

Going paperless in the Canadian securities market

CDS

2010

Presentation to issuers, underwriters and law firms

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Points to cover today

- CDS overview
- Dematerialization
- NTI destruction program
- New trust indenture wording
- Book Entry Only Securities Services Agreement
- Registrar and Paying Agent (RPA)
- Electronic closings
- Private placement distributions
- Eligibility Fees

CDS services

- Canada's national securities depository, clearing and settlement hub – provides a broad range of services to Canada's capital markets:
- Depository services
 - 77,000 eligible ISINs
 - 23,000 still certificated
 - Over \$3 trillion on deposit as of November 2009
- Entitlement services
 - Entitlement events, including corporate actions, are processed and associated payments are made to CDS's participants for beneficial owners
 - Over 165,000 entitlement payments processed in 2009 with a value of \$3.7 trillion

CDS services

- Clearing and settlement services
 - Deposited securities are cleared and settled in CDSX, including all exchange-traded equities, government and corporate debt, money market instruments and exercised options
 - Over 251 million domestic trades were processed in 2009
 - Average daily gross value of trades reported - \$238 billion
 - Average daily net value of settlement payments - \$6.2 billion
 - All settlement payments made electronically in final, irrevocable funds

CDS services

- Information and support services
 - Security Master File (SMF) data
 - CDS Bulletins
 - CUSIP/ISIN issuance
 - Holders of record reports

- ❖ CUSIP/ ISIN issuance and holders of records are now offered as services via CDS Securities Management Solutions Inc (CDS Solutions), which was launched in May 2009

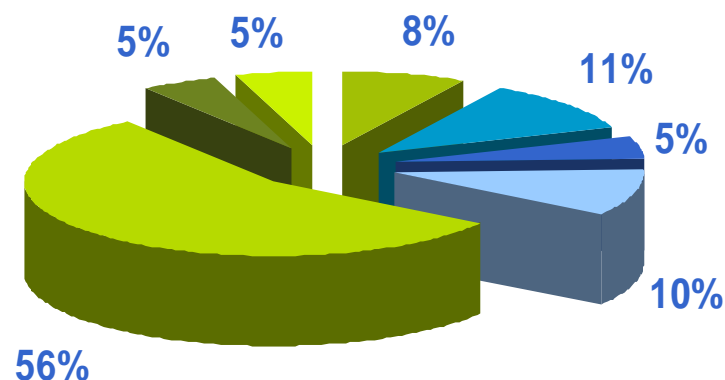
- ❖ Note: currently payment for ISIN Issuance is via credit card, however CDS is working on an enhancement that will provide CDS participants with the choice of using a credit card or to be billed for this service via their monthly CDS invoice. This feature will be available in February 2010.

International services

- CDS's links with DTCC are the most active, sophisticated inter-depository links in the world:
 - Over 46 million cross-border trades were processed in 2009
 - CDS sponsors Canadian participant account access to the Depository Trust Company (DTC) and the National Securities Clearing Corporation (NSCC) in the U.S.
 - DTC's Canadian Dollar Service allows DTC participants to clear and settle securities transactions in Canadian dollars through DTC's account at CDS
 - Links also exist with Euroclear France, SEB (Sweden), JASDEC (Japan) and CAVALI (Peru)

