge Account (a Memo Account) of the Pledgor Participant.</p> |
| 2 | <p>3.3.1(ii)</p> | <p>Remove the ability of Participants to designate their own settlement holidays</p> | <p>This functionality will no longer be supported in the new system. Participants will no longer be able to add additional settlement holidays to their profiles (ledgers). All settlement restrictions will be limited to \$USD and \$CAD "holidays" that are consistent with the U.S. Federal Reserve and Payments Canada clearing holidays.</p> |
| 3 | <p>6.10.2, 6.10.3(i)</p> | <p>Change the eligibility of Pooled Securities and make specific references to the Procedures for criteria applicable to Pooled and Stripped Securities.</p> | <p>With the new system, the ability to strip restricted securities (ie., non-eligible Securities) will no longer be supported.</p> <p>Specific reference is made to the Procedures, which will set out the criteria applicable to a Pooled Security and a Stripped Security.</p> |
| 4 | <p>7.3.7, 7.3.8, 7.4</p> | <p>Replace Batch/CNS Process with Settlement Optimization Process and amend related provisions</p> | <p>The Batch/CNS Process will be replaced with the new Settlement Optimization Process.</p> <p>The Batch/CNS Process is a batch net settlement process that increases settlement efficiency by combining the settlement of trades targeted to settle by CNS and Trade-for-Trade (“TFT”). The objective of this settlement optimization process is to</p> |

| No. | Rule Amended | Description of the Amendment | Nature and Purpose of the Amendment and Material Impact |
|-----|---|--|--|
| | | | <p>reduce a Participant's requirements for security positions, funds, System-Operating Cap, credit and Collateral.</p> <p>The Settlement Optimization Process is a batch net settlement process that increases settlement efficiency by running one or more iterations of a TFT settlement optimization batch followed by CNS settlement. The TFT optimization batch allows TFT activities to net against each other in the optimal way. The CNS settlement that follows uses funds and Securities delivered in the TFT batch for Settlements in the CCP Function. The iterative nature of the design allows for progressively improving upon overall settlement efficiency.</p> |
| 5 | 1.2.1 (definitions of Entitlement Processor and Paying Agent) 6.2.9(i)(h), 6.4.1 11.6.2 | Include Paying Agent as a defined term | <p>The new system will have the role of a Paying Agent. Hence, the definition of Payment Agent is added to the Rules.</p> <p>The exact roles and responsibilities of a Paying Agent will be set out in the Procedures, which will provide more clarity and certainty for CDS, Participants and those who perform the role of a Paying Agent.</p> |
| 6 | 1.2.1 (definition of Withholding Agent) 6.5.5 (new) | Include Withholding Agent as a defined term and add related provisions | <p>The new system will have the role of a Withholding Agent. Hence the definition of Withholding Agent and the topic of withholding tax are added to the Rules.</p> <p>The exact roles and responsibilities of a Withholding Agent will be set out in the Procedures, which will provide more clarity and certainty for CDS, Participants and those who perform the role of a Withholding Agent.</p> |
| 7 | 6.6.6 | Change the details relating to distribution of Entitlements. | The Rules will rely on and refer to the Procedures for details relating to distribution of Entitlements. |

Appendix 2 – Proposed Technical Amendments

| No. | Rule Amended | Description of the Amendment | Nature and Purpose of the Amendment |
|-----|--|---|---|
| 1 | 1.2.1 6.1.3(ii) | Deletion of RSP Account | An RSP Account is intended to hold Securities that relate to RSP investments and be used for all CDSX Transactions except for Trades to be Settled by CNS. The new system will no longer support an RSP Account. Currently, no Participants have Securities in an RSP Account. Prior to implementation, Participants will not be allowed to open an RSP Account or move Securities into an RSP Account. |
| 2 | 8.3.4 | Expansion of accounts under automatic segregation | Under the new system, the restriction of automatic segregation being limited to the Accounts of the same Ledger of a Participant will be removed. |
| 3 | 8.3.4 | Removal of segregation by exception indicator | Under the new system, a Participant will no longer have the option of exempting its General Account or certain Securities in its General Account from automatic segregation. |
| 4 | 11.1, 11.4.4, 11.4.7, 11.4.8, 11.4.12, 11.5, 11.5.1, 11.5.2, 11.5.3, 11.5.5 | Removal of all references to Deferred Certificate Inventory ("DCI") | The new system will no longer support the certification format of DCI. DCI will fall within the scope of the certificate format of Non-Certificated Inventory ("NCI"). |
| 5 | 3.1.1(b)i. | Update the roles of User Administrator and User | The new system will not distinguish between the roles of User Administrator and User. A single Administrator role will provide for both functions. |
| 6 | 1.2.1 6.1.5 (deleted), 6.2.3, 6.3.1 11.3.2, 11.4.3 | All references to TRAX (for deposits and withdrawals) are removed and the term "Transfer Request" is added | TRAX transfer requests will be incorporated into the depository functions of the new system, which will be called "Transfer Request" in the new system. |
| 7 | 1.2.1 6.9.5 (deleted) | All references to CALMS are removed | The new system will not support CALMS. |
| 8 | 5.11.1(c) | Streamline of Collateral Pools | In respect of the Pool Contributions of Participants in the same Category of Participant, the Participants will Pledge to the same Collateral Administration Ledger. |
| 9 | 10.2.5 | DTC & NSCC reports from DTC directly | Post-PTM, Cross-Border Participants will receive the reports from DTC and NSCC directly, instead of through CDS. |
| 10 | 11.5.7 | Amend TA related fee arrangements for clarity | The Rule is amended for better clarity to reflect the current processes of CDS. |
| 11 | 1.2.1 (added "funds" in the first bullet of the definition of Pledge) 7.2.2 | Changes to pre-entry system edits | Under the new system, a Pledge may be used to transfer funds without transfer of Securities between the Participants. |
| 12 | 12.2.5(ii) | Allow Participant to move all Ledger positions from Limited Purpose Participant to Full Service Participant at the end of day | A new feature in the system will be available to allow a Participant to move all Ledger positions from the Account of a Limited Participant to a Full Participant. Details on the new feature will be set out in the Procedures. |
| 13 | 6.6.3(ii) | Flexibility with payout of Entitlements to Accounts | Under the new system, payout of Entitlements may be set up by a Participant at the Account level or Ledger level. |

