

CDS Clearing and Depository Services Inc. (CDS®)

MATERIAL AMENDMENTS TO CDS PARTICIPANT RULES RELATED TO TIERED PARTICIPATION INFORMATION SHARING

NOTICE AND REQUEST FOR COMMENTS

A. DESCRIPTION OF THE PROPOSED RULE AMENDMENTS

The proposed rule amendments will specify that, upon request from CDS Clearing, Participants will be required to provide such information as CDS Clearing may reasonably request in order to ensure observance of CDS Clearing's obligations under *Principle 19 – Tiered Participation Arrangements* of the CPMI-IOSCO Principles for Financial Market Infrastructures (PFMIs). While disclosure and information sharing obligations are enshrined in several sections of the CDS Participant Rules, CDS Clearing, and CDS Clearing's principal regulators, are of the view that CDS Clearing's general observance of, *inter alia*, the PFMIs, CDS's regulatory oversight by the Bank of Canada, *National Instrument 24-102 – Clearing Agency Requirements* (NI 24-102), and of CDS's provincial recognition framework, will benefit from further clarification in the Rules as to the scope of such obligations.

The proposed rule amendments, to CDS Participant Rule 5.1, consist of the addition of a requirement to share information for the purposes of monitoring Participants' activities, and are provided in Appendix "A" to this Notice.

B. NATURE AND PURPOSE OF THE PROPOSED RULE AMENDMENTS

The legal basis for participation, and the operational relationship, which exists between CDS Clearing and its direct Participants is a fundamental aspect of Canada's indirect securities holding regime. This regime also results in the establishment of indirect clearing arrangements, pursuant to which a clearing broker provides services to a third party broker. The permissibility of the foregoing structure carries with it the obligation, on CDS Clearing and on CDS Clearing Participants, to ensure continued and fulsome observance of the PFMIs and the implementation of same under Canadian federal and provincial oversight.

Principle 19 of the PFMIs, originally published in April, 2012, requires CDS Clearing to identify, monitor and manage the material risks to CDS Clearing arising from the tiered participation arrangements of its direct Participants. In general, tiered participation arrangements occur when a firm (i.e., an indirect participant, which is defined as an entity that is not bound by the rules of a Financial Market Infrastructure (FMI), but whose transactions are cleared, settled, or recorded by or through the FMI) relies on the services provided by another firm (i.e., a direct Participant) to use CDS Clearing's Securities Settlement Service (SSS), Central Counterparty (CCP) service and/or Cross-Border DTCC (X-Border) services.

The Bank of Canada incorporated the PFMIs, including Principle 19, into their risk management standards for systemically important financial market infrastructures (FMIs) in 2012, and such FMIs have been expected to observe all applicable principles since 31 December, 2016.

Principle 19 applies to CDS Clearing at the provincial level pursuant to Section 3.1 of NI 24-102. CDS Clearing's recognition orders and decisions (2012), as subsequently varied and amended (Ontario Securities Commission Recognition Order, Section 9.1; *Autorité des marchés financiers* Recognition Decision, Section 28.1) required that CDS Clearing observe the PFMIs as soon as possible, and continue to so require.

In CDSX, the principal Participant categories are Extenders of Credit, Settlement Agents, and Receivers of Credit. These Participants have direct access to CDSX and are contractually bound by

CDS Clearing's Participant Rules. Indirect participants access CDS Clearing's SSS, CCP and X-Border FMI services via direct Participants. In other words, they are clients of CDS Clearing's direct Participants.