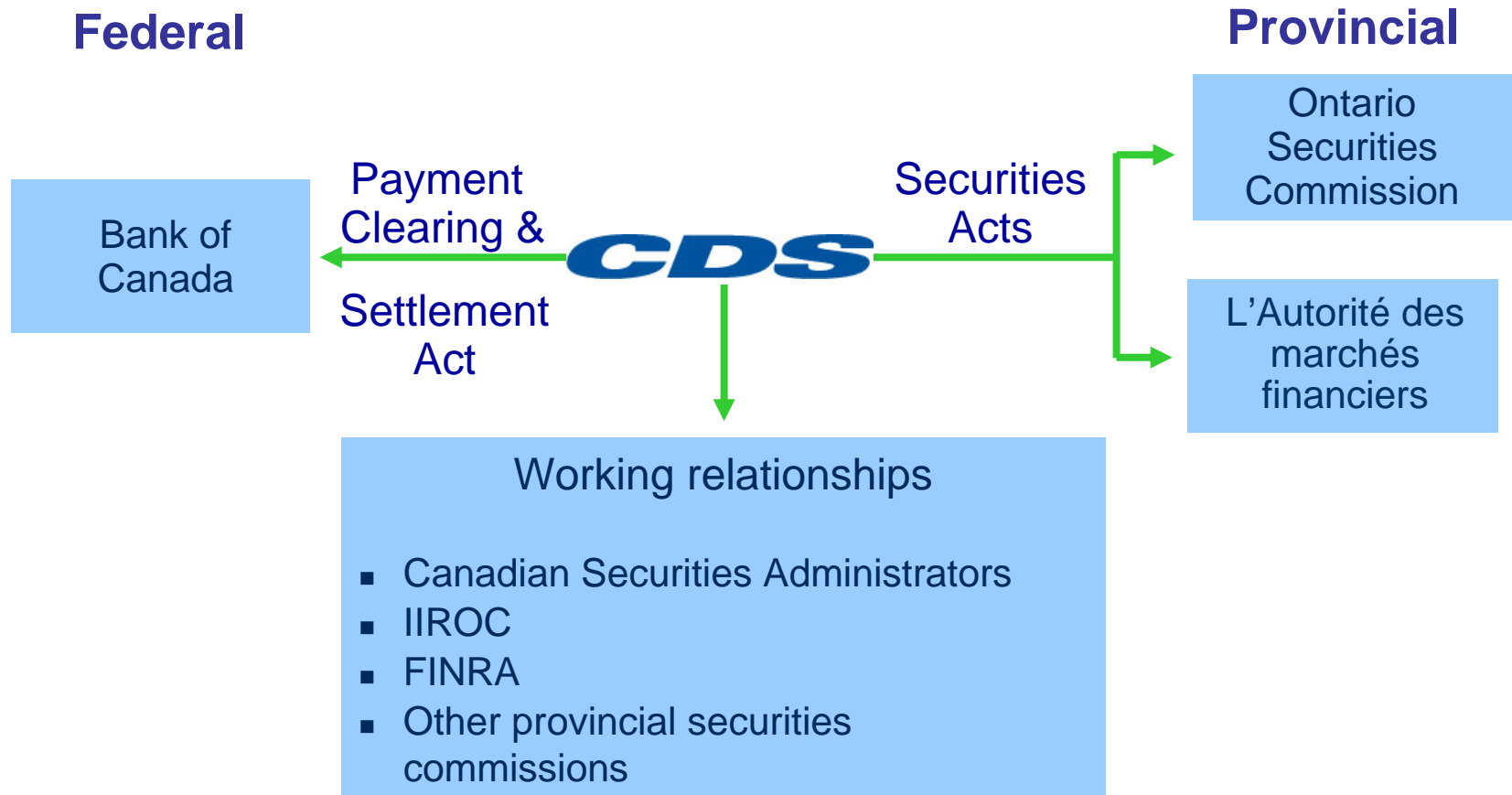
CDS participants and owners

- CDS is owned by six Schedule A banks, TSX and IIROC
- Offices in Toronto, Montreal, Calgary, Vancouver
- 98 participants



- Trust Companies
- Banks
- Transfer agent
- Others
- Investment dealers
- ATON Limited participants
- ACT Limited participants

CDS regulatory environment



CDS continues to meet world class standards

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Asset servicing risk	AA-
Operational risk	AA+
Financial risk	AA
Counterparty risk	AA
Liquidity risk	AA
Asset commitment risk	AA+
CDS overall rating	AA

AA Public Depository Rating (Thomas Murray) retained in 2009

Operational Risk:
AA → AA+ in 2008

“CDS remains one of the top rated CSDs in the world. The strength of CDS confirms the excellence of Canada’s capital market infrastructure.”

*~ Simon Thomas,
Thomas Murray*



THOMAS MURRAY

CDS Clearing and Depository Services Inc

Indirect securities holding system

- Canada uses an indirect securities holding system, also used in the U.S.
 - Issuers or their agents maintain the records of registered holders, including CDS's holdings
 - CDS maintains the records of its participants' holdings, with all holdings registered in CDS's nominee name (CDS & Co.)
 - Participants maintain the records of the holdings of their clients and beneficial holders

