13.3.2 Material Amendments to CDS Procedures – Amendments to the Buy-in Process – Request for Comments

CDS CLEARING AND DEPOSITORY SERVICES INC. (CDS®)

MATERIAL AMENDMENTS TO CDS PROCEDURES

AMENDMENTS TO THE BUY-IN PROCESS

REQUEST FOR COMMENTS

A. DESCRIPTION OF THE PROPOSED CDS PROCEDURE AMENDMENTS

The proposed amendments to the CDS Participant Procedures address limitations related to prioritizing settlement of Continuous Net Settlement Service (CNS) positions subject to buy-ins. CNS is used by CDSX® Participants to expedite settlement of outstanding CNS positions. These proposed amendments will (i) reduce a receiver's buy-in amount to zero if they are unable to accept a delivery; and (ii) allow the system to re-allocate a deliverer's liability related to the buy-in process in CNS.

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 in any particular transaction to accelerate settlement of outstanding CNS positions identified in the relevant procedures as 'to-receive'. An outstanding 'to-receive' CNS position is a quantity of shares that failed to settle on the value date of the transaction. 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 owed to the receiver. When the buy-in is entered, all participants who owe shares in CNS (deliverers) for the specified security are identified and are provided with 48 hours notice. This notice indicates that the deliverer may be required to deliver some or all of their portion of the buy-in quantity. This notice is provided via CDSX screens, reports and messages. Priority settlement, as outlined in the 'Proposed Amendments' section of this document, is applied to the buy-in; 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 process is initiated, the receiver may choose to execute on the remaining unsettled portion of a buy-in by updating the status of the transaction in CDSX. If the receiver chooses to execute the transaction, CDSX determines which deliverers will be required to satisfy the buy-in and identifies these deliverers 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 amount of the liability attributed to an identified deliverer on an executed buy-in is not available for any other buy-ins subsequently executed. An outstanding CNS position with an executed buy-in is assigned the highest CNS settlement priority, which allows a receiver of the executed buy-in to receive delivered shares before other receivers who do not have an executed buy-in.

The identified deliverers then have the option to request an extension to buy-in execution from the receiver, but only during the time frame when extension requests are permitted. A deliverer makes an extension request by updating the extension request field in CDSX. If a deliverer requests an extension and the receiver grants the request by updating the response field in CDSX, or does not respond to the request by the pre-determined cut off time, then the buy-in execution time for the identified deliverer is extended. If the extension request is denied, then the execution of the buy-in proceeds against the identified deliverer.

Identified deliverers have until the delivery cut-off time to satisfy the executed buy-in. Settlements received from deliverers are applied to outstanding CNS positions. If the receiver does not receive sufficient shares to satisfy the 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.

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 between CDS and the receiver and deliverer, respectively, 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. Once a repeat buy-in is created in CDSX, 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

CDS is proposing to implement the following two changes to the CNS buy-in process: (i) reduce a receiver's buy-in quantity to zero if they are unable to accept delivery; and (ii) reallocate a deliverer's liability to a different buy-in if the original buy-in is settled by another Participant. These two changes will ensure that a deliverer cannot be bought in on the market if it has delivered on its entire liability and that a receiver cannot be left without a deliverer allocated to its buy-in. Each of the proposed amendments is described below.

Reduction in Receiver's Buy-in Quantity if Unable to Receive

Currently, when a Participant's CDSX ledger balance is increased, the settlement sequence process is started, and the system attempts to settle outstanding CNS positions based on priority. The priority order is: (i) executed buy-ins, (ii) non-executed buy-ins and (iii) outstanding CNS positions with no buy-ins. If additional shares are delivered to a deliverer's ledger while the settlement sequence is in progress, this additional amount could be used to settle an outstanding CNS position of a lesser priority. If this were to occur, a deliverer could be bought in even though they had delivered sufficient position to CNS.

