ANNEX I
LOCAL MATTERS – ONTARIO

1. Qualitative and quantitative analysis of the anticipated costs and benefits of the Proposed Amendments

OSC staff (the **OSC**, the **Commission** or **we**) have undertaken an analysis of the anticipated costs and benefits of the Proposed Amendments, as set forth below, to analyze the regulatory need for the proposed rule changes. This analysis includes the potential economic impacts, including anticipated costs and benefits, relative to the current baseline (where no participation fee is paid by derivatives participants in relation to the Commission's oversight of the OTC derivatives market, including with respect to its expanded systemic risk related mandate in relation to OTC derivatives[1]), and subsequent fee reductions for issuers, registrants and unregistered capital market participants and simplifications in the fee rule).

The fee structure model set out in the Proposed Amendments is based on a 'cost-recovery model' – it is designed to recover the Commission's costs to provide protection to investors, promote efficient capital markets and confidence in capital markets, foster capital formation, and to contribute to the stability of the financial system and the reduction of systemic risk.

Proposed OTC derivatives fee

It is important that the OSC's oversight continues to evolve to adequately address the complexity and growth in the OTC derivatives sector. As of September 2021, there were over 3.7 million outstanding OTC derivatives transactions involving an Ontario local counterparty – the total notional amounts outstanding for these transactions is an estimated $60 trillion[2]. Costs to the Commission to monitor and regulate the OTC derivatives market are projected to increase significantly in the future and are anticipated to be nearly $13.5 million in annual costs to the Commission.[3] Currently, since there is no derivatives participation fee, all costs associated with derivatives regulation to date have been ultimately recovered from the population of securities market participants that are fee payers under the Fee Rule, including small and medium sized entities who may not contribute to systemic risk in OTC derivatives markets. Therefore, based on an analysis of funding sources, anticipated costs, and an assessment of futures market activity, we have determined that the OSC will require additional revenues to meet its regulatory obligations.

Proposed fee reductions and eliminations

Since the market decline experienced at the onset of the COVID-19 pandemic, the Ontario capital market have proven to be resilient and shown significant growth which has resulted in the OSC generating participation fees from issuers, registrants and unregistered capital market participants of greater than $100 million from over 5,700 market participants. The introduction of the proposed derivatives fees permits recovery from a sector that is experiencing regulatory growth while reducing fees for certain existing fee payers to ensure that fees collected are proportionate to the cost of regulation across market

[1] In 2017, the stated purposes of the *Securities Act* (Ontario) were amended and the OSC's mandate was expanded to include a new purpose - "… to contribute to the stability of the financial system and the reduction of systemic risk."
[2] All figures in Canadian dollars.
[3] As described in the Notice, these costs include direct costs and an allocation of indirect costs, such as premises, human resources, financial management, regulatory (including compliance audits), advisory, and enforcement.

segments and participant size. The proposed fee reductions are anticipated to primarily impact small and medium sized market participants, which account for approximately 5,500 market participants.

1.1 The anticipated costs of the Proposed Amendments

Where feasible, we have used available information to quantify the number of stakeholders that we anticipate will be impacted.[4]

1.1.1 Proposed OTC Derivatives Fee Costs

1.1.1.0 Overview of the number of derivatives firms anticipated to become "fee payers"

We estimate that there are at least 205 derivatives dealers transacting in OTC derivatives in Ontario (both local and foreign firms that are primarily banks).

The Proposed Amendments will require any entity that is a "reporting counterparty" under OSC Rule 91-507 *Trade Repositories and Derivatives Data Reporting* (mainly domestic and foreign banks that are derivatives dealers) at any time during a one-year period, to pay an annual participation fee (note, this in effect excludes recognized or exempt clearing agencies and other end-users such as corporate end-users, pension funds, and investment funds).

Currently, of this population of firms, based on our analysis of trade reporting data and the proposed tiered thresholds fee structure described in section 1.1.1.1 below, we estimate that 73 reporting counterparties that are derivatives dealers will become fee payers in respect of their derivatives activity under the Proposed Amendments (the **anticipated fee payers**) if the Proposed Amendments take effect in 2022**.**

1.1.1.1 Anticipated fees to be paid under the proposed tiered thresholds by anticipated fee payers

Just as there are participation fees charged to other market participants under the existing Fee Rule, the Proposed Amendments propose a participation fee for OTC derivatives activity comprised of a series of tiers based on a fee payer's average outstanding notional of all transactions that are required to be reported under OSC Rule 91-507 over a one-year period. The proposed tiered threshold structure is calibrated so that larger, more active, and systemically significant derivatives firms have higher fees, reflecting regulatory resource allocation (in particular, from a systemic risk perspective).