Steps to dematerialization

- **Immobilization**
 - CDS & Co. registered positions represented by certificated securities held at CDS
- **Non-certificated inventory (NCI) securities**
 - CDS & Co. registered positions represented by electronic records on security holders' register at issuer or transfer agent; other positions may be certificated
- **Book entry only (BEO) securities**
 - 100% of security's issue held by CDS is registered in CDS & Co.; no certificates available outside CDS; may be global certificate or uncertificated
- **Uncertificated**
 - Term used in provincial Securities Transfer Acts (STA) to represent either NCI or BEO holdings
- **Dematerialization**
 - Company board or legislation determines that no certificates to be issued to represent company's securities

Progressing to dematerialization

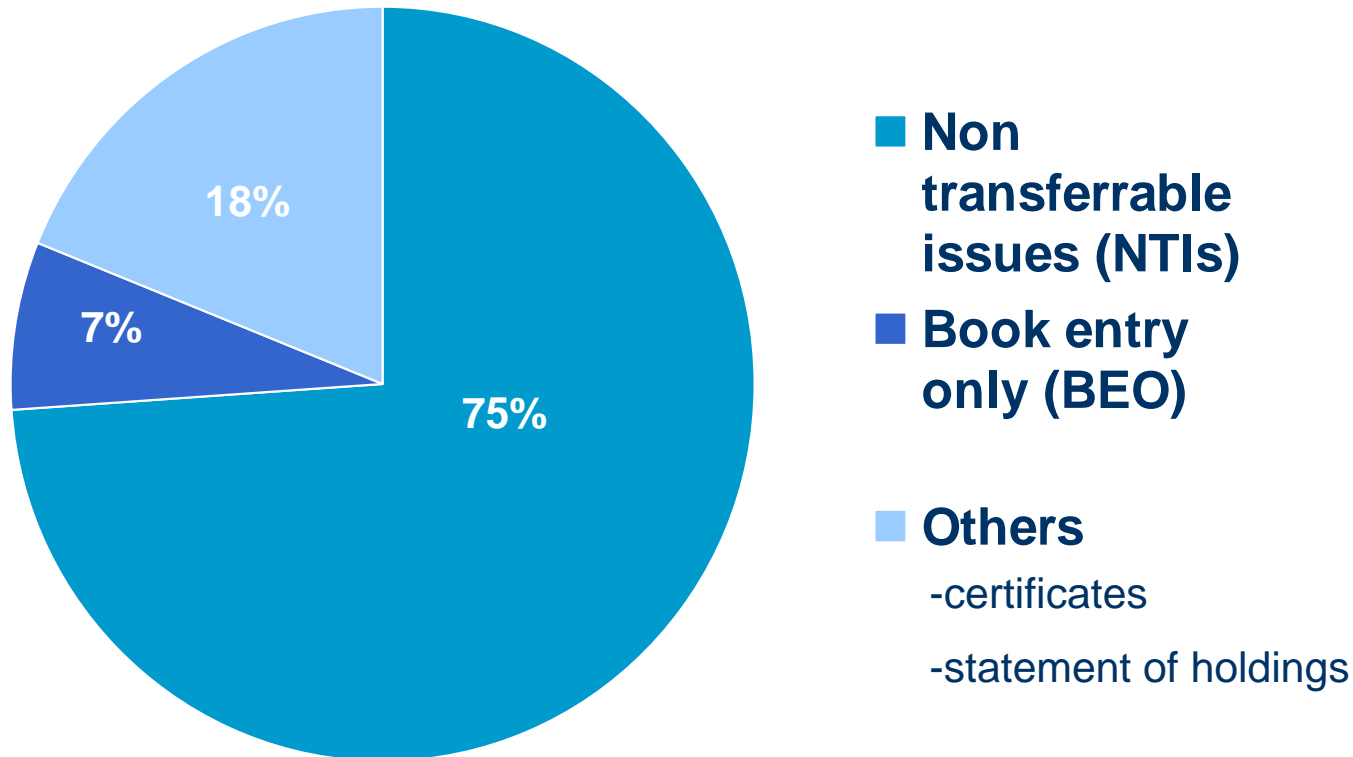
- Canada Bonds and T-bills are fully dematerialized
- Fully dematerialized countries:
 - Australia, Denmark, France, Japan, New Zealand, South Africa
- Countries initiating some form of dematerialization:
 - Belgium, India, Ireland, Italy, Netherlands, Norway, South Korea, Spain, Sweden, UK, Ukraine, USA

