

## Chapter 13

# SROs, Marketplaces and Clearing Agencies

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### 13.3 Clearing Agencies

#### 13.3.1 Material Amendments to CDS Rules – Real Time Continuous Net Settlement Process – Request for Comments

##### CDS CLEARING AND DEPOSITORY SERVICES INC. (CDS®)

##### MATERIAL AMENDMENTS TO CDS RULES

##### REAL TIME CONTINUOUS NET SETTLEMENT PROCESS

##### REQUEST FOR COMMENTS

#### A. DESCRIPTION OF THE PROPOSED CDS RULE AMENDMENTS

The proposed CDS Participant Rule amendments replace the intraday continuous net settlement process with a real time continuous net settlement process.

The intraday continuous net settlement process currently runs four times a day with cycles scheduled at 10:00, 12:00, 14:00 and 15:30.<sup>1</sup> The new real time continuous net settlement process will eliminate the four intra-day cycles and run throughout the day from the commencement of CDSX® daily processing to the start of payment exchange.

#### B. NATURE AND PURPOSE OF THE PROPOSED CDS RULE AMENDMENTS

The proposed CDS Participant Rule amendments create a new real time continuous net settlement process that will eliminate the 30 minute gap differential in completion times as well as creating a settlement process to match the real time running of the TFT settlement process.

Currently, the end of day intraday continuous net settlement process cycle runs at 15:30. The real time TFT<sup>2</sup> settlement process ends at 16:00. The 30 minute gap between the completion of each settlement process results in securities received through one settlement process being unavailable for use in the other settlement process. For instance, securities received through the real time TFT settlement process after 15:30 cannot be subsequently input into the intraday continuous net settlement process since the intraday continuous net settlement process would already be completed. Similarly, with intraday continuous net settlement process being completed at 15:30, no securities would be received that could be input into real time TFT settlement process between 15:30 and 16:00.

The amendment to CDS Participant Rule 7.4.1 corrects a typographical error.

#### C. IMPACT OF THE PROPOSED CDS RULE AMENDMENTS

As noted, the real time continuous net settlement process will be synchronized with the TFT settlement process allowing for settled positions to be used in the other settlement process right up to 16:00. For example, when a purchase trade in the TFT settlement process trade settles between 15:30 and 16:00, the received position may be used to settle an outstanding deliver position in the real time continuous net settlement process. Similarly, when a receive position settles in the real time continuous net settlement process between 15:30 and 16:00, that position may be used to settle a sell trade in the TFT trade settlement process. Participant's exposure to settlement and financial risk will hence be reduced as positions settled under one settlement process can subsequently be used in the other settlement process.

Due to the new real time continuous net settlement process running continually throughout the day, buy-in liabilities associated with outstanding CNS Obligations may be reduced.<sup>3</sup> Currently, the final buy-in execution list is generated at 14:30 while the intraday continuous net settlement process cycle runs at 14:00, creating a 30 minute gap where settlements are not effected and hence unavailable to reduce buy-in liabilities. Under the real time continuous net settlement process, settlements will continue to be effected up to 14:30, eliminating the 30 minute gap.

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<sup>1</sup> All time references in this Notice are Eastern Time.

<sup>2</sup> Trade for trade.

<sup>3</sup> See CDS Participant Rule 7.4.8(b) for a description of the buy-in procedure.

It is expected that the real time continuous net settlement process may result in additional settlement costs (compared to intraday continuous net settlement process) as trades are settled on a partial fill basis (as securities become available) as opposed to the four discrete cycles in the intraday continuous net settlement process (where securities are aggregated up to the running of each cycle). Generally, it is believed that the partial fills will not be significant in number and the benefits from reduced risk exceed any additional costs.

### **C.1 Competition**

There is no expected impact on competition. The proposed amendments create a new settlement process that will be available to all CDS Participants.

### **C.2 Risks and Compliance Costs**

Under the current intraday continuous net settlement process, CDS Participants may be exposed to settlement and financial risk through unnecessary collateral and capital charges, and unexpected cash outlays. Furthermore, CDS Participants incur added costs to mitigate against these risks.

The real time continuous net settlement process can reduce risk for CDS and its Participants by decreasing outstanding positions (due to the processing window being extended to 16:00).

### **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 Committee on Payment and Settlement Systems of the Bank for International Settlements and the Technical Committee of the International Organization of Securities Commissions have issued a joint consultative report (March 2011) for financial market infrastructures.<sup>4</sup> Principle 8 of this report addresses settlement finality and advocates final settlement intraday or in real time. To this end, the proposed amendments are consistent with Principle 8.

