

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

MATERIAL AMENDMENTS TO CDS PARTICIPANT RULES CONCERNING ENHANCEMENTS TO CNS (DEDICATED OWN RESOURCES) AND RELATED CHANGE TO FEE SCHEDULE

NOTICE AND REQUEST FOR COMMENTS

A. DESCRIPTION OF THE PROPOSED CDS RULE AMENDMENT

This Notice and Request for Comments (“**Notice**”) has two concomitant components: i) an amendment (“**Rule Amendment**”) to the CDS Participant Rules (“**Rules**”); and related ii) change to the CDS Fee Schedule (“**Fee Proposal**”).

The Rule Amendment will introduce a new requirement that CDS maintain its own dedicated, pre-funded resources (“**Dedicated Own Resources**”) in the CNS default waterfall for the Continuous Net Settlement function (“**CNS**”), CDS’ central counterparty (“**CCP**”) service for the central clearing of cash securities. The text of the proposed Rule Amendment is provided in Appendix A to this Notice.

CDS’ Dedicated Own Resources would be drawn upon only after a suspended or terminated Participant’s CNS Participant Fund and Default Fund contributions have been fully exhausted. Under the Rule Amendment, CDS would recover any drawn down Dedicated Own Resources from the suspended Participant’s excess collateral, on a pro-rata basis between CDS and CDS’ surviving Participants of other pools or services, pursuant to Rule 9.3.13. Under the Rule Amendment, CDS would also consider any drawn down Dedicated Own Resources as a continuing obligation against the suspended or terminated Participant pursuant to Rules 2.7.8 and 9.2.8.

The Fee Proposal (discussed in section C.2) will introduce a fee change to certain existing CNS services in the CDS Fee Schedule. The fee change will help CDS recover costs associated with the indefinite allocation of its capital.

B. NATURE AND PURPOSE OF THE PROPOSED CDS RULE AMENDMENT

CDS intends to segregate a sum of one million dollars as Dedicated Own Resources. This amount is over and above the six month operating capital required by CDS’ regulatory framework. CDS arrived at this amount using the methodology for calculating Dedicated Own Resources under the European Union’s European Market Infrastructure Regulation (“**EMIR**”), which is instructive in the absence of established international standards with respect to Dedicated Own Resources. Under EMIR, CCPs are required to set aside an amount equal to 25% of their own regulatory capital. The Dedicated Own Resource being set aside by CDS is 25% of the CDS regulatory capital that is attributable to CNS. CDS’ Dedicated Own Resources will consist of high quality liquid assets that correspond to the list of acceptable collateral under the Bank of Canada’s Standing Liquidity Facility.

The Bank of Canada has asked CDS to have Dedicated Own Resources in place by year end 2015. CDS supports Dedicated Own Resources in the CNS default waterfall as prudent risk management and as industry standard. CDS will join other key CCPs around the world by having Dedicated Own Resources earmarked to incentivize prudent risk-taking behaviour by CDS, as operator of CNS, as well as to reinforce appropriate risk-taking behaviour for clearing Participants.

The Rule Amendment would make Dedicated Own Resources a requirement by inserting a rule in the Participant Rules that would require CDS to contribute Dedicated Own Resources to the CNS default waterfall following the exhaustion of a suspended Participant’s CNS Participant Fund and Default Fund contributions. CDS’ positioning of its Dedicated Own Resources in the CNS default waterfall is consistent with the widely accepted global industry practice of other CCPs that also place their own

dedicated resources after a defaulting member's own contributions and before contributions of survivors.

C. IMPACT OF THE PROPOSED CDS RULE AMENDMENT

- (a) CDS Clearing – The Rule Amendment will align CDS' CCP function with widely accepted risk management practices of other CCPs and regulatory requirements in other jurisdictions.
- (b) CDS Participants –The Rule Amendment will benefit Participants by providing them with access to a market infrastructure that meets global standards, and where appropriate incentives are set for managing CCP and Participant risk behaviour.
- (c) & (d) Other Market Participants and Securities and Financial Markets in General – The Rule Amendment is intended to mitigate systemic risk and contribute to the efficiency and safe operation of Canadian capital markets.

C.1 Competition

The Rule Amendment will apply to all CDS Participants who currently are, or may choose to become Participants in CNS. As it concerns fair access, no CDS Participant will be disadvantaged or otherwise prejudiced by the introduction of these changes.

C.2 Risks and Compliance Costs

The Rule Amendment will result in enhancements to CDS's Risk Model.

The cost of complying with this Rule Amendment is the annual weighted average cost of capital used by TMX Group. Since the requirement to have Dedicated Own Resources did not exist when CDS' Fee Schedule was incorporated into CDS' regulatory regime, CDS was unable to embed this cost of doing business into CNS fees.

The current Fee Proposal is for CDS to increase certain existing CNS fees most relevant to this Rule Amendment by a weighted average of 2.56% (see Table below). Payment terms and frequency of billing for these fees will remain unchanged. The increase will only impact users of these CNS services.

