

**CDS Clearing and Depository Services Inc. (CDS<sup>®</sup>)**

**MATERIAL AMENDMENTS TO CDS RULES**

**PARTICIPANT APPROVAL AUTHORITY**

**REQUEST FOR COMMENTS**

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

The proposed Rule amendments modify the CDS Participant Rules to specify that CDS Management, rather than the CDS Board of Directors, shall be responsible for the approval or rejection of applications for participation to CDS and for the re-classification of a Participant at a Participant's request. The proposed Rule amendments also provide that a prospective Participant whose application for participation has been rejected by CDS has the right to appeal that decision to the CDS Board of Directors pursuant to the appeals process currently in-force.

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

*Background*

CDS's Participant Rules define the terms "Board of Directors or "Board" and "CDS" to mean, respectively, "the Board of Directors of CDS" and "CDS Clearing and Depository Services Inc. or a Person who succeeds to the rights and obligations of CDS with respect to the Services generally". Further, CDS Rule 3.2.1 – Actions under Rules – states that "CDS may take any action referred to in the Rules by any one of its officers, or by any Person designated from time to time by the Board of Directors or by the officers of CDS. The Board of Directors shall exercise its authority by a resolution duly passed by the Board..."

The practical consequence of the foregoing definitions, coupled with Rule 3.2.1, is that where the Participant Rules refer to CDS having the authority, capacity, or obligation to do some thing or make a determination, it is with CDS management that such authority, capacity, or obligation rests. By contrast, where the Participant Rules refer to the Board of Directors or the Board, the authority, capacity, or obligation rests solely with the Board of Directors.

The proposed rule amendments align the Participant approval and re-classification process with domestic and international market infrastructure standards and reaffirm the Board of Directors' role in approving Participant approval standards and formalizing a regular process for Board review and approval of participation requirements and restrictions. In support of this effort, CDS is proposing an amendment to the CDS Participant Rules that will vest responsibility for approving new Participants with management rather than with the Board. Under this proposed Rule amendments, an applicant whose application for participation has been rejected by management will continue to have recourse to the Board.

It is CDS's view that the Participant Rules should specify that the Board of Directors should:

- a) be governing the process by which prospective participants' applications or requests for re-classification are reviewed and approved or rejected, rather than reviewing and approving each application for participation, and
- b) be responsible for the continuous formal review and approval of participation standards and the process by which applications for participation are reviewed, assessed, and approved.

*Benefits*

The proposed amendments will have two key benefits:

1. The proposed amendments will result in the streamlining of the approval process for Applications for Participation and participant re-classifications, and will ensure good governance of the process by the Board of Directors and execution of the process by CDS Management; the proposed amendments will result in more rapid review, assessment, and eventual approval of new participants.
2. Ensures domestic regulatory compliance by eliminating the risk of a recognition order breach where a delayed Board approval for an application for participation results in regulatory notice requirements.

*Streamlined Approval Process and Process Governance*

CDS has a robust participant approval process which it follows for each application for participation that it receives. This review and approval process includes assessments by the Operations, Finance, Risk Management and Legal divisions. In particular, once an application for participation is received and complete, the application undergoes internal review by:

- a. The Corporate Controller, Finance, who reviews recent financial statements, calculates application fee, and receives an applicant's entrance fee.
- b. The Managing Director, Risk Management, who prepares a risk assessment (including financial institution status, regulatory oversight, evidence of financial insurance bond coverage, CPA and LVTS status, assurance of adequate available capital, impact on other credit ring members) for approval by the Chief Risk Officer.

In addition, where a prospective participant is a foreign entity, the admission of such a Participant also requires the provision of a legal opinion satisfactory to CDS and to its federal regulator. This primary review is followed by a report and recommendation to CDS's executive management.

CDS does not propose to change or modify this process in the present context.

Under the current Rules, once reviewed by CDS executive management, CDS's recommendation is then forwarded to the Risk Management and Audit Committee (RMAC) of the CDS Board of Directors which, after a further review, makes a recommendation to the Board of Directors regarding acceptance of the applicant.

Approval is granted by resolution of the Board of Directors (pursuant to Rule 3.2.1), which resolution authorizes and directs CDS (i.e., CDS Management) to execute the Participant Agreement.

