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 increase the Depository Trust and Clearing Corporation (DTCC) Mark-up and New York and DTC Direct Link Liquidity Premium fee from 17.8% to 22.30 % as the baseline, with the ability to increase this fee by 0.01% whenever an additional tranche of US$1.0 million of liquidity facility is required to maintain CDS' PFMI commitments 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.

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 maintains a liquidity facility (the liquidity facility was US$400 million until March 26th, 2018) 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.

CDS' ongoing PFMI compliance review determined that its existing liquid resources did not meet the PFMI standards.

To mitigate this, CDS has re-negotiated agreements with its lenders to increase the existing credit facility effective March 27th, 2018 from US$400 million to US$720 million with an accordion feature that will allow CDS to increase this amount up to US$1.32 billion and proposes to apply the fee change as of the date of regulatory approval to cover the cost of this increase in credit to support our liquidity risk.

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 17.80% was established to recover the annual costs of providing the liquidity facility at US$400 million.

Effective March 27, 2018, CDS has expanded its liquidity line from US$400 million to US$720 million with an accordion feature that will allow CDS to increase its liquidity line up to US$1.32 billion to maintain compliance with PFMI principles. This change will increase the annual costs of providing the liquidity facility by US$0.84 million based on the US$720 million liquidity line. Additionally, incremental costs will be added to the US$0.84 million for each US$1 million tranche increase if and when CDS exercises the accordion feature to increase the liquidity to comply with regulatory requirements. The proposed DTCC Mark-up fee of 22.30% based on the US$720 million liquidity line is comprised of the following factors:

- Annual increase of US$0.13 million in commitment fee (paid at the beginning of the term);
- Annual increase in standby fee of US$0.64 million paid monthly; and
- One-time legal costs of US$0.35 million amortized over five years ($0.07 million per annum).

Nature of the Accordion Feature, Costs, and Corresponding Fee Increase

The accordion feature embedded within the liquidity line is meant to provide CDS with the capacity to increase its available liquid resources up to a maximum of US$ 1.32 billion during the course of the year without the need to re-negotiate with its lenders. This lever provides CDS with the ability to be proactive with its available liquid resources thereby ensuring that it remains in line with its regulatory requirements. The accordion can be executed when CDS reasonably expects that its liquidity risk exceeds its available resources. For each US$1 million liquidity line increase will equate to 0.01% increase to the DTCC Mark-up and New York Link/DTC Direct Link Liquidity Premium fee should CDS exercise this feature.

CDS is committed to providing a 30-day notice period to participants when the accordion feature is exercised.

The new mark-up of 22.30% will increase all NYL and DTC direct link users’ cost by 25%. Based on 2017 billing data, top ten out of thirty nine users will absorb 85% (or US$ 0.70 million) of increased cost due to their higher usage of the service.

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 DTCC Mark-up and New York/DTC Direct Link Liquidity Premium fee to 22.30% with the ability to increase this fee by 0.01% whenever an additional tranche of US$1.0 million of liquidity facility is required to maintain CDS' PFMI commitments, was submitted to the CDS Participant Fee Committee for review and comment at a meeting of the Committee on April 18th, 2018. 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.

CDS has recommended an approach to the implementation of the proposed fee amendments that will close the existing PFMI gap by enabling an increase to the liquidity facility.

In order to close the PFMI gap and fund the increase to the costs of the liquidity facility, an increase of 4.50% will be implemented, from 17.8% to 22.30%. The DTCC Mark-up fee is considered to be a "core" fee, and will be included 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 and 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 22.30% plus 0.01% for each additional tranche of US$1.0 million of liquidity facility required to maintain CDS' PFMI commitments

CDS will include the US$ 0.84 million to its base year (November 2011 to October 2012) for the 50-50 rebate calculation. If CDS exercises the accordion feature, the additional expense of doing so will be included in the annual expense associated with the liquidity facility for purposes of the 50-50 rebate.

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:

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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.

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 and 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 17.8%	USD 22.30% plus 0.01% for each additional tranche of US$1.0 million of liquidity facility required to maintain CDS' PFMI commitments