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February 18, 2020

Wayne S. M. Ralph
Chief Operating Officer
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RE: OSC Staff Notice of Request for Comment - Proposed Significant Change to Eliminate CDS Fee Rebates and Proposed Amendments to Eliminate Network Connectivity Fees.

Dear Mr. Ralph,

Fidelity Clearing Canada ULC ("FCC") appreciates being provided with the opportunity to comment on the proposals by CDS Depository and Clearing Services Inc. ("CDS") to eliminate its fee rebates and network connectivity fees.

Since 2009, FCC has provided trade execution, clearing, custody and back office support services to brokerage firms based in Canada. It is one of a small number of Canadian carrying brokers serving investment dealers and portfolio managers in the Canadian market.

<u>Proposed Significant Change to Eliminate CDS Fee Rebates</u>

Removal of rebates tantamount to a fee increase

FCC does not support the proposed significant change to eliminate the 50/50 Rebates and the Additional Rebates that CDS currently offers its participants (collectively, the 50/50 Rebates and the Additional Rebates are referred to as the "Rebates"). We expect that the elimination of the Rebates will effectively result in FCC paying an additional 20% annually in CDS fees, which will have a negative and unfair financial impact on FCC. This is a substantial fee increase being imposed over a very short period of time and the only two viable options open to FCC are to absorb the considerable fee increase itself or to pass some or all of the fee increase on to its customers. Part of FCC's customer base is comprised of smaller firms and firms that have newly entered the market; these types of firms may not be able to withstand such a significant fee increase and may be required to exit the market. This is of grave concern given the number of IIROC members has been steadily decreasing in recent years. Accordingly, we submit that the elimination of the Rebates may act as an unreasonable, if not insurmountable, barrier to access, which is inconsistent with the CDS recognition order (the "Recognition Order").

Given its role as a carrying broker, FCC has a high level of activity at CDS. Due to the progressive methodology employed by CDS, FCC believes that it will be unfairly burdened by the elimination of the Rebates. As acknowledged by CDS, the impact of the elimination of the Rebates is highly concentrated with the 23 participants that comprise the "Greater Fees Segment". In the Notice of Request for Comment, CDS points out that the Greater Fees Segment is comprised principally of Schedule 1 banks, large domestic dealers, and participants providing correspondent clearing services, presumably because these types of large organizations can more easily bear the costs of the Rebate elimination. However, organizations in the Greater Fees Segment will also likely need to pass the cost of the Rebate elimination along to their customers. As mentioned above, in the case of FCC, many of these customers are smaller firms and new entrants.

Some of the CDS participants in the Greater Fees Segment are affiliated with the Maple Group Acquisition Corporation ("Maple Group") or 8090599 Canada Inc. For these participants, the impact of the elimination of the Rebates is likely to be neutral or much less significant due to their share ownership in the TMX. However, FCC and other CDS participants not affiliated with the Maple Group or 8090599 Canada Inc. shall fully bear the negative impact of the elimination of the Rebates without the opportunity to participate in any upside the TMX garners through the proposals.

Costs associated with CDSX replacement foreseeable

In FCC's view, eliminating the Rebates to offset the cost of the Post-Trade Modernization Project (the "PTMP") to allow the TMX to meet their minimum expected internal rate of return ("IRR") for the CDS business and fund CDS' ongoing future technology upgrades is an inappropriate use of these funds. As part of the due diligence exercised at the time of the acquisition of CDS, the Maple Group ought to have known that CDSX and its supporting systems would need to be replaced. We believe that it was entirely foreseeable, based on the cost of replacing SSS/BBS with CDSX in 2000 (i.e. $70M) that the estimated cost of replacing CDSX and the modernization of its supporting systems in 2022 would exceed $120 million. FCC believes it is unfair to ask CDS participants to bear any costs arising from any faulty estimates/assumptions/projections specified in the Notice of Request for Comment.