Recommendation 4 of the Group of Thirty's Report "Global Clearance and Settlement – A Plan of Action" provides that the timing between different clearing and settlement systems and associated payment and foreign exchange systems should be synchronized.<sup>5</sup> Moving to real time settlement processes increases the likelihood of synchronization between different clearing and settlement systems. Settlements under a real time settlement process become available to other clearing and settlement systems earlier than settlements obtained through cyclically run settlement processes (i.e. must wait for cycles to be run).

## **D. DESCRIPTION OF THE RULE DRAFTING PROCESS**

### **D.1 Development Context**

The Debt & Equity Subcommittee of CDS's Strategic Development Review Committee ("SDRC") requested that CDS find a solution to the end of day 30 minute time differential between the two settlement processes.

### **D.2 Rule Drafting Process**

Each amendment to the CDS Participant Rules is reviewed by CDS's Legal Drafting Group ("LDG"). The LDG is a committee that includes members of Participants' legal and business groups. The LDG's mandate is to advise CDS management and its Board of Directors on CDS Participant Rule amendments and other legal matters relating to centralized securities depository and clearing services in order to ensure that they meet the needs of CDS, its Participants and the securities industry.

These amendments were reviewed and approved by the Board of Directors of CDS Ltd. on April 20, 2011.

### **D.3 Issues Considered**

The primary concern was to eliminate the risk associated with unsynchronized settlement processes.

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<sup>4</sup> <http://www.bis.org/publ/cpss94.pdf>

<sup>5</sup> [http://www.group30.org/rpt\\_12.shtml](http://www.group30.org/rpt_12.shtml)

#### D.4 Consultation

The Debt & Equity Subcommittee of the SDRC has been kept apprised of the status of the initiative. The SDRC will vet the CDS Procedure amendments associated the initiative (a separate Notice addressing Procedure amendments regarding, *inter alia*, the real time continuous net settlement process is expected to be concurrently released for comment with this CDS Participant Rule amendments Notice).

#### D.5 Alternatives Considered

One alternative explored was to add a 16:00 cycle for the intraday continuous net settlement process to correspond with the end of the real time TFT settlement process. While this alternative would address the end of day timing differential, moving to a real time continuous net settlement process would also achieve the synchronization goal and add other benefits (such as reducing buy-in liabilities as discussed in section C above).

Another alternative that was explored was to schedule an additional combined batch net settlement/ continuous net settlement process cycle (normally run at 04:00) prior to payment exchange (which occurs at 16:00). The intended effect would be to synchronize as closely as possible the completion times of the intraday continuous net settlement process and real time TFT settlement process. However, the combined batch net settlement/ continuous net settlement process cycle requires significant technological processing capacity. If the combined batch net settlement/ continuous net settlement process was run at 16:00 (exactly synchronized), payment exchange would be significantly delayed. If combined batch net settlement/ continuous net settlement process was run at any other time after 15:30 but before 16:00, synchronization would not be achieved; additionally the real time TFT settlement process would need to be suspended during such cycle. In light of these limitations, this alternative was discarded.

It was also considered that a new CDS CUID<sup>6</sup> could be set up for the purposes of receiving securities from CDS Participants for input into the intraday continuous net settlement process after the last cycle at 15:30 (currently, no deliveries into intraday continuous net settlement process are permitted after 15:30). This alternative was rejected primarily on the basis of being more costly to develop than the other options. Furthermore, this alternative would require non-automated intervention by CDS Participants to input securities after 15:30 and thus be unappealing from an efficiency perspective.

While these options would address the timing issue faced by CDS Participants in part, the members of the Debt & Equity Subcommittee of the SDRC preferred moving to a real-time continuous net settlement process as this solution would more effectively address the timing issue.

#### 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*. 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 CDS Participant Rules may become effective upon approval of the amendments by the Recognizing Regulators following public notice and comment.

### E. TECHNOLOGICAL SYSTEMS CHANGES

#### E.1 CDS

CDS will need to undertake minor technological system changes to implement the real time continuous net settlement process. The changes will follow CDS's system development life-cycle protocol.

#### E.2 CDS Participants

No technological system changes will be required by CDS Participants.

#### E.3 Other Market Participants

No technological system changes will be required by other market participants.

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<sup>6</sup> CUID is customer unit identifier.

