

### 13.3 Clearing Agencies

#### 13.3.1 The Canadian Depository for Securities Limited and CDS Clearing and Depository Services Inc. – Application to Vary the Recognition Order – Request for Comment

##### REQUEST FOR COMMENT

##### APPLICATION TO VARY THE RECOGNITION ORDER FOR THE CANADIAN DEPOSITORY FOR SECURITIES LIMITED AND CDS CLEARING AND DEPOSITORY SERVICES INC.

#### A. Background

The Ontario Securities Commission (**Commission**) issued an order dated July 4, 2012, as varied and restated, pursuant to section 21.2 of the Securities Act (Ontario) (Act) continuing the recognition of The Canadian Depository for Securities Limited and CDS Clearing and Depository Services Inc. (collectively, **CDS**) as clearing agencies (**Recognition Order**).

CDS has filed an application (**Application**) with the Commission requesting that an order be granted varying the definition of an “independent director” in the Recognition Order (**Draft Order**) pursuant to section 144 of the Act for the limited purpose of permitting the same individuals to be considered “independent” for the boards of directors (**Boards**) of CDS and the Canadian Derivatives Clearing Corporation (**CDCC**), an affiliate of CDS. This would have the effect of enabling CDS and CDCC to have a mirror Board and, consequently, mirror Board committees.

#### B. Draft Variation Order

The Draft Order would vary the independence definition in section 4.3(a) of Schedule “B” of the Recognition Order to provide that notwithstanding paragraphs 4.3(a) (ii), (iii) and (iv) of such definition, a director of CDCC is not considered to be non-independent solely on the ground that he or she is a director, or in the case of the chair of the Board only, an officer, of CDCC, or in the case of the chair of the Board only, an officer of CDS<sup>1</sup>.

Subject to comments received, staff propose to recommend to the Commission that it grant CDS an order in the form of the proposed Draft Order attached at Appendix A.

#### C. Comment Process

The Commission is publishing for public comment the Application and Draft Order. We are seeking comment on the Application and Draft Order.

You are asked to provide your comments in writing, via e-mail and delivered on or before **November 11, 2017** addressed to the attention of the Secretary to the Commission, Ontario Securities Commission, 20 Queen Street West, Toronto, Ontario, M5H 3S8, e-mail: [comments@osc.gov.on.ca](mailto:comments@osc.gov.on.ca).

The confidentiality of submissions cannot be maintained as comments received during the comment period will be published.

Questions may be referred to:

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<sup>1</sup> CDS is defined as a recognized clearing agency in the Recognition Order.

**APPENDIX "A"**

**IN THE MATTER OF  
THE SECURITIES ACT,  
R.S.O. 1990, c. S.5, AS AMENDED  
(Act)**

**AND**

**IN THE MATTER OF  
THE CANADIAN DEPOSITORY FOR SECURITIES LIMITED  
AND  
CDS CLEARING AND DEPOSITORY SERVICES INC.**

**VARIATION ORDER (Section 144 of the Act)**

**WHEREAS** the Ontario Securities Commissions (**Commission**) issued an order dated July 4, 2012, as varied and restated on December 21, 2012 and as varied on December 7, 2012, May 1, 2013, June 25, 2013, June 24, 2014, January 27, 2015, March 27, 2015 and December 20, 2016, pursuant to section 21.2 of the Act continuing the recognition of The Canadian Depository for Securities Limited (**CDS Ltd.**) and CDS Clearing and Depository Services Inc. (together with CDS Ltd., **CDS**) as clearing agencies (the **Clearing Agency Recognition Order**);

**AND WHEREAS** CDS has filed an application (**Application**) with the Commission to vary the Clearing Agency Recognition Order pursuant to section 144 of the Act to replace the definition of "independent" in section 4.3(a) of Schedule "B" of the Clearing Agency Recognition Order (the **Independence Definition**) for the limited purpose of permitting the same individuals to be considered "independent" for the boards of directors of both CDS and the Canadian Derivatives Clearing Association (**CDCC**);

**AND WHEREAS** the Application requests that the Commission vary the Independence Definition to provide that notwithstanding paragraphs (ii), (iii) and (iv) of such definition, a director of CDCC is not considered to be non-independent solely on the ground that he or she is (v) a director, or in the case of the chair of the board of directors only, an officer, of CDCC, or (vi) in the case of the chair of the board of directors only, an officer of CDS, a recognized clearing agency;

