

13.1.3 CDS Recognition and Designation Order - ss. 21.2(1) and s. 144 of the Act and Part VI of the OBCA

IN THE MATTER OF
THE *SECURITIES ACT*
R.S.O. 1990, CHAPTER S.5, AS AMENDED (the "Act")

AND

IN THE MATTER OF
THE *BUSINESS CORPORATIONS ACT*
R.S.O. 1990, CHAPTER B.16, AS AMENDED (the "OBCA")

AND

IN THE MATTER OF
THE CANADIAN DEPOSITORY FOR SECURITIES LIMITED

RECOGNITION AND DESIGNATION ORDER
(Subsection 21.2(1) and Section 144 of the Act and Part VI of the OBCA)

WHEREAS the Ontario Securities Commission (the "Commission") issued an order dated February 25, 1997, which became effective on March 1, 1997, recognizing The Canadian Depository for Securities Limited ("CDS") as a clearing agency pursuant to subsection 21.2(1) of the Act and designating CDS as a recognized clearing agency pursuant to Part VI of the OBCA (the "1997 Recognition and Designation Order");

AND WHEREAS CDS has applied for an order pursuant to section 144 of the Act to vary the 1997 Recognition and Designation Order;

AND WHEREAS the Commission has received certain representations and undertakings from CDS in connection with its application to vary the 1997 Recognition and Designation Order;

AND WHEREAS the Commission considers it appropriate to set out in the order terms and conditions of CDS' recognition as a clearing agency under the Act which terms and conditions are set out in Schedule "A" attached;

AND WHEREAS CDS has agreed to the terms and conditions as set out in Schedule "A";

AND WHEREAS the terms and conditions set out in Schedule "A" may be varied or waived by the Commission;

AND UPON the Commission being of the opinion that it is not prejudicial to the public interest to vary the 1997 Recognition and Designation Order;

AND UPON the Commission being satisfied that it is in the public interest to continue to recognize CDS as a clearing agency pursuant to subsection 21.2(1) of the Act;

AND UPON the Commission wishing to continue to designate CDS as a recognized clearing agency for the purposes of Part VI of the OBCA;

IT IS ORDERED pursuant to section 144 of the Act that the 1997 Recognition and Designation Order be varied and restated in the form of this order;

THE COMMISSION HEREBY RECOGNIZES CDS as a clearing agency pursuant to subsection 21.2(1) of the Act, subject to the terms and conditions set out in Schedule "A";

AND THE COMMISSION HEREBY DESIGNATES CDS as a recognized clearing agency for the purposes of Part VI of the OBCA.

DATED February 25, 1997, as varied and restated on _____.

SCHEDULE "A"

TERMS AND CONDITIONS

GOVERNANCE

1. CDS' governance arrangements shall be designed to fulfill public interest requirements and to promote the objectives of its shareholders and the users ("participants") of its depository, clearing and settlement services (collectively, "settlement services").
2. Without limiting the generality of the foregoing, CDS' governance structure shall provide for:
 - (a) fair and meaningful representation on its board of directors and any committee of the board of directors;
 - (b) appropriate representation of persons independent of the shareholders and participants on the board of directors and any committees of the board of directors, and, for such purpose, a person is "independent" if the person is not:
 - (i) an associate, partner, director, officer or employee of a shareholder of CDS,
 - (ii) an associate, director, officer or employee of a participant of CDS or its affiliates or an associate of such director, officer or employee, or
 - (iii) an officer or employee of CDS or its affiliates or an associate of such officer or employee; and
 - (c) appropriate qualifications, remuneration, conflict of interest guidelines and limitation of liability and indemnification protections for directors, officers and employees of CDS.
3. CDS shall complete the current review of its governance structure by six months from the date of this order and shall submit for the Commission's consideration a report containing recommendations to amend the governance structure. Specifically the report shall:
 - (a) provide recommendations on alternative voting structures to ensure that the board is, in all cases, able to discharge its responsibilities;
 - (b) provide recommendations on how to achieve fair and effective representation of all stakeholders on the board of directors, board committees or other committees of CDS; and
 - (c) review the nomination process for directors and independent directors to include an assessment of the needs of the board and board committees.
4. CDS shall not, without the Commission's prior written approval, make significant changes to its governance structure or constating documents.
5. CDS shall not, without the Commission's prior written approval, enter into any contract, agreement or arrangement that may limit its ability to comply with the terms and conditions contained in this Schedule "A".

FITNESS

6. CDS shall take reasonable steps to ensure that each officer or director of CDS is a fit and proper person and the past conduct of each officer or director affords reasonable grounds for belief that such person will perform his or her duties with integrity.

