

13.3.2 CDS – Notice and Request for Comments – Material Amendments to CDS Procedures – Amendments to Buy-in Process Functionality

CDS CLEARING AND DEPOSITORY SERVICES INC. (CDS®)

MATERIAL AMENDMENTS TO CDS PROCEDURES

AMENDMENTS TO BUY-IN PROCESS FUNCTIONALITY

REQUEST FOR COMMENTS

A. DESCRIPTION OF THE PROPOSED CDS PROCEDURE AMENDMENTS

The proposed amendments to the CDS Participant Procedures will amend functionality of the buy-in process, in the Continuous Net Settlement Service (CNS), at the request of the Debt and Equity Subcommittee of the Strategic Development Review Committee (SDRC). The CNS buy-in process is used by CDSX® participants to expedite settlement of outstanding CNS positions.

Background

CNS is a central counterparty service designed to clear and settle primarily, but not exclusively, equity trades transacted on a Canadian exchange, a quotation and trade reporting system (QTRS) or an alternative trading system (ATS). The CNS buy-in process enables the buyer on the transaction to accelerate settlement of outstanding CNS positions that are identified in the relevant procedures as 'to-receive'. An outstanding 'to-receive' CNS position is a quantity of shares that failed to settle on value date. The buyer and seller are referred to as the receiver and deliverer respectively for the purposes of buy-in activity.

The lifecycle of the buy-in process is initiated when the receiver enters an intent to buy-in transaction in CDSX against an outstanding quantity of shares that are owed to them. When the buy-in is entered, all participants who are in an owing CNS position (deliverers) for the specified security are identified and are provided with 48 hours notice that they may be held liable to deliver on some or all of their portion of the buy-in quantity. This notice is provided via CDSX screens, reports and messages. Priority settlement is applied to the buy-in and any subsequent settlement to the receiver's account reduces the amount of the buy-in quantity and related liabilities.

Two days after the buy-in is initiated the receiver may choose to execute on the remaining unsettled portion of a buy-in. If the receiver chooses to execute, CDSX will determine which deliverers will be required to satisfy the buy-in and identify them to the receiver on the CDSX Buy-in Details screens. A message is also sent to the identified deliverers to advise them that the buy-in has been executed.

The identified deliverers then have the option of requesting an extension from the receiver during the time frame when extension requests are permitted. Extensions remove the deliverer as a party to the buy-in. If a deliverer requests an extension and the receiver grants the request, or does not respond to the request by the pre-determined cut off time, then all of the identified deliverers are extended and the buy-in is automatically cancelled and subsequently purged. If the extension request is denied, then the execution of the buy-in will proceed against all identified deliverers.

Identified deliverers have until the delivery cut-off time to satisfy the executed buy-in. If the identified deliverers fail to settle their outstanding positions against an executed buy-in by the delivery cut off time CDS will attempt to purchase the shares on a Canadian exchange on behalf of the receiver. Once CDS acquires the shares on a Canadian exchange, both the receiver's and deliverer's outstanding CNS and funds positions are adjusted to reflect this acquisition. Any price increase between the CNS price at the time of the buy-in and the fill price is applied to the deliverer.

A buy-in that has reached the execution date is cancelled and purged at the end of the day whether the buy-in was executed or not. Once cancelled, related liabilities are also extinguished. The repeat buy-in function is a facility that allows the receiver to maintain uninterrupted settlement priority until a buy-in is fully satisfied. A repeat buy-in is an extension of the original buy-in. Like a new buy-in, repeat buy-ins are entered manually on the CDSX Buy-in Intent Entry screen and confirmed on the Confirm Intent to Buy-in screen. Once confirmed, deliverers with outstanding CNS positions are identified and provided with a 48 hour notice period advising them that they may be held liable if the buy-in is executed. The repeat transaction effectively extends the execution date of the buy-in allowing the receiver to maintain settlement priority while also providing the deliverer with their requisite 48 hour notice.

Proposed Amendments

The SDRC Debt and Equity Subcommittee requested CDS to make the following three changes to the functionality of the CNS buy-in process: (i) allow the receiver to select which specific deliverers they wish to grant or deny extensions to, (ii) enhance the Deliverer Buy-in List screen to provide greater clarity with respect to the status of buy-in extensions, and (iii) introduce a new option that will allow the receiver to instruct the system to automatically create repeat buy-ins. Each of the three proposed amendments is described below.