**F. COMPARISON TO OTHER CLEARING AGENCIES**

Implementing a real time continuous net settlement process will align CDS's settlement process with NSCC's comparable CNS settlement process that operates on a daily ongoing-basis (analogous to real time settlement).<sup>7</sup>

**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 must be in writing and submitted within 30 calendar days following the date of publication of this notice in the Ontario Securities Commission Bulletin to:

Legal Department  
CDS Clearing and Depository Services Inc.  
85 Richmond Street West  
Toronto, Ontario M5H 2C9

Fax: 416-365-1984  
e-mail: [attention@cds.ca](mailto:attention@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<sup>e</sup> Anne-Marie Beaudoin  
Secrétaire de l'Autorité  
Autorité des marchés financiers  
800, square Victoria, 22<sup>e</sup> étage  
C.P. 246, tour de la Bourse  
Montréal (Québec) H4Z 1G3

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

Télécopieur: (514) 864-6381  
Courrier électronique: [consultation-en-cours@lautorite.qc.ca](mailto:consultation-en-cours@lautorite.qc.ca)

Fax: 416-595-8940  
e-mail: [marketregulation@osc.gov.on.ca](mailto:marketregulation@osc.gov.on.ca)

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

**I. PROPOSED CDS RULE AMENDMENTS**

Attached at Appendix A are the clean and blacklined versions of the proposed procedural amendments.

Appendix "A" contains text of current CDS Participant Rules marked to reflect proposed amendments as well as text of the CDS Participant Rules reflecting the adoption of the proposed amendments.

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<sup>7</sup> See Procedure VII. CNS Accounting Operation, C. Receipt and Delivery of Securities, 4. Day Cycle at p. 210 of the NSCC Rules and Procedures [http://www.dtcc.com/legal/rules\\_proc/nscc\\_rules.pdf](http://www.dtcc.com/legal/rules_proc/nscc_rules.pdf).

**APPENDIX "A"**  
**PROPOSED CDS PARTICIPANT RULE AMENDMENTS**

Text of CDS Participant Rules marked to reflect proposed amendments	Text of CDS Participant Rules reflecting the adoption of proposed amendments
<p><b>1.2.1 Definitions</b></p> <p>...</p> <p>"<del>Intraday Real Time</del> Continuous Net Settlement Process or "<del>Intraday CNS Process</del>" means one of the Settlement processes described in Rule 7.5.</p> <p><b>7.1.1 Overview of Settlement Service</b></p> <p>...</p> <p>(g) There are four Settlement processes: the <del>Intraday Real Time</del> Continuous Net Settlement Process, the Real Time TFT Settlement Process the Combined Batch Net Settlement/Continuous Net Settlement Process and the FINet Real Time Settlement Process.</p> <p><b>7.4.1 Overview of CNS Function</b></p> <p>The Continuous Net <del>Settlement</del> Function or CNS is a Function to net eligible Trades. CNS calculates CNS Obligations owing from time to time between a Participant and CDS by novating, on Value Date, the obligations between the Participants arising from an eligible Trade to obligations with CDS and by netting all of a Participant's like obligations with CDS. Each resulting CNS Obligation is a Central Counterparty Obligation that is Settled on its Value Date through the Settlement Service.</p> <p><b>7.5.1 Settlement Processes</b></p> <p>A pending Trade or outstanding Central Counterparty Obligation is considered for Settlement on its Value Date. There are four Settlement processes: the Real Time TFT Settlement Process (the Real Time TFT Process), the <del>Intraday Real Time</del> Continuous Net Settlement Process (the <del>Intraday CNS Process</del>), the Combined Batch Net Settlement/Continuous Net Settlement Process (the Combined Batch/CNS Process) and the FINet Real Time Settlement Process.</p> <p><b>7.5.3 <u>Intraday Real Time</u> <u>CNS</u>Continuous Net Settlement Process</b></p> <p>The <del>Intraday Real Time</del> Continuous Net Settlement Process:</p> <p>(a) is run <del>several times</del> <u>continuously</u> each day as a discrete process <u>in accordance with the Procedures</u>;</p> <p>(b) processes Settlement of outstanding Central Counterparty Obligations for CNS-;</p> <p>(c) does not usually novate or net newly reported Trades to create new Central Counterparty Obligations, but may be used by CDS in its discretion to novate and net newly reported Trades that have a CNS mode of settlement indicator in order to calculate new Central Counterparty Obligations, in which event it will also calculate and process</p>	<p><b>1.2.1 Definitions</b></p> <p>...</p> <p>"Real Time Continuous Net Settlement Process means one of the Settlement processes described in Rule 7.5.</p> <p><b>7.1.1 Overview of Settlement Service</b></p> <p>...</p> <p>(g) There are four Settlement processes: the Real Time Continuous Net Settlement Process, the Real Time TFT Settlement Process the Combined Batch Net Settlement/Continuous Net Settlement Process and the FINet Real Time Settlement Process.</p> <p><b>7.4.1 Overview of CNS Function</b></p> <p>The Continuous Net Settlement Function or CNS is a Function to net eligible Trades. CNS calculates CNS Obligations owing from time to time between a Participant and CDS by novating, on Value Date, the obligations between the Participants arising from an eligible Trade to obligations with CDS and by netting all of a Participant's like obligations with CDS. Each resulting CNS Obligation is a Central Counterparty Obligation that is Settled on its Value Date through the Settlement Service.</p> <p><b>7.5.1 Settlement Processes</b></p> <p>A pending Trade or outstanding Central Counterparty Obligation is considered for Settlement on its Value Date. There are four Settlement processes: the Real Time TFT Settlement Process (the Real Time TFT Process), the Real Time Continuous Net Settlement Process, the Combined Batch Net Settlement/Continuous Net Settlement Process (the Combined Batch/CNS Process) and the FINet Real Time Settlement Process.</p> <p><b>7.5.3 Real Time Continuous Net Settlement Process</b></p> <p>The Real Time Continuous Net Settlement Process:</p> <p>(a) is run continuously each day as a discrete process in accordance with the Procedures;</p> <p>(b) processes Settlement of outstanding Central Counterparty Obligations for CNS-;</p> <p>(c) does not usually novate or net newly reported Trades to create new Central Counterparty Obligations, but may be used by CDS in its discretion to novate and net newly reported Trades that have a CNS mode of settlement indicator in order to calculate new Central Counterparty Obligations, in which event it will also calculate and process the related Marks;</p>