CDS Clearing has not, to-date, formalized tiered participation arrangements pursuant to which CDS Clearing recognizes, acknowledges, or maintains a contractual relationship with, the clients of our direct Participants except for purposes of ensuring that beneficial security-holders are not deprived of the rights attached to such holdings. CDS Clearing does, however, retain the ability to both monitor Participant activities in CDSX and to require declarations from CDS Clearing Participants in respect of the securities which CDS Clearing holds on those participants' behalf. In 2017, CDS Clearing presented a Tiered Participation Risk Management Framework and requested certain information and data for the purpose of compliance with PFMI Principle 19. CDS Clearing prepared (i) a risk management framework to ensure that CDS operates within its risk appetite statement; and (ii) a participant questionnaire for the purpose of collecting information from its direct Participants in order to monitor and assess their activities in CDS Clearing's Services as such activities may relate to the magnitude and scope of their respective tiered participation arrangements.

The 2017 questionnaire was voluntary, and was circulated to a limited sample of Participants whose operations were known, by CDS, to include acting as a correspondent/clearing participant for non-participants. The results of the request were collected, analyzed, and presented at the end of 2017. To be assured of timely, complete and detailed survey responses, however, CDS is proposing the present rule amendments to make provision of tiered participation details mandatory for Participants.

The proposed rule amendments are intended to enhance the comprehensiveness of Tiered Participation information gathering by CDS and to improve data related to indirect Participant activity profiles and related risk exposures.

C. IMPACT OF THE PROPOSED RULE AMENDMENTS

- (a) CDS Clearing – The proposed rule amendments will align CDS Clearing with the PFMI requirements and with the legal and risk management practices of CDS Clearing's global comparators.
- (b) CDS Participants – The proposed rule amendments will codify Participants' obligation to share information related to tiered participation arrangements with CDS Clearing. The proposed rule amendments take account of other legislative or regulatory requirements to which Participants may be subject and of the possibility that disclosure to CDS Clearing may, in certain circumstances, be limited by the foregoing.
- (c) Other Market Participants – The proposed rule amendments will have no impact on other market participants. The proposed rule amendments take account of other legislative or regulatory requirements to which Participants may be subject and of the possibility that disclosure of information related to other market participants (i.e., Participant clients) to CDS Clearing may, in certain circumstances, be limited by the foregoing.
- (d) Securities and Financial Markets in General – The proposed rule amendments will have no impact on securities and financial markets in general.

C.1 Competition

The proposed rule will apply to all CDS Clearing Participants. As concerns fair access, no CDS Clearing Participant will be disadvantaged or otherwise prejudiced by the introduction of these changes.

C.2 Risks and Compliance Costs

The proposed rule amendments are intended to enhance CDS Clearing's information gathering abilities and risk management capacity and clarify Participant information provision obligations.

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 rule amendments are intended more clearly and specifically to align CDS Clearing's Participant Rules with the PFMLs.

D. DESCRIPTION OF THE RULE DRAFTING PROCESS

D.1 Development Context

CDS legal and risk management staff prepared documents describing the proposed rule amendments.

D.2 Rule Amendment Drafting Process

The proposed rule amendments were drafted by CDS Clearing legal staff in consultation with CDS Clearing risk management, and was subsequently submitted for consultation to the CDS Legal Drafting Group (“LDG”) on October 17, 2019. The LDG comments on the drafting of proposed amendments to the CDS Participant Rules and may suggest further revisions or additions. The LDG's membership includes representatives from a cross-section of the CDS Participant community and meets on an *ad hoc* basis.

D.3 Issues Considered

As noted above, in drafting the proposed rule amendments, CDS Clearing's primary consideration was to update its risk management practices with respect to PFMI 19 and to clarify CDS Clearing's Participant Rules related thereto.

D.4 Consultation

CDS Clearing received input from the following Participant Advisory Committee:

- The CDS Legal Drafting Group reviewed the Rule Amendment (17 October, 2019)

CDS Clearing's regulators attend Participant Advisory Committee meetings as observers.

The Rule Amendment was presented to the Risk Management and Audit Committee and the Board of Directors on October 31, 2019.