The balance of the authority and capacity under CDS Rule 2 – Participation – including, for example, the classification of a participant into a category (Rule 2.1.2 and Rule 2.3), the appointment of certain participants to certain roles (Rule 2.1.2 and Rule 2.4), the selection of a CDS Service or Function by the prospective participant (Rule 2.2.2), and the automatic or discretionary suspension of a participant (Rule 2.1.3 and Rules 9.1.1 and 9.1.2, respectively) already rests appropriately with CDS management. Only the Board of Directors, however, has the authority to terminate an entity's participation (Rule 2.1.3).

The proposed amendments eliminate the review and approval of applications, and requests for re-classification, by RMAC and by the Board of Directors and appropriately vest this authority with CDS Management.

CDS currently has a process in place by which RMAC and the CDS Board of Directors review, on an annual basis, CDS's participation standards and the participant approval process itself to ensure that these standards and the process are consistent with the PFMLs.

In that context, CDS also provides the Board of Directors with quarterly reports in respect of new participant entities approved in the previous quarter, applications that are currently being assessed for approval,

any applications for which approval (or denial) was not completed within 60 days of receipt, and any applications denied or rejected.

#### *Domestic Regulatory Compliance*

CDS's regulatory framework requires that CDS give its regulators prompt notice of the receipt of an application for participation and, more particularly to complete the granting or denial of access to CDS (i.e., the approval or rejection of an application for participation) within 60 days of the receipt of the application, after which further notice, and a report detailing the reasons for the delay, must be sent to CDS's regulators (this requirement may be found in sections 6.4 and 6.5 of Schedule B of the Ontario Securities Commissions CDS recognition order and Section 25.5 and 25.6 of AMF Decision 2012-PDG-0142).

As currently drafted, the CDS Participant Rules require that the Board of Directors approve an application subsequent to CDS internal review and assessment. If however, an application is received immediately following a scheduled meeting of the Board of Directors, CDS will be unable to provide approval (or denial) of that application within the required timeline. Vesting the capacity and the authority to approve applications with CDS management will ensure that applications for participation are assessed expeditiously and within established regulatory timelines.

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

The proposed amendments provide CDS management with flexibility to respond to disruption or possible disruption to the Canadian capital markets expeditiously, and will enhance the speed with which CDS management can respond to Emergencies.

The proposed amendments do not purport to modify existing participation requirements, standards, or qualifications. Authority, under the Rules, to amend, modify, or waive, any of the foregoing remains at the discretion and authority of the CDS Board of Directors. CDS management is, therefore responsible only for the application of those requirements, standards, or qualifications, and the execution of the application approval process.

#### **Competition**

The proposed rule amendments are not expected to impact the competitive landscape of the Canadian capital markets. The proposed rule amendments should, however, provide an indirect benefit to CDS Participants by honing CDS's alignment with domestic and international standards (See "Comparison to International Standards" and "Comparison to Other Clearing Agencies", below) by shifting the capacity and authority to approve applications for participation and participant re-classifications.

#### **Risks and Compliance Costs**

The proposed rule amendments are not expected to result in any compliance costs for CDS, its Participants, or other market participants.

#### **Comparison to International Standards**

The existing process for the approval of applications for participation, which requires Board approval, meets the *Principles for Financial Market Infrastructures* ("PFMIs") published by the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions ("CPSS-IOSCO") published in April 2012. The PFMIs also form the basis of proposed National Instrument 24-102 (Clearing Agency Requirements) and 24-102 CP (Companion Policy) which, once implemented, will apply to CDS.

Reference to Principle 2 (Governance) is informative however, since implicit in the Principle is the notion that oversight of management, strategic questions and major decisions affecting the firm are responsibilities which primarily vest with the Board, while responsibility for day-to-day activities typically resides with

management. This conceptual framework mirrors general corporate governance principles in the *Canada Business Corporations Act* and equivalent provincial legislation.

Two of the key considerations in Principle 2 are informative, stating in part that:

3. The roles and responsibilities of an FMI's board of directors (or equivalent) should be clearly specified, and there should be documented procedures for its functioning, including procedures to identify, address, and manage member conflicts of interest...
5. The roles and responsibilities of management should be clearly specified...

