

### 13.3 Clearing Agencies

#### 13.3.1 Material Amendments to CDS Rules – Multi-Classification of Limited Purpose Participants – Request for Comments

##### CDS CLEARING AND DEPOSITORY SERVICES INC. (CDS®)

##### MATERIAL AMENDMENTS TO CDS RULES

##### MULTI-CLASSIFICATION OF LIMITED PURPOSE PARTICIPANTS

##### REQUEST FOR COMMENTS

#### A. DESCRIPTION OF THE PROPOSED CDS RULE AMENDMENTS

The proposed amendments broaden the categories into which a limited purpose participant may be classified. Currently a limited purpose participant may only be multi-classified into the following two categories – ATON Participant and ACT Participant. With the expansion of the multi-classification categories, limited purpose participants have an increased ability to take on new lines of business.

#### B. NATURE AND PURPOSE OF THE PROPOSED CDS RULE AMENDMENTS

*Background – full participants cannot be also classified as limited purpose participants*

The first limited purpose participant category developed under the CDS Rules was the TA Participant. At that point, a participant was either categorized as a full participant or a TA Participant, but could not be categorized as both. This prohibition was reflected in CDS Rule 11.2.2. However, when CDS Rule 11.2.2 was drafted, it was not contemplated that additional limited purpose categories would be subsequently created. As such, the drafting of CDS Rule 11.2.2 was unintentionally broad. The intent of the prohibition was that full participants could not be likewise classified as a limited purpose participant. It was not intended that a limited purpose participant could not be classified in multiple categories (once these categories were created).

The prohibition against multi-classification in CDS Rule 11.2.2 was then replicated as a precedent for the subsequent development of Rule 12.2.3 for ATON. This was a drafting oversight as multi-classification is in fact permitted under in Rule 2.3.2(c) for ATON Participants and ACT Participants. Furthermore, Rule 12.1.1 provides that ATON may be used by all participants (all participants includes limited purpose participants).

*Holding of Securities*

In addition to expanding the breadth of multi-classification for limited purpose participants, a further rule amendment would be required for TA Participants. Currently, a TA Participant using ATON would be in contravention of Rule 11.2.4 which provides that a TA Participant may not hold securities credited to its ledger except in its capacity as a CDSX Depository Agent or Entitlements Processor.<sup>1</sup> In using ATON, a Participant's ledger is credited with securities. However, this holding is only on a temporary basis – these ledgers must be fully transferred to a designated custodial participant on a daily basis [Rule 12.2.7(b)]. In light of the nature of the temporary holding of securities from an ATON instruction, it is acceptable from a risk perspective that TA Participants be permitted to temporarily hold securities in their ledgers when using ATON.

#### C. IMPACT OF THE PROPOSED CDS RULE AMENDMENTS

##### C.1 Competition

The proposed Rule amendments would eliminate barriers faced by limited purpose participants to take on new lines of business. This would facilitate increased competition.

##### C.2 Risks and Compliance Costs

There is no increased risk with the elimination of the current CDS Rule barriers against multi-classified limited purpose participants. Limited purpose participants are unable to have a negative funds account (i.e. cash) balance, including multi-classified limited purpose participants. TA Participants would only be permitted to hold securities in their ledgers for limited purposes (and if for ATON, the ledgers are “swept” to a designated custodial participant each day).

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<sup>1</sup> Rule 11.2.4 also states that a TA Participant may not effect Settlements (a defined term in the CDS Rules). In using ATON, investment dealer accounts are transferred – ATON does not involve the settling of trades so there would be no breach in this regard.

CDS does not expect that the proposed Rule amendments will result in any compliance costs for CDS, its Participants, or other market participants.

**C.3 Comparison to International Standards – (a) Committee on Payment and Settlement Systems of the Bank for International Settlements, (b) Technical Committee of the International Organization of Securities Commissions, and (c) the Group of Thirty**

The proposed amendments are in alignment with principle 18 of the CPSS-IOSCO Principles for Financial Market Infrastructures, specifically that the criteria for participation be publicly disclosed and transparent. Rule amendments to broaden the multi-classification of limited purpose participants are preferable to ad hoc Board of Director waivers in respect to current rules prohibiting the same.

