

## Multilateral CSA Staff Notice 24-313

### *CSA Staff's Review of Proposed Amendments to Fee Schedule of The Canadian Depository for Securities Limited (CDS Limited) and CDS Clearing and Depository Services Inc. (CDS Clearing) (collectively, CDS)*

May 14, 2015

#### Introduction

In November 2014, CDS submitted to the Ontario Securities Commission (OSC), the Autorité des marchés financiers (AMF), and the British Columbia Securities Commission (BCSC) (collectively, the Regulatory Authorities) for approval a proposal to amend its fee schedule relating to issuer services (the issuer fee proposal). Under the issuer fee proposal, CDS intends to amend issuance and eligibility fees and to start charging entitlement and corporate action event management fees to issuers, either directly or through their transfer agents. This is the first CDS proposal under which it proposes to charge users who are non-participants for certain key depository services it provides.

Under the orders issued by the Regulatory Authorities recognizing CDS as a clearing agency pursuant to the *Securities Acts* in Ontario, Quebec and British Columbia (Acts),<sup>1</sup> CDS requires prior Regulatory Authorities' approval before implementing any amendments to its fee schedule, including new fees. The Regulatory Authorities' Staff (Staff or we) are publishing this Notice to provide market participants with background and information about our approach in reviewing proposed amendments to CDS's fee schedule, including this issuer fee proposal.

#### Background

In July 2012, the Regulatory Authorities issued orders recognizing CDS as a clearing agency (the CDS Orders). In Ontario and Quebec, the CDS Orders replaced previous CDS' recognition orders. The CDS Orders were made in connection with Maple Group Acquisition Corporation's (Maple) proposal to acquire TMX Group Inc. (TMX Group), Alpha Trading Systems Limited Partnership and Alpha Trading Systems Inc. (collectively, Alpha), and CDS.

CDS operates the depository and the clearing and settlement system for equities and fixed income securities in Canada,<sup>2</sup> and is the sole provider of such services for the Canadian cash

<sup>1</sup> In Ontario, section 21.2; in Quebec, section 169; in British Columbia, section 24.

<sup>2</sup> Clearing for fixed income transactions has moved from CDS to its affiliates, the Canadian Derivatives Clearing Corp, since December 2012.

market. Prior to Maple's acquisition, it was a user-owned, user-governed clearing agency<sup>3</sup> that operated on a cost recovery basis. Maple's acquisition resulted in CDS:

- becoming a subsidiary of TMX Group, which operates an integrated group of businesses providing trading, clearing, settlement and depository services in Canada (also known as a vertical model of providing trading and post-trade services or vertical integration), and
- beginning to operate on a for-profit basis.

The Regulatory Authorities conducted an extensive review of and consultation about Maple's proposal, focusing particularly on the impact of the proposal on the public interest. Key issues that were raised and considered by the Regulatory Authorities regarding the proposed acquisition of CDS were:

- the implications of vertical integration of trading, clearing, settlement and depository infrastructure under common ownership of TMX Group (formerly Maple),
- reorientation of CDS from a cost-recovery industry utility to a for-profit commercial enterprise whose ultimate shareholders may not be users,
- potential for TMX Group to act anti-competitively in the pricing of clearing, settlement and depository services, and
- fair access to clearing, settlement and depository services by those market participants not affiliated with TMX Group.

To address these issues, the Regulatory Authorities each proposed additional terms and conditions of CDS's recognition that provide for, among other things:

- CDS to operate in the public interest;
- representation of different stakeholder groups (including independent dealers and unaffiliated marketplaces) on the board of directors and key committees of CDS to ensure different views are duly considered by CDS;
- continuation of the use of participant committees with open membership to provide forums for participants to raise comments or concerns;

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<sup>3</sup> CDS was a privately owned company, whose shareholders were six Schedule I banks, the TMX Group and the Investment Industry Regulatory Organization of Canada (representing the ownership interest of its investment dealer members).

- fair access by participants, marketplaces and others (e.g. third party service providers) to CDS' clearing and settlement systems;
- fees must not have an effect of unreasonably creating barriers to access CDS' services or discriminating between CDS users or marketplaces;
- changes to CDS fees or introduction of new fees must be reviewed by CDS' Participant Fee Committee, published for comments and approved by the Regulatory Authorities; and
- model to allocate costs between CDS and its affiliates must be approved by the Regulatory Authorities.

In addition, the BCSC also requires that the board of directors and key committees of the board of CDS include representation from venture-market dealers, and CDS uses best efforts to include at least one venture-market dealer on its strategic development, risk advisory and fee participant committees.

Further, Maple proposed that any growth in revenues for clearing and other services of CDS that are defined as "core" from the 2012 level would be shared with participants on a 50/50 basis. The OSC and AMF, therefore, incorporated this as a term and condition of recognition.

In addition, the Regulatory Authorities also proposed enhanced ongoing oversight of CDS. Other than regular reporting requirements, approval of changes to rules and periodic on-site reviews, the Regulatory Authorities proposed adding the following components to their oversight program of CDS:

- regular communication and interaction with directors and management of CDS;
- regular communication and interaction with relevant CDS participant committees;
- periodic reporting by CDS of its activities and business developments;
- external verification of certain information/processes/performance standards; and
- review of access to CDS by unaffiliated marketplaces and dealers.

With these additional protections in place the Regulatory Authorities concluded that it is in the public interest to continue to recognize CDS as a clearing agency.<sup>4</sup>

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<sup>4</sup> The Competition Bureau conducted its own review of Maple's proposed acquisition and published a statement indicating the measures contained in the OSC's final recognition order changed the regulatory environment sufficiently to substantially mitigate its competition concerns. See Competition Bureau's position statement dated July 4, 2012 (<http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03480.html>).