**AND WHEREAS** the Commission has determined based on the Application and representations made by CDS that it is not prejudicial to the public interest to vary the Clearing Agency Recognition Order to replace the Independence Definition;

**IT IS HEREBY ORDERED** that, pursuant to section 144 of the Act, section 4.3(a) of Schedule "B" of the Clearing Agency Recognition Order is deleted and replaced with the following:

- (a) a director is independent, if the director is not:
  - (i) an associate, partner, director, officer or employee of a significant Maple shareholder;
  - (ii) an associate, partner, director, officer or employee of a Participant of the recognized clearing agency or such Participant's affiliated entities or an associate of such director, partner, officer or employee; or
  - (iii) an associate, partner, director, officer or employee of a marketplace or such marketplace's affiliated entities or an associate of such partner, director, officer or employee, or
  - (iv) an officer or employee of the recognized clearing agency or its affiliated entities or an associate of such officer or employee,notwithstanding paragraphs (ii), (iii) and (iv) above:
  - (v) a director of the Canadian Derivatives Clearing Corporation (**CDCC**) is not considered to be non-independent solely on the ground that he or she is a director, or in the case of the chair of the board of directors only, an officer, of CDCC; and
  - (vi) the chair of the board of directors of the recognized clearing agency is not considered non-independent solely on the ground that he or she is an officer of the recognized clearing agency; and

DATED at Toronto this \_\_\_\_\_ day of \_\_\_\_\_, 2017.

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*[Editor's Note: CDS' application for an order varying the recognition order for The Canadian Depository for Securities Limited and CDS Clearing and Depository Services Inc. follows on separately numbered pages. Bulletin pagination resumes with the index for this issue.]*



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August 14, 2017

**VIA OSC ELECTRONIC PORTAL**

Ontario Securities Commission  
20 Queen Street West, 22<sup>nd</sup> Floor  
Toronto, Ontario M5H 3S8

Attention: Secretary to the Commission

Dear Sirs/Mesdames:

**Re: Application for an order varying the recognition order for The Canadian Depository for Securities Limited and CDS Clearing and Depository Services Inc.**

The Canadian Depository for Securities Limited (“**CDS Limited**”) and CDS Clearing and Depository Services Inc. (“**CDS Clearing**”, and collectively with CDS Limited, “**CDS**”) are hereby applying to the Ontario Securities Commission (“**OSC**”) for an order varying the CDS recognition order. The variation order would revise the definition of an “independent” director to enable an individual to be an independent director of CDS, notwithstanding that the individual is also a director of the Canadian Derivatives Clearing Corporation (“**CDCC**”), so long as the individual meets all other director independence criteria in the CDS recognition order (the “**Requested Variation Order**”).<sup>1</sup>

CDS and CDCC are applying to the Autorité des marchés financiers (“**AMF**”) for similar variation orders. These variations to the CDS and CDCC recognition orders would have the effect of enabling CDS and CDCC to have mirror boards of directors and, consequently, mirror board committees.

TMX Group Limited (“**TMX**”), CDS and CDCC have embarked on a business initiative to bring CDS and CDCC closer together. This initiative is part of a vision that is designed to advance TMX’s evolution as a client-driven solutions provider to the Canadian and global capital markets. This vision includes an organizational emphasis on increasing efficiencies across the TMX enterprise. One phase of this initiative included a realignment that resulted in one individual, Glenn Goucher, becoming President and Chief Clearing Officer of CDS while retaining his position

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<sup>1</sup> We note that revised definition will also clarify that the chair of the board of directors of CDCC and CDS will not be considered non-independent solely on the grounds that he or she is an officer of CDCC and CDS. Pursuant to the *Canada Business Corporations Act*, which is CDS and CDCC’s incorporating statute, the chair of the board of directors is an officer of the corporation.

of President and Chief Clearing Officer of CDCC, and one individual, George Kormas, becoming the Chief Risk Officer of both clearing houses.

