CDS Clearing and Depository Services Inc. (CDS®)

Proposed Amendments to CDS Fee Schedule re New York Link/DTC Direct Link Services

NOTICE AND REQUEST FOR COMMENT

DESCRIPTION OF THE SERVICE AND PROPOSED AMENDMENTS TO FEE SCHEDULE

CDS proposes to amend its Fee Schedule for certain services which have been, and are currently, provided to CDS Participants. As a recognized clearing agency under the Ontario Securities Act and the British Columbia Securities Act, and a recognized clearing house under the Quebec Securities Act, CDS is providing this Notice and Request for Comment in accordance with the recognition requirements of each of these jurisdictions. CDS is requesting regulatory approval to segregate our current Depository Trust and Clearing Corporation (DTCC) Mark-up and New York and DTC Direct Link Liquidity Premium fee mark-up fee of 22.30% from one aggregated rate to two independent components. The first component is the sponsorship service fee of 14%. The second component is the pass through charge of direct liquidity facility costs.

The Services enable CDS Participants to clear and settle over-the-counter (OTC) trades with broker dealers in the United States via The National Securities Clearing Corporation ("NSCC"). The Services also gives Participants access to custodial and settlement services offered by The Depository Trust Company ("DTC") and eliminate the need for CDS Participants to maintain a U.S. presence for that purpose. While they can handle trade-for-trade transactions, the Services execute the majority of transactions on a continuous net settlement ("CNS") basis.

CDS sponsors Participants who use the Services as members in NSCC and DTC, an arrangement that entitles them to the privileges of direct membership in both organizations. As the sponsor, CDS is exposed to settlement obligations due to activities in its sponsored sub-accounts who use the Services and as such, CDS currently maintains a liquidity facility of US$720 million to reduce the likelihood of CDS being required to adjust credits to surviving members of the services. The current DTCC Mark-Up fee applied on CDS sponsored Participants DTCC invoices covers the service cost, the operational risk of service delivery, and direct costs of maintaining a liquidity facility.

Based on the discussions with our lenders for the upcoming liquidity facility renewal, we expect the combined commitment fee and standby fee to increase from total of 23.5bps to 27 bps effective March 231, 2021. As a result, CDS proposes to charge a 14% flat fee for the sponsorship service and operational risk of service delivery, and treat the direct liquidity facility costs as pass through charges and simplify the process of passing on direct liquidity facility costs whenever there is a change of facility size and/or cost The proposed fee change is based on the following guiding principles:

1. The Principles for Financial Market Infrastructures require that an FMI's default process be sufficiently robust to account for a wide range of potential stress scenarios that should include, but not be limited to, the default of the Participant and its affiliates that would generate the largest aggregate liquidity obligation for the FMI in extreme but plausible conditions and be diversified with a minimum of three liquidity providers.
2. The Principles for Financial Market Infrastructures requires that an FMI should effectively measure, monitor, and manage its liquidity risk. An FMI should maintain sufficient liquid resources in all relevant currencies to effect same-day and, where appropriate, intraday and multi-day settlement of payment obligations with a high degree of confidence under a wide range of potential stress scenarios that should include, but not be limited to, the default of the participant and its affiliates that would generate the largest aggregate liquidity obligation for the FMI in extreme but plausible market conditions.
3. Fees should be based on the service cost and the operational risk of service delivery, and direct costs should be passed on to the users of the service.

CDS has consulted with a wide variety of stakeholders to ensure that the proposed fees are consistent with the value provided, are easy to understand, are applied uniformly, and reflect the risk management offered by CDS as a central hub for securities processing. The proposed amendments to the CDS Fee reflect the incremental cost to CDS for the increase to our liquidity facility in providing the New York Link/DTC Direct Link Services.

Subject to regulatory approval, CDS intends to implement the proposed amendments as of the date of regulatory approval upon appropriate notice to stakeholders.

NATURE, PURPOSE AND IMPACT OF PROPOSED AMENDMENTS

Background

The current DTCC Mark-up and New York/DTC Direct Link Liquidity Premium fee of 22.30% was established to recover the annual costs of providing the liquidity facility at US$720 million with combined commitment and standby fees of 23.5bps

Effective March 23, 2021, these fees will increase by 3.5bps to 27bps, This change will increase the annual costs of providing the liquidity facility by US$0.3 million based on the US$720 million liquidity line. The proposed pass through charge is structured to be earnings neutral to CDS while accounting for the incremental cost of expanding the liquidity facility and diversifying the lenders and does not include any margin or mark-up on the costs to CDS of the New York Link Liquidity Facility.

The proposed approach aligns with our current CNS liquidity facility fees pass through process which was approved by the regulators in 2018. The proposed approach would also allow CDS to allocate the liquidity facility costs to participants on a pro rata basis according to the liquidity risk that a Participant generates through their use of the system, as opposed to using DTCC billing value which does not take the usage of the liquidity facility into consideration

Pass- through treatment would allow participants to receive 100% of the savings in the event that the liquidity premium is going down. The current fee structure does not pass the savings back automatically.

