

**CDS Clearing and Depository Services Inc. (CDS®)**

**MATERIAL AMENDMENTS TO CDS RULES**

**AMENDMENTS RELATED TO THE EXTENDERS OF CREDIT AND SETTLEMENT AGENT  
CATEGORY CREDIT RINGS**

**REQUEST FOR COMMENTS**

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

The proposed amendments to the CDS Participant Rules (“Amendments”) make changes with respect to certain category credit rings (“CCR”). Specifically, the Amendments require Participants in the Settlement Agent and Extenders of Credit CCRs, who have current or potential exposures, to fully cover their own losses with a high degree of confidence.

The Amendments to the Rules establish the legal framework for the changes to the CCRs. Technical details are more appropriately described in the “Material Amendments to CDS Procedures. Amendments Related to the Extenders of Credit and Settlement Agents Category Credit Rings,” to be published concurrently with this Notice.

CDS’s Recognition Orders require the observance, as soon as possible, of the CPSS-IOSCO Principles for Financial Market Infrastructures (“PFMI”). CDS’s PFMI self-assessment identified the need to reduce leverage in the Settlement Agent and Extender of Credit CCRs by reducing the mutualization of exposures in favour of increased collateralization of individual exposures.

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

Currently, Participants in the Extenders of Credit and Settlement Agent CCRs benefit from common use collateral held in their respective pools. Such collateral, pledged by all Participants in the CCRs, has a leveraged effect on individual contributions. Consequently, Participant exposures are not fully covered. This structure does not meet with recognized international standards as described in Principle 4 and Key Considerations 3.4.12 and 3.4.18 of the PFMIs.

Amendments – Extenders of Credit CCR

Using the existing calculation methodology each Extender of Credit will be credited an Initial ACV amount equal to its Extenders of Credit CCR collateral requirement/contribution. The members will see each member’s required collateral contribution and the total amount of collateral in the pool. The collateral requirement will be calculated once per quarter and will be locked-in for the quarter as is the current practice. Under this approach the member’s own collateral requirement becomes its initial ACV rather than the sum total of all the members’ collateral requirements.

Amendments – Settlement Agent CCR

Each Settlement Agent will be credited an Initial ACV amount equal to its Extenders of Credit CCR collateral requirement/contribution. Methodology changes are proposed for determining the System Operating Cap (“SOC”) and Collateral Requirements.

The changes to the SOC will introduce a maximum SOC for tenured members, a maximum SOC for new members and a maximum US\$ SOC.

Changes to the Settlement Agent requirement will specify pool collateral contribution to a maximum cap of 25% of the maximum SOC, and Participant collateral contribution equal to their pro-rate share of total elected SOC.

The Amendments will also make changes to how Available System Operating Cap and Initial ACV will be calculated. Ratings Discounts will be used to adjust the Initial ACV allocated to each Settlement Agent.

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

- (a) CDS Clearing - The Amendments will ensure CDS's observance of the PFMI and adoption of a recognized international standard for market infrastructures. The Amendments will also enhance risk management by removing leverage from the CCRs.
- (b) CDS Participants -The Amendments will benefit Participants by providing them with access to a market infrastructure that meets global standards.
- (c) & (d) Other Market Participants and Securities and Financial Markets in General -- The Amendments will help mitigate systemic risk and contribute the efficiency of Canadian capital markets.

### **C.1 Competition**

The Amendments will apply to all CDS Participants who currently are, or may choose to become Participants in the Settlement Agent or Extender of Credit CCRs. 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**

Amendments to the collateralization of the Extenders of Credit and Settlement Agents CCRs will result in changes to CDS's Risk Model and Procedures. CDS does not foresee other risks or compliance costs accruing to CDS Participants or other stakeholders.

### **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 are minimum international standards for enhancing the safety and efficiency of clearing, settlement and recording arrangements, which aim to limit systemic risk and foster transparency and financial stability. The PFMI apply to CCPs, central securities depositories ("CSDs") and security settlement systems ("SSS"). CDS engages in all three of these market infrastructure activities. According to the terms of CDS's recognition order requirements, CDS is required to observe PFMI as soon as possible.