Legislation

- Provincial Securities Transfer Acts have been adopted by all jurisdictions except the following:
 - New Brunswick passed, but not proclaimed
 - Nova Scotia is in the process of passing the act
 - P.E.I., Nunavut and Yukon Territories still to be done
- STA provides foundation for modern securities holding and transfer systems and recognizes that most securities are now uncertificated
- Federal government is considering amending legislation to conform with provincial STAs
- Recent amendments to Business Corporations Acts permit corporate boards to mandate dematerialization

Emptying CDS's vaults

As of July 31, 2009 CDS held 202,675 pieces of paper representing certificates:



Impediments to dematerialization

- Documentation, such as trust indentures, requiring certificates for debt issuance
- Reliance on paper for evidentiary purposes
- Related processes are typically certificate-based (i.e. issuer buy-backs and stock options)
- Resistance to change

Dematerialization initiatives

- Support electronic closings
- Advocate adoption of new trust indenture allowing uncertificated issuance
- Streamline processes for handling legends on restricted securities
- Remove requirements for certificates in securities processing functions (e.g. corporate actions, buy-backs, stock options)

Dematerialization initiatives

- Require electronic payment for entitlements
 - Effective November 2011 all entitlement payments paid to CDS must be in electronic form
- Amend CDS documentation to allow for conversion and future issuance of uncertificated or electronic holdings
- Review processes for private placement eligibility

Paper handling – it costs all of us!

- Few participants in the securities industry benefit from paper certificates (e.g. couriers, printers)
- Investors who report lost, stolen or fraudulent certificates and have to pay to replace the certificate
- Other costs are borne by issuers, brokers and financial intermediaries via:
 - custody and vault costs, audits, file maintenance
 - surety bonds
 - transporting physical certificates
 - loss replacements, clerical processing
- Education and co-operation are needed to change this outdated "tradition"

NTI Destruction Program

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NTI Destruction Program

- CDS implemented the software to enable the destruction of Non Transferable Issues (NTI) in June 2009
- The rule changes required to support this program are now undergoing regulatory review
- Issues that have been identified as NTI for 7 years are eligible for destruction (only equity issues will be destroyed – CDS currently only has 23 debt issues coded as NTI)
- Similar to DTC's program, except CDS's program is not driven by participants removing their positions
- Depository Acknowledgements are still available if a participant wishes to have their position removed

NTI Destruction Program

- All NTI issues will be scanned and the image of the certificate and any related documentation (PA, resolution, etc) is saved and maintained in the CDS inventory system. This provides the records required to balance the CDS ledger positions.
- Once an issue reaches the 7 year time period the certificates for that issue will be shredded, along with all related documentation. Shredding will be done using a commercial shredding company, with CDS staff present throughout the entire process

NTI Destruction Program

- As of July 2009 there were 6,362 NTI issues, with 150,212 certificates
- 2,500 PREM tickets (DTC's notice of a position removed), which are held in CDS's vaults, will be destroyed in 2009 to confirm all processes (the NTI Pilot)
- In 2010 1,695 issues, represented by 109,134 certificates, will be eligible for destruction. This represents 72% of the NTI inventory
- The remaining issues will be destroyed as they reach the 7 year criterion. It is expected that 95% of the certificates will be destroyed by 2014

NTI Destruction Program

- Initially CDS will only be destroying the issues that are already eligible in CDSX
- Prior to the 2010 destruction CDS will allow participants to deposit any of those issues into CDSX so that they can be included in the process
- Once the 2010 destruction takes place CDS will look at allowing participants to deposit issues that are currently not eligible so that the participants can remove those issues from their vaults. These deposit windows will be available prior to each year's destruction activity

NTI Destruction Program

- In the unlikely event that a NTI issue were to be reactivated, CDS will contact the issuer and advise them that our participants have positions in their issue. CDS will ask the issuer to advise the new transfer agent to provide replacement certificates or ideally, a NCI position in that issue
- If the transfer agent requires a bond of indemnity to replace the position, CDS has purchased an insurance policy that will enable them to provide that indemnity to the transfer agent
- Once the replacement certificates or position has been created CDS will credit the participant's ledger with the appropriate quantity

New Trust Indenture Wording

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Uncertificated debentures: Key concepts