Bringing CDS and CDCC together under one leader has harmonized our efforts to bring efficiencies across the risk, operations, systems and business development areas of the clearing houses. Consistent with this, CDS and CDCC have determined that creating mirror boards of directors to oversee the activities of the President and the risk operations of CDS and CDCC is an appropriate next step in this evolution. For the purposes of this application, “mirror boards” means that each of CDS and CDCC will continue to have its own, separate board of directors, but that each board will be populated with the same individuals. Similarly, “mirror board committees” means that each of CDS and CDCC will continue to have its own separate board committees, but that the same committee of each board will be populated with the same individuals.

### Recognition order provisions

The OSC’s varied and restated order recognizing CDS as a clearing agency dated December 21, 2012, as amended (the “**OSC CDS Recognition Order**”), the AMF’s Decision No. 2012-PDG-0142 recognizing CDS as a clearing house, as amended (the “**AMF CDS Recognition Order**”, and together with the OSC CDS Recognition Order, the “**CDS Recognition Orders**”), and the AMF’s Decision No. 2012-PDG-0078 recognizing CDCC as a clearing house, as amended (the “**CDCC Recognition Order**”),<sup>2</sup> contain provisions that have the effect of preventing CDS and CDCC from realizing the benefit of mirror boards of directors, as the definition of “independence” in these orders prevents CDS and CDCC from cross-appointing independent directors.

The CDS Recognition Orders require that 33% of the members of the CDS board of directors be independent, as that term is defined in the CDS Recognition Orders. The definition of the term “independent” states:

a director is independent, if the director is not;

- (i) an associate, partner, director, officer or employee of a significant Maple shareholder,
- (ii) an associate, partner, director, officer or employee of a Participant of the recognized clearing agency or such Participant's affiliated entities or an associate of such director, partner, officer or employee,
- (iii) an associate, partner, director, officer or employee of a marketplace or such marketplace's affiliated entities or an associate of such partner, director, officer or employee, or
- (iv) an officer or employee of the recognized clearing agency or its affiliated entities or an associate of such officer or employee.<sup>3</sup>

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<sup>2</sup> We note that the OSC CDCC recognition order dated April 8, 2014 incorporates the CDCC Recognition Order as an appendix and therefore indirectly contains provisions that have the effect of preventing CDS and CDCC from having mirror boards of directors. Further, TMX Group Limited’s undertakings to the AMF dated April 30, 2012 incorporate by reference the definition of “independent” in the CDCC Recognition Order.

<sup>3</sup> See s. 4.2 and s. 4.3 of the OSC CDS Recognition Order and s. 23.2 and 23.3 of the AMF CDS Recognition Order. Capitalized terms in this definition have the meaning ascribed to them in the CDS Recognition Orders.

The CDCC Recognition Order, similarly, requires that 33% of the members of the CDCC board of directors be independent, as that term is defined in the CDCC Recognition Order.<sup>4</sup>

The combined effect of paragraphs (iii) of the definition of “independent” in the CDS Recognition Orders and the CDCC Recognition Order is to preclude cross-appointments of independent directors between the CDS and CDCC boards. Paragraph (iii) of the CDS Recognition Orders excludes directors of an affiliated entity of a marketplace from being considered independent directors of CDS. CDCC is an affiliate of TSX Inc., Montréal Exchange Inc., TSX Venture Exchange Inc. and Alpha Exchange Inc., which are all marketplaces. Therefore, none of the independent directors of CDCC are independent for the purposes of the CDS Recognition Orders. Similarly, paragraph (iii) of the CDCC Recognition Order excludes directors of an affiliate of a marketplace that clears through CDCC from being considered independent directors of CDCC. Montréal Exchange Inc. clears through CDCC and is also an affiliate of CDS. Therefore, none of the independent directors of CDS are independent for the purposes of the CDCC Recognition Order. This is ultimately because CDS, CDCC and the marketplaces that clear through CDS and CDCC are under common control.

Additionally, paragraph (ii) of the definition of independence in the CDS Recognition Orders excludes directors of CDS participants from being considered independent directors of CDS. CDCC is technically a participant of CDS. As a result, none of the independent directors of CDCC are independent for the purposes of the CDS board.

