

CDS Clearing and Depository Services Inc. (CDS[®])

MATERIAL AMENDMENTS TO CDS RULES

ELECTIVE SYSTEM-OPERATING CAP FOR EXTENDERS OF CREDIT

REQUEST FOR COMMENTS

A. DESCRIPTION OF THE PROPOSED CDS RULE AMENDMENTS

The proposed amendments to the CDS Participant Rules amend the restrictions related to how CDS and certain Participants may make the Determination of Participant's System-Operating Cap ("SOC"). The Participant Rules define SOC to be *"the limit established in accordance with [CDS Participant] Rule 5.10 on the Transactions that may be effected by an Extender, Active Federated Participant, Settlement Agent or RCP Receiver"*, and results in a limit on the aggregate value of the transactions that may be effected at any one time by a Participant subject to a SOC. (CDS Participant Rule 1.6.9)

CDS Participants who are subject to a SOC are "Capped Participants", and are required regularly to provide CDS with certain information which may be relevant to a Capped Participant's classification or the calculation of the Participant's SOC. (CDS Participant Rule 3.7.2)

These proposed amendments, which add Extenders of Credit to the list of Capped Participants who may *Elect* their own SOC, are the result of extensive consultation by CDS with the CDS Extenders of Credit Council (the "ECC").

B. NATURE AND PURPOSE OF THE PROPOSED CDS RULE AMENDMENTS

The existing CDS Participant Rules state that:

"an Extender of Credit's System Operating Cap shall be the least of:

- a) the Formula Amount¹ calculated for that Participant;*
- b) the amount elected by that Participant (for an Active Federated Participant, a Settlement Agent or an RCP Receiver only); or*
- c) the amount designated by the Members of the Category Credit Ring to which that Participant belongs (for an Extender or a Settlement Agent only)."*

As currently drafted, the Rule does not allow an Extender of Credit (in contrast to the list of Capped Participants which are able to so elect) to elect its System Operating Cap. The operational inflexibility imposed on Extenders of Credit by the existing Rule results in Extender of Credit System Operating Caps that are much larger than historically required to account for the level of activity of each of the Extenders of Credit. CDS's review has determined that total Canadian Dollar Credit Capacity has, at times, been equal to approximately 8x actual usage. CDS proposes these amendments in order to more accurately align System Operating Cap usage with capacity. Further, a credit rating downgrade for an Extender of Credit below the CDS Participant Rule threshold² would, in light of the requirements of the CDS Participant Rules and the Financial Risk Model, result in significantly increased collateral pool

¹ CDS Participant Rule 5.10.4: Calculation of Formula Amount for Extender - The Formula Amount of an Extender shall be the result obtained by multiplying its Rating Discount times a percentage of its Capital.

² An Extender's short term debt may not be less than the equivalent of DBRS R-1 Low.

contributions (50% or 100% of the Extender of Credit's System Operating Cap). Given the current excess System Operating Cap capacity, the consequences of a rating downgrade and an increase in collateral pool contributions have the potential to engender significant costs for Extender of Credit Participants. The ability of an Extender to elect its own SOC has the effect of reducing the potential knock-on effects of such a rating downgrade.

The proposed rule amendments will amend Rule 5.10.3(b), and make corresponding, consequential amendments to several other Rules, to allow an Extender of Credit to *elect* their own System Operating Cap amount.

C. IMPACT OF THE PROPOSED CDS RULE AMENDMENTS

(a) CDS Clearing

Provided that Extenders of Credit elect System Operating Caps that more accurately reflect their transactional requirements, the proposed rule amendments will have the effect of removing the current – unused - excess settlement capacity in CDSX.

(b) CDS Participants

The proposed rule amendments give more flexibility to Extenders of Credit by allowing them to elect a System Operating Cap that better matches their transactional requirements in a manner similar to the flexibility afforded other Participant Categories.

C.1 Competition

The Amendments will apply to all Extenders of Credit in CDSX. From a fair access perspective, no CDS Participant will be disadvantaged or otherwise prejudiced with the introduction of these changes.

C.2 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.

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

Observance of PFMI standards is a requirement under CDS' recognition orders as well as under National Instrument 24-102 (Clearing Agency Requirements) and related Companion Policy 24-102CP. The proposed amendments do not affect CDS's observance of these standards.

D. DESCRIPTION OF THE RULE DRAFTING PROCESS

D.1 Development Context

While there may be an impact to the operations – by way of increased flexibility - of CDS's Extenders of Credit , the actual proposed amendments are relatively straight-forward, and consist of adding

Extenders of Credit to the list of Capped Participants who may elect their SOC.

D.2 Rule Drafting Process

The proposed rule amendments were drafted by CDS Risk Management group in collaboration with personnel from CDS Legal, Regulatory, and Government Affairs, and were reviewed by CDS' Legal Drafting Group ("LDG"). The LDG is an *ad hoc* advisory committee composed of legal and business representatives of participating CDS Participants.

D.3 Issues Considered

CDS considered System Operating Cap election options afforded to other CDS Participants (e.g., Settlement Agents and Receivers of Credit). This review indicated that the proposed Rule amendment could be similarly applied for the Extenders of Credit without additional financial or operational risk to CDS or to CDS's Participants.