- Trust indentures typically stipulate that, until the paper certificate is signed and delivered, the debenture is not duly issued or a binding obligation
- Certificates are used as evidence of ownership and are endorsed and given to the trustee to effect a transfer
- To advance dematerialization, concepts such as “certification” and “delivery” should be replaced
 - Only debentures that have been “authenticated” by the trustee will be enforceable.
- A sample trust indenture incorporating dematerialization concepts is posted on www.cds.ca

Uncertificated debentures: Key concepts

- Depository-related provisions
 - Payment to CDS to be in electronic form
 - Communications with CDS by electronic means
 - Debentures to be issued as book entry only debentures

- Reference documents
 - Sample trust indenture

BEO Securities Services Agreement

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BEO Securities Services Agreement

- Historically, Letter of Representations (LOR) sets out terms and conditions between CDS and issuers for deposit and continued eligibility of book-entry-only (BEO) securities at CDS, registered in CDS's nominee name.
- Other types of LOR include Blanket Letters of Representations and Memorandums of Understanding
- LORs allows CDS to replace lost or stolen certificates without a bond of indemnity

BEO Securities Services Agreement

- BEO Securities Services Agreement (BEO SSA) to replace Letter of Representations (LORs) to advance dematerialization
- BEO SSA will be composed of:
 - A short Agreement requiring signature by issuer and electronic delivery to CDS
 - Issuer Procedures incorporated by reference as part of the Agreement
 - BEO Acknowledgment, as part of the Procedures, for signature by issuer and electronic delivery to CDS for each deposit of a new issue
- Documents posted on www.cds.ca, as amended from time to time

BEO Securities Services Agreement

- BEO SSA and Issuer procedures:
 - Set out general provisions for making an issue eligible for deposit and use of BEO services at CDS
 - Like LORs, permits CDS to replace a lost or stolen certificate without a bond of indemnity
 - Eligible BEO securities now include uncertificated securities
 - CDS holdings can be evidenced by entries of a CDS recognized agent without any certificates being delivered to CDS
 - CDS recognized agent to provide daily closing balance confirmation of registered holdings in CDS Name
 - Securities represented by a global certificate may be converted to uncertificated issues
 - Requires electronic payment of entitlements in same-day final and irrevocable funds

BEO Securities Services Agreement

- Once signed, the BEO SSA replaces the LOR for all securities held at CDS
- Timing
 - July 1, 2009 – The new agreement became mandatory for all new issues; existing issues will also be covered by the BEO SSA

Registrar and Paying Agent Service

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Registrar and Paying Agent Service (RPA)

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- The RPA service will be offered through CDS Securities Management Solutions Inc. to issuers that appoint CDS Solutions as their registrar and paying agent
- Service will be targeted to issuers that are not using the services of a transfer agent
- All issues must be in book entry only (BEO) format
- Fees are applied to each issue, with reduced fees for uncertificated issues

Registrar and Paying Agent Service (RPA)

- The service includes the following:
 - The administration of participant holdings
 - Registrar reports
 - Participant holders of record
 - Confirmations of registered holdings for audit requests
 - A listing of issuer's total outstanding securities with CDS
 - Payment processing and distribution to participant holders
 - On request reports
 - Recording of exchanges, transfers and registrations of interests in the securities

Registrar and Paying Agent Service (RPA)

- The benefits to issuers are:
 - Significant cost savings through the elimination of certificated transfers, entitlement cheques and bank reconciliations
 - Cost effective access to CDS's efficient, secure electronic facilities to administer BEO issues
 - Making security reports available at discounted rates
 - Reduction in the operational and administration costs of registrar and payment obligations by centralizing these functions
 - Simplifying the process of corporate actions and entitlement payments
 - Timely and automated distribution of all BEO payments to CDS participant holders

Electronic Closings

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Electronic closings

- Closings usually still rely on issuance of one or more certificates for exchange between issuer's legal counsel and underwriter's legal counsel
- Exchange of payment typically done by wire transfer between closing parties' financial institutions
- Inefficient, risky and unnecessarily costly to still require certificate to be produced for exchange and then subsequently cancelled

Electronic closings

- CDSX functionality enables new issues to be closed in an electronic format
- All parties involved in the closing must agree to manage the process without involving a certificate
- The following graphics represents an example of the process that could be adopted to facilitate an electronic closing

Prior to closing date



The underwriter requests an ISIN from CDS and sets up the trades in CDSX for preliminary distribution

The underwriter's banking and selling group set up the secondary market trades with its counterparties

The underwriter processes a security deposit in CDSX for the quantity of the new issue

