

13.1.4 Notice and Request for Comment – Material Amendments to CDS Rules Relating to Cross-Border Services – Regulation SHO

THE CANADIAN DEPOSITORY FOR SECURITIES LIMITED (CDS)

**MATERIAL AMENDMENTS TO CDS RULES –
REGULATION SHO**

REQUEST FOR COMMENTS

DESCRIPTION OF THE PROPOSED AMENDMENTS

On January 26, 2006, the Board of Directors of The Canadian Depository for Securities Limited (“CDS”) approved amendments to the CDS Participant Rules which will facilitate adherence to Regulation SHO by CDS Participants utilizing Cross-Border Services (as that term is defined in Section 1.2 of the CDS Participant Rules) offered by CDS.

The proposed amendments shall include:

- an explicit requirement that Participants utilizing Cross-Border Services comply with Regulation SHO;
- a provision allowing CDS to release information to any self-regulatory organization (“SRO”) of which the Participant is a member or the primary Canadian Regulatory Body for the Participant, relating to that Participant’s compliance with Regulation SHO;
- a provision authorizing CDS to restrict a Participant’s access to Cross-Border Services (or other functionality) where there is non-compliance with Regulation SHO. This right will be in addition to CDS’s current authority, in its discretion, to suspend a Participant for failing to comply with CDS Participant Rules; and
- a provision mandating that CDS take the necessary steps to close out a Participant’s fail to deliver position in a threshold security.

NATURE AND PURPOSE OF THE PROPOSED AMENDMENTS

Background

The United States Securities and Exchange Commission (“SEC”) adopted Regulation SHO under the *Securities Exchange Act of 1934* (www.sec.gov/rules/final/34-50103.htm) with the compliance date effective on January 3, 2005. Regulation SHO imposes requirements on broker-dealers engaged in trading related activity on markets regulated by the SEC with respect to short sales of equity securities. Regulation SHO requires short sellers to locate securities to borrow before selling short, and imposes additional requirements when trading in securities in which a substantial number of failures to deliver have occurred (referred to as “threshold securities”). Threshold securities are defined in Rule 203(c)(6) of Regulation SHO. Generally, threshold securities are equity securities of issuers that fall within the scope of the Exchange Act (US) and for five (5) consecutive settlement days (i) there are aggregate fails to deliver at a registered clearing agency of 10,000 shares or more per security, (ii) the level of fails is equal to at least one-half of one percent of the issuer’s total shares outstanding, and (iii) the security is included on a list published by an SRO.

This new regulation impacts the National Securities Clearing Corporation’s (“NSCC”) continuous net settlements in the CDS Cross-Border Services, which facilitate the clearing and settlement of transactions by Participants with American brokers and institutions.* In order to offer these services to its Participants, CDS is a member of NSCC and the Depository Trust Corporation (“DTC”). As CDS (and not individual Participants in the Cross-Border Services) is the only “member” recognized by DTC and NSCC, and all of the accounts used to settle cross-border transactions are in CDS’s name, non-compliance by one Participant may affect all Participants using the Cross-Border Services.

As CDS is subject to US regulations in its capacity as a member of DTC and NSCC, it is CDS’ expectation that Participants trading directly or indirectly on SEC regulated markets will ensure their trading practices comply with Regulation SHO.

As a member of NSCC and DTC, CDS has an obligation to ensure that all activity conducted through CDS, by CDS Participants, is conducted in compliance with Regulation SHO. Participants are expected to monitor their individual compliance and to adopt policies and procedures to ensure that they act in accordance with Regulation SHO when utilizing the Cross-Border Services.

* The Services particularly affected are New York Link and ACCESS. CDS is proposing to bar new trades to the ACCESS service effective January 31, 2006. The DTC Direct Service is not affected because it settles transactions on a trade-for-trade basis, not continuous net settlement.

Compliance with Regulation SHO

CDS is proposing to amend Rule 10.2.3 by including a new Paragraph (b). The proposed Paragraph (b) will provide that CDS will close out a fail to deliver position of a Participant utilizing the Cross-Border Services relating to a threshold security where the fail to deliver position is in existence for a period of 13 consecutive settlement days. CDS shall have absolute discretion to use whatever means it believes are necessary to close out the failed position as quickly as possible. The Participant with the fail to deliver position will be responsible for all costs incurred by CDS in closing out the position including, but not restricted to, the purchase price of the security, costs of funding the acquisition, brokerage fees, legal fees and any other fees incurred by CDS as a result of closing out the position. The proposed amendments also include a provision releasing CDS from any liability which it may incur as a result of closing out a fail to deliver position. Specifics regarding the close out of a position will be set out in amendments to CDS Participant Procedures.