The Amendments aim to mitigate credit risk exposure by reducing CDS's reliance on the mutualization of risk resources. The Amendments align with Principle 4 (Credit Risk) and Key Considerations 3.4.12 and 3.4.18 of the PFMI which call for collateral pools to be collateralized such that current and potential future exposures to each participant are fully covered with a high degree of confidence (i.e. single-tailed confidence level of at least 99 percent of the estimated distribution of future exposures).

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

### **D.1 Development Context**

CDS actively engaged internal and external discussion to explore its options. It established separate workgroups with Participants from the Extenders of Credit and Settlement Agent CCRs. The workgroups agreed upon a preferred approach which was socialized by the Participants in the workgroup back to their respective organizations where they were endorsed. CDS also prepared documents describing the proposed Amendments which were tabled at the Risk Advisory Committee (“RAC”), a CDS Participant committee that meets monthly.

### **D.2 Rule Drafting Process**

The Amendments were drafted by CDS’s Risk Management group, and were subsequently submitted for consultation to the Legal Drafting Group (“LDG”) on September 17, 2014 with no contrary views expressed. The LDG comments on the drafting of proposed amendments to the CDS Participant Rules, and can suggest further revisions. The LDG’s membership includes representatives from a cross-section of the CDS Participant community and meets on an ad hoc basis. On October 29<sup>th</sup> and 30<sup>th</sup>, the proposed amendments were submitted to CDS’s Risk Management and Audit Committee (“RMAC”) and CDS’s Board of Directors (“BofD”) with a recommendation that they be approved.

### **D.3 Issues Considered**

Consideration was given to the operational impacts that the enhancements might create for CDS Participants as outlined in section C of this Notice.

### **D.4 Consultation**

This Amendment was initiated by CDS. CDS received input from the RAC on the concept and methodology underlying this Amendment, while the LDG commented on its legal drafting. The SDRC is expected to comment on the operational aspects of this Amendment as it is described in “Material Amendments to CDS Procedures. Amendments Related to the Extenders of Credit and Settlement Agent Category Credit Rings” to be published concurrently with this Notice.

CDS’s Customer Service account managers will provide continuous communication and status updates of all proposed changes to clients, as well as soliciting input on those changes.

CDS facilitates consultation through a variety of means, including regularly scheduled SDRC subcommittee meetings and monthly meetings with service bureaus to discuss potential development impacts to them. As a courtesy, development initiatives are presented to the Investment Industry Regulatory Organization of Canada’s (“IIROC”) Financial Administrators Section (“FAS”) working group.

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

Alternatives, essentially minor variations of the preferred option, were considered. The proposed methodology is the result of input received from the members of the RAC.

### **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 from the Recognizing Regulators following public notice and comment.

#### **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**

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

#### **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 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](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  
Télécopieur: (514) 864-6381  
Courrier électronique: [consultation-encours@lautorite.qc.ca](mailto:consultation-encours@lautorite.qc.ca)

Manager, Market Regulation  
Market Regulation Branch  
Ontario Securities Commission  
Suite 1903, Box 55,  
20 Queen Street West  
Toronto, Ontario, M5H 3S8  
Fax: 416-595-8940  
e-mail: [marketregulation@osc.gov.on.ca](mailto: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  
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Mark Wang  
Manager, Legal Services  
British Columbia Securities Commission  
701 West Georgia Street  
P.O. Box 10142, Pacific Centre  
Vancouver, B.C., V7Y 1L2  
Fax: 604-899-6506  
Email: [mwang@bcsc.bc.ca](mailto:mwang@bcsc.bc.ca)

