

### 13.3 Clearing Agencies

#### 13.3.1 CDS Clearing and Depository Services Inc. – Material Amendments to CDS Rules – Emergency Authority – Request for Comments

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

##### MATERIAL AMENDMENTS TO CDS RULES

##### EMERGENCY AUTHORITY

##### REQUEST FOR COMMENTS

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

The proposed rule amendment provides that where unforeseen circumstances occur that could risk the integrity of CDS or its systems or pose significant harm to Canadian capital markets (“Emergency”), CDS management may take such action as may be necessary to ensure the safe, fair and efficient operation of its systemically important clearing operations and adhere to its regulatory obligations in a manner that is consistent with the public interest. The proposed rule amendment also responds to CDS’s recognition order requirements to observe, as soon as possible, CPSS-IOSCO *Principles of Financial Market Infrastructure* (“PFMI”) requirements.

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

In Emergencies, time is of the essence and often may require urgent immediate action by the Chief Executive Officer, in consultation with the Chief Legal Officer and Chief Risk Officer, or any of their respective delegates, as the case may be. This proposed rule amendment provides CDS with the necessary flexibility to make, and act upon, decisions expeditiously, prudently and in a manner that is consistent with the public interest to avoid or mitigate harm to CDS, its Participants or Canadian capital markets.

Under its recognition order requirements, CDS is required to observe PFMI requirements as soon as possible. The PFMIs are internationally accepted guiding principles for financial market infrastructures. As a central securities depository and central counterparty clearing house, CDS is a financial market infrastructure. Principle 2 of the PFMI requirements establishes standards for sound governance. Key Consideration 6 of Principle 2 requires FMIs to have effective decision-making in crises and Emergencies. The proposed rule amendment would address a gap identified under Key Consideration 6.

The proposed rule amendment will insert a new section into the CDS Participant Rules entitled “Emergency Authority” as section 1.5.3, and a new defined term, “General Suspension”, in s. 1.2.1. CDS considers the approach in this rule amendment to emergency authority as an appropriate balance between broad and prescriptive discretionary power.

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

(a) *CDS Clearing* – This rule amendment provides important protection to CDS, its Participants and Canadian capital markets, and helps ensure CDS’s ability to deliver systemically important services. The proposed rule amendment will enhance the speed with which CDS management can respond to Emergencies.

(b) *CDS Participants* – The proposed rule amendment will help ensure that Participants and key stakeholders of CDS have the ability to protect the integrity of CDS or its Systems.

(c) & (d) *Other Market Participants and Securities and Financial Markets in General* – The proposed rule amendment provides CDS management with flexibility to respond to disruption or possible disruption to the Canadian capital markets expeditiously, prudently and in a manner that is consistent with the public interest.

##### C.1 Competition

The proposed rule amendment will have a net positive impact on the competitive landscape of the Canadian capital markets and CDS Participants by ensuring that CDS’ ability to respond to Emergencies is aligned to that of its industry peers.

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

In an Emergency, CDS may need to respond expeditiously and prudently to circumstances beyond its control. The proposed rule amendment strikes an appropriate balance between prudent principles of governance and the ability to adapt to emergency or exigent circumstances.

The proposed rule amendment is not expected to 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 PFMI is minimum international standards for enhancing the safety and efficiency of clearing, settlement and recording arrangements. The standards aim to limit systemic risk and foster transparency and financial stability. They apply to central counterparty clearinghouses (“CCPs”), central securities depositories (“CSDs”) and security settlement systems (“SSS”). According to the terms of CDS’s recognition order requirements, CDS is required to observe PFMI as soon as possible. Principle 2 of the PFMI describes governance standards that FMIs should observe. Key Consideration 6 of Principle 2 requires FMIs to have effective decision-making in emergency situations. The proposed rule amendment would address a gap identified under that requirement.

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

**D.1 Development Context**

CDS has had two recent experiences which have highlighted vulnerability in CDS’s rules. In the process of reviewing those incidents, CDS looked at the emergency authority rules of other clearinghouses and discovered that comparable clearinghouses had rules ensuring management had the necessary discretion to respond immediately and prudently in crises or emergency circumstances. CDS also came to realize that the absence of this kind of emergency authority was a gap in its PFMI observance.

**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.

**D.3 Issues Considered**

During an Emergency, CDS would make best efforts to adhere to established rules, procedures, communication practices, protocols and corporate governance practices, to the extent practicable, including without limitation providing prompt notification, to participants, regulators and the CDS Board. These established protocols would continue to be observed with the maximum level of diligence permitted under the circumstances.

Regarding communication, upon the occurrence of an Emergency, CDS anticipates, at a minimum, issuing to its Participants, with sufficient detail appropriate to the circumstances, notifying them of the Emergency and CDS’s response, further to section 1.12 of the *CDSX Procedures and User Guide* and Rules 1.3.5 and 1.3.7 of the *CDS Participant Rules*. Immediately upon issuing a Bulletin, CDS would file it with its regulators pursuant to current requirements (s. 2.4, Appendix E OSC RO and s. 2.4, Appendix F AMF RD). CDS is mindful of the current requirement to notify its regulators of occurrences that have caused or could reasonably cause significant risk to, adverse material effect on or significant potential disruption to CDS, its services, its Participants or Canadian financial markets (s. 2.1, Appendix E OSC RO and s. 2.1, Appendix F AMF RD). In an Emergency, CDS would engage in prompt and regular communication with its regulators and adhere to the requirements above as soon as possible.