**D. DESCRIPTION OF THE RULE DRAFTING PROCESS**

**D.1 Development Context**

A current CDS limited purpose participant has been granted a waiver by the CDS Board of Directors to be classified both as a TA Participant and as an ATON Participant and to hold securities in its ledger when using ATON. The proposed rule amendments will codify the effect of the waiver.

**D.2 Rule Drafting Process**

Each amendment to the CDS Participant Rules is reviewed by CDS's Legal Drafting Group ("LDG"). The LDG is a committee that 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.

These amendments were reviewed and approved by the Board of Directors of CDS Ltd. on November 28, 2012.

**D.3 Issues Considered**

The iterative manner in which the CDS Rules were developed resulted in an unintended consequence of restricting the multi-classification of limited purpose participants. The current Rules are contradictory in regards to ATON Participants being permitted (or not) to also be classified in another limited purpose participant category and this required rectification. Furthermore, the inclusion of TA Participants to be multi-classified does not import addition risk to CDS, its participants, or other market participants.

**D.4 Consultation**

As noted earlier, the proposed amendments have been reviewed with the LDG. The proposed amendments are remedial in nature and do not import risk to CDS, its participants, or other market participants. Through advisory via bulletin to all participants of the waiver being granted as noted in section D.1 above, all participants were also advised that CDS planned a rule amendment to broaden multi-classification of limited purpose participants.

**D.5 Alternatives Considered**

An alternative would be to seek CDS Board of Director waivers regarding the CDS Rules in their present state on an ad hoc basis for limited purpose participants wishing to undertake new lines of business. However, a curative Rule amendment was considered to be a more practical and transparent manner in which to permit multi-classification of limited purpose participants.

**D.6 Implementation Plan**

CDS is recognized as a clearing agency by the Ontario Securities Commission pursuant to section 21.2 of the Ontario *Securities Act* and by the British Columbia Securities Commission pursuant to s. 24(d) of the British Columbia *Securities Act*. The Autorité des marchés financiers has authorized CDS to carry on clearing activities in Québec pursuant to sections 169 and 170 of the Québec *Securities Act*. In addition CDS is deemed to be the clearing house for CDSX<sup>®</sup>, a clearing and settlement system designated by the Bank of Canada pursuant to section 4 of the *Payment Clearing and Settlement Act*. The Autorité des marchés financiers, the Bank of Canada, the British Columbia Securities Commission and the Ontario Securities Commission will hereafter be collectively referred to as the "Recognizing Regulators".

The amendments to Participant Rules may become effective upon approval of the amendments by the Recognizing Regulators following public notice and comment.

**E. TECHNOLOGICAL SYSTEMS CHANGES**

There are no technological systems changes required by CDS, CDS Participants, or other market participants. The proposed amendments pertain to existing CDS services.

**F. COMPARISON TO OTHER CLEARING AGENCIES**

The limited purpose participant categories are specific to CDS. As such, a comparison with other clearing agencies is not possible.

**G. PUBLIC INTEREST ASSESSMENT**

CDS has determined that the proposed amendments are not contrary to the public interest.

**H. COMMENTS**

Comments on the proposed amendments must be in writing and submitted within 30 calendar days following the date of publication of this notice in the Ontario Securities Commission Bulletin [•Autorité des marchés financiers Bulletin if this is the translated version•] to:

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

Fax: 416-365-1984  
e-mail: [attention@cds.ca](mailto:attention@cds.ca)

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:

M<sup>e</sup> Anne-Marie Beaudoin  
Secrétaire générale  
Autorité des marchés financiers  
800, square Victoria, 22<sup>e</sup> étage  
C.P. 246, tour de la Bourse  
Montréal (Québec) H4Z 1G3

Manager, Market Regulation  
Market Regulation Branch  
Ontario Securities Commission  
Suite 1903, Box 55,  
20 Queen Street West  
Toronto, Ontario, M5H 3S8

Télécopieur: (514) 864-6381  
Courrier électronique: [consultation-en-cours@lautorite.qc.ca](mailto:consultation-en-cours@lautorite.qc.ca)