D.4 Consultation

CDS consulted with members of the ECC in respect of the principle underpinning the proposed amendments. The ECC was provided with ongoing updates, most recently during the July, 2017, ECC meeting. The CDS Risk Advisory Committee (RAC) was also kept abreast of CDS's progress, and the proposed amendments were provided to RAC for their information. The proposed amendments were provided to the CDS Legal Drafting Group ("LDG") on October 30th, 2017, at which meeting no contrary views were expressed. The proposed amendments were presented to the CDS Board of Directors on November 7th, 2017, at which meeting Board approval for the amendments was granted.

D.5 Alternatives Considered

CDS considered replacing the Formula Amount found in Rule 5.10.3(a) with an upper limit on the System Operating Cap (i.e., Maximum System Operating Cap); this potential upper limit has, however, been the subject of much discussion, and broad consensus with respect to such a limit has not, to date, been achieved. Any future implementation of a Maximum System Operating Cap will require further consultation with CDS Participants.

While CDS did review the option of maintaining the status quo, the existing Rule is not, in CDS's view, either effective or efficient. Pursuant to the Rule, as drafted, the calculated Formula Amount for each Capped Participant, and as a result, their respective System Operating Caps, may continue to increase.

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[®], 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

The proposed rule amendments are 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

No comparable or similar rules were available for other clearing agencies in order effectively to conduct an analysis.

G. Public interest assessment

CDS believes that the proposed rule amendments are not contrary to the public interest, and that the proposed amendments, and the flexibility they bring, will benefit the Canadian capital marketplace.

H. Comments

Comments on the proposed rule amendments must be in made 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:

CDS Clearing and Depository Services Inc.
Attn: George Kormas
100 Adelaide Street West – Suite 300
Toronto, Ontario, M5H 1S3
or via email at
george.kormas@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:

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Secrétaire générale
Autorité des marchés financiers
800, square Victoria, 22^e étage
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Manager, Market Regulation
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Notice and Request for Comment – Material Amendments to CDS Participant Rules related to Elective System-Operating Cap for Extenders of Credit

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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 the proposed rule 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>5.10.3 - Determination of System-Operating Cap</p> <p>A Non-Contributing Receiver does not have any System-Operating Cap. The System-Operating Cap of a Capped Participant shall be the least of:</p> <ul style="list-style-type: none"> a) the Formula Amount calculated for that Participant; b) the amount elected by that Participant (for an <u>Extender of Credit</u>, an Active Federated Participant, a Settlement Agent or an RCP Receiver only); or c) the amount designated by the Members of the Category Credit Ring to which that Participant belongs (for an Extender or a Settlement Agent only). <p>A System-Operating Cap may be set at \$0. A System-Operating Cap for an Extender, an Active Federated Participant or an RCP Receiver may be set at an amount greater than the Formula Amount calculated for that Participant only in accordance with a voluntary adjustment made in accordance with Rule 5.10.11, Rule 5.10.12 or Rule 5.10.14, respectively.</p>	<p>5.10.3 - Determination of System-Operating Cap</p> <p>A Non-Contributing Receiver does not have any System-Operating Cap. The System-Operating Cap of a Capped Participant shall be the least of:</p> <ul style="list-style-type: none"> d) the Formula Amount calculated for that Participant; e) the amount elected by that Participant (for an Extender of Credit, an Active Federated Participant, a Settlement Agent or an RCP Receiver only); or f) the amount designated by the Members of the Category Credit Ring to which that Participant belongs (for an Extender or a Settlement Agent only). <p>A System-Operating Cap may be set at \$0. A System-Operating Cap for an Extender, an Active Federated Participant or an RCP Receiver may be set at an amount greater than the Formula Amount calculated for that Participant only in accordance with a voluntary adjustment made in accordance with Rule 5.10.11, Rule 5.10.12 or Rule 5.10.14, respectively.</p>
<p>5.10.11 - Voluntary Adjustment of Extender's System-Operating Cap</p> <p>At any time during a Business Day, an Extender may request a temporary increase in its System-Operating Cap to an amount not greater than 125% of its formula amount <u>the Extender's existing System-Operating Cap</u>. The request shall be made in writing by an authorized officer of the Extender, delivered to the branch for service of all other Extenders and to the duly appointed</p>	<p>5.10.11 - Voluntary Adjustment of Extender's System-Operating Cap</p> <p>At any time during a Business Day, an Extender may request a temporary increase in its System-Operating Cap to an amount not greater than 125% of the Extender's existing System-Operating Cap. The request shall be made in writing by an authorized officer of the Extender, delivered to the branch for service of all other Extenders and to the duly appointed officer of</p>

Notice and Request for Comment – Material Amendments to CDS Participant Rules related to Elective System-Operating Cap for Extenders of Credit