Service Description	Service Code	Unit price	Increase in price (rounded)	Updated price (rounded)
Exchange Trades - Reported	6000	0.0041	0.0001	0.0042
CNS Eligible Exchange Trades Netted	6080	0.0041	0.0001	0.0042
CNS Real-Time Settlement	6197	0.16	0.015	0.175

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 requirement to have Dedicated Own Resources in a CCP default waterfall is not a PFMI requirement. It is a legal requirement in certain jurisdictions. For example, it is a legal requirement in the EU under Article 5(2) of Commission Delegated Regulation (EU) No. 152/2013 (23 February 2013) supplementing EU legislation with respect to Regulation (EU) No 648/2012 also known as the European Market Infrastructure Regulation (“EMIR”).

While adopted by many CCPs across the globe, whether as legal requirement or as best practice, not all CCPs have Dedicated Own Resources in their default waterfalls, and amongst those that do there are differences as to its purpose, how it is calculated, and where it is positioned in the default waterfall.

D. DESCRIPTION OF THE RULE DRAFTING PROCESS

D.1 Development Context

CDS prepared documents describing the proposed Rule Amendment which were tabled at the Risk Advisory Committee, a CDS Participant committee that meets monthly.

CDS has established a working group made up of individuals from Risk Management, Finance and Legal to coordinate the operationalization of the Amendment.

D.2 Rule Amendment Drafting Process

The Rule Amendment was drafted by CDS’ Legal group in consultation with Risk Management, and was subsequently submitted for consultation to the Legal Drafting Group (“LDG”) with no contrary views expressed (07/14/2015). 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.

D.3 Issues Considered

CDS gave consideration to the position of its Dedicated Own Resource in the CNS default waterfall. Following industry practice, the Dedicated Own Resource was placed immediately after defaulter's own resources.

D.4 Consultation

CDS received input from the following Participant committees:

- Legal Drafting Group reviewed the Rule Amendment with no contrary views (07/14/2015)
- Risk Advisory Committee reviewed the Rule Amendment with no contrary views (07/15/2015)
- Fee Committee reviewed the Fee Proposal expressing reservations on the proposed pricing (08/17/2015). CDS took the Fee Committee's views into consideration and returned with a revised proposal which was unanimously endorsed by the Fee Committee (09/09/2015).

CDS regulators attend Participant committee meetings as observers.

The Rule Amendment and Fee Proposal were endorsed by the Risk Management and Audit Committee and the CDS Board of Directors on July 27 and 28, 2015, respectively, conditional upon no contrary views from the Fee Committee, which condition was met (09/09/2015).

The subject of Dedicated Own Resources has been discussed by CDS with its regulators including the Bank of Canada on multiple occasions.

CDS' 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.

D.5 Alternatives Considered

No alternatives were considered. The Rule Amendment is in response to a regulatory request.

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 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**".

Following regulatory approval from the Recognizing Regulators, the Rule Amendment and Fee Proposal are expected to become effective on January 1, 2016.

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 considered the similar rules of other clearing agencies in Canada and around the world including:

- CDCC paragraph 2 of Section A-609 “Application of Clearing Fund”
http://www.cdcc.ca/f_rules_en/cdcc_rules_en.pdf
- Eurex section 6.1.3 (Eurex Clearing AG’s dedicated own resources to the Clearing Fund)
http://www.eurexclearing.com/clearing-en/risk-management/lines-of-defense/contribution-of-eurex_clearing
- EuroCCP paragraph (d) of Rule 8.4.2 (Application of the Clearing Fund)
http://euroccp.com/sites/default/files/clearing_rule_book_march_2015_mark-up.pdf
http://euroccp.com/sites/default/files/euroccp_regulation_doer_12122014.pdf

G. PUBLIC INTEREST ASSESSMENT

CDS has determined that the proposed Rule Amendment and Fee Proposal are not contrary to the public interest.

H. COMMENTS

Comments on the proposed Rule Amendment and Fee Proposal 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: Hugo Maureira, Legal Counsel
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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 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
<p>[marked text of rules – additions are <u>underlined and in green font</u>; deletions are strikethrough text and in red font]</p>	
<p><u>9.3.19 CDS Dedicated Own Resources Contribution Amount in Respect of CNS</u></p> <p><u>CDS shall determine each fiscal year, and shall cause to be published, a dedicated own resources contribution amount in respect of CNS, which CDS shall draw upon, if needed, following the collection of a suspended Participant’s Funds Contributions and any ancillary amounts owing.</u></p> <p><u>CDS reserves the right to a pro-rata share of the general excess described in 9.3.13, if any, to recoup any dedicated own resources used pursuant to 9.3.19, and to treat any remaining portion of the used dedicated own resources as a continuing obligation to CDS by the suspended Participant pursuant to 2.7.8 and 9.2.8 with full benefit of applicable legislative priority.</u></p>	<p>9.3.19 CDS Dedicated Own Resources Contribution Amount in Respect of CNS</p> <p>CDS shall determine each fiscal year, and shall cause to be published, a dedicated own resources contribution amount in respect of CNS, which CDS shall draw upon, if needed, following the collection of a suspended Participant’s Funds Contributions and any ancillary amounts owing.</p> <p>CDS reserves the right to a pro-rata share of the general excess described in 9.3.13, if any, to recoup any dedicated own resources used pursuant to 9.3.19, and to treat any remaining portion of the used dedicated own resources as a continuing obligation to CDS by the suspended Participant pursuant to 2.7.8 and 9.2.8 with full benefit of applicable legislative priority.</p>