Fax: 416-595-8940  
e-mail: [marketregulation@osc.gov.on.ca](mailto:marketregulation@osc.gov.on.ca)

Ann Gander  
Secretary to the Commission  
British Columbia Securities Commission  
701 West Georgia Street  
P.O. Box 10142, Pacific Centre  
Vancouver, B.C. V7Y 1L2

Fax: 604-899-6506  
email: [agander@bcsc.bc.ca](mailto:agander@bcsc.bc.ca)

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

**I. PROPOSED CDS RULE AMENDMENTS**

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

**APPENDIX "A"**  
**PROPOSED CDS RULE AMENDMENTS**

| <b>Text of CDS Participant Rules marked to reflect proposed amendments</b>  | <b>Text CDS Participant Rules reflecting the adoption of proposed amendments</b>  |
|---|---|
| <p><b>2.3.2 Categories</b></p> <p>...</p> <p>(c) Categories of Limited Purpose Participants</p> <p><del>CDS shall classify each limited purpose Participant that satisfies the requirements set out in Rule 11.2.2 as a TA Participant. CDS shall classify each other limited purpose Participant into one or more both of the following categories:</del></p> <p>(i) ATON Participant</p> <p>if the Participant satisfies the requirements set out in Rule12.2.3.</p> <p>(ii) ACT Participant</p> <p>if the Participant satisfies the requirements set out in Rule10.12.</p> <p><u>(iii) TA Participant</u></p> <p><u>if the Participant satisfies the requirements set out in Rule11.2.2.</u></p> <p><b>2.4.7 Limited Purpose Participants</b></p> <p>(a) A-TA Participant:</p> <p><u>A TA Participant:</u></p> <ul style="list-style-type: none"> <li>(i) may not effect Settlements (including a transfer or Pledge of Securities) or hold Securities credited to its Ledger, except in its capacity as a CDSX Depository Agent or Entitlements Processor <u>or as permitted when classified under another limited purpose Participant category;</u></li> <li>(ii) may not make Lines of Credit available to other Participants;</li> <li>(iii) may not use Lines of Credit made available by an Extender of Credit or by the Active Federated Participant;</li> <li>(iv) may not use any CCP Function;</li> <li>(v) may not act as the ISIN Activator or Securities Validator for a Security; and</li> <li>(vi) may not act as a Custodian.</li> </ul> | <p><b>2.3.2 Categories</b></p> <p>...</p> <p>(b) Categories of Limited Purpose Participants</p> <p>CDS shall classify each limited purpose Participant into one or more of the following categories:</p> <p>(i) ATON Participant</p> <p>if the Participant satisfies the requirements set out in Rule12.2.3.</p> <p>(ii) ACT Participant</p> <p>if the Participant satisfies the requirements set out in Rule10.12.</p> <p>(iii) TA Participant</p> <p>if the Participant satisfies the requirements set out in Rule11.2.2.</p> <p><b>2.4.8 Limited Purpose Participants</b></p> <p>(b) TA Participant:</p> <p>A TA Participant:</p> <ul style="list-style-type: none"> <li>(i) may not effect Settlements (including a transfer or Pledge of Securities) or hold Securities credited to its Ledger, except in its capacity as a CDSX Depository Agent or Entitlements Processor or as permitted when classified under another limited purpose Participant category;</li> <li>(ii) may not make Lines of Credit available to other Participants;</li> <li>(iii) may not use Lines of Credit made available by an Extender of Credit or by the Active Federated Participant;</li> <li>(iv) may not use any CCP Function;</li> <li>(v) may not act as the ISIN Activator or Securities Validator for a Security; and</li> <li>(vi) may not act as a Custodian.</li> </ul> |

