

CDS Clearing and Depository Services Inc. (CDS®)

MATERIAL AMENDMENTS TO CDS PARTICIPANT RULES RELATED TO LINES OF CREDIT REQUIREMENTS FOR NON-CONTRIBUTING RECEIVERS OF CREDIT MAKING CANADIAN DOLLAR SETTLEMENTS

NOTICE AND REQUEST FOR COMMENTS

A. DESCRIPTION OF THE PROPOSED CDS RULE AMENDMENT

Each Participant in CDS is a member of a Category Credit Ring. Non-Contributing Receivers of Credit making Canadian dollar Settlements and Extenders of Credit are two distinct Category Credit Rings described in the CDS Participant Rules. Non-Contributing Receivers of Credit making Canadian dollar Settlements do not contribute collateral to the Receivers Collateral Pool and do not receive System-Operating Cap. Extenders of Credit are CDS Participants who among other things extend lines of credit to other CDS Participants.

The proposed Rule Amendment will require each member of the Non-Contributing Receivers (making Canadian dollar Settlement) Category Credit Ring to have at least two committed lines of credit from liquidity providers who are different members of the Extenders Category Credit Ring.

Under the Rule Amendment, a new provision requiring Non-Contributing Receivers of Credit making Canadian dollar Settlements will be added to CDS Participant Rule 5.9.1(b)(i) as further described in Appendix A to this Notice.

B. NATURE AND PURPOSE OF THE PROPOSED CDS RULE AMENDMENT

Currently, a Non-Contributing Receiver making Canadian dollar Settlements can have a line of credit from a single liquidity provider including from an affiliate which could exacerbate losses in the event of default. This Rule Amendment adds a stop gap measure by requiring Non-Contributing Receivers making Canadian dollar Settlements to have at least two committed lines of credit from different liquidity providers who are from the Extenders Category Credit Ring.

This Rule Amendment is consistent with CDS's risk diversification practices and contributes to a diversified portfolio of participants. This diversification protects CDS, its participants and Canadian capital markets. This Rule Amendment is also consistent with established sound risk management principles described in the *Principles for Financial Market Infrastructures* ("PFMI") and National Instrument 24-102 ("NI 24-102").

Diversifying liquidity risk amongst at least two independent liquidity providers improves the chances that the Participant can continue to meet its obligations should a single provider, including a provider who is an affiliate, defaults.

C. IMPACT OF THE PROPOSED CDS RULE AMENDMENT

(a) CDS Clearing – This Rule Amendment aligns CDS's risk diversification practices with risk management practices of other financial market infrastructures ("FMIs") as well as PFMI and NI 24-102 principles.

- (b) CDS Participants –This Rule Amendment benefits all CDS Participants by providing greater diversification and containment of risk within CDS.

- (c) & (d) Other Market Participants and Securities and Financial Markets in General – This Rule Amendment mitigates systemic risk and contributes to the reliable, efficient and safe operation of Canadian capital markets.

C.1 Competition

This Rule Amendment will apply to all CDS Participants who currently are, or may choose to become Non-Contributing Receivers of Credit making Canadian dollar Settlements. 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.

No changes to CDS's Fee Schedule are contemplated under this Rule Amendment.

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 for Non-Contributors of Credit making Canadian dollar Settlements to have more than one committed line of credit is consistent with risk management principles described in the PFMI and NI 24-102. For example, under Principle 3 (Framework for the comprehensive management of risks), and more specifically, Key Consideration 2, participants are encouraged to manage and contain risks they pose to the FMI. This principle not only benefits the FMI but also its participants by ensuring that risk is contained and that spillover effects are mitigated.

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 regularly throughout the year.

D.2 Rule Amendment Drafting Process

This Rule Amendment was drafted by CDS's Legal group in consultation with Risk Management and was subsequently submitted for consultation to the Legal Drafting Group ("LDG") on July 19, 2018. The LDG comments on the drafting of proposed Rule 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

As noted above, in drafting the rule amendment, CDS's primary consideration was the containment of a Participant's default risk on CDS and its participants. For Non-Contributing Receiver of Credit making Canadian dollar Settlements, that risk is best managed by ensuring that it has access to at least two committed lines of credit from liquidity providers who are members of the Extenders of Credit Category Credit Ring.

D.4 Consultation

CDS received input from the following Participant committees:

- Legal Drafting Group reviewed the Rule Amendment (07/19/2018)

CDS regulators attend Participant committee meetings as observers.

This Rule Amendment was presented to the Risk Management and Audit Committee and approved by the Board of Directors on August 8, 2018.

D.5 Alternatives Considered

No alternatives were considered. The Rule Amendment aligns CDS to best practices as well as PFMI and NI 24-102 principles.

D.6 Implementation Plan

CDS is recognized as a clearing agency by the Ontario Securities Commission pursuant to section 21.2 of the *Securities Act (Ontario)*, by the British Columbia Securities Commission pursuant to Section 24(d) of the *Securities Act (British Columbia)* and by the Autorité des marchés financiers pursuant to section 169 of the *Securities Act (Québec)*. 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**”.

This Rule Amendment is expected to become effective upon approval by the Recognizing Regulators following the prescribed public notice and comment period.

E. TECHNOLOGICAL SYSTEM CHANGES

This Rule Amendment is not expected to have an impact on technological systems, or require changes to the technological systems of CDS, CDS Participants, or other market participants.

F. COMPARISON TO OTHER CLEARING AGENCIES

Upon reviewing the participant diversification and liquidity risk management practices of other FMIs, CDS observed that all comparators had strategies for containing the liquidity risk of their participants which included the use of more than one liquidity provider.

G. PUBLIC INTEREST ASSESSMENT

CDS has determined that the proposed Rule Amendment is not contrary to the public interest.

H. COMMENTS

Comments on the proposed Rule Amendment 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, Clearing
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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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Secrétaire générale
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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>]</p>	
<p>5.9.1 Establishment of Category Credit Rings</p> <p>....</p> <p>(b) Category Credit Ring for Receivers.</p> <p>Each Receiver is a Member of two Category Credit Rings, one for each currency.</p> <p style="padding-left: 40px;">(i) Canadian dollar Settlements</p> <p>A Receiver must choose to be a Member of either the Credit Ring for RCP Receivers making Canadian dollar Settlements or the Credit Ring for Non-Contributing Receivers making Canadian dollar Settlements.</p> <p><u>Non-Contributing Receivers making Canadian dollar Settlements must have at least two committed lines of credit with different Extenders of Credit.</u></p> <p>....</p>	<p>5.9.1 Establishment of Category Credit Rings</p> <p>....</p> <p>(b) Category Credit Ring for Receivers.</p> <p>Each Receiver is a Member of two Category Credit Rings, one for each currency.</p> <p style="padding-left: 40px;">(i) Canadian dollar Settlements</p> <p>A Receiver must choose to be a Member of either the Credit Ring for RCP Receivers making Canadian dollar Settlements or the Credit Ring for Non-Contributing Receivers making Canadian dollar Settlements.</p> <p>Non-Contributing Receivers making Canadian dollar Settlements must have at least two committed lines of credit with different Extenders of Credit.</p> <p>....</p>