

Jack Rando

Director, Capital Markets
416.687.5477/jrando@iiac.ca

Barbara J. Amsden

Director, Special Projects
416.687.5488/bamsden@iiac.ca

Mr. Bob Hutchison
Borden Ladner Gervais LLP
Scotia Plaza, 40 King St. W.
Toronto, ON M5H 3Y4

Dear Bob:

Re: CDS Clearing and Depository Services (“CDS”) Rules and Arrangements Review

Thank you for providing the Investment Industry Association of Canada (“the IIAC”) the opportunity to contribute input as you prepare your Report, under the Orders of the Ontario Securities Commission and Autorité des marchés financiers approving CDS as a clearing agency, on the “rules and arrangements” of CDS following its acquisition by Maple Group in 2012. We understand the Report and review are to assess whether CDS’s rules and arrangements continue to be appropriate in light of the change in ownership structure and for-profit business model of CDS as a result of its acquisition by the Maple Group indirectly through the TMX Group Inc. (“the TMX”). The TMX’s reputation in Canada and abroad as a forerunner among global exchanges and innovator speaks for itself, and we know that the TMX will ensure CDS’s status as one of the world’s top-ranked depository, clearing and settlement organizations is maintained. Our members and we appreciate the smooth transition and have great respect and appreciation for CDS’s excellent staff, with whom we sometimes work closely. We also know that a good many issues have been reflected well in the Recognition Order (“the Order”) and so trust that BLG will be able to assist CDS stakeholders through its Report, in the case of our few comments below, by:

- Linking our comments to specific Rules, including “Procedures and formal and informal agreements and circumstances that govern or directly affect CDS participants [and others]” (“the Rules and Arrangements”) – we understand that these include, for example, inter-participant agreements such as credit rings, would be captured by this definition; and
- Identifying the implications of any conclusion in the Report that a Rule or Arrangement is not appropriate, for example, if the outcome results in CDS shedding certain activities, what might the impact be on costs; or, for example, if this results in a potential reduction in information needed by the securities industry, whether there is scope to recommend that access to the information is material to the efficient operation of capital markets and should be continued.

General Comments

As the operator of CDSX, CDS oversees one of only four pieces of capital market infrastructure designated as systemically important under Canada’s *Payment Clearing and Settlement Act*. Our

expectation, and that of our Member Firms, is that CDS's change in ownership structure and for-profit business model should not interfere with the efficient and continual functioning of CDSX and other CDS services essential for IIAC Member Firms' businesses and investors' participation in our capital markets. In other words, CDS must be able to continue providing critical services in all circumstances. To this end, as users, rather than owners, IIAC Member firms will rely considerably more on CDS's regulators to verify that CDS's risks are appropriately controlled and that CDS itself is not a channel through which systemic risk can be transmitted to the Canadian marketplace.

- The preamble to the Order states: "AND WHEREAS the Commission considers the operation of a clearing agency in the public interest to include, among other things, appropriate governance arrangements, fair access and services to all market participants, adequate management of risk, including systemic risk, and operational reliability, fair and non-discriminatory fees, and appropriate rules and procedures to foster competition in the Canadian financial markets;". CDS's stated mission goes beyond this and is, we believe, more appropriate to the public interest. That is, CDS's mission is "driven by the evolving needs of our stakeholders, we provide valued, secure and reliable securities market services that continuously improve efficiency, effectiveness and global competitiveness" (*emphasis added*). Readers of the Order may debate whether the word "adequate" is "sufficient" when it comes to risk management; also, there is a concern due to the absence of explicit reference to continuous efficiency improvement in the Order. **For clarity, IIAC Member Firms request that this be referenced in the Report as consistent with the public interest references in the Order and importance of the depository, clearing and settlement system, and related services, to the OSC's, AMF's and other securities commissions' mandates with respect to capital markets efficiency and investor protection. As well, we hope that the Report will recommend that CDS's annual public interest report (section 2.3) and on Participant Committees' recommendations/comments with TMX responses (section 4.5) be made available to CDS participants.**
- We know that CDS will continue to be required to meet new regulations. For example, and as mentioned in the Recognition Order, CDS is expected to conform with the Committee on Payment and Settlement Systems (CPSS)/International Organization of Securities Commissions (IOSCO) (CPSS-IOSCO) *Principles for Financial Market Infrastructure* (PFMI) (2012). The Principles present a prudent risk management framework that can be consistently applied across jurisdictions, although how the principles may be met can differ. Adoption of the Principles, however, likely will lead to changes in current costs and may lead to amendments to the obligations of CDS participants, particularly smaller participants. **We believe that it is paramount that CDS be mandated, consistent with the Recognition Order's emphasis on fair access, to include meaningful measurement, to the extent reasonable, of the impact on small, medium and large dealers in the commentary accompanying draft rules, including housekeeping changes, and that sufficient time for review and for implementation is provided, so that the services remain accessible for dealers of all sizes (Appendix A, subparagraph 4(b)(iii)C).**
- It is also important that depositories provide or co-operate in the provision of disclosure and assessments regarding adherence to principles of good business and that they make this information available publicly. Other depositories, following CDS's lead in the past, assess themselves or are assessed against certain standards, some voluntary and others mandatory. Three noteworthy ones in the past were CDS's self-assessments against:
 - CPSS-IOSCO Principles.
 - The G30 [Global Clearing and Settlement: A Plan of Action](#) (2003)
 - *ISSA Recommendations 2000*.

