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 for the proposed fee and fee changes related to the New York Link/DTC Direct Link services (the "Services") pursuant to Section 7.8 of Schedule B – Terms and Conditions of the Ontario Securities Commission's ("OSC") Recognition Order, pursuant to Article 26.6 of Recognition Decision 2012-PDG-0142 of the *Autorité des marchés financiers du Québec* ("AMF"), and pursuant to Section 9 of the British Columbia Securities Commission ("BCSC") Recognition Order, each as amended. A list of the proposed fee schedule amendments appears in Appendix "A" attached to this Notice.

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. Participants who use the Services contribute to a Link Fund administered by CDS, NSCC and DTC for protection against defaults in settlement obligations. In addition to this risk mitigation strategy, CDS maintains a liquidity facility (the liquidity facility was US$200MM until January 1, 2015, at which time it was increased to US$400MM, for the reasons outlined below) to provide further comfort that a Link Participant default will not result in CDS defaulting on an obligation to NSCC.

CDS' ongoing PFMI gap remediation initiative determined that the existing liquidity facility may be insufficient to adequately mitigate the default risk. In addition to other initiatives targeting liquidity risk (for example, amendments to CDS procedures, approved in September, 2014, which implemented a change to the New York Link default waterfall), two material enhancements were recommended: (1) diversify the liquidity facility to multiple lenders in order to protect against single-point-of-failure risk and (2) increase the overall size of the liquidity facility from US$200MM to US$400MM to offer a higher degree of protection against potential shortfalls caused by a CDS Participant default. Diversification of CDS`s liquidity arrangements accounting for the potential for a liquidity provider to be a defaulter is a PFMI requirement. Expansion of the size of the liquidity facility is a result of changes agreed to with Participants through the Risk Advisory Committee in order to reduce the likelihood of CDS being required to adjust credits to surviving members of the Services. CDS has negotiated and implemented the new, larger, liquidity facility, effective as of January 1, 2015 and proposes to implement the proposed fees and fee changes as soon as practicable, subject to regulatory approval.

The proposed Services fees are 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. Fees should comply with CDS's regulatory framework and eliminate any tiered pricing structures.

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 Schedule are:

I. The elimination of the existing 3-tiered fee structure, which currently offers a percentage reduction in fees based on transaction volume with a single price for all Participants;

II. The introduction of a New York Link/DTC Direct Link Liquidity Premium, which represents the incremental cost to CDS of the enhanced credit facility.

Subject to regulatory approval, CDS intends to implement the proposed amendments in the first quarter of 2015 upon appropriate notice to stakeholders.

NATURE, PURPOSE AND IMPACT OF THE PROPOSED AMENDMENTS

<u>Background</u>

The current fee structure for the Services was established on a cost-recovery basis prior to the Maple transaction and has not been revised under CDS' current for-profit model. The cost associated with an increase to the liquidity facility, however, represents a significant change in circumstances and requires changes to that structure. The proposed changes will affect Link Participants by either increasing or decreasing their fees for the use of the service.

In 2013, the Services generated $2.2MM in revenue to CDS, revenue which covered a portion of CDS's operating costs as well as a portion of the $450,000 annual cost of the existing $200MM liquidity line. Based on 2013 data, the proposed changes will result in an increase in the average fee from 14.24% to 18.75%. The proposal is structured to be revenue-neutral to CDS when taking into consideration the incremental cost of expanding the liquidity facility and diversifying the lenders.

CDS is proposing to increase the Services fee by $690,000 per year in order to pass through the costs associated with the proposed expansion of the liquidity line (from $200MM to $400MM), and moving from one lender to a syndicate of lenders. The new pricing does not include any margin or markup on these incremental costs.

This change will increase the annual cost of providing the liquidity facility from $450,000 to $1.1MM. The new cost is comprised of an annual commitment fee of $200,000 (paid at the beginning of the term) and a $900,000 annual standby fee (22.5 basis points, paid monthly). Consistent with market practice, CDS has also assumed responsibility for the external legal costs of establishing the agreements with the lenders supporting the liquidity facility; CDS has estimated this one-time cost at approximately $200,000 and has amortized the legal fees over five years in calculating the proposed fees. As noted above, in the aggregate, this increased cost represents a significant change to the cost of providing the Services. The table, appearing below in the section entitled "Alternatives Considered", outlines the calculation of the revised mark-up. CDS has rounded the pricing change to 18.75% to partially offset any delay to the implementation of the proposed pricing changes.

The impact to Participants is mixed. Twelve of forty-six Link Participants will see an increase. Large bank dealers will see the largest increase, as high as +73% over their current fees related to the service. For the largest Link dealer, however, this represents an annual increase of ~$163,000 (based on 2013 billing data). These large bank dealers will now also have the opportunity to participate in providing the liquidity line, which could generate annual fees for each of the six banks of ~$180,000. By contrast, small and mid-sized dealers who have historically only used the existing first tier will see a net decrease to their fees related to the services of 9-10%.