Key consideration 3 of Principle 18 states, in part, that:

3. An FMI should monitor compliance with its participation requirements on an ongoing basis and have clearly defined and publicly disclosed procedures for facilitating the suspension and orderly exit of a participant that breaches, or no longer meets, the participation requirements.

As noted, the existing process for approval of applications for participation and re-classification requests meets the PFMI. The proposed amendments further clarify that the role of CDS's Board of Directors is to govern CDS's participation requirements and standards and the process for approval of applications for participation and re-classification, whereas the role of CDS Management is executing that process and applying such participation standards and requirements.

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

##### **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.

The proposed amendments were presented to the Legal Drafting Group for review on April 20, 2015, with no objections noted.

CDS management presented its proposal to streamline the participant approval process, together with a preliminary outline of amendments to the CDS Rules, at the Board of Directors' scheduled meeting in January, 2015. The proposal was approved in principle, and CDS staff was requested to finalize the proposed amendments to the Rules for approval at the next scheduled meeting of the Board of Directors.

The proposed amendments were reviewed and approved by the Board of Directors of CDS Ltd. on May 7, 2015.

##### **Issues and Alternatives Considered and Consultation**

As outlined in section B, above, CDS management and personnel were consulted in order properly to describe the current Participant Approval process, the participant standards, and in order to assess whether the proposed amendments could result in any negative or unforeseen consequences.

In addition, CDS considered existing, ongoing, and continued monitoring of CDS participants, and their obligations to CDS. These include:

- Once an application is approved, Participants must comply with CDS's *Participant Rules*, procedures and user guides, which constitute a Participant's legal agreement with CDS.
- Participants must continue to meet CDS's qualifications and standards for their chosen role and category, and only the board has the authority to waive such qualifications and standards.
- CDS Risk Management regularly monitors compliance to Board-approved standards, reported in the Annual Compliance report.

- Money Market Participants must also complete an Annual certification process.
- Custodians must provide annual certification of compliance with standards.

CDS did not consider changing either existing standards or ongoing requirements in the present context.

CDS considered the rules of other clearing houses around the world. This analysis indicated that, consistent with PFMI standards and general corporate law principles, Boards of Directors review and approve participation standards and the application process, the execution of the process and the assessment of an individual application against those standards is the responsibility of management.

CDS concluded that the authority to approve applications for participation and re-classifications should properly rest with CDS Management, and in proposing the change to the CDS Rules.

### **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 are 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 and subject to provision of required Notice under the Participant Rules.

### **E. TECHNOLOGICAL SYSTEMS CHANGES**

The proposed amendments will have no impact or effect on CDS’s technological systems or those of its participants or other market participants

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

CDS conducted an analysis of the participant/member approval processes of other domestic and foreign clearinghouses, a sample of which is discussed below. CDS observed that – consistent with PFMI standards – admission procedures in other clearing houses task the Board with setting and observing the implementation of admissions standards while management addresses day-to-day admissions decisions, including the granting of admission.

At ASX Settlement (Australia), Euronext (EU), DTC (US) and NSCC (US), participant/member applications are approved by management. At Euroclear UK & Ireland and CDP (Singapore), applications for participation/membership are also approved by management but under their rules any applicant who have had their applications rejected may appeal the Board.

#### **Euronext**

Rule 2.2. (Requirements for Euronext Membership); Rule 2.3 (Application Procedure)

[https://www.euronext.com/sites/www.euronext.com/files/harmonised\\_rulebook\\_2015\\_03\\_06\\_en\\_0.pdf](https://www.euronext.com/sites/www.euronext.com/files/harmonised_rulebook_2015_03_06_en_0.pdf)

- No Board approval required

#### **The Central Depository Pte Limited (“CDP”) (Singapore)**

Rule 3.1. (Clearing Member); Rule 3.2. (The Application) Rule 3.3 (Appeal)

[http://rulebook.sgx.com/en/display/display\\_viewall.html?rbid=3271&element\\_id=359&print=1](http://rulebook.sgx.com/en/display/display_viewall.html?rbid=3271&element_id=359&print=1)

- No Board approval required; rejected applicants may appeal to Board

**Euroclear UK & Ireland**

2.1.2 (General Admission Policy); 2.1.2 (g) Admission Policy set by Board; 2.1.3 (Appeal)  
<https://my.euroclear.com/dam/EB/Legal%20information/Operating%20procedures/public/LG001-Operating-procedures-of-the-Euroclear-system.pdf>  
- No Board approval required; Board set admission policy; applicant may appeal rejection to Chair of the Board.