ACCESS

7. CDS shall provide any person or company reasonable access to its settlement services where that person or company satisfies the eligibility requirements established by CDS to access the settlement services.
8. Without limiting the generality of the foregoing, CDS shall:
 - (a) establish written standards for granting access to the settlement services;
 - (b) keep records of:

- (i) each grant of access including, for each participant, the reasons for granting such access, and
- (ii) each denial or limitation of access, including the reasons for denying or limiting access to any applicant.

FEES AND COSTS

- 9. CDS shall equitably allocate its fees and costs for settlement services. The fees shall not have the effect of unreasonably creating barriers to access such settlement services and shall be balanced with the criterion that CDS has sufficient revenues to satisfy its responsibilities.
- 10. CDS' process for setting fees and costs for settlement services shall be fair, appropriate and transparent. The fees, costs or expenses borne by participants in the settlement services shall not reflect any costs or expense incurred by CDS in connection with an activity carried on by CDS that is not related to the settlement services.

DUE PROCESS

- 11. CDS shall ensure that:
 - (a) participants affected by its decisions are given an opportunity to be heard or make representations; and
 - (b) it keeps a record, gives reasons and provides for appeals of its decisions to regulatory authorities.

RISK CONTROLS

- 12. CDS shall have clearly defined procedures for the management of risk which specify the respective responsibilities of CDS and its participants.
- 13. Without limiting the generality of the foregoing:
 - (a) Where a central counterparty service is offered by CDS, CDS shall rigorously control the risks it assumes.
 - (b) CDS shall reduce principal risk to the greatest extent possible by linking securities transfers to funds transfers in a way that achieves delivery-versus-payment.
 - (c) Final settlement shall occur no later than the end of the settlement day and intraday or real-time finality should be provided where necessary to reduce risks.
 - (d) Where CDS extends intraday credit to participants, including where it operates a net settlement system, it shall institute risk controls that, at a minimum, ensure timely settlement in the event that the participant with the largest payment obligation is unable to settle.
 - (e) Assets accepted by CDS used to settle the ultimate payment obligations arising from securities transactions shall carry little or no credit or liquidity risk. If same-day, irrevocable final funds are not used, CDS shall take steps to protect participants in settlement services from potential losses and liquidity pressures arising from the failure of the payor or its paying agent.
 - (f) Where CDS establishes links to settle cross-border trades, it shall design and operate such links to reduce effectively the risks associated with cross-border settlements.
 - (g) Where CDS engages in activities not related to the settlement services, it shall carry on such activities in a manner that prevents the spillover of risk arising from such activities where such risks might negatively impact CDS' financial viability.
 - (h) Where CDS materially outsources any of its settlement services or systems to a third party service provider, which shall include affiliates or associates of CDS, CDS shall proceed in accordance with best practices. Without limiting the generality of the foregoing, CDS shall:
 - (i) establish and maintain policies and procedures that are approved by its board of directors for the evaluation and approval of such outsourcing arrangements;
 - (ii) in entering any such outsourcing arrangement,

- (A) assess the risk of such arrangement, the quality of the service to be provided and the degree of control to be maintained by CDS, and
- (B) execute a contract with the third party service provider addressing all significant elements of such arrangement, including service levels and performance standards;
- (iii) ensure that any contract implementing such outsourcing arrangement, that is likely to impact the settlement services, permits the Commission to have access to and inspect all data, information and systems maintained by the third party service provider on behalf of CDS for the purposes of determining CDS' compliance with the terms and conditions of this Schedule "A" or securities legislation; and
- (iv) monitor the performance of the third party service provider under any such outsourcing arrangement.

FINANCIAL VIABILITY

- 14. CDS shall maintain sufficient financial and staffing resources to ensure the proper performance of the settlement services.
- 15. CDS shall establish financial tests for the purpose of monitoring its financial viability. Specifically CDS shall maintain:
 - (a) a debt to cash flow ratio less than or equal to 4/1; and
 - (b) a financial leverage ratio less than or equal to 4/1.