During 2018 and 2019, FCC and other CDS participants expended significant resources, in terms of both time and money, to assist CDS in determining business requirements for the PTMP. CDS largely discarded or ignored the input provided by CDS participants to-date. From 2020 through to PTMP implementation, CDS participants will need to expend further considerable resources to support the implementation of this project. We believe that the resources expended during the discovery phase and the implementation phase of the PTMP should be the extent of the costs imposed on CDS participants; they should not also have to bear what are effectively targeted fee increases.

Benefits of modernization to CDS participants unclear

Based on the information that has been provided to date, it is unclear to FCC how the replacement of the CDSX mainframe and the modernization of its supporting systems will be of benefit to FCC and other CDS participants. The current CDS system is very reliable and FCC finds value in a number of CDS' current products and services that are being discontinued under the proposals.

While we appreciate a general argument can be made to the benefits of technology modernization, CDS has not sufficiently articulated the benefits that will accrue to CDS participants from this particular investment. FCC requests that CDS outline specifically the value proposition for CDS participants resulting from CDS "*moving to a modern, scalable, reliable and* *more flexible technology platform*" and confirm in detail the deficiencies that exist in its current technology.

Elimination of Rebates may be inconsistent with Recognition Order

While CDS now operates on a for profit rather than a cost recovery basis, it largely remains a monopoly and as such, FCC believes that the checks and balances imposed by the Recognition Order relative to fees and rebates should be maintained.

As mentioned above, the elimination of the Rebates effectively results in a fee increase for many CDS participants, which may be inconsistent with, or even contrary to, the Recognition Order. We understand that the intention of the Recognition Order was, in part, to protect CDS participants not affiliated with the Maple Group or 8090599 Canada Inc. from unfair fee increases. In addition, in our view, the elimination of the Rebates may be inconsistent with the following sections of the Recognition Order:

- **SCHEDULE A - PART 2 - FEES** & **SCHEDULE B - PART II - 7 - FEES, FEE MODELS AND INCENTIVES**: As discussed above in greater detail above, FCC submits that the elimination of the Rebates may have the effect of creating unreasonable barriers to access.
- **APPENDIX B - FEE AND REBATE MODEL APPROVED BY THE COMMISSION:** The elimination of the Rebates may further be inconsistent with the terms of the Fee and Rebate Model set out in this Appendix to the Recognition Order. Further, paragraph 2 of this Appendix stipulates that the Maple Group shall not seek approval for fee increases on clearing and other core services unless there is a significant change from current circumstances. We submit (as discussed above) that errors in the Maple Group's due diligence process do not amount to a change in circumstances.

Furthermore, as a subsidiary of the TMX Group Limited, alternative and more appropriate mechanisms are available to CDS to raise capital to fund initiatives of this nature.

<u>Proposed Amendments to Eliminate Network Connectivity Fees</u>

FCC does not support the proposed amendments to eliminate network connectivity fees.

Network Fees

In 2020, CDS proposes to initiate a "cut over" from the CDS managed network to the participants' networks and to cease charging Network Fees to a participant once the transfer of network connectivity management from CDS to the participant is complete (the "Network Fees Proposal"). In FCC's view, the Network Fees Proposal is of questionable value to CDS participants. The Network Fees Proposal does not actually eliminate the costs of network connectivity management but instead transfers the responsibility along with the related costs and risks from CDS to its participants. Such a transfer of responsibility will negatively impact those CDS participants that have limited information technology infrastructures. In addition, the Network Fees Proposal may be inconsistent with Part 7 of Schedule "A" to the Recognition Order, which requires that CDS develop and maintain "*adequate information technology general controls, including controls relating to… network support*….".

To conclude, FCC does not support the current CDS proposal to eliminate fee rebates and network connectivity fees and has grave concerns that the implementation of such without a more detailed review including a cost/benefit analysis and determination that this proposal is consistent with the Recognition Order.

We would be happy to discuss our comments with you on the proposals by CDS to eliminate their Rebates and network connectivity fees.

Yours truly,

Bryan Moffitt
Chief Operating Officer

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