| No. | Rule Amended | Description of the Amendment | Nature and Purpose of the Amendment |
|-----|---|---|---|
| 14 | 1.2.1 5.12.4(b), 5.15.3 6.6.2, 6.6.3, 6.6.4, 6.6.5, 6.7, 6.8.4, 6.11.2(i) | Rename "Entitlements Ledger" of CDS to "Entitlements Account" and related amendments | The Rules are being updated to replace "Entitlements Ledger" with "Entitlement Account" to reflect its nature in the new system. The relevant Rules relating to "Entitlements Ledger" will not otherwise impacted. |
| 15 | 5.10.6(ii) | Delete Special Margin Collateral Contribution | Since the de-leveraging of the RCP CAD Pool a few years ago, the prescribed Special Margin Collateral Contribution in the case of early warning levels 1 and 2 is no longer required. |
| 16 | 9.3.7(iii)(b) | Incorporate changes regarding delivery of Category Credit Ring Collateral to a Survivor who is a non-LVTS Settlement Agent | The proposed amendments are to incorporate the amendments re non-LVTS Settlement Agent as set out in OSC's Notice #12 of March 2018, which has received regulatory approval. |
| 17 | 1.2.1 (definitions of Fund, Fund Contribution, and Member), 1.10.8 5.2.1, 5.7.1, 5.7.2, 5.7.3, 5.7.4, 5.9.6(b)(iii), 5.11.3 9.2.9, 9.3.3, 9.4.5, 9.5.1, 9.5.5, 9.5.6(b), 9.5.7(a) | To more accurately apply the terms "Fund" and "Fund Credit Ring" in the Rules | The proposed amendments are to more accurately apply the terms "Fund" and "Fund Credit Ring" in the Rules, based on the respective context of the Rules, and in particular, taking into account the fact that CNS Function has the default fund and the participant fund, with the former subject to mutualization and the latter not being so. |
| 18 | 3.3.3 | Removal of references to Rule 8 re cut-off times | The proposed amendment is to correct an inaccurate cross-referencing. Rule 8 does not set out the cut-off times. |
| 19 | 1.6.1 | To follow the language of the Recognition Order | The proposed amendments update the meaning of a technical amendment of the Rule to mirror the language in the Recognition Order. |
| 20 | 1.9.2(ii) | Update language to reflect that CDS may open USD account at one or more financial institutions. | The proposed amendment is matter of a technical nature in routine operating procedures and administrative practices relating to the CDS services. |
| 21 | 7.1.1(e) | Delete Certificate Based Settlement Method | The proposed amendment is matter of a technical nature in routine operating procedures and administrative practices relating to the CDS services. |
| 22 | 1.2.1 (added a new paragraph (a) under the Definition of "Account") | Amend the definition of Account by including CDS Account under Rule 1.9.2; this is to accurately reflect the meaning of the term as it is currently used in the Rules | The proposed amendment is matter of a technical nature in routine operating procedures and administrative practices relating to the CDS services. |
| 23 | 1.2.1 | Amend the definition of Payment Item | The proposed amendment is matter of a technical nature in routine operating procedures and administrative practices relating to the CDS services. |
| 24 | 3.2.4 | More accurately describe CDS Use of the System | The proposed amendment is matter of a technical nature in routine operating procedures and administrative practices relating to the CDS services. |

| No. | Rule Amended | Description of the Amendment | Nature and Purpose of the Amendment |
|-----|--|--|---|
| 25 | 5.2.4(c) | Amend wording re Settlement Service Collateral for clarity | The proposed amendment is matter of a technical nature in routine operating procedures and administrative practices relating to the CDS services. |
| 26 | 6.1.3(vi) | Amend wording re Accounts for Tenders for better clarity | The proposed amendment is matter of a technical nature in routine operating procedures and administrative practices relating to the CDS services. |
| 27 | 7.3.3 | Amend wording re Novation of Trades Prior to Settlement to reflect reality | The proposed amendment is matter of a technical nature in routine operating procedures and administrative practices relating to the CDS services. |
| 28 | 2.2.7 3.7.3, 3.9.3, 3.9.6 4.3.4, 4.3.5 5.5.3, 5.7.8(b), 5.14.2, 5.14.4, 5.14.5(ii) 6.2.9(ii), 6.3.3, 6.9.4 7.3, 7.3.4, 7.3.9, 7.3.11, 7.4.2 8.1.1, 8.5.4 9.6.2 10.5.3, 10.6.1, 10.8.4(v), 10.8.5, 10.9.1, 10.9.8, 10.10.1(ii), 10.10.2 11.2.2, 11.6.4 | stylistic formatting, including changes to headings or paragraph numbers | The proposed amendments are stylistic formatting, including changes to headings or paragraph numbers. |