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February 18, 2020

Wayne S.M. Ralph
Chief Operating Officer
CDS Clearing and Depository Services Inc.
100 Adelaide Street West
Toronto Ontario

Sent via email: wayne.ralph@tmx.com

Dear Wayne:

RE: Proposed Change to Eliminate Fee Rebates and Eliminate Network Connectivity Fees

The Investment Industry Association of Canada ("IIAC") appreciates this opportunity to submit comments on CDS Clearing and Depository Services Inc's ("CDS") proposal to eliminate fee rebates and network connectivity fees (the "Proposals"). IIAC members comprise approximately half of all CDS participants and are among the heaviest users of CDS services. Furthermore, IIAC members that are **not** participants of CDS will also potentially be impacted by the Proposals[1]. The IIAC has engaged with its members to obtain views on the Proposals and to better understand the industry impacts. We recognize, however, that each member will be affected differently (based on their usage of CDS services) and have, therefore, also encouraged members to submit comments directly to CDS.

While the IIAC appreciates the measures taken by CDS to present a palatable fee model for participants, we find CDS's plan to suspend fee rebates on a full and permanent basis tantamount to a fee increase by CDS and difficult to accept without additional information, considerations and analysis from CDS.

Background

In 2017 the TMX Group announced plans to implement a single, integrated technology platform for Canada's clearing and settlement businesses[2]. The platform, *TCS BaNCS for Market Infrastructure*, would replace the legacy systems deployed by CDS and CDCC. The original estimate for implementing the

[1] Dozens of IIAC Members are "introducing brokers" relying on a "carrying broker" to utilize the clearing, settlement and other services of CDS. It is unknow to the IIAC what impact the Proposal will have on the fee arrangements between introducing brokers and their carrying firm.
[2] See: *"TMX Group selects TCS BaNCS to Power Next Phase of Business Integration Initiative"*

technology was $55 - $60 million which was to be self-funded via annual savings in operating expenses accruing to CDS of between $6 -$8 million[3].

The complex nature of the project has contributed to management changes at CDS, a re-evaluation of the scope of the project and revisions to the estimated costs. CDS now projects the cost of replacing its CDSX mainframe and to modernize supporting systems at $120 to $135 million.

Given the new projected cost of CDS's technology initiative and TMX Group's desire to obtain a suitable rate of return from their investment in CDS, the Proposals seek to establish a funding model whereby the costs of implementing CDS's technology enhancements, as well as all future upkeep, be borne by the participants of CDS via the elimination of rebates.

General Comment

While we believe there will be benefits technology modernization brings, CDS has not sufficiently articulated those benefits to CDS participants. Members have commented that it remains unclear how they will be able to leverage the new CDS functionality, how it will help in their firm's daily operations or what potential new business opportunities the technology could present?

Members also expressed concerns with their unknown costs related to the new CDS platform. CDS has just recently started rolling out some of the business specifications for PTM which have alerted members to the possible need for internal/external development and testing. At a glance, the available business specifications also reveal that some existing functionality may no longer be supported by CDS which may entail further solutioning by some participants. In other words, our members would have preferred to evaluate the Proposals in the context of their expected overall CDS related costs.

As a general comment, therefore, CDS could have perhaps laid some better groundwork prior to release of the Proposals to help participants understand the full cost implications of PTM as well as the potential benefits. As it stands, asking participants to pay for this large initiative through the Proposals without participants fully knowing how they will benefit from the new functionality or what additional costs they might have to incur, has resulted in the Proposals being met with some resistance.

Comments and Concerns Related to the Proposals

Under the Proposals CDS plans to eliminate completely and indefinitely the rebates that are paid annually to participants and to also eliminate the Network Connectivity fees (comprised of "Port Fees" and "Network Fees") that participants pay to CDS to connect to CDS systems. In 2018 CDS paid out $10.1

[3] See TMX Update on Modernization of Clearing Platforms dated February 2019 and contained in Q4 2018 Management's Discussion and Analysis (page 6)

million in rebates while collecting $1.36 million in Port Fees and an additional $1.48 million in Network Fees. The Proposal, therefore, result in annual net savings of $7.3 million to CDS (based on 2018 data).

Our comments are as follows:

- CDS is proposing, in part, to eliminate fee rebates on a permanent basis so that it can fund ongoing future technology projects. We suspect that it is difficult for CDS to know at present what those future projects could be. However, it is also difficult for participants to blindly forego all future rebates so that they can help fund unknown projects at CDS which may not materialize, or which fail to deliver the level of value expected by participants.