**ASX Settlement**

4.2 (Admission of Participants)  
[http://www.asx.com.au/documents/rules/asx\\_settlement\\_rules\\_section\\_04.pdf](http://www.asx.com.au/documents/rules/asx_settlement_rules_section_04.pdf)

**DTC**

Rule 2, Section 1 (Participants and Pledges)  
[http://www.dtcc.com/~media/Files/Downloads/legal/rules/dtc\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/dtc_rules.pdf)

**NSCC**

Rule 2A (Initial Membership Requirements), Section 1 (Eligibility for Membership)  
[http://www.dtcc.com/~media/Files/Downloads/legal/rules/nsc\\_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/nsc_rules.pdf)

**PUBLIC INTEREST ASSESSMENT**

CDS has determined 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 [•Autorité des marchés financiers Bulletin if this is the translated version•] to:

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Managing Director – Business Development  
CDS Clearing and Depository Services Inc.  
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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  
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Autorité des marchés financiers  
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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 CDS Participant Rules reflecting the adoption of proposed amendments
<p>[marked text of rules – additions are underlined and in <b>green</b> font; deletions are strikethrough text and in <b>red</b> font]</p> <p><b>2.2.1 - Application for Participation</b></p> <p>If an applicant is eligible for participation and meets the qualifications and standards for participation set by CDS in accordance with the Rules, it may apply to participate in one or more Services by signing and delivering to CDS an application for participation in the current form made available by CDS. <del>The Board of Directors</del> <b>CDS</b> may approve or reject an application in its sole discretion. Upon acceptance of the application, an applicant for participation shall become a Participant and the application shall become the Participant Agreement between CDS and that Participant. <u>An applicant whose application for participation has been rejected by CDS shall have the right to appeal such decision pursuant to Rules 3.2.3 and 3.2.4.</u></p> <p><b>2.3.1 Classification of Participants</b></p> <p>An applicant for participation shall specify the category in which it wishes to be classified. At the time that an applicant is accepted as a Participant, CDS shall classify it into one of the categories specified in Rule 2.3.2. At any time, a Participant may apply to <del>the Board of Directors</del> <b>CDS</b> to be reclassified into any category for which it is qualified. CDS may reclassify a Participant if it ceases to meet any qualification, standard or classification requirement for the category into which it has been classified. Each Participant shall provide CDS with such information and assurances as may be required to classify the Participant appropriately. CDS shall give notice to a Participant of its classification or reclassification. Unless the other Extenders waive notice, CDS shall give all Extenders at least 15 Business Days notice of a request by an applicant or a Participant to be classified as an Extender, or of a request by an Extender for reclassification into another category, before effecting the classification or reclassification.</p>	<p><b>2.2.1 - Application for Participation</b></p> <p>If an applicant is eligible for participation and meets the qualifications and standards for participation set by CDS in accordance with the Rules, it may apply to participate in one or more Services by signing and delivering to CDS an application for participation in the current form made available by CDS. CDS may approve or reject an application in its sole discretion. Upon acceptance of the application, an applicant for participation shall become a Participant and the application shall become the Participant Agreement between CDS and that Participant. An applicant whose application for participation has been rejected by CDS shall have the right to appeal such decision pursuant to Rules 3.2.3 and 3.2.4.</p> <p><b>2.3.1 Classification of Participants</b></p> <p>An applicant for participation shall specify the category in which it wishes to be classified. At the time that an applicant is accepted as a Participant, CDS shall classify it into one of the categories specified in Rule 2.3.2. At any time, a Participant may apply to CDS to be reclassified into any category for which it is qualified. CDS may reclassify a Participant if it ceases to meet any qualification, standard or classification requirement for the category into which it has been classified. Each Participant shall provide CDS with such information and assurances as may be required to classify the Participant appropriately. CDS shall give notice to a Participant of its classification or reclassification. Unless the other Extenders waive notice, CDS shall give all Extenders at least 15 Business Days notice of a request by an applicant or a Participant to be classified as an Extender, or of a request by an Extender for reclassification into another category, before effecting the classification or reclassification.</p>