Overall, the proposed pricing for sponsored membership in and access to DTCC continues to reflect significant cost savings over direct membership by CDS Participants. 2013 data, for example, indicates that the average cost of direct membership for a large bank dealer would be ~$300,000 per year, and the median cost for all dealers would be ~$25,000 per year.

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 increase the New York Link fees to 18.75%, in the aggregate, were submitted to the CDS Participant Fee Committee for review and comment. The CDS Fee Committee did not disapprove of CDS's proceeding with the submission of the proposed fees for regulatory approval.

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

CDS has recommended an approach to the implementation of the proposed fee amendments that consists of two components which, combined, achieve the twin goals of eliminating the existing stratified fee structure and closing the existing PFMI gap by enabling an increase to the liquidity facility.

First, in order to ensure compliance with CDS's regulatory framework, the current three-tier model on the Fee Schedule will replaced with a single tier (14.25 percent, rounded to the nearest 1/20th of a percent) based on 2013 activity and will remain "core" revenue and subject to the 50 percent rebate;

Second, in order to close the PFMI gap and fund the increase to the costs of the liquidity facility, a new 4.50 percent fee entitled "New York Link/DTC Direct Link Liquidity Line Premium" will be implemented, will be considered to be a "core" fee, and will be included for purposes of the rebate program. The "New York Link/DTC Direct Link Liquidity Line Premium" did not exist in 2012, when the base period was established for assessing the 50/50 rebate. Consequently, a base amount of $690,000, equal to CDS' annual incremental cost, will be included in CDS's rebate model. The rebate model itself is subject to annual audit. Any incremental revenue above CDS' $690,000 cost base will be included in the 50/50 rebate calculations. CDS will assess Services transaction volumes such that the total aggregate charge for the service will equal 18.75%. The proposed liquidity premium of 4.5% consists, as noted above, of legal costs (amortized over 5 years), the Annual Additional Commitment Fee, and the Additional Standby Fee. The proposed Fee Schedule will appear, subject to the forego-ing 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 14.25%
TBD	New York Link/DTC Direct Link Liquidity Premium	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 4.50%

Prior to finalizing this recommendation, CDS considered several alternatives, each of which was informed by CDS's regulatory framework since the Services are designated as Core under CDS' regulatory framework. The framework provides that 50 percent of any revenue growth above the 2012 base period shall be rebated to CDS Participants at the end of each fiscal year. In consequence, 50% of the proposed price increase would have to be rebated to Participants, leaving a 50% shortfall in the overall cost-recovery objective for the service and for the proposed fees.

The alternatives are as follows:

1. Raising fees by a higher amount (in effect doubling the pass-through costs) to offset any rebate implications;
2. Reclassifying the Services as non-core and, therefore, not subject to the rebate model.

CDS determined, in consultation with its regulators, that none of these alternatives were effective means towards meeting CDS's pricing objectives while at the same time respecting CDS's regulatory framework and its pricing approval processes.

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 fees for the New York Link/DTC Direct Link Liquidity Premium, 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:

Fran Daly
Managing Director, Business Development
CDS Clearing and Depository Services Inc.
85 Richmond Street West

Toronto, Ontario M5H 2C9

Telephone: 416-365-8625
Email: fdaly@cds.ca

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:

Me Anne-Marie Beaudoin
Secrétaire générale
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3

Télécopieur: (514) 864-6381
Courrier électronique: consultation-en-cours@lautorite.qc.ca

Manager, Market Regulation
Market Regulation Branch
Ontario Securities Commission
Suite 1903, Box 55,
20 Queen Street West
Toronto, Ontario, M5H 3S8

Fax: 416-595-8940
Email: marketregulation@osc.gov.on.ca

Doug MacKay
Manager, Market and SRO Oversight
British Columbia Securities Commission
701 West Georgia Street
P.O. Box 10142, Pacific Centre
Vancouver, B.C. V7Y 1L2

Fax: 604-899-6506
Email: dmackay@bcsc.bc.ca

Mark Wang
Manager, Legal Services
British Columbia Securities Commission
701 West Georgia Street
P.O. Box 10142, Pacific Centre
Vancouver, B.C., V7Y 1L2

Fax: 604-899-6506
Email: mwang@bcsc.bc.ca

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

Appendix A: Proposed New York Link/DTC Direct Link Fees

Current Fee Description	Fee Description	Existing fee	Proposed Fee
Depository Trust and Clearing Corporation (DTCC) Mark-up	First US$20,000 in monthly billings from NSCC/DTC	20.60%	14.25%
Depository Trust and Clearing Corporation (DTCC) Mark-up	Monthly billings of US$20,000 – US$35,000 from NSCC/DTC	13.60%	14.25%
Depository Trust and Clearing Corporation (DTCC) Mark-up	Monthly billings above US$35,000 from NSCC/DTC	9.10%	14.25%
New York Link Liquidity /DTC Direct Link Premium	CDS mark-up of NSCC/DTC/Omgeo monthly billing statements for New York and DTC Direct Link users based on previous month's activity	*No Fee*	USD 4.50%