Provision of Information to Regulators by CDS

Proposed amendments to Paragraph (b) of Rule 10.2.3 and Paragraph (g) of Rule 3.6.2 will provide CDS with clear and explicit authority to release information relating to each Participant's compliance with Regulation SHO to any SRO of which the Participant is a member and to its primary Canadian Regulatory Body for the Participant. This provision of information will help facilitate the enforcement of these bodies' rules and regulations relating to such requirements.

In particular, it should be noted that the Investment Dealers Association of Canada ("IDA") has indicated that a failure to comply with foreign laws, including Regulation SHO, may be considered to be engaging in a "conduct or practice that is unbecoming or detrimental to the public interest" and therefore a breach of IDA By-law 29.1. The IDA issued member regulation Notice MR0320, which specifically indicates that members acting in violation of Regulation SHO will be considered to be engaging in conduct or practices which are unbecoming or detrimental to the public interest.

Restriction of Access

CDS is proposing to amend Paragraph (e) of Participant Rule 2.7.1 to provide additional, explicit clarification of CDS's ability to restrict a Participant's access to use any CDS system functionality where a Participant fails to comply with Regulation SHO as required by proposed Rule 10.2.3(b).

IMPACT OF PROPOSED AMENDMENTS

In addition to the proposed amendments to Participant Rules described in this notice, CDS is proposing to implement changes to procedures to facilitate adherence to Regulation SHO by its Participants. CDS is proposing to generate reports identifying threshold securities and outstanding positions in relation to these threshold securities both on an aggregate basis, for all CDS Participants, and by individual Participant. Participants will receive their respective reports and will be expected to remedy any non-compliant status. Participant reports will also be provided to the Participant's appropriate SRO or primary Canadian Regulatory Body to allow such entity to conduct investigations and, where appropriate, enforcement actions in relation to any violations. As previously noted the IDA has issued a notice dealing specifically with its members' obligations to comply with Regulation SHO and it is anticipated that the provision of CDS reports will assist the IDA in ensuring compliance with the terms of that notice.

To comply with the proposed Participant Rule amendments CDS Participants will be expected to adopt internal procedures or policies when utilizing Cross-Border Services to ensure compliance with Regulation SHO. Participants will be expected to utilize reports provided by CDS to identify threshold securities and to take proper steps to satisfy specific obligations under applicable securities law. The internal procedures and policies adopted by Participants will differ depending on each Participant's unique circumstances but all Participants will be expected to be in compliance with Regulation SHO when utilizing Cross-Border Services.

Where a Participant utilizing CDS's Cross-Border Services is in a fail to deliver position in relation to a threshold security the Participant will have a period of 13 settlement days to close out the position before CDS will take steps to close out the position on behalf of the Participant. When closing out a position CDS will, as quickly as possible, take whatever steps that CDS, in its discretion, determines are necessary to close out the position, at the Participant's expense. Participants must be aware that CDS may not be in a position to achieve optimal execution in acquiring the securities for the Participant and that, to ensure best execution, Participants should close out the position prior to the 14th settlement day after the creation of the position.

The proposed amendment will have no effect on the policies, procedures, operations or technology of Participants who do not utilize Cross-Border Services.

DESCRIPTION OF THE RULE DRAFTING PROCESS

CDS is recognized as a clearing agency by the Ontario Securities Commission pursuant to Section 21.1 of the Ontario *Securities Act* and as an SRO 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")).

Each amendment to the CDS Participant Rules is reviewed by CDS's Legal Drafting Group ("LDG"). The LDG is a committee which 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 will be effective upon approval of the changes by the Recognizing Regulators following public notice and comment.

COMMENTS

Comments on the proposed amendments should be in writing and delivered by March 6, 2006 to:

Jamie Anderson
Senior Legal Counsel
The Canadian Depository for Securities Limited
85 Richmond Street West
Toronto, Ontario M5H 2C9

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

A copy should also be provided to the Ontario Securities Commission by forwarding a copy to:

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.

COMPARISON TO OTHER CLEARING AGENCIES

CDS has a unique relationship with American institutions which allows CDS to offer its Participants the Cross-Border Services and as such there are no comparable requirements imposed by other clearing agencies.

PUBLIC INTEREST ASSESSMENT

In analyzing the impact of the proposed amendments to the Participant rules, CDS has determined that the implementation of these amendments would not be contrary to the public interest.