To eliminate this possibility, settlement will ensure that a higher priority outstanding CNS position does not exist prior to settling a lower priority outstanding CNS position. If a higher priority outstanding CNS position exists, then the ledger will be used to satisfy that position first. No amendments to the Trade and Settlement Procedures are required for this change as these procedures correctly state the priority sequence in section 8.5 (Real-time CNS Settlement Process).

The consequence of this proposed amendment is that the entire quantity of a receiver's buy-in will be reduced to zero if the receiver cannot receive shares from a deliverer (i.e., the receiver does not have sufficient funds or aggregate collateral value). Currently, when a receiver cannot accept delivery, their buy-in quantity is reduced only by the amount of the attempted settlement and this amount is reported as an unserviced quantity. The quantity reduced from the buy-in will continue to be reported as an unserviced quantity.

Deliverer Liability Reallocation

Currently, when a buy-in is executed a deliverer is identified and the executed liability amount is established for that buy-in. Another deliverer, not identified for the buy-in, may settle all or part of the buy-in, which reduces the amount that the identified deliverer must settle to satisfy the buy-in. However, when this occurs, the identified deliverer's reduction in executed liability is not made available for reallocation if the execution of another buy-in (for which the deliverer has been given notice) is attempted. Consequently a receiver may not be able to execute on its buy-in quantity.

To eliminate this possibility, when an identified deliverer has their executed liability amount reduced as a result of a settlement from another deliverer, the executed liability amount satisfied will be made available for reallocation to another buy-in upon execution.

Housekeeping Item

During the analysis of the buy-in process it was noted that Section 9.1.4 of the Trade and Settlement Procedures (Extension to buy-in requests) required a correction to the start time of the extension window. Participants are currently able to start requesting and responding to extension requests as of 7:30 a.m. ET (5:30 a.m. MT and 4:30 a.m. PT). The extension table provided in the procedure must be amended to reflect this timeframe.

B. NATURE AND PURPOSE OF THE PROPOSED CDS PROCEDURE AMENDMENTS

The proposed procedure amendments will enhance the effectiveness of the CNS settlement process related to the buy-in process for Participants.

Reduction in Receiver's Buy-in Quantity if Unable to Receive

CNS Participants in a deliver position will benefit from the changes to the settlement process as the new process will ensure that all ledger positions are used to settle the highest priority items first. The new process will eliminate the possibility of a deliverer being bought in on the market when it has delivered a sufficient quantity to fully satisfy an executed buy-in.

Deliverer Liability Reallocation

CNS Participants in a receiver position will benefit from the liability reallocation as the new process will ensure that a deliverer can be identified at all times when a receiver executes a buy-in.

When a deliverer is identified at execution, the executed liability amount allocated currently remains locked to the buy-in even if another deliverer has settled and reduced the amount of the buy-in. In cases where the executed liability has been satisfied by another deliverer, the liability of the allocated deliverer must be made available for other buy-ins to ensure that a deliverer is always available to a receiver upon execution.

C. IMPACT OF THE PROPOSED CDS PROCEDURE AMENDMENTS

The proposed procedure amendments will enhance CNS settlement effectiveness for CDS participants related to buy-in processing.

Reduction in Receiver's Buy-in Quantity

The changes made to the settlement process will ensure that higher priority items are settled first, thus eliminating the possibility of a deliverer being bought in on the market when the deliverer has provided sufficient securities to fully satisfy an executed buy-in.

A receiver with priority settlement (i.e., a buy-in) will be required to be in a position to accept their receive position. The inability to receive that amount will result in the entire buy-in quantity being reduced to zero In this case the receiver must enter a new buy-in in CDSX to replace the buy-in that was reduced.

Deliverer Liability Reallocation

Deliverer liability reallocation will ensure that sufficient liability is identifiable and available at all times to allow receivers to execute a buy-in. The changes will require that deliverers who have received an extension from a receiver may be required to renew a request for an extension if the liability is reallocated to a different buy-in upon execution.

The impact of these changes is limited to those CDS Participants that use 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 changes.