  There is also concern that eliminating rebates to fund future technology projects would make it difficult to keep CDS accountable on how and where it spends participant resources. What governance framework would be put in place at CDS to evaluate the cost-benefit of future technology projects and what role would participants play in the process?

- It is our members understanding that the prices set by CDS for its service, as reflected in the CDS Price Schedule[4], already incorporate a budgeted amount for CDS projects and enhancements[5]. In other words, CDS's prices not only cover the cost for CDS to deliver the service but may also include a gross-up which CDS uses to reinvest in its systems while still earning a targeted rate of internal return. An elimination of rebates would duplicate the costs already paid on an ongoing basis by participants for CDS enhancements via the current pricing of CDS's services.

  Can CDS confirm whether its Price Schedule includes a budgeted amount for reinvestment in CDS systems. If so, what amount is that currently and how is this reflected in the Proposals?

- In December 2016 CDS received regulatory approval to amend fees relating to the management of Entitlement and Corporate Action Events (E&CA) and ISIN Issuance and CDS Eligibility Services (together the CDS Issuer Services)[6]. CDS articulated it required these additional revenues to replace its existing E&CA system and providing on-going systems maintenance. These ancillary revenues into CDS would also appear to duplicate CDS's rationale for eliminating fee rebates to fund future technology enhancements.

- Not reflected in the Proposals are the cost savings that will accrue to CDS from the PTM initiative. In its Proposals CDS states that its current Main Frame system is costly to maintain. Presumably, therefore, moving off the Main Frame will bring savings to CDS. Additionally, while CDS indicates

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[4] CDS 2019 Price Schedule available at https://www.cds.ca/resource/en/275/

[5] CDS's strategic development review committee (SDRC) determines, prioritizes and oversees CDS-related systems development and other changes. SDRC was historically allotted a set number of "development days" in a year which the IIAC understands were funded through CDS's budget.

[6] See Approval Notice here

that eliminating Network Fees will reduce CDS revenues by $1.48 million we also presume that moving participants onto other network providers reduces costs to CDS.

In its initial BaNCS proposal CDS estimated annualized cost savings of $6-8 million[7]. What are the expected cost savings to CDS from the current PTM initiative and how are these reflected in the Proposals and in the TMX's IRR calculations?

- There was a view expressed by members that the Proposals shift a disproportionate amount of the financial burden (and risk) of the PTM initiative on to CDS participants. Specifically, over the course of the useful life of the PTM project participants will have subsidized (via their lost rebates) the majority of the PTM development costs[8].

  We recognize that as a for-profit entity CDS must generate a return on investment. However, through the Proposals CDS will in effect be substantially off-loading the costs (and risks) of its capital projects onto participants. We believe the Recognition Orders were established, in part, to help achieve a proper balance among the interests of the owners of CDS and the participants. The Proposals should be evaluated in this light.

- Members expressed concern with giving up their rebates prior to implementation of the PTM technology. While we appreciate CDS's attempt to align the elimination of the rebates with the targeted PTM implementation date of Q1 2022 the risk of delay is always a possibility for projects of this nature and magnitude. Should implementation get delayed even a few short months (say to Q3 or Q4 of 2022) that would result in participants foregoing nearly two years' worth of rebates before they come to realize any of the potential benefits from the new technology at CDS.

- For some participants the dollar impact of the Proposals will be material. Specifically, some members commented that the elimination of the CDS rebate will directly impact their firm's staffing decisions as they look for ways to offset the additional costs of running their business.

  Conversely, other members commented they will have to bring in additional resources to help in evaluating the new requirements and overseeing the associated testing and development.

- We did not hear strong views from members with CDS's plans to eliminate Network Fees, however, members noted that such a move would not necessarily translate to cost savings for all CDS participants. While some participants already have their own connectivity into TMX facilities others do not and will, therefore, need to source their own network providers to connect to CDS.

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[7] Refer to footnote 3

[8] CDS estimates the PTM project to cost between $120 and $135 million and is expected to have a 10 to 15 year useful life

Conclusion

The IIAC understands the pivotal role filled by CDS in Canada's capital market infrastructure and supports initiatives aimed at improving the efficiency and resiliency of clearing and settlement in Canada. Our submission, however, raises several important questions and concerns by members with respect to the Proposals.

To encourage a more constructive discussion with participants we believe it helpful if CDS undertake efforts to better explain the deficiencies that exist currently with its technology, how the PTM initiative addresses those issues and how participants would benefit directly from their investment in CDS's new technology. Providing participants with further visibility on what additional resources they will have to devote to ingest the new technology would also be helpful.

Sincerely,

"Jack Rando"

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