In order for CDS and CDCC to have mirror boards of directors, CDS is requesting an order varying the definition of “independent” in the OSC CDS Recognition Order for the limited purpose of permitting the same individuals to be considered “independent” for both the CDS and CDCC boards of directors.<sup>5</sup> In particular, CDS is requesting that the revised definition of “independent” read as follows (the new text is underlined>):

a director is independent, if the director is not;

- (i) an associate, partner, director, officer or employee of a significant Maple shareholder;
- (ii) an associate, partner, director, officer or employee of a Participant of the recognized clearing agency or such Participant’s affiliated entities or an associate of such director, partner, officer or employee; or

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<sup>4</sup> The definition of the term “independent” in the CDCC Recognition order states:

an independent director means a person who is not:

- (i) a partner, director, officer or employee of a Significant Maple Shareholder;
- (ii) a partner, director, officer or employee of a CDCC member or of an affiliate of such member, or an associate of such partner, director, officer or employee;
- (iii) a partner, director, officer or employee of a marketplace that clears through CDCC or of an affiliate of such marketplace, or an associate of such partner, director, officer or employee; or
- (iv) an officer or employee of CDCC or of a CDCC affiliate, or an associate of such officer or employee;
- (v) notwithstanding subparagraphs (i) to (iv) above and the definition of “officer” in section 3 of the Derivatives Act, the Chair of the Board of Directors is not considered to be non-independent solely on the ground that he or she is, or has been within the last three years, Chair of the Board of Directors of CDCC on a part-time basis.

<sup>5</sup> The independent directors of the CDS and CDCC mirror boards of directors will not be members of the board of directors of another TMX entity.

- (iii) an associate, partner, director, officer or employee of a marketplace or such marketplace's affiliated entities or an associate of such partner, director, officer or employee, or
- (iv) an officer or employee of the recognized clearing agency or its affiliated entities or an associate of such officer or employee,

notwithstanding paragraphs (ii), (iii) and (iv) above:

- (v) a director of the Canadian Derivatives Clearing Corporation ("CDCC") is not considered to be non-independent solely on the ground that he or she is a director, or in the case of the chair of the board of directors only, an officer, of CDCC, and
- (vi) the chair of the board of directors of CDS<sup>6</sup> is not considered non-independent solely on the ground that he or she is an officer of CDS.

### **Rationale for mirror boards of directors**

Having mirror boards of directors is an extension of the initiative that CDS and CDCC are currently undertaking to work more closely together. This initiative is part of the TMX vision to increase collaboration among entities and focus on increasing efficiencies across the TMX enterprise. This broad vision includes a strategy to achieve a number of very important goals. While each clearing house will continue to manage a separate risk pool, with its own rule book and processes, we have undertaken a project to form a common technology platform to support the two clearing houses. In addition, as part of the CDS and CDCC initiative to work more closely together, we effected an organizational redesign to allow one individual, Glenn Goucher, to be the President and Chief Clearing Officer of both clearing houses.

Management of CDS and CDCC believe that it is in the public interest for CDS and CDCC to have mirror boards of directors due to the level of interaction between CDS and CDCC (interaction that can result in efficiencies for participants and other stakeholders). This is particularly true given the relatively small size of the Canadian market as compared to the markets that are served by our global clearing house peers. In the case of all nominees to the boards of directors, the respective Governance Committees<sup>7</sup> must assess nominees to ensure that they each possess the appropriate competencies, skills, expertise and experience, when complemented by the other directors, to guide the strategies and business operations of the clearing house. The respective Governance Committees will continue to consider the independence, professional or board expertise, and other relevant expertise and experience of nominees. In particular, the selection criteria will continue to focus on identifying knowledgeable persons who understand the industry and have subject matter expertise in derivatives clearing and equities clearing. The objective will continue to be to ensure that the board's composition provides an appropriate mix of skills and experience. Using mirror boards will not diminish in any way the broad skills and qualifications that the clearing houses seek in their board members.

We acknowledge that the effect of the mirror boards is that every director will be a director of two clearing houses. CDS and CDCC are mindful that each director must be in a position to commit sufficient time to these directorships in order to successfully fulfil his or her director roles. The

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<sup>6</sup> CDS is defined as the "recognized clearing agency" in the CDS Recognition Orders.

<sup>7</sup> As discussed above, we note that the CDS and CDCC Governance Committees will be populated by the same individuals.

clearing houses will ensure that each director is aware of the time commitment related to these directorships by clearly communicating expectations regarding directors' responsibilities and workload before nominating an individual to the board. The clearing houses will schedule board and committee meetings in a manner that provides directors with sufficient time to fulfil their obligations to each clearing house. Given improved coordination among the clearing houses, as well as some of the dual CDS-CDCC oversight roles that are now undertaken by CDS and CDCC management, we are confident that the clearing house directors will be in a position to dedicate appropriate time to their director roles for both clearing houses.