C.2 Risks and Compliance Costs

CDS Risk Management has reviewed the proposed modifications to buy-in processing and has determined that they will not result in any changes to CDS's Financial Risk Model and the resulting management of financial risks in CDS's clearing, settlement and depository services.

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. Principle #21 states that financial market infrastructure such as CDS "should be designed to meet the needs of its participants and the markets it serves, in 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 will result in the enhancement of CNS settlement effectiveness related to the buy-in process for the CDS Participants.

[1] The report can be found at http://www.bis.org/publ/cpss101.htm

D. DESCRIPTION OF THE PROCEDURE DRAFTING PROCESS

D.1 Development Context

CDS's analysis of the buy-in function determined that enhancements were required to the CNS settlement and liability reallocation processes to improve the effectiveness of the buy-in process for CDS Participants. CDS prepared a document providing the results of the analysis which was tabled at the SDRC Debt and Equity Subcommittee. The document outlined the areas that required enhancements as well as the impacts to the Participant as a result of the changes.

D.2 Procedure Drafting Process

The CDS procedure amendments were drafted by CDS's Product Development group, and subsequently reviewed 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 by the SDRC on June 27, 2013.

D.3 Issues Considered

During the analysis of the initiative, consideration was given to the operational impacts that the enhancements might create for CDS Participants as outlined in section C. It was determined that the need to (i) improve the CNS settlement process to ensure that high priority outstanding CNS positions are settled first and (ii) ensure that deliverer liability is always available upon execution of a buy-in were essential to address the current limitations of the buy-in process. Consequently, CDS Participants may be required to modify some internal processing methods to accommodate the initiative (i.e. submission of new buy-in if the original is reduced to zero, monitoring of extended buy-ins in case of reallocation of liability).

D.4 Consultation

This development is being initiated by CDS. CDS reviewed the changes with the SDRC Buy-in Working Group and 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

No alternatives were considered. The changes are required to ensure that (i) deliverers are not bought in on the market when their liability has been satisfied in full and (ii) deliverers are always available for identification upon execution of a buy-in by a receiver.

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 Relationship Management client meetings. The Relationship Managers and the Customer Service department will provide their clients with details of the upcoming changes, and provide customer-related training during the months of July and August 2013. 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*, and by the British Columbia Securities Commission pursuant to section 24(d) of the British Columbia *Securities Act*, and as a clearing house by the *Autorité des marchés financiers* pursuant to Section 169 of the Quebec *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 Participant Procedures may become effective upon approval of the amendments by the Recognizing Regulators following public notice and comment. Implementation of this initiative will be effective September 30, 2013.

E. TECHNOLOGICAL SYSTEM CHANGES

E.1 CDS

The settlement process and liability reallocation will be impacted by these changes as follows:

a) Allow for the CNS settlement process to bypass a lower priority outstanding CNS position if a higher priority outstanding CNS position exists.

b) Allow the settlement process to reduce a receiver’s outstanding buy-in quantity to zero if a receiver is unable to accept a settlement.

c) Update the receiver’s unserviced quantity field on reports and messages to reflect the outstanding buy-in quantity at the time that it is reduced to zero.

d) Allow for a deliverer’s liability on a buy-in to be reallocated to another buy-in if a different deliverer, not identified for the buy-in, settles the obligation.

E.2 CDS Participants

There are no technological system changes required by CDS Participants.

E.3 Other Market Participants

There are no technological system changes required by CDS Participant service bureaus.

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 May 22, 2013 (Procedure VII, Section J: Recording of CNS Buy-ins and Procedure X, Execution of Buy-ins, Section A: CNS System).

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, the British Columbia Securities Commission Bulletin or the Autorité des marchés financiers Bulletin to:

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Copies should also be provided to the Autorité des marchés financiers, the 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 PROCEDURE AMENDMENTS

Access the proposed amendments to the CDS Procedures on the User documentation revisions web page (http://www.cds.ca/cdsclearinghome.nsf/Pages/-EN-UserDocumentation?Open).