| Text of CDS Participant Rules marked to reflect proposed amendments  | Text CDS Participant Rules reflecting the adoption of proposed amendments  |
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| <p>(b) ATON Participant</p> <p>An ATON Participant:</p> <ul style="list-style-type: none"> <li>(i) may effect Settlements or hold Securities credited to its Ledger only in connection with the transfer of client accounts;</li> <li>(ii) may not effect Settlements that result in a negative balance in its Funds Account;</li> <li>(iii) may not deposit or withdraw Securities;</li> <li>(iv) may not make Lines of Credit available to other Participants;</li> <li>(v) may not use Lines of Credit made available by an Extender of Credit or by the Active Federated Participant;</li> <li>(vi) may not use any CCP Function;</li> <li>(vii) may not act as the ISIN Activator, Securities Validator, Entitlements Processor or CDSX Depository Agent for a Security; and</li> <li>(viii) may not act as a Custodian.</li> </ul> | <p>(c) ATON Participant</p> <p>An ATON Participant:</p> <ul style="list-style-type: none"> <li>(i) may effect Settlements or hold Securities credited to its Ledger only in connection with the transfer of client accounts;</li> <li>(ii) may not effect Settlements that result in a negative balance in its Funds Account;</li> <li>(iii) may not deposit or withdraw Securities;</li> <li>(iv) may not make Lines of Credit available to other Participants;</li> <li>(v) may not use Lines of Credit made available by an Extender of Credit or by the Active Federated Participant;</li> <li>(vi) may not use any CCP Function;</li> <li>(vii) may not act as the ISIN Activator, Securities Validator, Entitlements Processor or CDSX Depository Agent for a Security; and</li> <li>(viii) may not act as a Custodian.</li> </ul> |
| <p>(c) ACT Participant</p> <p>An ACT Participant that is not also an ATON Participant <u>or a TA Participant</u> may not use CDSX.</p> <p>...</p>  | <p>(d) ACT Participant</p> <p>An ACT Participant that is not also an ATON Participant or a TA Participant may not use CDSX.</p> <p>...</p>   |
| <p><b>5.1.9 Role of ACT Participant</b></p> <p>Notwithstanding the provisions of this Rule 5, an ACT Participant that is not also an ATON Participant <u>or a TA Participant</u> may not use CDSX and accordingly:</p> <ul style="list-style-type: none"> <li>(a) does not grant nor use a Line of Credit;</li> <li>(b) is not a Member of a Fund Credit Ring;</li> <li>(c) is not a Member of a Category Credit Ring;</li> <li>(d) does not make any Contribution to any Fund or Collateral Pool;</li> <li>(e) does not grant any security interest to CDS;</li> <li>(f) does not have a System-Operating Cap that limits its Transactions; and</li> <li>(g) is not required to satisfy the ACV edit.</li> </ul> <p>...</p>   | <p><b>5.1.9 Role of ACT Participant</b></p> <p>Notwithstanding the provisions of this Rule 5, an ACT Participant that is not also an ATON Participant or a TA Participant may not use CDSX and accordingly:</p> <ul style="list-style-type: none"> <li>(h) does not grant nor use a Line of Credit;</li> <li>(i) is not a Member of a Fund Credit Ring;</li> <li>(j) is not a Member of a Category Credit Ring;</li> <li>(k) does not make any Contribution to any Fund or Collateral Pool;</li> <li>(l) does not grant any security interest to CDS;</li> <li>(m) does not have a System-Operating Cap that limits its Transactions; and</li> <li>(n) is not required to satisfy the ACV edit.</li> </ul> <p>...</p>  |

