

**13.1.3 CDS Application re Restructuring of The Canadian Depository for Securities Limited**

Cindy Petlock  
Manager, Market Regulation  
Ontario Securities Commission  
20 Queen Street West, Suite 800  
Toronto, Ontario  
M5H 3S8

August 30, 2006

Dear Ms. Petlock:

**Re: Restructuring of The Canadian Depository for Securities Limited ("CDS Ltd.")**

In connection with the proposed restructuring of CDS Ltd., targeted for completion on November 1, 2006, CDS Ltd. hereby makes application to the Ontario Securities Commission ("Commission") for an order of the Commission pursuant to section 144 of the Ontario Securities Act amending the existing recognition order of CDS Ltd. to reflect the new status of CDS Ltd. as the holding company of, *inter alia*, CDS Clearing and Depository Services Inc. and to recognize CDS Clearing and Depository Services Inc. as a clearing agency pursuant to section 21.2(1) of the Ontario Securities Act and designate CDS Clearing and Depository Services Inc. as a recognized clearing agency pursuant to Part VI of the Ontario Business Corporations Act.

**A. Background**

CDS Ltd. currently performs all securities clearing, settlement and depository services ("Settlement Services") for the cash market in Canada. CDS Ltd. has one wholly owned subsidiary, CDS Inc. that currently operates the NRD, SEDI and SEDAR services (referred to as the "e-Reg Services") and a range of other services primarily related to data dissemination but also including ancillary services to the Settlement Services. CDS Ltd. is proposing to restructure its corporate composition.

Under the proposed restructuring, CDS Ltd. will be transformed into a holding company with three wholly-owned operating subsidiaries: (1) CDS Clearing and Depository Services Inc. ("CDS Clearing"), (2) CDS Inc. [in new capacity providing only e-Reg Services] ("E-Reg"), and (3) CDS Innovations Inc. ("Innovations").

The proposed restructuring of CDS Ltd. is intended to position the CDS group of companies as a flexible business organization while isolating and containing any risks arising out of the various independent business activities. The proposed restructuring will also facilitate focused regulatory oversight on the clearing agency activities.

CDS Clearing will assume responsibility for all of the existing Settlement Services. All necessary assets and liabilities will be transferred from CDS Ltd. to CDS Clearing to allow for the proper functioning of the Settlement Services. The Commission is also requested to recognize and designate CDS Clearing as a clearing agency.

E-Reg will operate only the e-Reg Services. All other services presently being operated in CDS Inc. will be transferred either to CDS Clearing or Innovations.

It is intended that, over time, Innovations will provide a range of services. Initially, Innovations will concentrate on the data dissemination business that was previously operated out of CDS Inc. (e.g., SCRIBE, SIES Bulletins [i.e. enhanced bulletins providing corporate event information] and CUSIP services).

As E-Reg and Innovations will not provide any Settlement Services, it is proposed they not be subject to the recognition and designation order.

The holdings of common shares in the parent company, CDS Ltd., will not be changed by the proposed restructuring.

Until such time as the outstanding corporate governance issues are resolved, CDS Ltd. will maintain its current board structure and the existing arrangements with its shareholders including any pooling agreement(s) between its shareholders. The resolution of the corporate governance issues are considered to be a separate initiative and are not considered to be a prerequisite to the completion of the corporate restructuring exercise.

The responsibilities of the CDS Ltd. Board will be to govern the affairs of CDS Ltd. as an owner of three wholly-owned, separate and independent subsidiaries.

Separate management teams will be responsible for the day-to-day operations of each of the subsidiaries. CDS Ltd. will provide certain support functions to CDS Clearing. These functions include information technology development, maintenance and

operations, legal services, risk management, financial management and support, human resource functions, internal audit, facilities management, and executive governance and communications. Each support service will be governed by a services agreement between CDS Ltd. and CDS Clearing and will contain mutually agreed upon performance targets.

The businesses and service offerings, assets and resource allocation, regulatory oversight, corporate governance, rule and rule-making authority, and various other matters are addressed in more detail below.