D.5 Alternatives Considered

CDS Clearing legal personnel, in consultation with CDS Clearing risk management, reviewed existing CDS Clearing Participant Rules and determined that, while the Participant Rules provide for the monitoring of Participants' activities by CDS Clearing, and for the potential restriction or suspension of a Participant's system functionality, the obligation to provide information in furtherance of CDS Clearing's observance of regulatory oversight requirements was not explicitly or specifically stated.

CDS Clearing personnel considered whether it was appropriate to make specific reference to CDS Participant's existing obligation to provide notice of material change to information (Rule 2.2.11), but determined that the most appropriate location for the proposed amendments was in the context of CDS Clearing's existing rights to monitor Participants, and to take action consequent to such monitoring (Rule 5.1.3).

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 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*.

This Rule Amendment is expected to become effective upon approval by the Recognizing Regulators following the prescribed public notice and comment period.

E. TECHNOLOGICAL SYSTEM CHANGES

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 Clearing's principal international comparator is the Depository Trust & Clearing Corporation (DTCC), and its two operating subsidiaries, the Depository Trust Company (DTC) and the National Securities Clearing Corporation (NSCC) in the United States. CDS Clearing reviewed the DTC & NSCC Rules, and determined that the rules of both DTC and NSCC contained specific reference to the provision of information related to clients of DTC and NSCC members. The PFMI disclosure frameworks for each of DTC and NSCC also refer to this authority in the context of DTC and NSCC's management of risk related to tiered participation arrangement.

G. PUBLIC INTEREST ASSESSMENT

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

H. COMMENTS

Comments on the proposed Rule Amendment should be in writing and submitted within 30 calendar days following the date of publication of this Request for Comments in the Ontario Securities Commission Bulletin to:

Legal Department
Attn: Tony Hoffmann, Senior Legal Counsel
CDS Clearing and Depository Services Inc.
100 Adelaide Street West, Suite 300
Toronto, Ontario M5H 1S3

e-mail: tony.hoffmann@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

Manager, Market Regulation
Market Regulation Branch
Ontario Securities Commission
Suite 1903, Box 55,

Autorité des marchés financiers
800, square Victoria, 22^e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3
Télécopieur: (514) 864-6381
Courrier électronique: consultation-en-cours@lautorite.qc.ca

20 Queen Street West
Toronto, Ontario, M5H 3S8
Fax: 416-595-8940
e-mail: marketregulation@osc.gov.on.ca

Doug MacKay
Manager, Market and SRO Oversight
British Columbia Securities Commission
701 West Georgia Street
P.O. Box 10142, Pacific Centre
Vancouver, B.C. V7Y 1L2
Fax: 604-899-6506
Email: dmackay@bcsc.bc.ca

Ms. Ami Iaria
Senior Legal Counsel
British Columbia Securities Commission
701 West Georgia Street
C.P. 10142, Pacific Centre
Vancouver (Colombie-Britannique) V7Y 1L2
Télécopieur : 604 899-6506
Courriel : aiaria@bcsc.bc.ca

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

I. PROPOSED CDS RULE AMENDMENT

Appendix “A” contains text of current CDS Participant Rules marked to reflect the proposed Rule Amendment as well as text of these rules reflecting the adoption of the proposed Rule Amendment.