Text of CDS Participant Rules marked to reflect proposed amendments	Text of CDS Participant Rules reflecting the adoption of proposed amendments
<p>the related Marks;</p> <p>(d) Settles an outstanding Central Counterparty Obligation either in its entirety or partially;</p> <p>(e) applies the pre-settlement system edits described in Rule 5.13 to the Securities and Funds Account balances resulting from the Settlement of each individual outstanding Central Counterparty Obligation.</p> <p>When the Settlement of a Central Counterparty Obligation is effected by the <del>Intraday</del> <u>Real Time CNSContinuous Net Settlement</u> Process, amounts are used under the System-Operating Cap and Lines of Credit at the same time that Securities are delivered pursuant to Rule 7.6.2 or Rule 7.6.4 and payment is made pursuant to Rule 7.6.5. All of the entries required for each Settlement processed are processed on a committed basis, with the result that either all of the entries (including all entries to Funds Accounts and Securities Accounts and all entries using amounts under System-Operating Caps and Lines of Credit in respect of negative Funds Account balances) required to complete that Settlement are made, or, if for any reason any of the entries cannot be made, then none of the entries are made and the Central Counterparty Obligation is not Settled.</p> <p><b>7.5.4 Combined Batch/CNS Process</b></p> <p>...</p> <p>(a) is run once each day as a discrete process before the Real Time TFT Process or the <del>Intraday</del> <u>Real Time CNSContinuous Net Settlement</u> Process is run, and may be run at additional times if CDS considers such action desirable to optimize Service functionality;</p>	<p>(d) Settles an outstanding Central Counterparty Obligation either in its entirety or partially;</p> <p>(e) applies the pre-settlement system edits described in Rule 5.13 to the Securities and Funds Account balances resulting from the Settlement of each individual outstanding Central Counterparty Obligation.</p> <p>When the Settlement of a Central Counterparty Obligation is effected by the Real Time Continuous Net Settlement Process, amounts are used under the System-Operating Cap and Lines of Credit at the same time that Securities are delivered pursuant to Rule 7.6.2 or Rule 7.6.4 and payment is made pursuant to Rule 7.6.5. All of the entries required for each Settlement processed are processed on a committed basis, with the result that either all of the entries (including all entries to Funds Accounts and Securities Accounts and all entries using amounts under System-Operating Caps and Lines of Credit in respect of negative Funds Account balances) required to complete that Settlement are made, or, if for any reason any of the entries cannot be made, then none of the entries are made and the Central Counterparty Obligation is not Settled.</p> <p><b>7.5.4 Combined Batch/CNS Process</b></p> <p>...</p> <p>(a) is run once each day as a discrete process before the Real Time TFT Process or the Real Time Continuous Net Settlement Process is run, and may be run at additional times if CDS considers such action desirable to optimize Service functionality;</p>