CDS expects overall liquidity facility fees to increase by 14% or USD 0.3M on an annual basis upon 2021 renewal. Eighty percent of the fee increase is expected to be passed to the participants that are also the lenders of NYL line of credit.

Competition

The proposed amendments to the Fee Schedule for the Services are not expected to have an impact on competition for CDS or its Participants. The Services are optional and Participants retain other alternatives to access DTCC, either through their US-based affiliates or through another DTCC member. It is important to note however, that while alternatives to the Services are available to Participants, it is CDS's view that those alternatives would cost significantly more than the fees being proposed here. Finally, all Participants who use the Services will be charged equally, which is consistent with CDS's business practice and with CDS's obligations under its regulatory framework.

THE FEE SETTING PROCESS

Development Context

The proposed amendments to the Fee Schedule, which introduce the DTCC liquidity fee pass through was submitted to the CDS Participant Fee Committee for review and comment at a meeting of the Committee on January 14, 2021. While the Fee Committee did not disapprove of CDS's proceeding with the submission of the proposed fee for regulatory approval, two specific objections to the proposal were noted. In the first instance, a member of the Committee objected to the proposed premium allocated to small and medium sized dealers on the basis that these firms are unlikely to be the participant that will generate the single largest payment obligation to the CCP, and that it is therefore not equitable for them to bear an activity - proportionate share of the liquidity requirement related to that obligation. CDS staff responded that the size of the liquidity requirements are designed to maintain compliance with the PFMIs and result from the mutualisation of risk, and the most equitable method of allocating the liquidity fees to each firm is in proportion to their activity in the New York/DTC Direct Link. In the second instance, a member questioned the level of the standby fee(s) charged by the syndicate of Canadian banks providing the credit facility and queried whether CDS had sought competitive quotes from banks in the United States. CDS noted the objection and indicated that non-Canadian banks had not been considered during the development of the proposal. CDS staff indicated that non-Canadian banks have previously been part of syndicates providing credit to TMX post-trade services, and had withdrawn from those syndicates. CDS staff further expressed the view that Canadian banks have incentives to provide a standby credit facility for post-trade services for a variety of reasons, including their interest in a robust and risk-proofed clearing and settlement system, and not only by the fees charged for the facility.

Prior to submission for regulatory approval, the proposed fee was tabled with the CDS Board of Directors for review and comment. The Board made no changes to the proposed fee as presented by CDS management and instructed CDS to proceed to submit the proposed fee for regulatory approval.

Consultation

In preparing the recommendation to expand the liquidity facility and expand its provision by a single lender to provision by a syndicate of lenders, CDS consulted with a broad array of stakeholders. Included in the discussion and formation of the recommendation was CDS' Risk Management Committee, the external Risk Advisory Committee, the Risk Management and Audit Committee of CDS' Board of Directors, the CDS Fee Committee, as well as individual discussions with various Participants in the Services.

Alternatives Considered

The provision of the Services is not financially viable without recovering the direct costs of the Service. While the direct costs of the existing liquidity facility are accounted for by fees on the existing CDS Fee Schedule, the incremental costs of the increase to the liquidity facility threaten the Services' future viability.

The DTCC liquidity facility cost pass through fee is considered to be non "core" fee, and will be excluded for purposes of the rebate program. The proposed Fee Schedule will appear, subject to the foregoing assessment, as follows:

Code	Product Description	Billing Definition	Price
5050	Depository Trust and Clearing Corporation (DTCC) Mark-up	CDS mark-up of NSCC/DTC/Omgeo monthly billing statements for New York and DTC Direct Link users based on previous month's activity.	USD 14% plus 0.01% for each additional tranche of US$1.0 million of liquidity facility required to maintain CDS' PFMI commitments
TBD	New York Link/DTC Direct Link Liquidity Facility Pass Through	Quarterly costs to be passed back to participants based on pro rata share amongst New York Link participants according to the liquidity risk that they generate through their use of the system	USD based on actual cost of liquidity facility

COMPARISON TO INTERNATIONAL CLEARING AGENCIES

The Services are unique; no other comparator clearing agency provides comparable access to DTCC and a direct comparison of the proposed fee model is, therefore, not available.

PUBLIC INTEREST

CDS submits that the proposed fee for the DTCC Mark-up and New York Lin/DTC Direct Link Liquidity Premium fee, as developed and described in this Notice, are not contrary to the public interest.

COMMENTS

Comments on the proposed amendments should be in writing and submitted within 30 calendar days following the date of publication of this notice in the Ontario Securities Commission Bulletin or the Autorité des marchés financiers' Bulletin to:

Yinong Sun
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Copies should also be provided to the Autorité des marchés financiers, the British Columbia Securities Commission and the Ontario Securities Commission by forwarding a copy to each of the following individuals:

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Comments received by CDS during the comment period will be made available to the public.