| Text of CDS Participant Rules marked to reflect proposed amendments   | Text CDS Participant Rules reflecting the adoption of proposed amendments  |
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| <p><b>10.12.2 Eligibility for Participation</b></p> <p>Any Person who is a Regulated Financial Institution, Foreign Institution or Government Body, <u>TA Participant</u>, or who is an ATON Participant, is eligible to apply to become a limited purpose ACT Participant. A full service Participant <del>or a limited purpose TA Participant</del> is not eligible to apply to become a limited purpose ACT Participant.</p> <p>...</p> <p><b>10.12.3 Participation Qualifications and Standards</b></p> <p>When requested by CDS, an ACT Participant shall demonstrate to the satisfaction of CDS that it meets the qualifications and standards set out in Rule applicable to the category to which it belongs (Regulated Financial Institution, Foreign Institution, Government Body or <u>other limited purpose participant</u> <del>ATON Participant</del>, as the case may be).</p> <p>...</p> <p><b>11.1.1 General Description</b></p> <p>The Depository Service is a Service established by CDS by which CDS holds Securities on behalf of Participants and maintains book accounts recording such Securities. CDS and each TA Participant shall co-operate as set out in this Rule to manage the Deposit and Withdrawal of eligible Securities to and from the Depository Service of CDS. A TA Participant shall be a limited purpose Participant as set out herein, and its activities in CDSX shall be limited to (i) managing the Deposit and Withdrawal of Securities as set out in this Rule 11, (ii) at its option, acting as a CDSX Depository Agent, <del>and</del> (iii) at its option, acting as an Entitlements Processor as set out in this, <u>and (iv) acting in the capacity of another category of limited purpose participant for which it is categorized.</u></p> <p>...</p> <p><b>11.2.2 Eligibility for Participation</b></p> <p>A Person is eligible to participate in CDSX as a TA Participant if it has been appointed as the Transfer Agent of a sufficient number of CDSX eligible Securities. An Issuer of a CDSX eligible Security who has not appointed a Transfer Agent for that Security is eligible to participate as a TA Participant with respect to that Security, and any references in this Rule 11 to the TA Participant acting as the agent of an Issuer include an Issuer who is a TA Participant acting for itself. <del>A full service Participant that is classified in a category other than that of TA Participant</del> may not act as a TA Participant, even if it is an Issuer of CDSX eligible Securities or the Transfer Agent of such an Issuer.</p> <p>...</p> | <p><b>10.12.2 Eligibility for Participation</b></p> <p>Any Person who is a Regulated Financial Institution, Foreign Institution or Government Body, TA Participant, or who is an ATON Participant, is eligible to apply to become a limited purpose ACT Participant. A full service Participant is not eligible to apply to become a limited purpose ACT Participant.</p> <p>...</p> <p><b>10.12.3 Participation Qualifications and Standards</b></p> <p>When requested by CDS, an ACT Participant shall demonstrate to the satisfaction of CDS that it meets the qualifications and standards set out in Rule applicable to the category to which it belongs (Regulated Financial Institution, Foreign Institution, Government Body or other limited purpose participant, as the case may be).</p> <p>...</p> <p><b>11.1.1 General Description</b></p> <p>The Depository Service is a Service established by CDS by which CDS holds Securities on behalf of Participants and maintains book accounts recording such Securities. CDS and each TA Participant shall co-operate as set out in this Rule to manage the Deposit and Withdrawal of eligible Securities to and from the Depository Service of CDS. A TA Participant shall be a limited purpose Participant as set out herein, and its activities in CDSX shall be limited to (i) managing the Deposit and Withdrawal of Securities as set out in this Rule 11, (ii) at its option, acting as a CDSX Depository Agent, (iii) at its option, acting as an Entitlements Processor as set out in this, and (iv) acting in the capacity of another category of limited purpose participant for which it is categorized.</p> <p>...</p> <p><b>11.2.2 Eligibility for Participation</b></p> <p>A Person is eligible to participate in CDSX as a TA Participant if it has been appointed as the Transfer Agent of a sufficient number of CDSX eligible Securities. An Issuer of a CDSX eligible Security who has not appointed a Transfer Agent for that Security is eligible to participate as a TA Participant with respect to that Security, and any references in this Rule 11 to the TA Participant acting as the agent of an Issuer include an Issuer who is a TA Participant acting for itself. A full service Participant may not act as a TA Participant, even if it is an Issuer of CDSX eligible Securities or the Transfer Agent of such an Issuer.</p> <p>...</p> |