New issue closing



Issuer's transfer agent and legal counsel attend closing with the underwriter's legal counsel

Transfer agent confirms the deposit in CDSX as part of the closing process

Once the deposit is confirmed the trades that were entered into CDSX will be settled within the system, assuming that each buyer's funds are available for the settlement to occur

Using CDSX to settle funds

- The following describes a process that could be used to move the funds for a closing in CDSX, rather than via wire transfer. In order to use this process the issuer's banker must agree to be involved:

Prior to the closing

- The Issuer's bank enters a deposit request for the new issue security
- The issuer's bank enters a CDSX trade against the underwriter, where the quantity and value equal that of the new issue, with the trade's value date equal to closing date
- The underwriter confirms the trade

Using CDSX to settle funds

- At closing, after all other documentation is accepted:
 - The transfer agent/custodian or CDS, as a custodian, confirms the deposit
 - The trade between the bank and underwriter settles in real-time
 - The bank credits the Issuer's bank account based on monies received in CDSX
- ❖ The bank will settle their daily activity, including these funds, when CDS's payment exchange occurs. The funds settled at payment exchange are final and irrevocable funds.

Improved Distribution of Private Placements

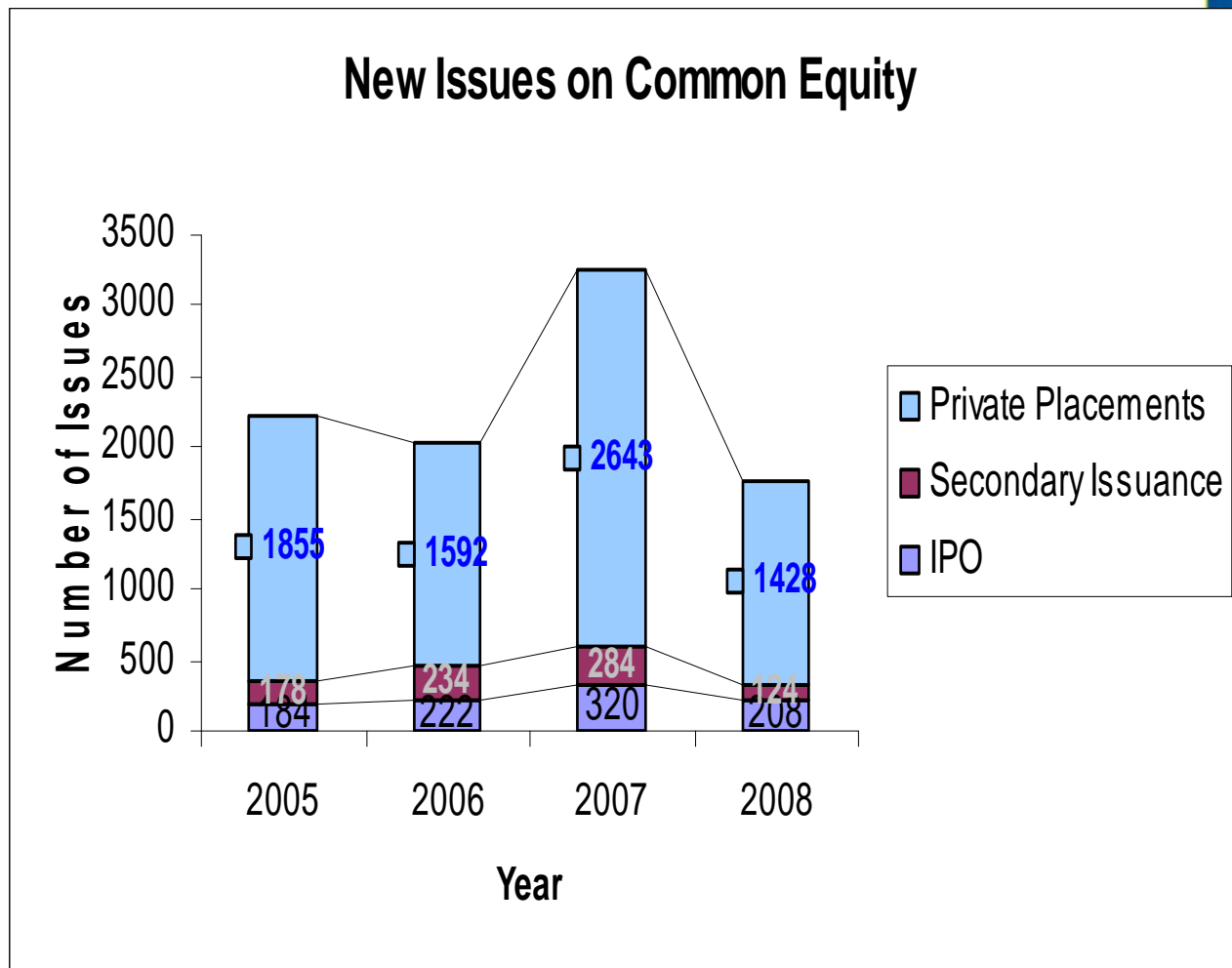
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Private placements