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

**I. PROPOSED CDS PROCEDURE 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 underlined and in green font; deletions are strikethrough text and in red font]</p>	
<p>5.10.6 Calculation of Formula Amount for Settlement Agent</p> <p>The Formula Amount of a Settlement Agent shall be the amount for which the Settlement Agent is eligible as set out <del>result obtained by multiplying its Rating Discount times a percentage of its Regulatory Capital. The Regulatory Capital of a Settlement Agent means the capital of the Settlement Agent as determined in accordance with the definition of capital (Tier 1 and Tier 2) in the guidelines for international convergence of capital measurement and capital standards issued by the Bank for International Settlements, as implemented in Canada, or in any successor to such guidelines. The percentage of its Capital to be used to calculate the Formula Amount shall be the percentage set out in a communication</del> in writing to CDS from time to time pursuant to the Settlement Agents Credit Ring Agreement and incorporated by CDS into the Procedures and User Guides.</p>	<p>5.10.6 Calculation of Formula Amount for Settlement Agent</p> <p>The Formula Amount of a Settlement Agent shall be the amount for which the Settlement Agent is eligible as set out in writing to CDS from time to time pursuant to the Settlement Agent Credit Ring Agreement and incorporated by CDS into the Procedures and User Guides.</p>
<p>5.10.8 Calculation of Rating Discount</p> <p>The "Rating Discount" of a Participant means a factor based on the rating of its short-term debt by a Bond Rating Service.</p> <p>The Rating Discount of an Extender shall be the discount determined in accordance with a formula or tables prepared from time to time by the Extenders Senior Risk Management Committee and incorporated by CDS into the Procedures and User Guides, provided that the Extenders Senior Risk Management Committee may set an Extender's Rating Discount at any time by informing CDS in writing of the new Rating Discount.</p> <p>The Rating Discount of an Active Federated Participant <del>or a Settlement Agent</del> shall be:</p> <p>(a) 100% for DBRS R-1 High or S&amp;P A-1 (high);                  (b) 95% for DBRS R-1 Mid or S&amp;P A-1 (mid);                  or                  (c) 80% for DBRS R-1 Low or S&amp;P A-1 (low).</p>	<p>5.10.8 Calculation of Rating Discount</p> <p>The "Rating Discount" of a Participant means a factor based on the rating of its short-term debt by a Bond Rating Service.</p> <p>The Rating Discount of an Extender shall be the discount determined in accordance with a formula or tables prepared from time to time by the Extenders Senior Risk Management Committee and incorporated by CDS into the Procedures and User Guides, provided that the Extenders Senior Risk Management Committee may set an Extender's Rating Discount at any time by informing CDS in writing of the new Rating Discount.</p> <p>The Rating Discount of an Active Federated Participant shall be:</p> <p>(a) 100% for DBRS R-1 High or S&amp;P A-1 (high);                  (b) 95% for DBRS R-1 Mid or S&amp;P A-1 (mid);                  or                  (c) 80% for DBRS R-1 Low or S&amp;P A-1 (low).</p> <p>The Rating Discount of a Settlement Agent shall be</p>