Such standards and best practices may be updated and there may be new ones. We believe there is benefit to having appropriate third parties assess and/or for CDS to self-assess against these, and publish the results. We suspect that CDS would continue to participate in such exercises. **We recommend that the Report provide that CDS continue to complete self-assessments, made public as in the past, against CPSS-IOSCO principles as provided for in the Recognition Order and other credible bodies' recommended practices (e.g., those of the Group of Thirty) to inform CDS participants and others with a material interest in the cost-efficient, secure operation of Canadian markets.**

Participant Committees

CDS has relied extensively over the years on its Strategic Development Review Committee (SDRC) and its subcommittees for participant input on CDS initiatives. In its current format, we continue to see the SDRC and subcommittees as effective Participant Committee channels for incorporating views of CDS's participants into CDS's Rules and Arrangements and service offerings. The Order provides for any contemplated material changes to the committee framework to be subject to consultation with participants and in this regard we understand that SDRC participants have been asked to comment on the new SDRC make-up and mandate. **Whatever the make-up of the committees, we believe that CDS participants should be entitled to listen to meetings or at least to receive, on a timely basis, agenda material and minutes as a way to keep apprised of planned developments (and possible impacts on their budgets and technology).** As well, while not referenced formally, but based on previous Rules and Arrangements, it would be helpful for the Report to confirm that the triennial review of fees (section 20.1) would be a report presented to and reviewed with participant committees before presentation to the OSC and AMF.

Bullet-proof Reliability and Disaster Recovery

CDS has an enviable reputation in terms of business continuity with a very high degree of service reliability. There is every reason for CDS to continue to operate as it has in the past.

- **Service Level Standards**

CDS had an enviable reputation for meeting uninterrupted delivery targets. These included, from the last published source identified, most of the items listed in Schedule D to the Recognition Order, however, one former service level standard is not specifically described and a second is not referenced. **We recommend that the Report add reference to one and provide clarification of two service level standards, specifically:**

- Under the disaster recovery provision, CDS participants would like to see completion of a successful annual community-involved test once per year, AND CDS will complete a successful annual processing cycle test once per year as it had in the past.
- CDS participants would like to see continued operation of CDS's innovative claims process where participants could seek re-imburement from CDS, up to a standard annual limit (\$240,000 at one time), to keep CDS focused on full reliability and provide CDS participants with an effective way of ensuring the high-quality and value of CDS services is maintained; as previously, claims submitted by CDS participants should be processed within 20 business days, with management's decision presented to the audit/risk committee at its next meeting for information purposes.
- CDS Participants would be entitled to receive the results (or relevant parts of the results) of the 3416 Report as in the past for regulatory and their internal risk management purposes.

- **Emergency Preparedness**

CDS plays a critical role in emergencies such as blackouts and, most notably, 9/11. As part of critical infrastructure, CDS co-ordinates with the Bank of Canada, Canadian Payments Association and Canadian Bankers Association, under the auspices of a group at least formerly known as the Problem Resolution Group, to continue to facilitate the exchange of cash for securities and cash for cash. As part of the communications necessary for service continuing during such situations, IIAC Member Firms and its regulator were able to obtain information critical to their being able to continue to serve their clients whose assets remain at considerable market risk during a business outage (for example, information from utilities as to when power may resume, etc.). **We strongly believe that the Report should recommend that a designated IIAC staff person be included in those entitled to listen to emergency calls and receive reports during critical events. This is to enable us to keep IIAC Member Firms aware of key matters, which IIAC staff will keep confidential as appropriate, that will affect delivery of Member Firm services to their clients, just as banks are in a position to obtain such emergency information through their industry association.**

