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VIA EMAIL: comments@osc.gov.on.ca; consultation-en-cours@lautorite.qc.ca

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Ontario Securities Commission
Officer of the Superintendent of Securities, Newfoundland and Labrador
Officer of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

The Secretary
Ontario Securities Commission
20 Queen Street West, 22nd Floor
Toronto, ON M5H 3S8

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, rue du Square-Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3

Dear Sirs/Madams,

RE: Proposed Amendments to National Instrument 24-102 and Companion Policy 24-102

TMX Group Limited ("**TMX Group**") appreciates the opportunity to comment on proposed amendments to National Instrument 24-102 ("**NI 24-102**") and Companion Policy 24-102 ("**24-102CP**") published by the Canadian Securities Administrators (the "**CSA**") for public comment on October 18, 2018 (collectively, "**Proposed Amendments**"). In general, we are in agreement with the Proposed Amendments with the exception of two specific amendments which we strongly believe do not benefit clearing agencies or their regulators.

TMX Group

TMX Group is an integrated, multi-asset class exchange group. TMX Group's key subsidiaries operate cash and derivatives markets for multiple asset classes, including equities and fixed income, and provide clearing facilities, data driven solutions, and other services to domestic and global financial and energy markets. TMX Group's subsidiaries include The Canadian Depository for Securities Limited ("**CDS**") and Canadian Derivatives Clearing Corporation ("**CDCC**"), both recognized clearing agencies.

1) Provisions Related to Chief Risk Officer ("CRO") and Chief Compliance Officer ("CCO") Reporting Lines

The CSA proposes to make changes to subs. 4.3(1) of NI 24-102 to eliminate the permissive ability of the Board of Directors of a recognized clearing agency to elect that the CRO or CCO report directly to the Chief Executive Officer (rather than the Board of Directors). Currently, NI 24-102 permits the Board of Directors to delegate CRO and CCO direct reporting to the Chief Executive Officer of a clearing agency ("**Delegative Authority**"). It is our understanding that the proposed rule change would only eliminate Delegative Authority; it would not prohibit dual line reporting of the CRO or CCO positions to management and the Board of Directors. We note that a number of clearing agencies in North America and Europe permit dual line reporting for the CRO and CCO positions, and we believe this is beneficial to give flexibility of direct Board access while retaining administrative reporting lines to enable efficient and practical operation of business.

TMX Concern

Notwithstanding that the CRO of CDS and CDCC has direct dual reporting lines to both the President (who is the Chief Executive Officer) and the Chairperson of the Risk Committees[1] of those corporations, pursuant to their governance frameworks, we believe that the elimination of Delegative Authority is not required, particularly as regards to the CCO role, for the reasons described below.

The current framework in NI 24-102 includes the Delegative Authority, which places a positive obligation on the Board to determine if reporting should be to the Board, to the CEO/President, or both. The CDS and CDCC Boards are composed of a mix of stakeholder representatives as well as independent directors as prescribed by recognition order requirements. Both Boards are expressly mandated with a "public interest responsibility". The Boards have overall responsibility for risk management and compliance and are best placed to determine where the reporting lines for these roles should be, and if it so determines that risk management and compliance are sufficiently independent with reporting to the CEO, to permit that reporting. If, however, a Board determined that sufficient independence was not present in that structure (or if it wanted direct reporting for other reasons), then the Board would change the reporting.

We submit that under the current construct of NI 24-102, the CCO has sufficient access to the Board and appropriate independence from management by virtue of various direct reporting obligations that the CCO has to the Board. Subs. 4.3(3) of NI 24-102 prescribes direct reporting obligations on key matters such as becoming aware of any circumstance of non-compliance with securities legislation, non-compliance that creates risk of harm to participants, non-compliance that creates risk of harm to the broader financial system, non-compliance that is part of a pattern of non-compliance and becoming aware of a conflict of interest that creates a risk of harm to a participant or to capital markets. The CCO must also prepare and certify an annual report assessing compliance by the clearing agency, and individuals acting on its behalf, with securities legislation and submit the report to the Board. Such legislated interaction with the Board has the effect of ensuring that the CCO is engaged with the Board on key matters, and is engaged with the Board at least annually, in a manner that is independent of management. We would also note that other foreign clearing agencies and certain non-domestic clearing agencies that operate in Canada have governance structures that permit the CCO to report directly to management and not to the Board.

[1] "Risk Committees" means collectively, the Risk Management and Audit Committee of the Board of Directors of CDS and the Risk & Audit Committee of the Board of Directors of CDCC.

To the extent that the CSA believes that greater access to the Board and independence from the CEO is needed, we believe that this concern should be addressed through dialogue between individual clearing agencies and their regulators to discuss how this goal can be achieved through the clearing agency's own governance framework as opposed to prescriptive changes to subs. 4.3(1), which CPMI-IOSCO did not request and is not a PFMI requirement.

2) Provisions Related to Notification of "Security Incidents" and New Reporting Obligations

The Proposed Amendments include changes to certain notification and reporting obligations for "Systems" and "Auxiliary Systems" as described below. We are concerned that the Proposed Amendments may have unintended consequences in that they: (i) impose a quarterly reporting requirement of non-material events that, combined with the new definition of "security incident" will result in over-reporting that will be burdensome for clearing agencies and not useful for regulators; and (ii) introduce in 24-102CP a broad definition of "security incident" and references to "materiality" that raise confusion rather than clarity for clearing agencies, and may result in a notification regime that is unwieldy and uncertain for clearing agencies. We believe that through changes to the Proposed Amendments, particularly in 24-102CP, the CSA could introduce clearer language that would confirm that it should be the impact of the event on key business processes of the clearing agency that should determine the notification process and any subsequent reporting.