Text of CDS Participant Rules marked to reflect proposed amendments	Text of CDS Participant Rules reflecting the adoption of proposed amendments
<p>The Rating Discount of a Settlement Agent shall be the amount as set out in the Procedures and User Guides.</p>	<p>the amount as set out in the Procedures and User Guides.</p>
<p>If the ratings by the two Bond Rating Services are not the same, the factor shall be determined with reference to the lower rating.</p>	<p>If the ratings by the two Bond Rating Services are not the same, the factor shall be determined with reference to the lower rating.</p>
<p>5.10.9 Effect of Low Rating Discount</p> <p>If the rating of an Extender's short term debt is less than the equivalent of DBRS R-1 Low, the Extender shall provide increased Collateral Pool Contributions pursuant to Rule 5.12.4. If such rating is less than the equivalent of DBRS R-2 Mid, the Extender shall have a System-Operating Cap of \$0 unless the Extenders Senior Risk Management Committee determines that it shall have a greater System-Operating Cap and the Extender has provided increased Collateral Pool Contributions. An Active Federated Participant <del>or a Settlement Agent</del> with a rating lower than DBRS R-1 Low or S&amp;P A-1 (low) shall have a System-Operating Cap of \$0 unless arrangements satisfactory to the other Members of its Category Credit Ring have been made to secure the obligations of the Active Federated Participant <del>or Settlement Agent</del> with the low rating, including the provision of increased Collateral Pool Contributions pursuant to Rule 5.12.5 <del>or Rule 5.12.6, respectively</del>. In such event, the System-Operating Cap shall be, for an Active Federated Participant, the amount designated by the other Federated Participants in its Category Credit Ring, <del>and for a Settlement Agent, the amount designated in a written direction given pursuant to the Settlement Agents Credit Ring Agreement.</del></p> <p>A Settlement Agent Participant with a rating lower than what is prescribed in the Procedures and User Guides shall have a System-Operating Cap of \$0 unless arrangements satisfactory to the other Members of its Category Credit Ring have been made to secure the obligations of the Settlement Agent Participant with the low rating, including the provision of increased Collateral Pool Contributions pursuant to Rule 5.12.6. In such event, the System-Operating Cap shall be the amount designated in a written direction given pursuant to the Settlement Agents Credit Ring Agreement.</p>	<p>5.10.9 Effect of Low Rating Discount</p> <p>If the rating of an Extender's short term debt is less than the equivalent of DBRS R-1 Low, the Extender shall provide increased Collateral Pool Contributions pursuant to Rule 5.12.4. If such rating is less than the equivalent of DBRS R-2 Mid, the Extender shall have a System-Operating Cap of \$0 unless the Extenders Senior Risk Management Committee determines that it shall have a greater System-Operating Cap and the Extender has provided increased Collateral Pool Contributions. An Active Federated Participant with a rating lower than DBRS R-1 Low or S&amp;P A-1 (low) shall have a System-Operating Cap of \$0 unless arrangements satisfactory to the other Members of its Category Credit Ring have been made to secure the obligations of the Active Federated Participant with the low rating, including the provision of increased Collateral Pool Contributions pursuant to Rule 5.12.5. In such event, the System-Operating Cap shall be, for an Active Federated Participant, the amount designated by the other Federated Participants in its Category Credit Ring.</p> <p>A Settlement Agent Participant with a rating lower than what is prescribed in the Procedures and User Guides shall have a System-Operating Cap of \$0 unless arrangements satisfactory to the other Members of its Category Credit Ring have been made to secure the obligations of the Settlement Agent Participant with the low rating, including the provision of increased Collateral Pool Contributions pursuant to Rule 5.12.6. In such event, the System-Operating Cap shall be the amount designated in a written direction given pursuant to the Settlement Agents Credit Ring Agreement.</p>
<p>5.12.3 Calculation of Individual Collateral Pool Contribution</p>	<p>5.12.3 Calculation of Individual Collateral Pool Contribution</p>