**APPENDIX “A”
PROPOSED CDS RULE AMENDMENT**

| Text of CDS Participant Rules marked to reflect proposed amendment | Text of CDS Participant Rules reflecting the adoption of proposed amendment |
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| <p>[marked text of rules – deletions are <u>strikethrough text and in red font</u>]</p> | |
| <p>5.1.3 Monitoring of Participants</p> <p>Monitoring of Participants In order to measure potential risks to CDS and the Services, CDS shall monitor the Transactions, Settlement obligations and activity in the system of that Participant. Acting in good faith and in accordance with the Rules, CDS shall take steps to ensure the due performance by the Participant of its obligations to CDS, when CDS considers such action to be necessary to protect the interests of CDS and to be in the best interest of all other Participants. In taking such steps, CDS shall take into consideration any relevant information, including the financial stability or regulatory status of the Participant, the amount of its obligations to CDS, the market volatility, liquidity, concentration or market float of any issue of Securities held by or to be delivered by or to the Participant, and any other factor that CDS considers relevant. The steps CDS may take include:</p> <p>(a) requiring the Participant to provide additional Contributions to any Fund or Link Fund of which the Participant is a Member, pursuant to Rules 5.8.2 or 10.6.4;</p> <p>(b) requiring the Participant to grant to CDS a security interest in Specific Collateral, CCP Collateral, or Cross-Border Specific Collateral pursuant to Rules 5.2.3, 5.14.3, or 10.5.3;</p> <p>(c) decreasing the Participant's System-Operating Cap pursuant to Rule 5.10.18; restricting the Participant's right to use system functionality in any Function or Service pursuant to Rule 2.7.1;</p> <p>(d) releasing giving information relating to the Participant's CCP Contributions Total in accordance with Rule 5.14.2; or</p> <p>(e) requiring the Participant to provide, upon request by CDS, information sufficient, in a form acceptable to CDS, to demonstrate the Participants satisfactory financial condition and operational capability, including, but not limited to, information in respect of the Participant's operations and in respect of its risk management practices with respect to CDS's Services used by the Participant for another Person or Persons; provided, however, that the provision</p> | <p>5.1.3 Monitoring of Participants</p> <p>Monitoring of Participants In order to measure potential risks to CDS and the Services, CDS shall monitor the Transactions, Settlement obligations and activity in the system of that Participant. Acting in good faith and in accordance with the Rules, CDS shall take steps to ensure the due performance by the Participant of its obligations to CDS, when CDS considers such action to be necessary to protect the interests of CDS and to be in the best interest of all other Participants. In taking such steps, CDS shall take into consideration any relevant information, including the financial stability or regulatory status of the Participant, the amount of its obligations to CDS, the market volatility, liquidity, concentration or market float of any issue of Securities held by or to be delivered by or to the Participant, and any other factor that CDS considers relevant. The steps CDS may take include:</p> <p>(a) requiring the Participant to provide additional Contributions to any Fund or Link Fund of which the Participant is a Member, pursuant to Rules 5.8.2 or 10.6.4;</p> <p>(b) requiring the Participant to grant to CDS a security interest in Specific Collateral, CCP Collateral, or Cross-Border Specific Collateral pursuant to Rules 5.2.3, 5.14.3, or 10.5.3;</p> <p>(c) decreasing the Participant's System-Operating Cap pursuant to Rule 5.10.18; restricting the Participant's right to use system functionality in any Function or Service pursuant to Rule 2.7.1;</p> <p>(d) releasing information relating to the Participant's CCP Contributions Total in accordance with Rule 5.14.2; or</p> <p><u>(e)</u> requiring the Participant to provide, upon request by CDS, information sufficient, in a form acceptable to CDS, to demonstrate the Participants satisfactory financial condition and operational capability, including, but not limited to, information in respect of the Participant's operations and in respect of its risk management practices with respect to CDS's Services used by the Participant for another Person or Persons; provided, however, that the provision of any such</p> |

| Text of CDS Participant Rules marked to reflect proposed amendment | Text of CDS Participant Rules reflecting the adoption of proposed amendment |
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| <p><u>of any such financial or operational information to CDS shall be subject to Rule 3.6 and to any applicable laws or rules and regulations of regulatory bodies having jurisdiction over the Participant which relate to the confidentiality of records.</u></p> <p>(f) taking any other feasible steps consistent with the Rules.</p> | <p>financial or operational information to CDS shall be subject to Rule 3.6 and to any applicable laws or rules and regulations of regulatory bodies having jurisdiction over the Participant which relate to the confidentiality of records.</p> <p>(e)(f) taking any other feasible steps consistent with the Rules.</p> |