- More private placements than secondary issuance and IPOs year over year
 - In last four years, 7,518 common equity private placements were completed with total value of \$46 billion
- Only 152 private placement issues were presented to CDS for eligibility



Private placements

- Certificated issuance of private placements has high costs and risks
- Average number of certificates held in CDS participant vaults: 800 (for smaller firms) to 25,000 (for larger firms)



Private placements

- CDS participants have asked CDS to find ways to reduce certification and increase deposits of private placements in CDS
- CDS seeking to understand why private placement issues remain certificated and steps needed to achieve dematerialization
- CDS eligibility criteria allow deposits of private placements in depository

Eligibility criteria for private placements

Requirements to Make a Private Placement Eligible	Reporting Issuer	Non-Reporting Issuer
Apply online for ISIN through CDS Securities Management Solutions Inc (Available in April 2009)	Required	Required
Temporary ISIN assigned if there are freely trading shares	Required	Not Required
Attach necessary documentation regarding issue (Offering Memorandum, Subscriptions Agreement)	Required	Required
Book Entry Only/NCI	Required	Required
Register via recognized transfer agent (i.e. TA participant, signed TA Agreement or RPA)	Required	Required
Confirmation letter from the issuer on when the hold period should be lifted	Required	Required

Eligibility of private placements at CDS

- Upon confirmation that the eligibility criteria have been met, CDS will:
 - Distribute a CDS bulletin informing participants of the details of the private placement
 - Set up security in CDSX

Possible impediments

- Why are private placements not being made eligible in CDSX?
 - Lack of understanding of CDS eligibility criteria for private placements
 - Misconception that CDS will only make private placements of reporting issuers eligible
- Requirement by provincial regulators for written approval from issuers adds time and costs to the closing – As of September 28, 2009 issuers no longer are required to obtain regulatory approval to have their issue brought into CDSX

Possible impediments

- Lack of awareness of services provided by CDS to streamline issue closings by issuers, legal counsel and syndicate groups
- No definitive source for issuers, underwriters, syndicate groups that provides guidance on the most efficient methods of closing and distribution
- The belief that physical certificates provide issuers and transfer agents better control on trading restrictions and provide a cross guarantee at closings

CDS efforts to improve process

- Review eligibility criteria
- Promote the electronic closing process
- Promote CDS Registrar and Paying Agent service for issuers who do not use a transfer agent as a registrar
- Launch new subsidiary to provide online services for issuers (CDS Securities Management Solutions Inc.)
- Raise awareness of the benefits of going paperless and seek support among market participants, such as legal agents

Eligibility Fees

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Eligibility Fees

- CDS will be instituting a new fee that will be applied to all requests for the eligibility of an issue
 - Money market issues are not subject to this fee
 - A web-based process, similar to the new ISIN Issuance process, will be developed to automate the request and billing of the fees
 - The firm that requests the issue's eligibility will pay the fee
 - Non-participants will pay via credit card
 - CDS participants can choose to pay via credit card or have the fee billed to their monthly CDS invoice
 - The fee will be implemented on August 3, 2010

Eligibility Fees

- The fees are structured to encourage dematerialization and have been based on the relative value of the work that CDS undertakes on each format

Definitive certificates held by CDS	\$1,000
BEO Global certificates held by CDS	\$500
Uncertificated, no certificates held by CDS	\$0

- Issuers and their agents are encouraged to review their processes to determine if they can move to an NCI format for all new issues

CDS Contact Information

Fran Daly
Managing Director
Customer Service
416 365-8625
fdaly@cds.ca

Mike Polak
Director
Operations Support
416 365-3856
mpolak@cds.ca

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