For the purpose above:

- (i) debt to cash flow ratio is the ratio of total debt to EBITDA (earnings before interest, taxes, depreciation and amortization) for the most recent 12 months, and
 - (ii) financial leverage ratio is the ratio of total assets to shareholder's equity.
- 16. CDS shall notify Commission staff as soon as practicable of any decision made to retain all or part of its transaction volatility premiums collected or to be collected.
- 17. If CDS fails to maintain, or anticipates it will fail to maintain, the debt to cash flow ratio or financial leverage ratio, it shall immediately notify the Commission staff. If CDS fails to maintain either of the debt to cash flow ratio or the financial leverage ratio for a period of more than three months, its Chief Executive Officer will deliver a letter advising the Commission staff of the continued ratio deficiencies and the steps being taken to address the situation.
- 18. On a quarterly basis (together with the financial statements required to be filed pursuant to item 19), CDS shall report to Commission staff that quarter's monthly calculation of the debt to cash flow ratio and financial leverage ratio.
- 19. CDS shall file with Commission staff unaudited quarterly financial statements within 60 days of each quarter end and audited annual financial statements, prepared in accordance with generally accepted accounting principles, together with any annual report to the shareholders, within 90 days of each year end. The quarterly and annual financial statements of CDS shall be provided on an unconsolidated and consolidated basis.

OPERATIONAL RELIABILITY

- 20. CDS shall adopt procedures and processes that, on an ongoing basis, ensure the provision of accurate and reliable settlement services to participants.
- 21. CDS shall annually file with Commission staff the Report on Internal Controls and Safeguards including CDS' external auditor's opinion on the design and effectiveness of these control systems.

CAPACITY AND INTEGRITY OF SYSTEMS

- 22. For all of its core systems supporting the settlement services and related business operations (the "systems"), CDS will:
 - (a) on a reasonably frequent basis, and in any event, at least annually;
 - (i) make reasonable current and future capacity estimates,

- (ii) conduct capacity stress tests of the systems to determine the ability of those systems to process transactions in an accurate, timely and efficient manner,
 - (iii) develop and implement reasonable procedures to review and keep current the development and testing methodology of the systems,
 - (iv) review the vulnerability of the systems and data centre computer operations to internal and external threats including breaches of security, physical hazards and natural disasters, and
 - (v) maintain adequate contingency and business continuity plans;
- (b) annually, cause to be performed an independent review and written report, in accordance with generally accepted auditing standards, of the stated internal control objectives of the systems, whether as part of the report described in item 21 or as a separate review; and
- (c) promptly notify Commission staff of material systems failures and changes.

PROTECTION OF CUSTOMERS' SECURITIES

23. CDS shall employ securities depository, account maintenance and accounting practices and safekeeping procedures that protect participants' securities.

RULES

24. CDS shall establish rules, operating procedures, user guides, manuals or similar instruments or documents (collectively, "rules") that are necessary or appropriate to govern, regulate, and set out all aspects of the settlement services offered by CDS.
25. The rules shall be consistent with the general goals of:
- (a) ensuring compliance with securities legislation;
 - (b) fostering co-operation and co-ordination with self-regulatory organizations and persons or companies operating marketplaces, clearing and settlement systems and other systems that facilitate the processing of securities transactions and safeguarding of securities; and
 - (c) controlling systemic risk.
26. The rules will not:
- (a) permit unreasonable discrimination among participants; or
 - (b) impose any burden on competition that is not necessary or appropriate in furtherance of compliance with securities legislation or the objects and mandate of the clearing agency.
27. CDS' rules and the process for adopting new rules or amending existing rules shall be transparent to participants and the general public.
28. CDS shall file with the Commission all rules and amendments to the rules and comply with the rule protocol attached as Appendix "A", as amended from time to time.

ENFORCEMENT OF RULES AND DISCIPLINE

29. The rules of CDS shall set out appropriate sanctions in the event of non-compliance by participants.
30. CDS shall reasonably monitor participant activities and impose sanctions to ensure compliance by participants with its rules.

INFORMATION SHARING

31. CDS shall share information and otherwise cooperate with the Commission and its staff, other recognized clearing agencies, recognized exchanges, recognized quotation and trade reporting systems, registered alternative trading systems, recognized self-regulatory organizations, the Canadian Investor Protection Fund and any regulatory authority

having jurisdiction over CDS, subject to any applicable privacy or other laws governing the sharing of information and the protection of personal information, and subject to any confidentiality provisions contained in agreements entered into with the Bank of Canada pertaining to information received from the Bank of Canada in its roles as registrar, issuing agent, transfer agent or paying agent for the Government of Canada.

32. CDS shall permit the Commission to have access to and inspect all data and information in its possession that is required to assess compliance with the terms and conditions of this Schedule "A" or securities legislation, subject to applicable privacy or other laws governing the sharing of information and the protection of personal information, and subject to any confidentiality provisions contained in agreements entered into with the Bank of Canada pertaining to information received from the Bank of Canada in its roles as registrar, issuing agent, transfer agent or paying agent for the Government of Canada.
33. CDS shall comply with Appendix "B" setting out the reporting obligations, as amended from time to time, regarding the reporting of information to the Commission.