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|---|--|
| <p><b>11.2.4 Role of TA Participant</b></p> <p>A TA Participant:</p> <ul style="list-style-type: none"> <li>(a) shall confirm or reject the Deposit and Withdrawal of Securities and shall provide a Closing Balance Report to CDS, with respect to all CDSX eligible Securities for which it is the Transfer Agent;</li> <li>(b) may act as a Depositary Agent (including a CDSX Depositary Agent) or Entitlements Processor;</li> <li>(c) may not effect Settlements (including a transfer or Pledge of Securities) or hold Securities credited to its Ledger except in its capacity as a CDSX Depositary Agent or Entitlements Processor <u>or as permitted when classified under another limited purpose Participant category</u>;</li> <li>(d) may not make Lines of Credit available to other Participants;</li> <li>(e) may not use Lines of Credit made available by an Extender of Credit or by the Active Federated Participant;</li> <li>(f) may not use the CNS or FINet Functions;</li> <li>(g) may not act as the ISIN Activator or Securities Validator for a Security; and</li> <li>(h) may not act as a Custodian.</li> </ul> <p>...</p> | <p><b>11.2.4 Role of TA Participant</b></p> <p>A TA Participant:</p> <ul style="list-style-type: none"> <li>(i) shall confirm or reject the Deposit and Withdrawal of Securities and shall provide a Closing Balance Report to CDS, with respect to all CDSX eligible Securities for which it is the Transfer Agent;</li> <li>(j) may act as a Depositary Agent (including a CDSX Depositary Agent) or Entitlements Processor;</li> <li>(k) may not effect Settlements (including a transfer or Pledge of Securities) or hold Securities credited to its Ledger except in its capacity as a CDSX Depositary Agent or Entitlements Processor or as permitted when classified under another limited purpose Participant category;</li> <li>(l) may not make Lines of Credit available to other Participants;</li> <li>(m) may not use Lines of Credit made available by an Extender of Credit or by the Active Federated Participant;</li> <li>(n) may not use the CNS or FINet Functions;</li> <li>(o) may not act as the ISIN Activator or Securities Validator for a Security; and</li> <li>(p) may not act as a Custodian.</li> </ul> <p>...</p> |
| <p><b>12.2.3 Eligibility for Participation</b></p> <p><del>A Participant that is classified in a category other than that of ATON Participant may not act as a limited purpose ATON Participant.</del> A Person is eligible to apply to become an ATON Participant if it is:</p> <ul style="list-style-type: none"> <li>(i) a Regulated Financial Institution;</li> <li>(ii) a mutual fund dealer that is a member of the Mutual Fund Dealers Association of Canada;</li> <li>(iii) a mutual fund dealer that is regulated as such by a Regulatory Body that is a provincial securities commission; or</li> <li>(iv) a broker, dealer, bank, savings bank, trust company, loan company or insurance company that trades in Securities or mutual funds and that is incorporated, established or formed under the laws of a jurisdiction situate outside of Canada or that is primarily regulated under the laws of a jurisdiction situate outside Canada.</li> </ul>   | <p><b>12.2.3 Eligibility for Participation</b></p> <p>A Person is eligible to apply to become an ATON Participant if it is:</p> <ul style="list-style-type: none"> <li>(v) a Regulated Financial Institution;</li> <li>(vi) a mutual fund dealer that is a member of the Mutual Fund Dealers Association of Canada;</li> <li>(vii) a mutual fund dealer that is regulated as such by a Regulatory Body that is a provincial securities commission; or</li> <li>(viii) a broker, dealer, bank, savings bank, trust company, loan company or insurance company that trades in Securities or mutual funds and that is incorporated, established or formed under the laws of a jurisdiction situate outside of Canada or that is primarily regulated under the laws of a jurisdiction situate outside Canada.</li> </ul>   |

*For reference, the text of related CDS Participant Rules are reproduced below:*

#### **2.4.8 Limitation**

Bank of Canada may effect Settlements and make payment without limit as to the amount of such Settlements and payments. A TA Participant or an ATON Participant may effect Settlements provided that such Settlements do not result in a negative balance in its Funds Account, and accordingly neither a TA Participant nor an ATON Participant uses a System-Operating Cap or a Line of Credit. Any Participant other than Bank of Canada may exercise the powers specified for the category into which it is classified only if such Transactions can be effected within its System-Operating Cap, if any, and any Line of Credit established for it.

#### **12.1.1 General Description**

ATON (the Account Transfer Online Notification Service) is a service to facilitate the electronic transfer of client account information to assist in the transfer of client assets between Participants. ATON may be used by ATON Participants and by all other Participants.