The Bank of Nova Scotia
Global Equity
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and

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Via Email

Re: Request for Comments – Revised Proposal to Eliminate Fee Rebate Model, Eliminate Network Connectivity fees, and Eliminate Report File Transmission Fees

Scotia Capital Inc. and The Bank of Nova Scotia (collectively "Scotiabank") thank you for the opportunity to provide comments on the revised proposal submitted by CDS Clearing and Depository Services Inc. (CDS) to permanently eliminate the "50/50 Rebate" and the "Additional Rebate" currently provided to participants. As one of the largest users of CDS, elimination of these rebates will have significant financial impact to Scotiabank.

Background

We understand the origin of both rebates as being a compensatory measure introduced as part of the Maple Group acquisition of CDS in 2012. With CDS transitioning from a mutual utility to a for-profit entity, the rebates serve to give the stakeholders – the dealer community – some continuing economic benefit to compensate for loss of mutual control over CDS by way of the Maple transaction. These rebates allow the dealer community to recover some of the incremental clearing costs that come with the growth of Canada's capital markets.

The rebate structure is a critical counterbalancing factor to the CDS structure, as CDS is both a for-profit entity and a crucial utility without which the securities dealers are unable to function. Indeed, we

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believe that the dealer community is a captive consumer of CDS's service, and the fee structure should be governed with this principle firmly in mind.

We view the current proposal, as well that which was filed previously, as a significant regression of the economic balance currently in place between CDS and the dealer community.

Post Trade Modernization ("PTM")

At the inception of the PTM project, the original understanding was that the PTM project cost would be fully funded by CDS. We assumed that PTM would eventually pay for itself by providing savings and efficiencies to TMX Group. As the cost of the project grew from the original estimate of approximately $50mm to the current estimate of $120mm-$135mm, CDS is now looking to participants to cover the overrun. While we appreciate that the PTM platform will have some operational benefits to CDS participants, we are unable to fully understand why the cost of PTM should be substantially (or entirely) borne by participants through the permanent elimination of the annual rebates.

CDS's own estimates of the financial impact of the elimination of rebates is on the order of $10mm annually, on the assumption that the foregone 50/50 Rebate amount does not grow over time (an assumption we disagree with). The PTM initiative is expected to have a useful life of up to 15 years, and cost $120-$135mm. At current long-term risk-free yields of roughly 2%, this represents a present value of $130mm from the rebate portion alone. A similar analysis using TMX Group debt with the nearest maturity (2031) results in a present value of $126mm. Using CDS's estimates of costs to the Street inclusive of the elimination of network charges and some file delivery fees (which we believe are misleading and discussed below) represents a present value of $91-94mm. We therefore conclude that fee package proposed pays for most or all of the PTM initiative's price tag.

We must point out that this arrangement also leaves CDS with several areas of upside:

- Cost efficiencies through the decommissioning of older technologies
- Potential extension of useful life beyond the currently-forecast 15 years – at which point the savings offered would remain, to the benefit of CDS.
- Potential increase in the value of rebate foregone by the Street through the increase in trading volume

The latter source of revenue is significant, as the value of the rebate has grown at a CAGR of 19.6% between 2015 and 2019 based on CDS's audited financial reports. This growth would be applied to the 50/50 Rebate only (as the Additional Rebate is capped at $4mm).

If we assume a modest compound annual growth rate for the 50/50 Rebate of 10% for the 15-year life of PTM, a growth rate far below that experienced over the past several years, and give CDS full value for

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the elimination of network & file delivery fees, we estimate the present value of this fee structure change to be between $170mm and $180mm today.

In short, CDS is expecting its captive customer base, the dealer community, to pay for the entirety of its technology upgrade while leaving the upside in the hands of CDS. We do not believe this is appropriate given CDS's utility function for the industry and the context in which the rebate structure was established.

CDS Network & Report Fees

We appreciate the concession made by CDS in the revised proposal to eliminate the cost of outbound file delivery in addition to the network charges. However, outbound file fees were expected to be reduced significantly with PTM, as participants would be required to access and export their data to create the reports they need. In other words, participants would be economically incentivized to save this cost directly by taking advantage of the features of PTM. Further, only charges for files delivered via SFTP are being eliminated and all remaining outbound file charges will remain in place, greatly diminishing the value of this concession.

CDS is also asking participants to assume responsibility for their own network connections. This typically involves the services of external vendors, at a cost that would be borne by the participants. The savings gained form the elimination of CDS network charges would therefore be offset by fees paid to another network service provider. CDS's claim that this is a savings is a simplification: the cost is simply being borne elsewhere.

Additionally, we believe there are further costs. Based on the information provided, it appears that the new PTM platform would require participants to implement several technology changes (at a cost to participants) in order to gain all the efficiencies that the PTM project is intending to deliver. This includes managing our own connectivity as well as the archiving of reports currently available for 7-10 years, but which will only be available for one year post implementation. None of these additional costs are included in CDS's analysis of savings offered to the Street.

An analysis of the revised proposal, based on 2020 data, indicates that Scotiabank would incur additional costs totaling approximately 82% of the value of the ancillary fees proposed to be eliminated. We conclude that CDS's estimate of savings from the elimination of network & file delivery charges are overstated.

Concluding Remarks

Given the above, we would ask that CDS reconsider the plan to permanently eliminate the participants' share of the 50/50 Rebate, as well as the Additional Rebate. We believe these structures remain as appropriate today as they were at the time of the Maple transaction in 2012. We also do not believe it

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is appropriate for CDS, a for-profit entity, to ask its customer base to shoulder the burden of a technology upgrade while leaving all economic upside with CDS and TMX Group.

We further request that the Ontario Securities Commission, in its role as the recognizing regulatory authority for CDS and pursuant to paragraph 7.6 of the CDS recognition order, deny this application by CDS.

Sincerely,

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