## Staff's Approach in Reviewing Proposed Amendments to CDS' Fees

CDS must file any proposed amendments to its fee schedule with the Regulatory Authorities for approval pursuant to its recognition orders. This section sets out Staff's approach when reviewing and evaluating any CDS proposed fee amendments and recommending to the Regulatory Authorities whether to approve a CDS' proposal.

The key principles underlying the Regulatory Authorities' expectations about how CDS sets its fees include:

- (a) fair access to CDS' services,
- (b) equitable allocation of fees and costs,
- (c) commercially reasonable fee structures,
- (d) non-discriminatory basis and
- (e) provision of sufficient resources to CDS.

In other words, the Regulatory Authorities recognize that CDS must have sufficient resources to provide clearing, settlement and depository services given the centrality of its functions to the Canadian capital markets, and expect that CDS will do so in a fair, equitable and appropriate manner.

In particular, the following sections from the recognition orders of the Regulatory Authorities<sup>5</sup> are relevant to our fee reviews:

### *Criteria of recognition:*

- All fees imposed by the clearing agency are equitably allocated. The fees do not have the effect of creating unreasonable barriers to access. (OSC s. 2.1; AMF 10.1 & 25.2)
- The process for setting fees is fair and appropriate, and the fee model is transparent. (OSC s. 2.2; AMF 10.1)
- The clearing agency has sufficient financial resources for the proper performance of its functions and to meet its responsibilities and allocates sufficient financial and staff resources to carry out its functions as a clearing agency in a manner that is consistent with any regulatory requirements. (OSC s. 8.1; AMF 41.1)

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<sup>5</sup> The above-mentioned provisions are the sections of the OSC recognition order. The equivalent AMF provisions achieve substantially the same outcome. The BCSC recognition order indirectly requires CDS to comply with these provisions by requiring CDS to comply with the terms and conditions set out in the OSC recognition order (see s. 2 of the BCSC recognition order).

*Terms and conditions of recognition:*

- The recognized clearing agency shall not, directly or indirectly:
  - (a) permit unreasonable discrimination among existing and potential Participants and marketplaces; or
  - (b) impose burden on competition that is not reasonably necessary or appropriate. (OSC s. 6.2; AMF 25.3)
- The recognized clearing agency shall allow any person or company, including other third party post-trade service providers, to interface or connect to any of its services or systems on a commercially reasonable basis, for the purposes of facilitating post-trade processing of securities transactions by Participants. (OSC s. 6.6; AMF 25.7)
- The recognized clearing agency shall provide its services and products, including any interface or connection to its services or systems, to any person or company, including a third party service provider, on a non-discriminatory basis and at service level or performance standards comparable to that which would be provided to its affiliated entities. (OSC s. 6.8; AMF 25.9)
- The recognized clearing agency's fees shall not have the effect of unreasonably creating barriers to access the recognized clearing agency's services or discriminating between users of the recognized clearing agency's services or marketplaces, and shall be balanced with the criterion that the recognized clearing agency has sufficient revenues to satisfy its responsibilities. (OSC s. 7.1; AMF 26.1)
- The recognized clearing agency shall not, through any fee schedule, fee model or any contract with any Participant or other market participant, provide any discount, rebate, allowance, price concession or similar arrangement on any services or products offered by the recognized clearing agency that is conditional upon the purpose of any other service or product offered by the recognized clearing agency or any affiliated entity. (OSC s. 7.2; AMF 26.2)
- The fees shall be charged on a per transaction basis and shall not provide a discount, rebate, allowance or similar price concession based on a Participant's level of activity. (OSC s. 7.3; AMF 26.3)
- The fees, costs or expenses borne by the recognized clearing agency, and indirectly by the users of the recognized clearing agency's services, for each of the services provided by the recognized clearing agency, shall not reflect any cost or expense incurred by the recognized clearing agency in connection with an activity carried on by the recognized clearing agency that is not related to that service. (OSC s. 8.4; AMF 27.4)

Staff will review and evaluate any CDS' fee proposals against these required outcomes. The overall objective of Staff's review is to determine whether the proposed fees are fair, equitable and appropriate and balance the need for CDS to maintain sufficient resources to provide critical functions.

Specifically, to understand whether the required outcomes have been met, Staff take into consideration:

- the potential impact of the proposed fee change or new fee to the safety and efficiency of, and competition within, Canada's capital market;<sup>6</sup>
- the potential impact of the proposed fee change or new fee on access to Canada's capital markets;
- the anticipated impact to CDS' customers (current and prospective);
- views expressed by customers and other stakeholders during the consultation with respect to the proposal;
- the reason(s) for the fee change or new fee;
- how other businesses and revenues of CDS would be impacted;
- the projected change in revenue for CDS;
- historic and projected costs of CDS in providing the particular service;
- how financial ratios that must be maintained by CDS pursuant to its recognition order will be impacted;
- the movement of overhead and direct costs between CDS' services, and between core and non-core services;
- how the proposed fees benchmark to fees for comparable services in other jurisdictions; and
- how the proposed fees will be rolled out and implemented.

Staff note that the above are general minimum guiding factors for our evaluation of CDS' fee proposals, and no single factor will be determinative in an assessment. Staff may take into consideration other factors on a case by case basis as necessary.

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<sup>6</sup> In assessing the impact of a fee proposal on Canada's capital market, BCSC staff also pay particular focus on Canada's public venture market.

Questions on this Notice may be referred to:

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