We believe that using mirror boards at CDS and CDCC has the potential to enhance the ability of senior management at CDS and CDCC to manage risk, particularly by having the common President and a common Chief Risk Officer overseen by a common board of directors. We also believe that using mirror boards of directors has the potential to broaden the oversight capabilities of the CDS and CDCC board members. We discuss these opportunities in more detail below.

### ***Enhanced risk management***

A mirror board structure has the potential to improve the board's oversight of the overall risk profile of CDS and CDCC. CDS and CDCC intend to integrate risk management operations across the two clearing houses,<sup>8</sup> which will enable CDS and CDCC to manage risk effectively and consistently across both entities.<sup>9</sup> The integrated risk management operations, as well as improved coordination between the two clearing houses, will afford CDS and CDCC the opportunity to be more effective in certain scenarios, such as managing defaults. As the management of a clearing agency's risk profile is a significant oversight topic for its board of directors, having mirror boards of directors will ensure that each board has a holistic view of the overall risk profile of CDS and CDCC. As CDS and CDCC move toward integrating risk management operations across the two clearing houses, a mirror board structure will enhance the board's oversight of the overall risk profile of the two entities.

We note that the Companion Policy to National Instrument 24-102 *Clearing Agency Requirements* (the "**Companion Policy**") emphasizes the importance of a consolidated entity managing risk appropriately across the entity. The Companion Policy states that a consolidated entity should have an appropriate risk management framework that considers the risks of each subsidiary and the additional risks related to their interdependencies. Further, consolidated entities should identify and manage the risks they pose to one another as a result of their interdependencies.<sup>10</sup> CDS and CDCC believe that a mirror board structure aligns with this guidance and complies with the requirements in National Instrument 24-102 *Clearing Agency Requirements* ("**NI 24-102**").

The Committee on Payments and Market Infrastructures of the International Organization of Securities Commissions ("**CPMI IOSCO**") recently articulated that the board of a clearing house has ultimate responsibility for establishing a risk management framework and for the effectiveness of its implementation. In carrying out this responsibility, the board is not expected to itself implement the risk management framework or to carry out the day-to-day management of risks. Rather, the board, in discharging its ultimate responsibility over risk management matters, should work closely with the clearing house's management.<sup>11</sup> At each committee meeting, the Chief Risk

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<sup>8</sup> Certain integrations between the two clearing houses, including integration of risk management operations, may be subject to regulatory approval. We are not seeking regulatory approval for such integrations in this application.

<sup>9</sup> CDCC and CDS will continue to be separate legal entities with separate clearing funds. They will continue to have separate rule books and separate risk procedures for default management.

<sup>10</sup> See Box 2.2 of Annex I to the Company Policy.

<sup>11</sup> See Section 2.2 of the Final Report on the Resilience of Central Counterparties: Further Guidance on the PFMI



Officer provides each entity's Risk Management and Audit Committee ("**RMAC**") with an update regarding the clearing house's program for compliance with the Principles for Financial Market Infrastructures ("**PFMIs**"), including an update on the clearing house's gap assessment and closure program. These activities will continue under the mirror board structure. Therefore, compliance with the PFMIs will continue to be a key area of focus for the boards of CDS and CDCC.

### ***Enhanced operational oversight***

A mirror board structure will enhance the board of directors' oversight over the operations of each entity. The CDCC and CDS boards currently have four board members in common.<sup>12</sup> Each board has found that these directors are able to provide the board with important insight into the operations of the clearing agency due to these dual roles. We expect that there will be strengthened cross-organizational oversight from a board structure that results in all directors having insight into the operations of both clearing houses. Additionally, since CDS and CDCC now have one President and one Chief Risk Officer, reporting to mirror boards of directors will ensure that the board has a comprehensive view of all aspects of these roles. Therefore, the mirror board construct will allow for consistency in operational decision-making across both clearing houses, with all board members having the benefit of all relevant information.