Notification Requirement

Currently para. 4.6(c) of NI 24-102 requires clearing agencies to notify regulators of "any material systems failure, malfunction, delay or security breach." The CSA proposes to change this notification requirement to capture "any systems failure, malfunction, delay or security incident that is material". At the centre of this change is the concept of "security breach" which has been broadened to "security incident". The main challenge related to this proposed change is the language in para 4.6(1)(c) of 24-102CP which creates confusion, and, in our view, gives guidance on the meaning of "material" that is inappropriate and will lead to unintended consequences for clearing agency regulatory reporting. The 24-102CP drafting challenges include: a description of "material" based on internal clearing agency reporting activities rather than the impact of the event; a statement that non-material events may become material events if they recur or have a cumulative effect; and new language which captures events that "potentially" jeopardize the confidentiality, integrity or availability of an information system, and are material. While we expect that the purpose of the Proposed Amendments in 24-102CP is to provide clarity, we are concerned that the Proposed Amendments will in fact have the unintended consequences of adding confusion and will result in clearing agencies focussing inappropriately on events that are not impactful.

Reporting Obligation

The CSA proposes to add new subs. 4.6(2) of NI 24-102 which will require clearing agencies to provide a log and summary description of <u>any</u> system failure, malfunction, delay or security incident and reasons why the clearing agency assessed the system failure, malfunction, delay or security incident to be not material, on a quarterly basis. The Proposed Amendments, if enacted, would impose a new mandatory regulatory reporting obligation related to <u>all</u> events regardless of materiality, even where there is no impact to external stakeholders and no impact to clearing agency business processes.

TMX Concern

Our interpretation of these changes is that the definition of "security incident" is significantly broader in scope than the current "security breach" definition and that the guidance on materiality in the Companion Policy is unwieldly and creates uncertainty for clearing agencies. This will impact clearing agencies by significantly increasing their notification and reporting obligations with, in our view, marginal benefit to regulators. It will also impact clearing agencies by perpetually leaving open the possibility that a non-material recurring incident could at any point become material without offering guidance to clearing agencies to understand the circumstances in which such a conversion could occur. How many times would the incident have to recur and would it be appropriate for a non-material recurring incident to become material if it had little to no impact to systems or auxiliary systems? Our expectation is that the vast majority of security incidents that will be captured by the new reporting requirements will be low severity incidents of warning or informational value including false-positive events such as log-in errors or inappropriate website visits. An unintended consequence of the Proposed Amendments therefore will be the over-reporting of low level severity incidents that do not impact key business processes. Imposing additional burden on regulated entities without commensurate benefit to regulators and to the industry is a poor outcome, and is inconsistent with work being done by a number of CSA members to reduce unnecessary regulatory burden.

We believe that clearing agencies have the best perspective to understand and manage their operational risks. We observe that other financial regulators and financial institutions in Canada have a similar view. CDS and CDCC have established processes in place to intercept, assess and manage threats and vulnerabilities to systems and auxiliary systems. CDS and CDCC's focus for incident management is the impact that an event may have on the clearing agencies' ability to perform their key business processes. This approach helps better distinguish meaningful events from near misses, and more accurately gauges how severely a system may be compromised. We are concerned that proposed changes to para. 4.6(1)(c) of NI 24-102 related to "security incident" and the new reporting of non-material "security incidents" and para. 4.6(1)(c) of 24-102CP that expands the former "security breach" to *potential* security incidents, without including any reference to the impact of the event, will undermine our impact-based methodology used to determine the severity of incidents, which CDS and CDCC believe to be a suitable method for clearing agency incident management.

We note that CDS and CDCC currently have robust notification requirements in their recognition orders that are written so as to cover not only actual events or occurrences but also those that could reasonably be expected to cause significant risk or potential disruption (i.e. have a meaningful impact) to the clearing agency, its participants, its services or Canadian financial markets, for example:

> "[CDS] shall immediately notify the Commission of any event or occurrence that has caused or could reasonably be expected to cause a significant risk to; an adverse material effect on; or a significant or potential disruption to [CDS], its participants, any of its services or the Canadian financial markets, including but not limited to, a participant default; fraudulent activity; or a significant breach of [CDS] rules by its participant(s)." (s. 2.1, Appendix "E" to the OSC Recognition Order).

CDCC has substantially similar immediate notification requirements in its recognition order.

We believe that the language in these recognition orders is appropriately focused on the impact that an event could have on the clearing agency and its participants. We would be pleased to work with the CSA to revise the wording in the Proposed Amendments related to “security incident” and the definition of “material”, to ensure that CDS and CDCC’s focus for incident management can continue to be appropriately directed at the incidents that could have a material impact on key business processes. We would like to discuss with the CSA, the use by CDS and CDCC of an impact-driven incident reporting methodology that we believe would provide our regulators with the most relevant information in the most efficient manner for both regulators and clearing agencies. If we were to agree on the components of the impact-driven incident reporting methodology, we could then collaboratively review with the CSA the Proposed Amendments, and remove any language that causes confusion or that could have the unintended consequence of importing unnecessary regulatory burden into the clearing agency oversight regime.

We would be pleased to discuss these comments in further detail with the CSA, including discussing the merits of an impact-driven regulatory reporting methodology for clearing agencies.

Sincerely,

Deanna Dobrowsky
Vice President, Regulatory