PROPOSED RULE AMENDMENTS

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

QUESTIONS

Questions regarding this notice may be directed to:

Toomas Marley
Vice-President, Legal and Corporate Secretary
The Canadian Depository for Securities Limited
85 Richmond Street West
Toronto, Ontario M5H 2C9

Telephone: 416-365-8545
Fax: 416-365-1984
e-mail: attention@cds.ca

TOOMAS MARLEY
VICE-PRESIDENT, LEGAL AND CORPORATE SECRETARY

**APPENDIX "A"
PROPOSED RULE AMENDMENT**

Text of current CDSX Rules marked to reflect proposed amendments	Text CDSX Rules reflecting the adoption of proposed amendments
<p>2.7.1 Restrictions on System Functionality</p> <p>CDS may restrict the right of a Participant to use system functionality in the following circumstances:</p> <p>(a) CDS determines that the Participant is unable to properly use system functionality due to operational or technical problems with the Participant's own systems or the systems of third parties, or due to events over which the Participant has no control;</p> <p>(b) in accordance with Rule 5.14 with respect to the Participant's CCP Cap;</p> <p>(c) the Participant requests CDS to do so; or</p> <p>(d) in the course of monitoring the Participant pursuant to Rule 5.1.3, CDS determines such action is necessary to protect the interests of CDS and is in the best interest of all other Participants; <u>or</u></p> <p><u>(e) the Participant fails to comply with Rule 10.2.3 with respect to the Cross-Border Services.</u></p> <p>A restriction may apply to any Service or any Function, to a particular Security or class of Securities, to a particular Transaction or class of Transactions, or to Securities or Transactions generally. A restriction may be limited to a particular location or office of the Participant or a particular Office of CDS. CDS may remove the restriction when CDS in its sole discretion determines that the Participant is able to resume normal operations.</p>	<p>2.7.1 Restrictions on System Functionality</p> <p>CDS may restrict the right of a Participant to use system functionality in the following circumstances:</p> <p>(a) CDS determines that the Participant is unable to properly use system functionality due to operational or technical problems with the Participant's own systems or the systems of third parties, or due to events over which the Participant has no control;</p> <p>(b) in accordance with Rule 5.14 with respect to the Participant's CCP Cap;</p> <p>(c) the Participant requests CDS to do so;</p> <p>(d) in the course of monitoring the Participant pursuant to Rule 5.1.3, CDS determines such action is necessary to protect the interests of CDS and is in the best interest of all other Participants; or</p> <p>(e) the Participant fails to comply with Rule 10.2.3 with respect to the Cross-Border Services.</p> <p>A restriction may apply to any Service or any Function, to a particular Security or class of Securities, to a particular Transaction or class of Transactions, or to Securities or Transactions generally. A restriction may be limited to a particular location or office of the Participant or a particular Office of CDS. CDS may remove the restriction when CDS in its sole discretion determines that the Participant is able to resume normal operations.</p>
<p>3.6.2 Release of Information</p> <p>Each Participant authorizes CDS to release any information concerning the Participant:</p> <p>(a) to the auditors of CDS, of the Participant and of other Participants, as may reasonably be required to perform their duties;</p> <p>(b) to the legal counsel of CDS as may reasonably be required to perform their duties;</p> <p>(c) requested by the Issuer of Securities held for the Participant or by any other Person, if such information is limited to information with respect to the Securities held for the Participant and if CDS is reasonably satisfied that such information is sought for a purpose concerning an effort to influence the voting by Security holders of the Issuer, an offer to acquire Securities of the Issuer or any other matter relating to either the affairs of the Issuer or Transactions in the Securities of the Issuer effected by the Participant, provided that any information released under this subsection (c) does not identify any client or customer of the Participant;</p>	<p>3.6.2 Release of Information</p> <p>Each Participant authorizes CDS to release any information concerning the Participant:</p> <p>(a) to the auditors of CDS, of the Participant and of other Participants, as may reasonably be required to perform their duties;</p> <p>(b) to the legal counsel of CDS as may reasonably be required to perform their duties;</p> <p>(c) requested by the Issuer of Securities held for the Participant or by any other Person, if such information is limited to information with respect to the Securities held for the Participant and if CDS is reasonably satisfied that such information is sought for a purpose concerning an effort to influence the voting by Security holders of the Issuer, an offer to acquire Securities of the Issuer or any other matter relating to either the affairs of the Issuer or Transactions in the Securities of the Issuer effected by the Participant, provided that any information released under this subsection (c) does not identify any client or customer of the Participant;</p>

