

13.1.2 CDS Notice and Request for Comments – Material Amendments to CDS Procedures Relating to Late Delivery of Collateral

THE CANADIAN DEPOSITORY FOR SECURITIES LIMITED (CDS)

MATERIAL AMENDMENTS TO CDS PROCEDURES

LATE DELIVERY OF COLLATERAL

REQUEST FOR COMMENTS

A. DESCRIPTION OF THE PROPOSED AMENDMENTS

A proposal to amend The Canadian Depository for Securities Collateral Pledging Procedures was reviewed and accepted by the Risk Advisory Committee in December, 2005. The proposed amendments were subsequently reviewed and accepted by the CDS Risk Committee.

On January 25, 2006, the Audit Committee of the Board of Directors of CDS considered the matter of amendments to CDS Collateral Pledging Procedures. The Audit Committee recommended the amendments to the Board of Directors for Approval, and the latter gave its approval during its meeting on January 26, 2006.

The proposed amendments include changes to CDS Procedures in respect of the collateral administration for domestic collateral pools or participant funds and in respect of participant funds in the New York Link with the National Securities Clearing Corporation (NSCC).

Specifically, these changes include:

Domestically:

- A requirement on CDS to levy a fine on a Participant who fails to meet the current deadline (13h00 Eastern Time) for making required contributions to a collateral pool or participant fund.
- Provision for the automatic suspension of a Participant who does not make the required contributions to a collateral pool or participant fund by an extended deadline of 14h00 Eastern Time.

For the New York Link:

- A requirement on CDS to levy a fine on a Participant who fails to meet the current deadline (13h00 Eastern Time) for making required contributions to the participant fund.
- Provision for the automatic suspension of a Participant who does not make the required contributions to the participant fund by an extended deadline of 14h00 Eastern Time.
- An exception to the automatic suspension of the New York Link Participant who satisfies both of the following two conditions:
 1. The Participant must pledge acceptable collateral equal to the collateral deficiency as of the initial deadline.
 2. The Participant must provide evidence that the instructions for delivery of the required collateral have been completed by the Participant's banker and that the delay in delivery is not due to the Participant's inability to meet the collateral requirement.

B. NATURE AND PURPOSE OF THE PROPOSED AMENDMENTS

The proposed amendments to the Collateral Pledging Procedures are made with a view to the standardization of treatment of deficiencies of required pledged collateral in participant funds (both domestic and cross-border) and category credit ring collateral pools. The proposed amendments are made as a consequence of changes to CDS Participant Rule 9.1, which now provide for the automatic suspension of a Participant that fails to make its required contributions to a collateral pool or participant fund. CDS Procedures currently require daily collateral requirements to be met by 13h00 Eastern Time; a failure to do so results in the *automatic* suspension of the Participant. The purpose of the proposed amendments is to *require* CDS to levy a fine for collateral requirement deficiencies as of 13h00 Eastern Time and, should such deficiencies not be cured by 14h00 Eastern Time, the automatic suspension of the Participant.

The Proposed Amendments to domestic procedures will be mirrored by amendments to the procedures governing collateral pledging requirements in the New York Link participant fund. In the latter situation, however, Participants will be able to avoid automatic suspension for collateral deficiencies by pledging acceptable collateral to cure the deficiency *and* providing acceptable evidence to CDS that the delay in curing the deficiency is not due to the Participants' inability to meet the collateral requirement.

Finally, proposed amendments to CDS Procedures will institutionalize both a degree of flexibility with respect to pledging of collateral requirements – for Participants – and further reduce systemic risk to CDS in cases where operational issues have prevented a collateral pledge in a cross-border transaction.

C. IMPACT OF PROPOSED AMENDMENTS

CDS Participants, both domestic and those who participate in the New York Link, are impacted in two principal ways: first, the proposed amendments afford a degree of latitude with respect to the pledging of required collateral while at the same time impressing on Participants the importance of their obligations by means of the levied fine; and second, the proposed amendments allow for late delivery without automatic suspension in extraordinary circumstances.