Notwithstanding its commitment to established rules and protocols for notification to Participants, regulators and the Board, CDS would, nevertheless, make every effort to immediately communicate with and provide frequent updates to affected participants, regulators and the Board by telephone, fax, email or any other method at its disposal to effect prompt and ongoing communication throughout the life of the Emergency, until it is resolved.

CDS also considered the industry practice of other clearinghouses around the world which showed that emergency authority decision making was a standard feature of comparator organizations. CDS considered CPSS-IOSCO PFMI requirements, specifically Principle 2, Key Consideration 6 on decision making in crises and emergencies as well as CDS’s recognition order requirement to observe CPSS-IOSCO PFMI requirements as soon as possible.

**D.4 Consultation**

Due to the nature of the proposed amendment, CDS consulted directly with members of the CDS Board during the development of the proposed amendment. In addition, CDS management and employees as well as other clearinghouses within the TMX Group were consulted.

#### **D.5 Alternatives Considered**

CDS considered broad versus prescriptive approaches to emergency authority rule construction, looking at examples from other clearinghouses. CDS proposes, through this rule amendment, an approach that appropriately balances these considerations. For example, emergency is not presumptively defined but limited by who declares the emergency and CDS's public interest responsibility.

#### **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*, by the British Columbia Securities Commission pursuant to Section 24(d) of the British Columbia *Securities Act* and by the *Autorité des marchés financiers* ("AMF") pursuant to section 169 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 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 amendments to CDS Participant Rules are expected to become effective upon approval of the amendments by the Recognizing Regulators following public notice and comment.

#### **E. TECHNOLOGICAL SYSTEMS CHANGES (E.1, E.2, E.3)**

The proposed rule amendment is not expected to have an impact on technological systems, or require changes to such systems for CDS, CDS Participants, or other market participants.

#### **F. COMPARISON TO OTHER CLEARING AGENCIES**

CDS conducted a detailed analysis of the emergency authority provisions of other Canadian clearinghouses as well as comparable clearing and depository institutions outside of Canada, a sample of which is discussed below. We observed that all comparators had some form of emergency authority power articulated in clearinghouse rules or by-laws. The rules of the Canadian Derivatives Clearing Corporation ("CDCC") define the term "Emergency" and allow CDCC to exercise broad discretion in the event of an Emergency or *force majeure* event. The rules of the Depository Trust Company ("DTC"), the National Securities Clearing Corporation ("NSCC") and the Fixed Income Clearing Corporation ("FICC") allow management to suspend, extend or waive any rules and procedures when, at its discretion, such action is necessary or expedient. The rules of the Natural Gas Exchange ("NGX") permit management to exercise discretionary power when NGX's management or its regulators determine that an emergency situation exists which threatens, among other things, orderly trading and the integrity of NGX.

#### **G. PUBLIC INTEREST ASSESSMENT**

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

#### **H. COMMENTS**

Comments on the proposed amendments should be in writing and submitted within 30 calendar days following the date of publication of this notice in the Ontario Securities Commission Bulletin 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

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:

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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**

Text of CDS Participant Rules marked to reflect proposed amendments	Text of CDS Participant Rules reflecting the adoption of proposed amendments
<p>[marked text of rules – additions are underlined; deletions are strikethrough text]</p> <p>1.2.1 Definitions</p> <p><u>“General Suspension” means the termination of access to CDSX for all Participants in relation to some or all Services, whether on a temporary or longer basis.</u></p> <p>1.5.3 Emergency Authority</p> <p><u>In the event that (i) the Chief Executive Officer, in consultation with the Chief Legal Officer and Chief Risk Officer, or any of their respective delegates, as the case may be, determines, that an emergency situation exists, or (ii) any of CDS’ regulators determine that an emergency situation exists, and in each case in which fair and orderly clearing, settlement or depository activities or the liquidation of, or delivery pursuant to, any Transaction, is likely to be disrupted, or the financial integrity of CDS or CDSX or the Services is threatened, or the normal functioning of CDS or CDSX or the Services has been or is likely to be disrupted, CDS may take such action as may in CDS’ sole discretion appear necessary to prevent, correct or alleviate such emergency situation, including but not limited to (i) declining to enter into any Transactions; (ii) causing a Participant’s suspension; (iii) causing a General Suspension; (iv) effecting close-out; (v) effecting liquidation processes; vi) taking reasonable action to preserve the integrity of capital markets or the public interest; and/or (vii) taking any other reasonable actions to preserve the integrity and security of CDS or CDSX or the Services.</u></p>	<p>1.2.1 Definitions</p> <p>“General Suspension” means the termination of access to CDSX for all Participants in relation to some or all Services, whether on a temporary or longer basis.</p> <p>1.5.3 Emergency Authority</p> <p>In the event that (i) the Chief Executive Officer, in consultation with the Chief Legal Officer and Chief Risk Officer, or any of their respective delegates, as the case may be, determines, that an emergency situation exists, or (ii) any of CDS’ regulators determine that an emergency situation exists, and in each case in which fair and orderly clearing, settlement or depository activities or the liquidation of, or delivery pursuant to, any Transaction, is likely to be disrupted, or the financial integrity of CDS or CDSX or the Services is threatened, or the normal functioning of CDS or CDSX or the Services has been or is likely to be disrupted, CDS may take such action as may in CDS’ sole discretion appear necessary to prevent, correct or alleviate such emergency situation, including but not limited to (i) declining to enter into any Transactions; (ii) causing a Participant’s suspension; (iii) causing a General Suspension; (iv) effecting close-out; (v) effecting liquidation processes; vi) taking reasonable action to preserve the integrity of capital markets or the public interest; and/or (vii) taking any other reasonable actions to preserve the integrity and security of CDS or CDSX or the Services.</p>