No derivatives participation fees are payable by a prospective fee payer in respect of a derivatives fee year (calculated by reference to a one-year period beginning on July 1 of the previous calendar year and ending on June 30 of the then current calendar year) if its average outstanding notional of OTC derivatives during that year is below $3 billion.

The total population of anticipated fee payers and the number of anticipated fee payers that will fall within each respective tier threshold is described in Table 1.

[4] Including data reported under OSC Rule 91-507 *Trade Repositories and Derivatives Data Reporting*.

Table 1: Proposed Fee Tier Threshold and Associated Fees

Outstanding Notional Threshold	Fee	Number of Derivatives Firms in Fee Threshold (July 2022)
$10 trillion and over	$1,900,000	2
$4 trillion to under $10 trillion	1,350,000	3
$1 trillion to under $4 trillion	750,000	1
$500 billion to under $1 trillion	450,000	3
$300 billion to under $500 billion	200,000	6
$100 billion to under $300 billion	100,000	14
$50 billion to under $100 billion	50,000	14
$15 billion to under $50 billion	15,000	11
$7.5 billion to under $15 billion	7,500	10
$3 billion to under $7.5 billion	3,000	9
		Total Firms: 73

1.1.1.2 Other implementation costs to anticipated fee payers

Generally, anticipated fee payers will incur initial and ongoing costs from analyzing the Proposed Amendments, updating policies and procedures for compliance, and updating IT systems for recordkeeping and reporting purposes. The estimated incremental implementation costs arising from the Proposed Amendments for derivative fees are summarized in Table 2. Associated IT systems costs, if any, should be minimal given that the fee is determined according to notional amounts which reporting counterparties are already required to record and report on a daily basis under the trade reporting rule.

Table 2: Implementation Costs – Total Initial and Ongoing Yearly Costs to Fee Payers

Type of Administrative Cost	Total Initial Cost (Year 1) for each Anticipated Fee Payer	Total Initial Cost (Year 1) for Entire Population of Anticipated Fee Payers	Total Ongoing Yearly Cost for each Anticipated Fee Payer	Total Ongoing Yearly Cost for Entire Population of Anticipated Fee Payers
Learning about and implementing the Proposed Amendments	$537	$39,219	N/A	N/A
Compliance with Proposed Amendments	390	28,481	$390	$28,481
Recordkeeping and reporting	110	8,003	110	8,003
Total implementation costs	**$1,037**	**$75,704**	**$500**	**$36,484**

The estimates reflect the number of hours spent per task by staff in different functions within each fee payer. Hourly rates are based on information found in published fee surveys and compensation guides subject to certain adjustments (e.g. application of local market adjustments).

1.1.1.3 No cost to investors or other end-users of OTC derivatives

There will be no direct costs to investors or end-users of derivatives (e.g., pension funds, insurance companies, corporations, investment funds) because of the Proposed Amendments.

1.1.2 Cost Estimates of proposed fee reductions and eliminations

1.1.2.0 Fee reductions and eliminations cost overview

Except for modifying the basis of calculating late fees from business days to calendar days, the remaining Proposed Amendments include a reduction and elimination of certain fees that are expected to reduce administration effort and fees for most market participants. Late fees are triggered when market participants do not pay or do not file regulatory forms by established due dates as required by securities legislation. Late fees are intended to promote compliance with securities legislation to allow for filings to be made publicly available on a timely basis and to ensure the OSC can carry out our required regulatory tasks. The change to use calendar days instead of business days for calculating late fees creates a harmonization of late fee calculations across the OSC in addition to further harmonization across the CSA. There may be an increase in late fees due to the additional penalties by adding weekends and holidays (i.e., if filing/paying on a Monday, the filer will have incurred an extra $200 (depending on the form) in late fees). We estimate that filers will also have an initial learning cost of $66 per filer[5]. The OSC has fee caps on late fees to ensure late filings do not result in significant monetary difficulties for any filer as the OSC's main objective is to promote compliance in capital markets as well as participation in the market.

1.1.2.1 No cost to investors or other end-users of proposed fee reductions and eliminations

There will be no direct costs to investors as a result of these Proposed Amendments.

1.2 The anticipated benefits of the Proposed Amendments

In this section, we present our assessment of the anticipated benefits of the Proposed Amendments. Overall, the Proposed Amendments and appropriate funding benefit the public interest by providing the resources to contribute to the stability of Ontario's financial system through reduced risk, enhanced data analysis for systemic risk monitoring, and ensuring that the Commission can fulfill its derivatives market oversight responsibilities and adapt to changing markets and evolving market behaviours.