Text of current CDSX Rules marked to reflect proposed amendments	Text CDSX Rules reflecting the adoption of proposed amendments
<p>(d) as may be required from time to time by order, summons, subpoena, statutory direction or other process of, or pursuant to an agreement with, a court, Regulatory Body or other administrative or regulatory agency, having, in the opinion of CDS, jurisdiction over CDS;</p> <p>(e) pursuant to any statutory or regulatory requirement including National Instrument 54-101 <i>Communication with Beneficial Owners of a Reporting Issuer</i> (as it may be reformulated from time to time) or any similar policy, instrument or Rule adopted or made by the Canadian Securities Administrators;</p> <p>(f) to any securities exchange, commodities exchange, alternative trading system, securities depository, securities clearing agency, payment clearing system or self-regulatory organization of which the Participant is a member or the services of which the Participant uses in connection with its participation in CDS, or to any insurer of the Participant including the Canadian Investor Protection Fund or the Canada Deposit Insurance Corporation; and</p> <p>(g) <u>to any self-regulatory organization of which the Participant is a member and to the primary Canadian Regulatory Body for the Participant in regards to compliance with Rule 10.2.3(b); and</u></p> <p>(h) <u>that is in a statistical, summary or other format, provided the information in that format does not specifically identify a particular Participant, or, if the information concerns debt Securities, provided the information in that format does not identify any industry group.</u></p> <p>CDS shall take all reasonable steps to avoid releasing any information that may identify a particular client or customer of a Participant. When CDS is required pursuant to subsection (d) to disclose confidential information concerning a Participant that is directed exclusively to the activities of a particular Participant, CDS shall give notice to the Participant of the request before making the disclosure unless the terms of any applicable statute, regulation, ruling or order prohibit such notice. When CDS releases confidential information pursuant to subsection (f), CDS shall request the recipient to treat such information as confidential.</p>	<p>(d) as may be required from time to time by order, summons, subpoena, statutory direction or other process of, or pursuant to an agreement with, a court, Regulatory Body or other administrative or regulatory agency, having, in the opinion of CDS, jurisdiction over CDS;</p> <p>(e) pursuant to any statutory or regulatory requirement including National Instrument 54-101 <i>Communication with Beneficial Owners of a Reporting Issuer</i> (as it may be reformulated from time to time) or any similar policy, instrument or Rule adopted or made by the Canadian Securities Administrators;</p> <p>(f) to any securities exchange, commodities exchange, alternative trading system, securities depository, securities clearing agency, payment clearing system or self-regulatory organization of which the Participant is a member or the services of which the Participant uses in connection with its participation in CDS, or to any insurer of the Participant including the Canadian Investor Protection Fund or the Canada Deposit Insurance Corporation;</p> <p>(g) to any self-regulatory organization of which the Participant is a member and to the primary Canadian Regulatory Body for the Participant in regards to compliance with Rule 10.2.3(b); and</p> <p>(h) that is in a statistical, summary or other format, provided the information in that format does not specifically identify a particular Participant, or, if the information concerns debt Securities, provided the information in that format does not identify any industry group.</p> <p>CDS shall take all reasonable steps to avoid releasing any information that may identify a particular client or customer of a Participant. When CDS is required pursuant to subsection (d) to disclose confidential information concerning a Participant that is directed exclusively to the activities of a particular Participant, CDS shall give notice to the Participant of the request before making the disclosure unless the terms of any applicable statute, regulation, ruling or order prohibit such notice. When CDS releases confidential information pursuant to subsection (f), CDS shall request the recipient to treat such information as confidential.</p>
<p>10.2.3 Compliance Cross-Border Documents</p> <p><u>(a) Cross-Border Documents</u></p> <p>The making of a Cross-Border Movement or an ACCESS Deposit by any Participant, and the use of the Cross-Border Services by each Cross-Border Participant, is governed by all agreements entered into, instruments executed, declarations made and acts done by CDS from time to time in respect of CDS's membership in NSCC and DTC. Each Cross-Border Participant shall enter into any such further agreements or instruments, and make such declarations</p>	<p>10.2.3 Compliance</p> <p>(a) Cross-Border Documents</p> <p>The making of a Cross-Border Movement or an ACCESS Deposit by any Participant, and the use of the Cross-Border Services by each Cross-Border Participant, is governed by all agreements entered into, instruments executed, declarations made and acts done by CDS from time to time in respect of CDS's membership in NSCC and DTC. Each Cross-Border Participant shall enter into any such further agreements or instruments, and make such declarations</p>