## **B. Restructuring of CDS Ltd.**

### *Holding Company Structure*

As previously noted, CDS Ltd. proposes to restructure into a holding company with three independent subsidiaries. The primary purpose for the adoption of this structure is to avoid risk spill-over from one business to another. In particular, the restructuring is intended to segregate existing securities clearing, settlement and depository operations – which operate on a cost recovery basis – from profit-generating operations with a higher risk/reward profile than the CDS Clearing business model.

### *Regulatory Oversight*

CDS Ltd., in its new capacity as the holding entity for the three operating subsidiaries, proposes that regulatory oversight of its operations be limited to its interaction – by way of service agreements, guarantees, or other arrangement – with the operations of CDS Clearing. CDS Ltd. proposes amendments to the existing recognition and designation order to reflect the segregation of the independent businesses.

### *Ownership*

The proposed holding company structure for CDS Ltd. does not contemplate any change in ownership of CDS Ltd., and the process is intended to have no consequences in respect of the pooling agreement(s) made between CDS Ltd.'s owners.

### *Corporate Governance & the CDS Ltd. Board of Directors*

It is acknowledged that there are outstanding issues concerning the governance model currently in place for CDS Ltd. There are processes in effect to resolve these issues. However, for the purposes of implementing the proposed restructuring, CDS Ltd. proposes no changes to its existing governance model. It is proposed that the corporate governance and corporate restructuring exercises be handled separately with neither one being a prerequisite for the other. Consequently, the restructuring does not contemplate any changes at this time in the relationship that CDS Ltd. currently has with its shareholders. The responsibilities of the CDS Ltd. Board of Directors will be to govern the affairs of CDS Ltd. as the owner of three separate and independent operating companies.

### *Services offered by CDS Ltd. to the Operating Subsidiaries*

CDS Ltd. will provide all, or substantially all, of the support services required to operate the subsidiaries. The activities that are unique to each subsidiary will be managed and performed by staff directly assigned to each subsidiary company.

The support services that will be provided by CDS Ltd. to all of the subsidiary companies include the following:

- Administrative Services (including Facilities and Office Services, Design & Publishing Services, Communications and Linguistic Services);
- Executive Governance including the facilitation of strategic and operational committees dealing with the standardisation of policies and procedures across the entire group of companies;
- Financial Accounting and Reporting Services;
- Human Resources Services including Payroll Services;
- Internal Audit services;
- Legal and Corporate Secretarial Services;
- Risk Management Services for both financial and operational risk.

In terms of Information Technology ("IT") Services, CDS Ltd. will provide all IT Services for CDS Clearing and Innovations. CDS Inc. already has in place its own IT group and will continue to maintain this group. However, CDS Ltd. will continue to provide certain IT infrastructure services to E-Reg (e.g., management of the Internet infrastructure, data centre space and facilities, etc.).

### *Services to be offered by Operating Subsidiaries*

The services currently offered by CDS Ltd. and its wholly owned subsidiary CDS Inc. are to be allocated according to the following principles post-restructuring:

1. Services offered to either full or limited participants in the CDSX system will be supplied and offered by CDS Clearing. These services comprise the Settlement Services and will be governed by the rules for the Settlement Services to which all participants must adhere.
2. Services offered and operated by CDS Inc. on behalf of the Canadian Securities Administrators – the *SEDAR*, *SEDI*, and *NRD* systems – will continue to be supplied and offered by E-Reg. These services will be governed by individual contracts in place between CDS Inc. and the CSA (and the IDA in the case of the *NRD* service).
3. Services offered to non-participants will be supplied by Innovations. These services will be governed by individual contracts between Innovations and the customer for the service. In the case that such services involve the provision of information or data originating from CDS Clearing, or E-Reg, service agreements and licenses for use will govern any such data or information transfer and any subsequent data dissemination.

**C. Recognition and Designation Order**

The recognition and designation order currently governing the operations of CDS Ltd. was originally obtained in 1997 and has been restated and varied to reflect subsequent events and changes. In order to ensure that CDS Ltd. would act in the public interest, the recognition and designation order contained a number of terms and conditions that CDS Ltd. was required to satisfy in order to maintain such recognition and designation.