No other impacts to CDS Participants, Market Participants, or the Securities Markets in general, are foreseen.

D. DESCRIPTION OF THE PROCEDURE 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 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. All CDS Procedure Amendments are reviewed and approved by CDS' Strategic Development Review Committee prior to regulatory approval.

E. IMPACT OF PROPOSED AMENDMENTS ON TECHNOLOGICAL SYSTEMS

An analysis of the impact of the proposed amendments on CDS' technological systems has determined that the implementation of these amendments will have no material impact on such systems and that, consequently, no systems changes will be required. Further, the proposed amendments will not require changes to the technological systems of Participants or other market participants.

F. COMPARISON TO OTHER CLEARING AGENCIES

The proposed amendments have been compared to the rules and procedures of other clearing agencies and were found similar thereto. Addendum P of the National Securities Clearing Corporation (NSCC) Rules, for example, includes a graded scale of fines to be levied in the case of the late satisfaction of a clearing fund deficiency call. CDS' proposed amendments do not take into account the number of occurrences of late satisfaction, for two reasons: first, the proposed amendments are made with a view to simplifying CDS procedures as much as possible; and second, the facilities and technology to track the number of times a participant misses the deadline for a collateral contribution do not currently exist within CDS' technological systems. Finally, the proposed timeline for fines and subsequent suspension are a relatively rare occurrence, and introducing the level of complexity inherent in a sliding scale for fines would counteract the benefit of the simple fine and suspension procedure proposed.

G. PUBLIC INTEREST ASSESSMENT

An analysis of the impact of the proposed amendments on the Participant Procedures 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 July 10, 2006 and delivered to:

Tony Hoffmann
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.

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
The Canadian Depository for Securities Limited
85 Richmond Street West
Toronto, Ontario M5H 2C9

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

JAMIE ANDERSON
Senior Legal Counsel

APPENDIX "A"

PROPOSED PROCEDURE AMENDMENT

Text of CDS Procedures marked to reflect proposed amendments	Text CDS Procedures reflecting the adoption of proposed amendments
<p>CHAPTER 13 – COLLATERAL ADMINISTRATION (Participating in CDS Services, Release 3.1)</p> <p>Each participant designates a collateral administrator who is responsible for maintaining their collateral pool or participant fund.</p> <p>All collateral requirements must be in place by 1:00 p.m. ET (11:00 a.m. MT, 10:00 a.m. PT) each day. If CDS does not receive the additional contribution by the specified deadline, the participant is suspended. At all times, participants are required to maintain with CDS an amount of collateral that is at least equal to their required collateral pool or participant fund contribution.</p> <p><u>At all times, participants are required to maintain with CDS an amount of collateral that is at least equal to their required collateral pool or participant fund contribution. All collateral requirements must be in place by 1:00 p.m. ET (11:00 a.m. MT, 10:00 a.m. PT) each day. If CDS does not receive the required contribution by the specified deadline, the participant is fined. If the contribution is still outstanding by 2:00 p.m. ET (12:00 p.m. MT, 11:00 a.m. PT), the participant is suspended.</u></p> <p>...</p>	<p>CHAPTER 13 – COLLATERAL ADMINISTRATION (Participating in CDS Services, Release 3.1)</p> <p>Each participant designates a collateral administrator who is responsible for maintaining their collateral pool or participant fund.</p> <p>At all times, participants are required to maintain with CDS an amount of collateral that is at least equal to their required collateral pool or participant fund contribution. All collateral requirements must be in place by 1:00 p.m. ET (11:00 a.m. MT, 10:00 a.m. PT) each day. If CDS does not receive the required contribution by the specified deadline, the participant is fined. If the contribution is still outstanding by 2:00 p.m. ET (12:00 p.m. MT, 11:00 a.m. PT), the participant is suspended.</p> <p>...</p>
<p>15.6.2 CNS and ACCESS collateral requirements</p> <p>...</p> <p>Participants must contribute sufficient collateral to their participant fund by 1:00 p.m. ET (11:00 a.m. MT, 10:00 a.m. PT). If a required additional contribution is not received at CDS by the deadline, the participant is suspended.</p> <p><u>Participants must contribute sufficient collateral to their participant fund by 1:00 p.m. ET (11:00 a.m. MT, 10:00 a.m. PT). If CDS does not receive the required contribution by the specified deadline, the participant is fined. If the contribution is still outstanding by 2:00 p.m. ET (12:00 p.m. MT, 11:00 a.m. PT), the participant is suspended.</u></p>	<p>15.6.2 CNS and ACCESS collateral requirements</p> <p>...</p> <p>Participants must contribute sufficient collateral to their participant fund by 1:00 p.m. ET (11:00 a.m. MT, 10:00 a.m. PT). If CDS does not receive the required contribution by the specified deadline, the participant is fined. If the contribution is still outstanding by 2:00 p.m. ET (12:00 p.m. MT, 11:00 a.m. PT), the participant is suspended.</p>
<p>16.1 DetNet margin collateral</p> <p>...</p> <p>The DetNet Margin report lists the value of a participant's required margin contribution, which they must deliver to CDS by 1:00 p.m. ET (11:00 a.m. MT, 10:00 a.m. PT) on the following business day. If a required contribution is not received at CDS by the deadline, the participant is <u>fin</u>ed. <u>If the contribution is not provided by 2:00 p.m. ET (12:00 p.m. MT, 11:00 a.m. PT), the participant is suspended.</u></p>	<p>16.1 DetNet margin collateral</p> <p>...</p> <p>The DetNet Margin report lists the value of a participant's required margin contribution, which they must deliver to CDS by 1:00 p.m. ET (11:00 a.m. MT, 10:00 a.m. PT) on the following business day. If a required contribution is not received at CDS by the deadline, the participant is fined. If the contribution is not provided by 2:00 p.m. ET (12:00 p.m. MT, 11:00 a.m. PT), the participant is suspended.</p>