Text of current CDSX Rules marked to reflect proposed amendments	Text CDSX Rules reflecting the adoption of proposed amendments
<p>and provide such information, relating to its use of the Cross-Border Services, as may be required by CDS.</p> <p>Each Participant shall observe and comply with the Cross-Border Documents applicable to the Participant to the same extent as if the Participant were a direct member of NSCC or DTC, notwithstanding that CDS is the member of NSCC or DTC and that the Participant's use of the Cross-Border Service does not confer on or grant to the Participant any rights, benefits or privileges directly against, or obligations or liabilities to, NSCC or DTC. Without limiting the generality of the foregoing, each Cross-Border Participant acknowledges that the Cross-Border Documents may include a grant of a security interest in the securities held with NSCC or DTC, mark-to-the market requirements, liquidation rights, buy-in and sell-out rights, and other terms which may affect the Cross-Border Participant's interest in Securities held for it through the Cross-Border Service. At the request of a Participant, CDS shall make available to it the Cross-Border Documents applicable to it.</p> <p><u>(b) Regulation SHO</u></p> <p><u>"Regulation SHO" means Regulation SHO adopted by the United States Securities and Exchange Commission promulgated under United States federal securities law.</u></p> <p><u>"Non-compliant Position with Regulation SHO" means a Participant using a Cross-Border Service is in a fail to deliver position regarding a sale of a threshold security, as defined in Rule 203(c)(6) of Regulation SHO, for 13 consecutive settlement days, as provided in Rule 203(b)(3).</u></p> <p><u>Each Participant using a Cross-Border Service shall comply with the terms of Regulation SHO. CDS shall take the necessary steps to close out the Participant's Non-compliant Positions with Regulation SHO by the purchase of threshold securities in the amount specified by Rule 203(b)(3) of Regulation SHO. Such Participant shall reimburse CDS for all costs and expenses in regards to steps taken by CDS to close out the Participant's Non-compliant Positions with Regulation SHO, including the purchase price of the threshold securities, cost of funding, and fees and expenses of legal counsel and other professionals retained by CDS. CDS shall have absolute discretion to purchase such threshold securities by any means available. Each Participant acknowledges that CDS must close out a Participant's Non-compliant Positions with Regulation SHO immediately and therefore the purchase price of such threshold securities may be greater than a price that could be obtained by alternative means of purchase or delay in purchase.</u></p> <p><u>Each Participant using a Cross-Border Service releases and discharges CDS from any liability or claim arising from the exercise of the powers granted pursuant to this Rule 10.2.3 (b).</u></p>	<p>and provide such information, relating to its use of the Cross-Border Services, as may be required by CDS.</p> <p>Each Participant shall observe and comply with the Cross-Border Documents applicable to the Participant to the same extent as if the Participant were a direct member of NSCC or DTC, notwithstanding that CDS is the member of NSCC or DTC and that the Participant's use of the Cross-Border Service does not confer on or grant to the Participant any rights, benefits or privileges directly against, or obligations or liabilities to, NSCC or DTC. Without limiting the generality of the foregoing, each Cross-Border Participant acknowledges that the Cross-Border Documents may include a grant of a security interest in the securities held with NSCC or DTC, mark-to-the market requirements, liquidation rights, buy-in and sell-out rights, and other terms which may affect the Cross-Border Participant's interest in Securities held for it through the Cross-Border Service. At the request of a Participant, CDS shall make available to it the Cross-Border Documents applicable to it.</p> <p>(b) Regulation SHO</p> <p>"Regulation SHO" means Regulation SHO adopted by the United States Securities and Exchange Commission promulgated under United States federal securities law.</p> <p>"Non-compliant Position with Regulation SHO" means a Participant using a Cross-Border Service is in a fail to deliver position regarding a sale of a threshold security, as defined in Rule 203(c)(6) of Regulation SHO, for 13 consecutive settlement days, as provided in Rule 203(b)(3).</p> <p>Each Participant using a Cross-Border Service shall comply with the terms of Regulation SHO. CDS shall take the necessary steps to close out the Participant's Non-compliant Positions with Regulation SHO by the purchase of threshold securities in the amount specified by Rule 203(b)(3) of Regulation SHO. Such Participant shall reimburse CDS for all costs and expenses in regards to steps taken by CDS to close out the Participant's Non-compliant Positions with Regulation SHO, including the purchase price of the threshold securities, cost of funding, and fees and expenses of legal counsel and other professionals retained by CDS. CDS shall have absolute discretion to purchase such threshold securities by any means available. Each Participant acknowledges that CDS must close out a Participant's Non-compliant Positions with Regulation SHO immediately and therefore the purchase price of such threshold securities may be greater than a price that could be obtained by alternative means of purchase or delay in purchase.</p> <p>Each Participant using a Cross-Border Service releases and discharges CDS from any liability or claim arising from the exercise of the powers granted pursuant to this Rule 10.2.3 (b).</p>