In light of the restructuring, it is proposed that CDS Ltd. and CDS Clearing each be recognized and designated as a clearing agency. As CDS Ltd. will act in the capacity of a holding company and CDS Clearing will act as the operating subsidiary for the Settlement Services, separate terms and conditions should apply to each. CDS Ltd. and CDS Clearing will meet the terms and conditions as provided in the Recognition and Designation Order and outlined in the summary of Schedule A included below.

The draft recognition and designation order is attached hereto. The following is a discussion of the recognition and designation order including its terms and conditions as set out in Schedule A.

The recognition and designation order has been amended to reflect the following changes that will be the result of the restructuring of the operations of CDS Ltd.:

- recitals detailing the two orders made by the Commission between the issuance of the original 1997 Order and today;
- a recital detailing how CDS Clearing will assume the Settlement Services currently provided by CDS Ltd.;
- a recital stating that CDS Ltd. will provide certain support functions to Clearing;
- a recital indicating and acknowledging that the terms and conditions governing CDS Ltd. have been changed to reflect its new status as the sole owner of CDS Clearing rather than as the organization which operates the clearing system;
- a recital indicating and acknowledging that the terms and conditions governing CDS Clearing will be wholly similar to those which governed its predecessor in the role, CDS Ltd.;
- an amendment to reflect that the recognition and designation order of CDS Ltd. shall be continued under the proposed order;
- an amendment to reflect the recognition and designation of CDS Clearing as a recognized and designated clearing agency under the *Ontario Securities Act* and the *Ontario Business Corporations Act*.

**I. Schedule A to the Recognition and Designation Order**

**Compliance**

This new term and condition applies to CDS Ltd. by virtue of its control over the operating company providing the Settlement Services. CDS Ltd., as 100% owner of CDS Clearing, will be able to mandate that CDS Clearing meet and be able to meet all terms and conditions enumerated in Part II of Schedule A.

**Governance**

The terms and conditions for governance will apply to both CDS Ltd. and CDS Clearing (sections 2.0 and 10.0, respectively). Such terms and conditions are continued from the previous Recognition and Designation Order for CDS Ltd. The board of directors of CDS Clearing will mirror the board of directors of its parent company, CDS Ltd. and, as such, the governance structure will be identical.

**Fitness**

The term and condition for fitness will apply to both CDS Ltd. and CDS Clearing (sections 3.0 and 11.0, respectively). No changes have been made to the current process for fitness criteria and will be the same as under the previous Recognition and Designation Order for CDS Ltd.

**Access**

The terms and conditions for access shall no longer apply to CDS Ltd. inasmuch as CDS Ltd. will not be the company operating the Settlement Services. Such terms and conditions will apply to CDS Clearing. The processes for access currently applied by CDS Ltd. will be transferred to CDS Clearing.

**Fees and Costs**

The terms and conditions for fees and costs shall no longer apply to CDS Ltd. inasmuch as CDS Ltd. will not be the company operating the Settlement Services. Such terms and conditions will apply to CDS Clearing. The processes for fees and costs currently applied by CDS Ltd. will be transferred to CDS Clearing.

**Due Process**

The terms and conditions for due process shall no longer apply to CDS Ltd. inasmuch as CDS Ltd. will not be the company operating the Settlement Services. Such terms and conditions will apply to CDS Clearing. Due process as currently applied by CDS Ltd. will be transferred to CDS Clearing.

**Risk Controls**

Terms and conditions regarding risk controls shall continue in respect of Clearing, appropriately amended to acknowledge that CDS Clearing will only provide services that are governed by the participant rules. CDS Ltd. will be subject to appropriate risk control terms and conditions to prevent the spillover of risks from subsidiaries where such risks might negatively impact the financial viability of CDS Ltd. and/or CDS Clearing.

**Allocation of Costs**

This new term and condition provides that CDS Ltd. shall ensure that the costs associated with the provision of services to its subsidiaries are fairly and equitably allocated.

Costs that are dedicated to a subsidiary of CDS Ltd. are incurred directly by the subsidiary or are charged directly to the subsidiary. For services that are provided as shared services, CDS will have Shared Service Agreements between the CDS Ltd. and each of the subsidiaries. The cost for the shared services will be jointly agreed to by CDS Ltd. and each of the subsidiaries on an annual basis.