Selection of Deliverer for Extensions on Buy-Ins

Currently, if the receiver grants an extension request to one deliverer then all deliverers receive an extension and the entire buy-in is cancelled. This amendment will allow a receiver to manage who they wish to grant or deny an extension to if a buy-in is executed.

Enhanced status codes on the Deliverer – Buy-in List Screen

Each deliverer may have several buy-in liabilities existing for a specific security. The Deliverer – Buy-in List screen provides an aggregate view of its outstanding buy-ins including whether there are any extension requests pending. Currently, the deliverer cannot determine if all of their buy-ins for that execution date have an extension request applied against them and whether all or some of their extension requests have been granted or denied. That detail is available only on the Deliverer – Buy-in Detail screen. This amendment will introduce additional values on the Deliverer – Buy-in List screen to provide greater clarity to deliverers regarding extensions requested and extensions granted or denied.

Automatic Entry of Repeat Buy-Ins

Currently, receivers must manually enter and confirm repeat buy-in transactions daily in order to extend the execution date and maintain uninterrupted settlement priority until a buy-in is fully satisfied. This amendment will allow a receiver to automatically establish repeat buy-in transactions in CDSX, until such time as the buy-in is satisfied or the receiver cancels the request for automatic repeat buy-ins, thus eliminating the need for daily manual entry.

B. NATURE AND PURPOSE OF THE PROPOSED CDS PROCEDURE AMENDMENTS

The proposed procedure amendments are enhancements to current functionality which will provide for processing efficiencies and management flexibility in the buy-in process.

Selection of Deliverer for Extensions on Buy-ins

CDS participants (receivers) will benefit from the ability to manage extensions at a more granular level as the proposed amendment will give them the flexibility to accommodate different extension requests and take into account any special arrangements that may be negotiated. It will also allow for more latitude with respect to managing their receive positions. Receivers will no longer be bound to extending to all or none allowing them to partially satisfy outstanding CNS positions.

Changes will be applied to both the Receiver – Buy-in List screen and the Receiver – Buy-in Detail screens (Buy-in Inquiry Details and Buy-in Modify / Extend Details). The information displayed on these screens will be modified to reflect the receiver's response to buy-in extension requests.

The Receiver – Buy-in List screen will now differentiate between whether one or many extensions were granted or denied in the extension granted (EXT GRT) field. The values representing the possible scenarios are described on page 97 of CDS's *Trade and Settlement Procedures* manual, in the proposed documentation changes.

The Receiver – Modify / Extend Buy-in Details screen will be modified to allow the receiver to respond to individual extension requests separately. The extension granted (Extension GRT) field will be demoted from the buy-in level to the deliverer level to achieve this. The executable quantity will be reduced by the liability amount of any deliverers granted an extension.

In addition to the changes that will be applied to the CDSX screens, the Receiver Buy-in Notification message will populate the deliverer detail fields when generated due to a response to an extension request. Finally, the Buy-in Activity Report for Receivers (intraday and end of day report) will be modified to provide the receiver with a breakdown of the deliverer's extension requests as well as the receiver's response to each request. A new field titled 'Extended Qty' will be added to the report in order that the receiver can reconcile the original buy-in quantity with the execution quantity fields.

Enhanced status codes on the Deliverer – Buy-in List Screen

CDS participants (deliverers) will benefit from the proposed enhancements to the Deliverer – Buy-in List screen which will provide greater clarity around buy-in extension activity. Greater clarity will reduce risks due to a misinterpretation of the status of an extension.

New values will be introduced for the extension requested (EXTN REQ) and extension granted (EXTN GRT) fields on the Deliverer – Buy-in List screen to provide greater clarity for buy-in items where there are multiple extension requests and responses. Deliverers use the Deliverer – Buy-in List and the Deliverer – Buy-in Details screens in CDSX to monitor their buy-in activity and determine if action is required. Whereas the current environment only informs the deliverer that at least one extension was requested and that at least one extension was either granted or denied, the proposed change will indicate multiple scenarios. The values representing the possible scenarios are described on page 108 of CDS's *Trade and Settlement Procedures* manual, in the proposed documentation changes.

Automatic Entry of Repeat Buy-Ins

CDS participants (receivers) will benefit from the ability to request automatically generated repeat buy-in transactions by reducing or eliminating manual entry. Repeat transactions will reduce the risk of losing settlement priority until a new buy-in is entered which would unintentionally delay their ability to execute on the buy-in until the notice period on the new buy-in expires.