The anticipated quantitative benefits of the Proposed Amendments can be separated into two categories: benefits from derivatives fees, and benefits from proposed fee reductions

1.2.1 Benefits from Derivatives Fees

The quantitative benefits of the Proposed Amendments relating to the derivatives fee can be considered in two ways:

- one alternative to the Proposed Amendments (that the Commission rejected) would be to raise fees for over 5,700 market participants that currently pay fees under the Fee Rule, including small

[5] The estimates reflect the number of hours spent per task by staff in different functions within each fee payer. Hourly rates are based on information found in published fee surveys and compensation guides subject to certain adjustments (e.g. application of local market adjustments).

and medium sized market participants who do not contribute to risk in the OTC derivatives market. Therefore, one benefit of the Proposed Amendments is the elimination of cross-subsidization of regulatory oversight costs by these market participants because these 5,700 market participants will not have to pay a combined $7.9 million in additional fees (an average of approximately $1,386 per participant);

- the 2008 financial crisis had a significant global financial impact.[6] Increased systemic risk monitoring and improved oversight of the OTC derivatives markets in Ontario will contribute to our ability to mitigate against similar crises, and the resulting costs, associated with systemic risks in the OTC derivatives markets that can also potentially have a material effect on the overall capital markets.

In the absence of a net increase in fees, the Commission will not be able to effectively fulfill our mandate to contribute to the stability of the financial system and the reduction of systemic risk. We will also not be able to uphold Canada's G20 commitment "to create more powerful tools to hold large global firms to account for the risks they take."[7] We will not be able to hire and retain staff with the appropriate expertise to conduct core oversight activities (including market examination and surveillance, data analysis, enforcement, regulation and rulemaking, and providing effective and data-driven policy development), or make the necessary investments over time in the technology needed to support these activities.

1.2.1.1 Adequate funding will enable the OSC to fulfill its mandate of systemic risk monitoring

The OSC's mandate was expanded recently to include the mandate to contribute to the stability of the financial system and the reduction of systemic risk in the capital markets. Systemic risk in the OTC derivatives market was a significant contributor to the 2008 global financial crisis. Adequate funding of the OSC's systemic risk monitoring program related to OTC derivatives will:

- provide oversight of the emergence of risks and vulnerabilities that can threaten the stability of Ontario's capital markets and have serious negative consequences to Ontario's economy;

- identify challenges (such as access to liquidity, market fragmentation, and trends in price formation) that may impede market efficiency;

- identify opportunities to strengthen and increase the competitiveness and growth of Ontario markets, and improve policy development; and

- improve coordination and cooperation with other provincial, federal, and foreign agencies to enhance the identification of financial system vulnerabilities and promote financial system reliance.

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[6] For example, a 2018 study by the Federal Reserve Board found that the crisis cost every single American $70,000. See: https://www.frbsf.org/economic-research/publications/economic-letter/2018/august/financial-crisis-at-10-years-will-we-ever-recover/

[7] G20 Leaders Statement: The Pittsburgh Summit, September 24-25, 2009 at para. 17. See: G20 Leaders Statement: The Pittsburgh Summit (utoronto.ca)

1.2.1.2 Adequate funding will enable the OSC to improve protection for end-users of the OTC derivatives market

- The fees will fund the OSC's efforts to protect Ontario investors from financial systemic risk and misconduct by providing the OSC with the necessary resources to continue to design and implement a framework for analyzing OTC derivatives data for systemic risk oversight and market conduct purposes.

1.2.1.3 Fee structure is fair and proportionate to risk – avoids fee increases for small and medium sized participants

- In order to achieve effective systemic risk oversight in OTC derivatives markets, we require significant increases in staffing resources and technological enhancements in our capabilities for risk analysis.

- The benefit of the Commission's proposed approach is that it allocates costs proportionate to the risk that market participants contribute to the OTC derivatives market, rather than increasing existing fees across securities market participants.

- Based on current data – since the majority of derivatives activity takes place with the anticipated fee payers that are large financial institutions – it would not be equitable for costs to be borne by other participants in capital markets.

- The derivatives dealers in the top tiers in the rule are responsible for the vast majority of derivatives transactions occurring in Ontario, and therefore are introducing the largest operational risks and potential systemic risk concerns in the province. Accordingly, they should bear the costs of our oversight, instead of small and medium sized participants in the market.

1.2.1.4 Derivatives fee structure effectively avoids charging end-users and smaller dealers

- The anticipated fee payers will be the 73 largest domestic and foreign derivatives dealers.