Text of CDS Procedures marked to reflect proposed amendments	Text CDS Procedures reflecting the adoption of proposed amendments
<p>CHAPTER 5 – NEW YORK LINK PARTICIPANT FUNDS (New York Link Participant Procedures, Release 22.0)</p> <p>Making additional contributions</p> <p>...</p> <p>The provision of collateral must be completed before 1:00 p.m. ET (11:00 a.m. MT, 10:00 a.m. PT).</p> <p>If a required additional contribution is not received by CDS by the specified deadline, the participant is suspended.</p> <p><u>All collateral requirements must be in place by 1:00 p.m. ET (11:00 a.m. MT, 10:00 a.m. PT) each day. If CDS does not receive the required contribution by the specified deadline, the participant is fined. If the contribution is still outstanding by 2:00 p.m. ET (12:00 p.m. MT, 11:00 a.m. PT), the participant is suspended. To avoid suspension, the participant must meet both of the following conditions:</u></p> <ul style="list-style-type: none"> • <u>Pledge acceptable collateral that is equal to the current collateral deficiency.</u> • <u>Provide evidence that the instructions for the delivery of the participant’s required collateral has been completed by their banker and that the delay is not due to their inability to meet the collateral requirements.</u> 	<p>CHAPTER 5 – NEW YORK LINK PARTICIPANT FUNDS (New York Link Participant Procedures, Release 22.0)</p> <p>Making additional contributions</p> <p>...</p> <p>All collateral requirements must be in place by 1:00 p.m. ET (11:00 a.m. MT, 10:00 a.m. PT) each day. If CDS does not receive the required contribution by the specified deadline, the participant is fined. If the contribution is still outstanding by 2:00 p.m. ET (12:00 p.m. MT, 11:00 a.m. PT), the participant is suspended. To avoid suspension, the participant must meet both of the following conditions:</p> <ul style="list-style-type: none"> • Pledge acceptable collateral that is equal to the current collateral deficiency. • Provide evidence that the instructions for the delivery of the participant’s required collateral has been completed by their banker and that the delay is not due to their inability to meet the collateral requirements.