<p>officer of the CBA by facsimile transmission or other agreed method of communication, setting out the reason for the request and the amount of increase requested, and such other information as required by the industry standard request form in effect at the time. Within a reasonable time after receiving a request in proper form, each Extender shall inform the CBA in writing by facsimile whether it approves or disapproves of the requested increase. If all Extenders approve the increase, CBA shall immediately inform CDS and Bank of Canada of the amount of the temporary increase to be permitted to the requesting Extender and the required increase in the amount of its Collateral Pool Contribution which shall be not less than 15% of the amount by which its increased System-Operating Cap exceeds the <u>Extender's existing System-Operating Cap</u>. CDS shall increase the Extender's System-Operating Cap in accordance with the communication from the CBA, provided that the corresponding increase in its Collateral Pool Contribution required pursuant to Rule 5.12.4 has been made. CDS shall return the System-Operating Cap of the Extender to its normal level before the start of business on the next Business Day.</p>	<p>the CBA by facsimile transmission or other agreed method of communication, setting out the reason for the request and the amount of increase requested, and such other information as required by the industry standard request form in effect at the time. Within a reasonable time after receiving a request in proper form, each Extender shall inform the CBA in writing by facsimile whether it approves or disapproves of the requested increase. If all Extenders approve the increase, CBA shall immediately inform CDS and Bank of Canada of the amount of the temporary increase to be permitted to the requesting Extender and the required increase in the amount of its Collateral Pool Contribution which shall be not less than 15% of the amount by which its increased System-Operating Cap exceeds the Extender's existing System-Operating Cap. CDS shall increase the Extender's System-Operating Cap in accordance with the communication from the CBA, provided that the corresponding increase in its Collateral Pool Contribution required pursuant to Rule 5.12.4 has been made. CDS shall return the System-Operating Cap of the Extender to its normal level before the start of business on the next Business Day.</p>
<p>5.10.15 - Mandatory Adjustment of Extender's System-Operating Cap</p> <p>At any time during a Business Day, any Extender may request the CBA to canvass the Extenders with a view to reducing the System-Operating Cap of an Extender other than itself to an amount less than its Formula Amount. The CBA shall immediately inform all Extenders other than the affected Extender of the proposed decrease in the affected Extender's System-Operating Cap. Each Extender so informed shall, within reasonable time, inform the CBA in writing by facsimile whether it approves of the proposal. If all Extenders other than the affected Extender approve the decrease, the CBA shall immediately inform CDS of the amount and duration of the temporary decrease to be imposed upon the named Extender. CDS shall decrease the System-Operating Cap of the affected Extender immediately upon receipt of</p>	<p>5.10.15 - Mandatory Adjustment of Extender's System-Operating Cap</p> <p>At any time during a Business Day, any Extender may request the CBA to canvass the Extenders with a view to reducing the System-Operating Cap of an Extender other than itself. The CBA shall immediately inform all Extenders other than the affected Extender of the proposed decrease in the affected Extender's System-Operating Cap. Each Extender so informed shall, within reasonable time, inform the CBA in writing by facsimile whether it approves of the proposal. If all Extenders other than the affected Extender approve the decrease, the CBA shall immediately inform CDS of the amount and duration of the temporary decrease to be imposed upon the named Extender. CDS shall decrease the System-Operating Cap of the affected Extender immediately upon receipt of the direction from the CBA, and shall inform the</p>

Notice and Request for Comment – Material Amendments to CDS Participant Rules related to Elective System-Operating Cap for Extenders of Credit

<p>the direction from the CBA, and shall inform the affected Extender of the decrease imposed upon the direction of the CBA.</p>	<p>affected Extender of the decrease imposed upon the direction of the CBA.</p>
<p>5.12.4 – Increased Collateral Contribution by Extender (a) System Operating Cap Increase</p> <p>If at the request of an Extender its System-Operating Cap is temporarily increased to an amount greater than its Formula Amount, then for the Business Day on which its System-Operating Cap is increased:</p> <ul style="list-style-type: none"> (i) the required amount of its Collateral Pool Contribution shall be increased by the amount specified in the communication from the CBA; and (ii) in the event that the Extender is suspended prior to Payment Exchange, CDS and the Survivors who are Members of the Extender's Credit Ring shall be entitled to realize only a proportionate amount of the increase in the Collateral Pool Contribution; the proportionate amount shall be in the same proportion to the total increase in the Collateral Pool Contribution that the used amount of the Extender's increase in its System-Operating Cap is of the total increase in its System-Operating Cap. 	<p>5.10.4 – Increased Collateral Contribution by Extender (a) System Operating Cap Increase</p> <p>If at the request of an Extender its System-Operating Cap is temporarily increased, then for the Business Day on which its System-Operating Cap is increased:</p> <ul style="list-style-type: none"> (i) the required amount of its Collateral Pool Contribution shall be increased by the amount specified in the communication from the CBA; and (ii) in the event that the Extender is suspended prior to Payment Exchange, CDS and the Survivors who are Members of the Extender's Credit Ring shall be entitled to realize only a proportionate amount of the increase in the Collateral Pool Contribution; the proportionate amount shall be in the same proportion to the total increase in the Collateral Pool Contribution that the used amount of the Extender's increase in its System-Operating Cap is of the total increase in its System-Operating Cap.