The Confirm Intent to Buy-in screen will be modified to allow the receiver to indicate whether repeat transactions are required to be entered in CDSX by the system ('Y'es or 'N'o). CDSX will generate repeat buy-ins automatically with the same information that would have been entered on the Buy-in Intent Entry screen if it was entered manually by the receiver. Manual entry of a repeat buy-in will continue to be permitted. Repeat buy-ins entered automatically will behave in the same manner as those entered manually by the receiver.

A new repeat indicator field will be introduced on the Receiver – Buy-in List and the Receiver – Buy-in Details screens indicating whether or not automatic repeat transactions apply to the buy-in. The value in the repeat indicator field on the Receiver – Modify/Extend Buy-in Details screen can be updated to reflect either a 'Y'es or 'N'o value,

C. IMPACT OF THE PROPOSED CDS PROCEDURE AMENDMENTS

The proposed procedure amendments will provide processing efficiencies and management flexibility in the buy-in process. The impact of these changes will be limited to those CDS participants that utilize the buy-in function and related buy-in reports of the CNS service.

C.1 Competition

The proposed procedure amendments apply to all CDS participants who currently use, or may choose in the future to use, the CNS service. Consequently, no CDS participant will be disadvantaged with the introduction of these enhancements.

C.2 Risks and Compliance Costs

CDS Risk Management has determined that the proposed amendments will not change the risk profile of CDS or its participants.

The introduction of the proposed buy-in enhancements to the buy-in process will not result in any changes to the existing CDSX settlement process. The method of applying settlements to buy-in transactions and their impact on executable amounts remains unchanged. The prioritization of settlements related to buy-ins is also not impacted by these initiatives.

There are no compliance costs to the participants associated with the proposed buy-in enhancements to the buy-in process.

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

CDS continues to monitor the development of new international standards for payment, clearing and settlement systems set out in the CPSS/IOSCO report *Principles for Financial Market Infrastructures*¹, and will work with the financial services industry to achieve compliance with the new standards.

The proposed amendments are within the scope of Principle #21 – Efficiency and effectiveness – which states that a financial market infrastructure such as CDS “should be designed to meet the needs of its participants and the markets it serves, in

¹ The report can be found at <http://www.bis.org/pub/cpss101.htm>

particular, with regard to choice of a clearing and settlement arrangement; operating structure; scope of products cleared, settled, or recorded; and use of technology and procedures”.

This development requested by some of CDS’s participants supports greater flexibility for managing buy-in extensions. In addition, automating the repeat buy-in entry process and providing more meaningful information on the deliverer’s CDSX screens is expected to result in operational efficiencies.

D. DESCRIPTION OF THE PROCEDURE DRAFTING PROCESS

D.1 Development Context

The development request was tabled at the SDRC Debt and Equity Subcommittee as an opportunity to increase efficiencies and flexibility in the buy-in process. Once approved by the SDRC for further analysis, CDS developed a requirements document that was reviewed with a Buy-in Working Group established by the SDRC Debt and Equity Subcommittee (SDRC Buy-in Working Group). Their input was incorporated into the final design which was subsequently approved by the SDRC.

D.2 Procedure Drafting Process

The CDS procedure amendments were drafted by CDS’s Business Systems Development and Support group, and subsequently reviewed and approved by CDS’s Strategic Development Review Committee (SDRC). The SDRC determines or reviews, prioritizes and oversees CDS-related systems development and other changes proposed by participants and CDS. The SDRC’s membership includes representatives from a cross-section of the CDS participant community and it meets on a monthly basis.

These amendments were reviewed and approved by the SDRC on April 26, 2012.

D.3 Issues Considered

Included in the original requirements from the SDRC Buy-in Working Group was the need for receivers to be provided with the date that a failed CNS position came into existence. It was felt that this information may be of assistance when determining whether to grant an extension to a deliverer. During the review of the requirements document it was decided that this information might be misleading and should not be included. This is because CDSX captures the deliverer’s positions at the time that a buy-in is entered. The age of the ‘outstanding to deliver positions’ is determined by the date when the deliverer’s CNS position first became negative. This date is only reset when a deliverer’s position is cleared. A small failure amount would establish the date on a failed position however it would not be indicative as to when a subsequent, and possibly much larger, failed position was created.

D.4 Consultation

This development was requested by the SDRC Debt and Equity Subcommittee. CDS reviewed the requirements document with the SDRC Buy-in Working Group and received final approval for the proposal from the SDRC Debt and Equity Subcommittee.