The recognized exchanges within TMX – TMX Group Limited, TMX Group Inc., TSX Inc., TSX Venture Exchange Inc., Montréal Exchange Inc. and Alpha Exchange Inc. – have mirror boards. TMX Group Limited's undertakings to the AMF, the Alberta Securities Commission and the British Columbia Securities Commission require Montréal Exchange Inc. and TSX Venture Exchange Inc. to have mirror boards with TMX Group Limited. In this regard, one group of individuals is empowered with the oversight, including oversight of strategic development, of these entities. This construct enables the board members to ensure that they are provided with the appropriate level of information from each exchange, which gives the board members the knowledge to effectively oversee strategic decision-making for the organization. These strategic decisions can then be implemented in a consistent manner across the organization. Furthermore, we note that TMX's directors are able to devote the amount of time required to fulfil their fiduciary obligations to six separate entities, including an entity that is a reporting issuer and publicly traded company.<sup>13</sup> CDS and CDCC believe that a mirror board structure at the clearing house level will have similar benefits for these entities. CDS and CDCC believe that their directors will similarly be able to manage the time commitment associated with being members of the board of directors of more than one entity.<sup>14</sup>

### ***Alignment of interests between CDS and CDCC***

CDS and CDCC are aligned in terms of their risk management practices (including related to each entity's designation as a systemically important clearing house) and as regulated entities that operate in the public interest. Due to their systemic importance, their public interest responsibilities, the interdependence of their operations discussed above, and the overlap with respect to their key stakeholders, CDS and CDCC's interests are aligned. Each clearing house is under the common control of TMX Group Limited, which is ultimately accountable to regulators and the public. As noted above, CDCC is technically a participant of CDS. The board of directors

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published in July 2017 by CPMI IOSCO.

<sup>12</sup> Jean Desgagné, Glenn Goucher, Pat Cronin and Lloyd Costley.

<sup>13</sup> We note that many of TMX's directors are also members of the board of directors of other publicly traded companies.

<sup>14</sup> For greater certainty, we note that CDS and CDCC are not proposing that CDS or CDCC have mirror boards with the recognized exchanges.

of CDS may, therefore, consider the impact of corporate decisions on particular stakeholders, including CDCC, when considering what is in the best interests of the corporation. The reverse is also true for the board of directors of CDCC. CDS and CDCC believe that it is appropriate for the board of directors to consider such impacts, as long as the board of directors also considers the best interests of each corporation. The boards of directors would also need to be mindful of any potential conflicts of interest that could arise in the event of any related party transactions between CDS and CDCC. CDS and CDCC believe that it is unlikely that a circumstance will arise that would result in a potential conflict of interest between CDS and CDCC that would lead to board members being unable to fulfill their fiduciary obligations and public interest responsibilities with respect to each entity.

The governance arrangement we are proposing does not, apart from the potential dealings between CDS and CDCC resulting from CDCC's status as a participant of CDS, or a related party transaction, give rise to an inherent risk of a conflict of interest. The PFMI's lay out a number of specific board responsibilities, such as overseeing risk management, overseeing internal audit and ensuring compliance. CDS and CDCC do not believe that being a director of both entities will create a conflict for the director in carrying out his/her duties, since the approach of both CDS and CDCC to such issues is consistent. CDS and CDCC will ensure that their board members understand the PFMI's by providing training on these requirements, including the requirements regarding risk management. The PFMI's indicate that the key characteristic of independence is the ability to exercise objective, independent judgment after fair consideration of all relevant information and views and without undue influence from executives or from inappropriate external parties or interests. The mirror board structure proposed by CDS and CDCC fulfills these requirements.

The mirror board structure discussed above for TMX's recognized exchanges permits independent directors on one board to qualify and count towards the necessary independence requirements on the affiliated board, and vice versa. Similarly, directors that are independent for the purposes of the TMX Group Limited board of directors are also considered independent for the purpose of the board of directors of Natural Gas Exchange Inc. In developing NI 24-102, regulators put in place governance requirements, including guidance with respect to independence requirements, which apply to all Canadian-recognized clearing agencies. NI 24-102 does not prevent independent directors of affiliated entities or participants from serving as independent directors on a clearing agency's board even though it is common for clearing agencies to be part of a larger conglomerate that consists of other clearing agencies and exchanges. We note that other exchange/clearing conglomerates operating in Canada are not subject to restrictions imposed by Canadian securities regulators that are equivalent to paragraph (iii) of the definition of "independent" in the CDS Recognition Orders and the CDCC Recognition Order.