Services provided by CDS Ltd. that support all subsidiaries are charged to the subsidiaries using a Shared Service Cost Model. A Shared Service Cost Model has been developed by CDS Ltd. through discussion with the staff and management within each of the shared service units in CDS Ltd., and with the management of the subsidiaries by giving due recognition to the services and service support requirements of each of the subsidiaries. A fair and equitable charging for the shared services has been established by first reviewing and analyzing the costs to be charged to each subsidiary by the management of CDS Ltd. and subsequently a review and agreement with each subsidiary's management.

**Allocation of Resources**

This new term and condition provides that CDS Ltd. shall allocate sufficient financial and other resources to CDS Clearing and that CDS Ltd. will immediately advise the Commission in the event that this term and condition cannot be met. This term and condition previously applied to CDS Ltd. under the previous Recognition and Designation Order and shall apply to CDS Ltd. in its capacity as parent of CDS Clearing.

**Financial Viability**

The terms and conditions for financial viability will apply to both CDS Ltd. and CDS Clearing. (sections 7.0 and 16.0, respectively). It is proposed that for CDS Clearing, the financial leverage ratio exclude customers deposits from the calculation. The reason for this proposal is that customer deposits do not belong to the company and have the effect of distorting the calculation when included therein. Furthermore, it is proposed that the financial viability tests for CDS Ltd. shall be performed by CDS Ltd. on an unconsolidated basis.

**Operational Reliability**

Terms and conditions regarding operational reliability shall continue in respect of CDS Clearing, as appropriately amended for the provision of the results of an audit by CDS Ltd. to Commission staff as required by section 8.1(b).

### **Capacity and Integrity of Systems**

Terms and conditions regarding capacity and integrity of systems shall apply to both CDS Ltd. and CDS Clearing (sections 8.0 and 18.0, respectively). The processes in regards to capacity and integrity of systems has not changed from that employed by CDS Ltd. under the previous Recognition and Designation Order.

### **Protection of Customers' Securities**

Terms and conditions regarding protection of customers' securities shall continue in respect of CDS Clearing but shall no longer apply to CDS Ltd. in its role as a holding company. The processes for protection of customers' securities currently applied by CDS Ltd. will be transferred to CDS Clearing.

### **Rules**

Terms and conditions regarding rules shall continue in respect of CDS Clearing but shall no longer apply to CDS Ltd. in its role as a holding company. The processes for rules currently applied by CDS Ltd. will be transferred to CDS Clearing.

### **Enforcement of Rules and Discipline**

Terms and conditions shall continue in respect of CDS Clearing but shall no longer apply to CDS Ltd. in its role as a holding company. The processes for enforcement of rules and discipline currently applied by CDS Ltd. will be transferred to CDS Clearing.

### **Information Sharing**

The terms and conditions for information sharing will apply to both CDS Ltd. and CDS Clearing (sections 9.0 and 22.0, respectively). The processes in place under the previous Recognition and Designation Order for CDS Ltd. have not changed and will apply to CDS Ltd. and CDS Clearing.

## **II. Appendices A and B to the Recognition and Designation Order**

Appendix A to the recognition and designation order has been amended to reflect the fact that CDS Clearing will be responsible for the submission of Rules to the Commission in accordance with the protocol set out therein.

Appendix B to the recognition and designation order has been amended to reflect the following:

- In cases where the reporting obligation described relates to the operations of CDS Clearing and is reasonably the obligation of the clearing agency, the text of Appendix B has been so amended.
- In cases where the reporting obligation described relates to the operations of both CDS Ltd. and CDS Clearing the text of Appendix B has been so amended.
- Section 1.2 (of the section entitled Prior Notification) has been inserted to reflect that the activities or business operations of the other operating subsidiaries of CDS Ltd., excluding CDS Clearing, do not fall within the scope of notification requirements.

Sincerely,

"Toomas Marley"

Toomas Marley  
Chief Legal Officer  
CDS Ltd.