- In the Ontario derivatives market, market participants that are not in the business of trading derivatives (end-users) typically transact with dealers, rather than with other end-users. As a result, generally end-users do not have a reporting obligation and therefore would not be fee payers in Ontario.

- In addition, any end-users or smaller dealers with under $3 billion in outstanding notional would not be subject to the fee.

1.2.1.5 Derivatives fee structure is simple and easy for market participants to administer

- The fee structure contemplated by the Proposed Amendments relies on the existing concept of "reporting counterparty" in the trade reporting rule. Market participants will already know whether they are a reporting counterparty.

- The derivatives fee is determined according to notional amounts which reporting counterparties are already required to record and report on a daily basis under the trade reporting rule.

- Therefore, the implementation of the Proposed Amendments will not require significant system or process changes by firms.

1.2.1.6 Derivatives fee structure alleviates potential concerns around market liquidity

- Canadian banks have, in the past, expressed concerns that smaller foreign banks may cease to trade with them if they are subject to additional regulatory requirements.

- Under industry developed reporting logic that is used to determine who is a reporting counterparty,[8] swap dealers registered with the U.S. Commodity Futures Trading Commission are the reporting counterparty for transactions with dealers that are not CFTC registered, even if the transaction is not required to be reported in the U.S. This means that a smaller overseas bank, for example, that is not accustomed to paying fees in North America, and that is only providing liquidity to the six large Canadian banks, would not be the reporting counterparty and would not be a fee payer. The six banks, all of whom are CFTC registered swap dealers, would be the reporting counterparty.

- Therefore, smaller foreign banks would not have a reporting requirement if only providing liquidity to the Canadian banks. Larger foreign dealers that are registered with the CFTC are already accustomed to paying fees associated with that registration.

1.2.2 Benefits from Proposed Fee Reductions and Eliminations

The Proposed Amendments include $5.6 million in fee reductions that will benefit more than 5,500 market participants. The reductions include $3.1 million in the form of participation fee reductions to issuers with a capitalization for the previous year below $1 billion, and registrant firms and unregistered capital market participants with Ontario specified revenues below $100 million. A reduction of $1.8 million is projected from over 12,000 filing Fees relating to exempt distributions (under OSC Rule 45-501 *Ontario Prospectus*

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[8] See the ISDA 2014 Multilateral Canadian Reporting Party Agreement (Deemed Dealer Version) available at https://www.isda.org/2014/09/22/isda-2014-multilateral-canadian-reporting-party-agreement-deemed-dealer-version/ which incorporates the Canadian Transaction Reporting Party Requirements available at https://www.isda.org/2015/03/20/canadian-transaction-reporting-party-requirements-2/ at page 6.

and Registration Exemptions and NI 45-106 *Prospectus Exemptions*) representing a 30% reduction in fees, and a further $0.7 million from the elimination of certain activity and late fees.

1.2.2.1 Participation fee reductions for a majority of issuers, registrants and unregistered capital market participants

- Issuers with a capitalization below $1 billion, with a current population over 2,200 issuers[9], are expected to see rate savings between 5% to 16%. Registrant firms and unregistered capital market participants with specified Ontario revenues below $100 million, representing over 3,100 market participants, are expected to see rate savings between 2% to 16%.

Corporate Finance Participation Fees	Class 1/2 Current Fee	Proposal	Estimated Population[10]	Estimated Total Savings	Reduction
Under $10 million	$ 890	$ 750	1,048	$ 146,720	*16%*
$10 million to $25 million	1,070	1,000	290	20,300	*7%*
$25 million to $50 million	2,590	2,400	249	47,310	*7%*
$50 million to $100 million	6,390	6,100	180	52,200	*5%*
$100 million to $250 million	13,340	12,700	199	127,360	*5%*
$250 million to $500 million	29,365	27,900	137	200,705	*5%*
$500 million to $1 billion	40,950	38,900	113	231,650	*5%*
Total Participation Fee Reductions			2,216	$ 826,245	

Corporate Finance Participation Fees	Class 3A&3B Current Fee	Proposal	Estimated Population	Estimated Total Savings	Reduction
Under $10 million	$ 890	$ 750	32	$ 4,480	*16%*
$10 million to $25 million	1,070	1,000	64	4,480	*7%*
$25 million to $50 million	1,195	1,110	9	765	*7%*
$50 million to $100 million	2,135	2,030	17	1,785	*5%*
$100 million to $250 million	4,450	4,225	8	1,800	*5%*
$250 million to $500 million	9,780	9,300	5	2,400	*5%*
$500 million to $1 billion	13,650	13,000	12	7,800	*5%*
Total Participation Fee Reductions			148	$ 23,510	