CDS submits that since the same individuals are considered independent directors for the purposes of the boards of directors of TMX Group Limited's recognized exchanges and Natural Gas Exchange Inc., Canadian securities regulators have recognized that such an arrangement does not by itself create a conflict. Similarly, CDS submits that NI 24-102 and the guidance in Companion Policy do not appear to presume that a conflict of interest exists for a similar governance arrangement among clearing agencies.<sup>15</sup> Therefore, CDS and CDCC believe that the Requested Variation Order complies with the regulatory standards applicable to Canadian clearing houses set out in NI 24-102 and the Companion Policy.

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<sup>15</sup> See Box 2.2 of Annex I to the Company Policy.

## **Rationale for mirror board committees**

As discussed above, having mirror boards of directors is an extension of the initiative that CDS and CDCC are currently undertaking to work more closely together. Having mirror board committees is the natural extension of the mirror board structure. Management of CDS and CDCC believe that it is in the public interest for CDS and CDCC to have their board committees operate on a mirror basis due to the level of overlap in the responsibilities and expertise required for the corresponding committees. Further, we believe that the alternative, having the corresponding committees of CDS and CDCC composed of different directors, would be unworkable.

## ***Alignment of committee responsibilities***

The responsibilities and expertise required of members of the CDS and CDCC RMACs are substantially similar. Similarly, the responsibilities and expertise required of members of the CDS and CDCC Governance Committees are the same. CDS and CDCC have worked together to make the charters for their respective Governance Committees and RMACs as similar as possible to the charters for the corresponding board committee of the other clearing house.<sup>16</sup> There is consistency in the responsibilities and expertise required for the same committees of each board. Therefore, CDS and CDCC believe that the most efficient committee structure is the mirror board committee structure.

Both RMACs are charged with, among other things, assisting the board in fulfilling its risk management responsibilities, including assessing the clearing house's risk management policies and procedures and the adequacy of and the adequacy of the implementation of appropriate procedures to mitigate and manage such risks. Members of each RMAC are required to possess experience or expertise in one or more of the following areas: internal risk controls, risk assessments and reporting, legal matters, government and public policy, accounting, risk management and corporate governance. As discussed above, risk management is a significant oversight topic for each of the CDS and CDCC boards. Therefore, having mirror RMACs will ensure that the same individuals have a detailed holistic view of the overall risk profile of CDS and CDCC. In contrast, not having mirror RMACs would fail to realize this significant benefit.

Similarly, both Governance Committees are charged with, among other things, assisting the board on matters related to corporate governance, including candidate selection and nomination, orientation of new board members and oversight of policies and procedures for the identification and resolution of conflicts of interest. Each Governance Committee reviews on an ongoing basis the composition of the board and is charged with identifying any gaps in the board's composition and seeking to fill those gaps. Having mirror Governance Committees will ensure that these committees are engaging in coordinated reviews of the mirror board's composition and are providing consistent recommendations in respect thereof to the board. Not having mirror Governance Committees would be less efficient and may result in inconsistent recommendations to the board.

Therefore, CDS and CDCC management have determined that having mirror board committees is the natural extension of having mirror boards of directors. The mirror board committee structure will facilitate the enhanced risk management and operational oversight of each clearing house.

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<sup>16</sup> The charters of the CDS and CDCC RMACs are the same except for a few matters specific to CDS that the CDS Recognition Orders require to be included in the CDS RMAC's charter.

### ***Efficient use of time and expertise***

The mirror board committee structure is the most efficient use of directors' time and expertise given the mirror board structure that CDS and CDCC are proposing. CDS and CDCC are currently considering a board of directors composed of 12 individuals. As a group of 12 individuals will have to populate four board committees, many directors will be members of more than one board committee. It is the most efficient use of such directors' time to be on the same board committee for each of CDS and CDCC. A mirror board committee structure will enable the same groups of directors to do in depth reviews of similar issues for each clearing house. Therefore, having mirror board committees, composed of the directors with the most relevant expertise to fulfil the responsibilities of the applicable committee, is the most efficient arrangement for a mirror board structure.