Text of CDS Participant Rules marked to reflect proposed amendments	Text of CDS Participant Rules reflecting the adoption of proposed amendments
<p>The amount of each Extender's Collateral Pool Contribution shall be its pro rata share of the minimum amount of the Extenders Collateral Pool, in the proportion which the Record Date MEP Average of that Extender is of the aggregate Record Date MEP Averages of all Extenders. If an Extender is required to make an increased Collateral Pool Contribution, the Collateral Pool Contributions of the other Extenders shall not be reduced and each Extender's proportionate share of the minimum amount of the Collateral Pool shall be calculated without regard to the increase in the Collateral Pool Contribution. The Active Federated Participant shall contribute all of the Collateral Pool Contributions required for its Federated Participants Collateral Pool. The amount of each Settlement Agent's Collateral Pool Contribution shall be <del>its pro rata share of the minimum amount of the Settlement Agents Collateral Pool, in the proportion which the System Operating Cap of that Settlement Agent is of the aggregate System Operating Caps of all Settlement Agents, subject to any minimum Collateral Pool Contribution requirement</del> set out in the Procedures and User Guides. If a Settlement Agent is required to make an increased Collateral Pool Contribution, the Collateral Pool Contributions of the other Settlement Agents shall not be reduced and each Settlement Agent's proportionate share of the minimum amount of the Collateral Pool shall be calculated without regard to the increase in the Collateral Pool Contribution. The amount of each RCP Receiver's Collateral Pool Contribution shall be the amount determined in accordance with the formula determined by CDS and set out in the Procedures and User Guides.</p>	<p>The amount of each Extender's Collateral Pool Contribution shall be its pro rata share of the minimum amount of the Extenders Collateral Pool, in the proportion which the Record Date MEP Average of that Extender is of the aggregate Record Date MEP Averages of all Extenders. If an Extender is required to make an increased Collateral Pool Contribution, the Collateral Pool Contributions of the other Extenders shall not be reduced and each Extender's proportionate share of the minimum amount of the Collateral Pool shall be calculated without regard to the increase in the Collateral Pool Contribution. The Active Federated Participant shall contribute all of the Collateral Pool Contributions required for its Federated Participants Collateral Pool. The amount of each Settlement Agent's Collateral Pool Contribution shall be set out in the Procedures and User Guides. If a Settlement Agent is required to make an increased Collateral Pool Contribution, the Collateral Pool Contributions of the other Settlement Agents shall not be reduced and each Settlement Agent's proportionate share of the minimum amount of the Collateral Pool shall be calculated without regard to the increase in the Collateral Pool Contribution. The amount of each RCP Receiver's Collateral Pool Contribution shall be the amount determined in accordance with the formula determined by CDS and set out in the Procedures and User Guides.</p>
<p>5.13.3 Allocation of Initial ACV</p> <p>In order to apply the ACV edit, CDS establishes an initial ACV amount for each Capped Participant (excluding Members of the Credit Ring for RCP Receivers making US dollar Settlements). The initial ACV amount is calculated in accordance with the Procedures <del>based on the minimum amount of the Collateral Pool to which the Capped Participant contributes</del>. The designated associate of an Associated Group of Participants shall allocate its initial ACV amount among itself and its associates who are Receivers (including associates who are Non-Contributing Receivers). A Receiver who is a Non-Contributing Receiver and who is not an associate in an Associated Group has no initial</p>	<p>5.13.3 Allocation of Initial ACV</p> <p>In order to apply the ACV edit, CDS establishes an initial ACV amount for each Capped Participant (excluding Members of the Credit Ring for RCP Receivers making US dollar Settlements). The initial ACV amount is calculated in accordance with the Procedures. The designated associate of an Associated Group of Participants shall allocate its initial ACV amount among itself and its associates who are Receivers (including associates who are Non-Contributing Receivers). A Receiver who is a Non-Contributing Receiver and who is not an associate in an Associated Group has no initial ACV. Each Participant shall allocate among its Ledgers its initial ACV amount and, if it is a</p>



<b>Text of CDS Participant Rules marked to reflect proposed amendments</b>	<b>Text of CDS Participant Rules reflecting the adoption of proposed amendments</b>
<p>ACV. Each Participant shall allocate among its Ledgers its initial ACV amount and, if it is a Receiver in an Associated Group, its share of the allocated initial ACV amount. The designated associate may from time to time: (i) leave unallocated some of the total initial ACV amount for the Associated Group; (ii) retract the allocation of any portion of the Associated Group's initial ACV amount that was allocated to a member of the Associated Group but that has not yet been allocated by that member to one of its Ledgers; (iii) allocate to a member of the Associated Group any unallocated portion of the Associated Group's initial ACV amount; and (iv) allocate zero initial ACV amount to any member of the Associated Group. Each Participant may from time to time: (i) leave unallocated some of its initial ACV amount; (ii) retract the allocation of any unused portion of its initial ACV amount from one of its Ledgers; (iii) allocate to a Ledger any unallocated portion of its initial ACV; and (iv) allocate zero initial ACV amount to any of its Ledgers.</p>	<p>Receiver in an Associated Group, its share of the allocated initial ACV amount. The designated associate may from time to time: (i) leave unallocated some of the total initial ACV amount for the Associated Group; (ii) retract the allocation of any portion of the Associated Group's initial ACV amount that was allocated to a member of the Associated Group but that has not yet been allocated by that member to one of its Ledgers; (iii) allocate to a member of the Associated Group any unallocated portion of the Associated Group's initial ACV amount; and (iv) allocate zero initial ACV amount to any member of the Associated Group. Each Participant may from time to time: (i) leave unallocated some of its initial ACV amount; (ii) retract the allocation of any unused portion of its initial ACV amount from one of its Ledgers; (iii) allocate to a Ledger any unallocated portion of its initial ACV; and (iv) allocate zero initial ACV amount to any of its Ledgers.</p>