[9] As of end of OSC fiscal year 2020-2021

[10] Based on participant payments in fiscal year 2020-2021

Capital Markets Participation Fees	Current Fee Amount	Proposal	Estimated Population	Estimated Savings	Reduction
under $250,000	$ 835	$ 700	1,747	$ 235,845	*16%*
$250,000 to under $500,000	1,085	975	211	23,210	*10%*
$500,000 to under $ 1 million	3,550	3,200	255	89,250	*10%*
$ 1 million to under $3 million	7,950	7,150	393	314,400	*10%*
$3 million to under $5 million	17,900	16,100	146	262,800	*10%*
$5 million to under $10 million	36,175	34,300	164	307,500	*5%*
$10 million to under $25 million	74,000	70,000	126	504,000	*5%*
$25 million to under $50 million	110,750	105,200	60	333,000	*5%*
$50 million to under $100 million	221,500	217,000	38	171,000	*2%*
Total Participation Fee Reductions			3,140	$ 2,241,005	

1.2.8 *Simplification of participation fee submissions by registrant firms and unregistered capital markets participants and Class 2 reporting issuers*

- Currently, annual registrant participation fees are due on December 31st. Most firms who have a December 31st year-end do not have their financials completed and/or audited by this time. Registrant firms and unregistered capital market participants are required to use good faith estimates for filing their Ontario specified revenues by December 1st. Over 2,500 registrant firms and unregistered capital market participants are currently filing using good faith estimates. Consequently, their participation fees are based on an estimate which has resulted in significant adjustments in the form of payment resubmissions or refund requests following their financial audit. To address this issue, we are proposing to amend the fee rules to have registrants base their calculations using their most recent completed audited financial statements. This will reduce administrative burden on market participants reducing costs by an estimate of $1,548 per form.

- The Proposed Amendments repeal section 2.5, Participation fee estimate for Class 2 reporting issuers, of the Main Fee Rule and the accompanying Form 13-502F2A *(Adjustment of Fee Payment for Class 2 Reporting Issuers)* and eliminate the use of estimates which we estimate will reduce market participants burden by $208 per form. The method of calculating capitalization under section 9 of the Main Fee Rule, which is relevant for issuer participation fees, has also been clarified.

1.2.9 Elimination of certain late fees

- This initiative allows for reduced burden for market participants while still ensuring proper safeguards in place to carry out effective regulatory work. Late fees are used as a tool to promote compliance with filing requirements. The majority of late fees proposed for elimination are triggered on the late filing of participation fee forms. We also charge late fees when market participants pay late, representing a potentially duplicative penalty relating to fee submissions. While late fees represent a tool necessary to promote compliance with filing requirements, the removal of these fees meets our objective to focus late fees on critical filings that do not compromise investor protection. Also, registrants do not need to spend administrative efforts towards reporting and processing payment of late fee invoices estimated at $110 per payment.

- Market participants are anticipated to have savings totaling $0.5 million in regulatory costs and individual burden reductions of $110 for reporting and payment of each late fee.

2 Legislative Authority for Rule Making

The following provision of the *Securities Act* (Ontario) provides the Commission with the authority to adopt the Proposed Amendments:

- Paragraph 43 of subsection 143(1) of *the Securities Act* (Ontario) authorizes the Commission to make rules prescribing fees payable to the Commission.

The following provision of the *Commodity Futures Act* (Ontario) provides the Commission with the authority to adopt the Proposed Amendments:

- Paragraph 25 of subsection 65(1) of the *Commodity Futures Act* (Ontario) authorizes the Commission to make rules prescribing fees payable to the Commission.

3 **Alternatives Considered**

The Commission considered increasing existing fees across all market participants; however, we are proposing these amendments because the increasing regulatory costs for the oversight of OTC derivatives markets, and the risks they contribute to the Ontario capital markets, should be borne directly by the entities that create the need for this oversight. The derivatives dealers in the top tiers in the rule are responsible for the vast majority of derivatives transactions occurring in Ontario and therefore are a significant source of potential operational and systemic risk in the Ontario capital markets. Accordingly, they should be bearing the costs of this oversight, instead of small and medium sized participants in the market.

4 **Reliance on Unpublished Studies**

In developing the Proposed Amendments, the Commission is relying on derivatives data collected under OSC Rule 91-507.

We welcome comments on all aspects of the Proposed Amendments, including the estimated costs associated with complying with the requirements of the Fee Rule.