A mirror board committee structure will ensure that the directors with the most relevant expertise for each committee are members of the applicable committee of both the CDS and CDCC boards. A mirror board committee structure will enable the board to appoint the directors with the most relevant risk operations oversight expertise to the RMACs of both clearing houses, instead of having to divide such directors across two separate RMACs. The board will similarly be able to appoint the directors with the most relevant corporate governance expertise to both Governance Committees. Therefore, a mirror board committee structure is the most practical and effective manner to populate committees given the mirror board structure.

We note that the recognized exchanges within TMX have a mirror board committee structure for their Audit Committees, which enables the same groups of individuals to oversee similar issues at each exchange. This results in each committee member being a member of six Audit Committees. Due to the alignment of the responsibilities of each exchange's Audit Committee and the expertise of the members of the Audit Committee, this is the most efficient and effective arrangement for each exchange. CDS and CDCC believe the same benefits will accrue to each clearing house from a mirror board committee structure.

Finally, CDS and CDCC will ensure that the composition of the RMACs of CDS and CDCC continues to comply with the independence requirements set out in NI 24-102 and the guidance in the Companion Policy.

### **Pro forma board composition**

If the OSC grants the Requested Variation Order and the AMF provides similar relief, the mirror board of directors for CDS and CDCC will continue to meet the composition requirements in the CDS Recognition Orders and the CDCC Recognition Order. Based on the requirements applicable to the boards of CDS and CDCC, the composition of the mirror board of directors will be as follows:

- 33% of directors who are independent, where the term "independent" means a person who is not:
  - an associate, partner, director, officer or employee of a significant Maple shareholder,
  - an associate, partner, director, officer or employee of a participant of CDS or such participant's affiliated entities or an associate of such director, partner, officer or employee,

- an associate, partner, director, officer or employee of a marketplace or such marketplace's affiliated entities (other than CDS and CDCC) or an associate of such partner, director, officer or employee, or
- an officer or employee of the CDS or CDCC or its affiliated entities or an associate of such officer or employee,

provided that a director shall not be considered to be non-independent solely on the ground that he or she is a director, or in the case of the chair of the board of directors only, an officer, of both CDS and CDCC;

- 33% of directors who are representatives of participants of CDS, of which:
  - one who is a nominee of the Investment Industry Regulatory Organization of Canada;
  - one who is a nominee of TMX Group Limited selected from one of the five largest participants of CDS (with the participant and its affiliated entities aggregated for this purpose);
  - one who is a nominee of TMX Group Limited that, for so long as a Maple nomination agreement is in effect, is that is unrelated to original Maple shareholders (as the terms "Maple nomination agreement" and "unrelated to original Maple shareholders" are defined in the CDS Recognition Orders);
- 33% directors who are partners, directors, officers or employees of clearing members of CDCC or affiliates of such members, be financially literate within the meaning of National Instrument 52-110 *Audit Committees* and have expertise in derivatives clearing, including:
  - the chief executive officer of Montreal Exchange Inc., or such other officer or employee of Montreal Exchange Inc. as is appointed by Montreal Exchange Inc., notwithstanding that such person is not a partner, director, officer or employee of a clearing member of CDCC or an affiliate of such member;
  - two directors who are not partners, directors, officers or employees of a Significant Maple shareholder (as defined in the CDCC Recognition Order) and who are, for as long as a Maple Nomination Agreement is in effect, unrelated to Original Maple Shareholders (as the terms "Maple Nomination Agreement" and "Unrelated to Original Maple Shareholders" are defined in the CDCC Recognition Order);
- the chief executive officer (i.e., President) of CDCC;
- one director who is a representative of a marketplace unaffiliated with TMX Group Limited and nominated by the marketplaces unaffiliated with TMX Group Limited;
- 25% of directors who are residents of Québec;
- 50% of directors who have expertise in derivatives clearing;

- 50% of directors who have expertise in clearing and settlement; and
- two directors who represent investment dealers that are independent of a bank and that have a significant amount of their dealer activity in trading, clearing and settling securities listed on a venture exchange in Canada.

## Conclusion

In conclusion, CDS submits that a mirror board structure will be beneficial to CDS and CDCC's operations and the Canadian capital markets. We attach at Appendix A a draft variation order for the Requested Variation Order.

Yours truly,



Deanna Dobrowsky  
Vice President, Regulatory

cc: Susan Greenglass, *Ontario Securities Commission*  
Élaine Lanouette, *Autorité des marchés financiers*  
Doug MacKay, *British Columbia Securities Commission*