Specific CDS Services

We believe there are conditions or circumstances particular to CDS's services and products that justify continuation of unique Rules and Arrangements, although they may exist in all other depository, clearing and settlement organizations. These include the following:

- **Income Tax Requirement**

Sections 204.1 and 229.1 of the *Income Tax Act Regulations* provide for:

"... the disclosure to the public of certain information by public trusts and public partnerships. The purpose of these rules is to make information available with respect to distributions or allocations of income, losses and capital of a public trust or public partnership so that information returns such as the T3 information return in respect of trusts and T5013 information return in respect of partnerships can be prepared on a timely basis by those that require this information. The type of information that would be made available would be the information that is currently disclosed by public trusts and public partnerships on the Internet website of CDS Innovations Inc., a subsidiary of the Canada Depository for Canadian Securities Limited" (<http://www.fin.gc.ca/n07/07-058-eng.asp>)"

Related to this requirement, CDS Innovations offers users (for a fee) a file feed of data extracted from this Mutual Fund and Limited Partnership Tax Breakdown Service, for reporting to the CRA. Public access to this facility, the ability of issuers to file on it annually, and extraction of the data for use in tax reporting are critical to the Canadian tax system and important to the reputation of, and confidence in, the Canadian securities industry and IIAC Member Firms. CDS staff are annually involved with the IIAC, representing the industry, in implementing changes reflecting tax changes received from the CRA that affect the CDS spreadsheet posting facility and file feed. Once the CRA requirements are known, this involvement extends to CDS committing trained staff on a timely basis to programming and development to be ready for the tax reporting season, and to upload, on an as-required basis, information to the posting facility and its French equivalent.

- **Account Transfer – Online Notification (ATON)**

CDS is host to ATON, which automates the exchange and confirmation of requests for transfer and asset list details between the deliverer and receiver of account transfers. IIAC Member Firms and other regulated financial firms rely on ATON for the efficient transfer and receipt of client account assets. For IIAC Member Firms, the prescribed use of ATON is contained in IIROC Dealer Member Rule 2300, and is an important part of what enables IIROC dealers to meet investor expectations of timely account transfers at a 10-business day standard not met by a number of other parts of the financial industry.

We recommend that the Report clearly identify as Rules and Arrangements that should continue to be mandated as part of CDS the Mutual Fund and Limited Partnership Tax Breakdown Service and ATON – both examples of CDS services pointed to by third-party regulations. Their mandated use by stakeholders will require CDS to ensure sufficient resources and oversight are maintained over such services.

Other

- **Institutional Trade Matching**

CDS was host to the Canadian Capital Markets Association (CCMA), the formalization of Canada's Group of Thirty Advisory Committee that had co-ordinated Canada's move from T+5 to T+3, drawing together dealers, custodians and asset managers. With CDS having a critical role to play in achieving a shorter settlement cycle and being a central third party, the CCMA played a critical role when it appeared in the late 1990s that the U.S. was going to shorten its settlement cycle to T+1. While Canada and the U.S. have distinct market features, Canadian and U.S. markets must move in lockstep when it comes to the settlement cycle. The CCMA is currently not active as it was in the past, however, CDS still hosts the CCMA website on which certain information is posted and CDS provides certain support. **We recommend that the Report clearly identify that the remaining CCMA functions remain reasonably within CDS as it relates to institutional trade matching.**

- **Shortening the Settlement Cycle**

Recently, there again have been discussions of a shorter settlement cycle in the U.S. and Europe, and the benefit of shortening the settlement cycle can only be achieved if all parties to the transaction process work together. In such an eventuality, there is a need for a funded, central, independent, credible organization that is not aligned with a single segment of the investment industry and the CCMA served that function. TMX and what is now IIROC funded the CCMA, with others that had a material interest in efficient and competitive capital markets, and we hope to be able to count on both (and others) to finance co-ordination of any such move in future to keep pace, as we must, with the U.S. and Europe. This is fair because shorter settlement cycles will benefit all Canadians ultimately. **We would be happy to discuss with CDS and the TMX any necessary re-engagement of the CCMA.**

Thank you for providing us with this opportunity to provide input into the Report. CDS has played a considerable and impressive role in the development of the Canadian capital markets and has been well-respected as one of the earlier and best-run depositories, highly rated by such organization as Thomas

Murray. We know that the TMX has a deep interest in CDS and its depository, clearing, settlement and other services remaining efficient and secure. We would be happy to discuss any of our comments with you in further detail.

Yours sincerely,



Cc:

Jean Desgagné, CDS

Max Paré, OSC

Jacinthe Bouffard, AMF

Richard Corner, IIROC