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

CDS facilitates consultation through a variety of means, including regularly scheduled SDRC subcommittee meetings which provide a forum for detailed requirement review, and monthly meetings with service bureaus to discuss development impacts to them. All development initiatives are also presented to the Investment Industry Regulatory Organization of Canada’s (IIROC) Financial Administrators Section (FAS) working group.

D.5 Alternatives Considered

The SDRC Buy-in Working Group proposed two options to address the requirement for uninterrupted settlement priority. They were to (i) automate the repeat buy-in process and (ii) maintain the original buy-in indefinitely, until such time as the buy-in quantity is settled in full. The latter option was rejected because the requirement to provide 48 hour notice to deliverers and the requirement to hold only those deliverers liable who have an outstanding position when a buy-in is entered could not be satisfied. Automating the entry of repeat buy-ins would maintain the current process while providing the participants with the efficiencies requested.

D.6 Implementation Plan

The proposed procedure amendments and the scheduled date of implementation have been communicated regularly to CDS participants through the SDRC and its subcommittees, as well as through Customer Service relationship meetings. The

Customer Service account managers will provide their clients with details of the upcoming changes, and provide customer-related training during the month of July 2012. In addition, message testing with CDS participants and service bureaus will be performed following the successful completion of internal testing. CDS will distribute a bulletin to all CDS participants the week before implementation reminding them of the upcoming changes and confirming the effective date of those changes.

CDS is recognized as a clearing agency by the Ontario Securities Commission pursuant to section 21.2 of the Ontario *Securities Act*. The Autorité des marchés financiers has authorized CDS to carry on clearing activities in Québec pursuant to sections 169 and 170 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 Autorité des marchés financiers and the Bank of Canada will hereafter be collectively referred to as the "Recognizing Regulators".

The amendments to Participant Procedures may become effective upon approval of the amendments by the Recognizing Regulators following public notice and comment. Implementation of this initiative is planned for August 27, 2012.

E. TECHNOLOGICAL SYSTEM CHANGES

E.1 CDS

CDSX functionality will be impacted by these changes as follows:

- a) Modify the extension request response function to allow a receiver response at the individual deliverer level instead of at the buy-in level
- b) Exclude extended deliverers liability amount from the execution quantity
- c) Modify the receiver view of the extension granted values, currently applied at the buy-in level, to an aggregate value of all deliverers and implement new values
- d) Modify the deliverer view of the extension requested and extension granted values, currently applied to a single buy-in, to an aggregate value of all buy-ins and implement new values
- e) Report the status of extension requests / extension responses at the individual deliverer level, as well as the extended quantity, on the existing 'Buy-in Activity Report for Receivers'
- f) Implement functionality to allow receivers to request or cancel automatic repeat buy-ins
- g) Enhance an existing receiver message to include deliverer information

E.2 CDS Participants

CDS participants (receivers) may need to make changes to their internal systems to accommodate the additional deliverer data (i.e., deliverer company code, ledger code and executable quantity) being provided in the response message, if they choose to use this information.

E.3 Other Market Participants

Service bureaus may need to make changes to their internal systems to accommodate the additional deliverer data (i.e., deliverer company code, ledger code and executable quantity) being provided in the response message, if they, or their clients, choose to use this information.

F. COMPARISON TO OTHER CLEARING AGENCIES

A similar CNS buy-in process is provided by the National Securities Clearing Corporation (NSCC) as outlined in the NSCC Rules and Procedures dated March 7, 2012 (Procedure VII, Section J: Recording of CNS Buy-ins and Procedure X, Execution of Buy-ins, Section A: CNS System). No reference to extensions of CNS buy-in requests is made in these areas and CDS is not aware of any impending rule changes in this regard.

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:

Elaine Spankie
Senior Business Analyst
Business Systems Development and Support
CDS Clearing and Depository Services Inc.
85 Richmond Street West
Toronto, Ontario M5H 2C9

Telephone: 416-365-3595
Email: espankie@cds.ca

Copies should also be provided to the Autorité des marchés financiers and the Ontario Securities Commission by forwarding a copy to each of the following individuals:

M^e Anne-Marie Beaudoin
Secrétaire générale
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

Manager, Market Regulation
Capital Markets Branch
Ontario Securities Commission
Suite 1903, Box 55,
20 Queen Street West
Toronto, Ontario, M5H 3S8

Fax: 416-595-8940
email: marketregulation@osc.gov.on.ca

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