



August 6, 2016

Market Regulation Branch
Ontario Securities Commission
20 Queen Street West, 22nd Floor
Toronto, Ontario
M5H 3S8
marketregulation@osc.gov.on.ca

Autorité des marchés financiers
800, square Victoria, 22 étage
C.P. 246 tour de la Bourse
Montréal (Québec)
H4Z 1G3
consultation-en-cours@lautite.qc.ca

and

Fran Daley
Manager Director, Business Development
CDS Clearing and Depository Services Inc.
85 Richmond Street West, 3rd Floor
Toronto, Ontario M5H 2C9
fdaly@cds.ca

British Columbia Securities Commission
701 West Georgia Street
P.O Box 10142, Pacific Centre
Vancouver, B.C.
V7Y 1L2
dmackay@bcsc.bc.ca
bsinclair@bcsc.bc.ca

Re: CDS PROPOSED AMENDMENTS TO CDS FEE SCHEDULE - CDS MARKETPLACE SET-UP FEES REVISED NOTICE AND REQUEST FOR COMMENT

Dear Sirs/Mesdames:

Nasdaq CXC Limited (“Nasdaq CXC” or “we”) welcomes the opportunity to provide comments on CDS Clearing and Depository Services Inc.’s (“CDS”) Proposed Amendments to CDS Fee Schedule - CDS Marketplace Set-up Fees Notice and Request for Comment (“Notice”) which proposes to introduce set-up fees for new marketplaces.

We believe the proposed 80k CDS fee for non-listing marketplaces and 150k CDS fee for listing exchanges (“Proposed Fees”) is unfair and unreasonable for several reasons. Unlike CDS Participant Members (“CDS Participants”), marketplaces do not impose comparable costs to CDS and also do not share comparable benefits from CDS which mean that costs will fall disproportionately on marketplaces. The only direct service that marketplaces are provided from CDS is the provisioning of a network connection which is used to simply connect to CDS and assist in the clearing and settlement of customer trades. Since 2008 the proliferation of trading venues in Canada has directly benefited CDS by increasing the number of overall trades and resulting in over an estimated 330 percent increase in clearing revenues.¹ We believe that these revenues should be shared with marketplaces or at a minimum, used to offset any costs incurred by CDS related to these marketplaces.

CDS justifies the Proposed Fees on the basis of cost recovery however there are minimal incremental costs CDS incurs for providing access to a new marketplace. The main cost of establishing a network connection is a service that CDS already charges for today. CDS offers virtually no explanation for why the minimal additional work necessary for listing venues justifies the 70k additional fee over other non-listing marketplaces. Finally, we believe that Proposed Fees that will be required for a new entrant

¹ Trades increased between 2007 and 2015 by 334%. Given that the CDS fee model applies a fee based on the number of trades, a proportionate increase in revenue should be reflected.

represents an unreasonable financial burden that will impact competition. We therefore encourage the Ontario Securities Commission (OSC), the Autorité des marchés financier and the British Columbia Securities Commission (together, “Securities Commissions”) to not permit the Proposed Fees until CDS provides sufficient justification for Proposed Fees.

WHY THE PROPOSED FEES ARE UNFAIR

a) CDS Participants and Marketplaces do not impose comparable costs on CDS and do not share comparable benefits from CDS

CDS uses the comparison between marketplaces with CDS Participants to justify the introduction of a comparable entrance fee by maintaining that the Proposed Fees are consistent with the fair treatment of market participants and with CDSs entrance fee structure.² We believe this comparison is inappropriate for several reasons; marketplaces do not receive any clearing and settlement services, they are not eligible to receive any rebates or refunds from CDS and, based on their relationship to CDS, they are not required to meet any of CDS’s operational, systemic or financial membership requirements.

Marketplaces should not be required to pay an equivalent entrance fee as CDS Participants. Whereas CDS Participants receive the benefit of clearing and settlement services, marketplaces facilitate the provision of clearing and settlement services on behalf of their participants by sending end of day trade files that are used to cross reference trade information sent by Participants about trades executed on a marketplace for each trading day. The only service that is provided to a marketplace by CDS is the provision of network connectivity used to access CDS so that this end of day file can be transmitted electronically. For this connection, CDS in turn applies a monthly fee. In fact in the case of an ATS, National Instrument 21-101 (NI 21-101) permits the option for either the ATS or its subscribers to report all trades to CDS.³ The decision therefore for an ATS to access CDS and send this end of day file is a choice, made at cost, to facilitate CDS services on behalf of its subscribers.

CDS Participant entrance fees are determined by the services that each category of CDS Participant is granted access. All Participants are divided into two categories; full service Participants and limited purpose Participants.⁴ A full service Participant may use all of the services offered by CDS. A limited purpose Participant is subject to restrictions on its use of the services offered by CDS, as specified in the rules applicable to that category. Given that marketplaces are not entitled to receive any direct CDS service, we do not understand why any kind of entrance fee should be required.

Unlike a CDS Participant, a marketplace is ineligible to receive additional rebates and refunds from CDS. When CDS operated as a utility prior to the purchase of the TMX Group by the Maple consortium, it returned a portion of any excess revenue above its annual estimate from clearing and settlement services to Participants for the year. To ensure the practice of providing rebates to its Participants continued, the OSC required CDS, in its Recognition Order, to rebate its Participants an increasing amount each year, for the period ending October 31, 2016. For each 12 month period thereafter, it is required to rebate 4 million in respect to clearing services for trades conducted on an exchange or ATS.⁵ Marketplaces however, are not entitled to these rebates.

² *CDS Notice and Request for Comment - Proposed Amendments to the CDS Fee Schedule – CDS Marketplace Set-Up Fees* July 7th 2016 Page 1, Background.

³ Subsection 15.1 of Companion Policy to National Instrument 21-101.

⁴ CDS Participant Rules (Release 2016.01.29), Section 2.3 – *Participant Classification*.

⁵ CDS Recognition Order Appendix B, *Fee and Rebate Model Approved by the Commission*.

Additionally, unlike CDS Participants, marketplaces are not required to meet any of CDS Participant operational, systemic or financial requirements and therefore do not contribute to the CDS costs required to monitor compliance with CDS rules. Given that marketplaces are not exposed to trading positions, do not hold customer assets and do not normally act as counterparties to the trades executed on their trading platforms there is no reason for a marketplace to meet these criteria. Instead, as a regulated marketplace and Investment Dealer (in the case of an ATS), marketplaces are required to meet the operational, systematic and financial requirements of the CSA and IIROC. If the only role of a marketplace is to report the trades executed on any of its trading books, why would it be required to pay the equivalent of a CDS Participant Fee?

Based on the comparison between marketplaces and Participants, CDS claims that an exception has been made for securities exchanges and ATSs by not having been assessed entrance fees to date.⁶ This exception CDS says has been based on several factors including the limited number of new exchanges and/or ATSs which have been required to be set up and that CDS operated as an industry utility. Given that marketplaces do not receive any direct CDS services, are not eligible to receive reimbursements and play a completely different role to CDS than CDS Participants, we disagree that an “exception” has been made for marketplaces that CDS may now end. Marketplaces and Participants have rightly been handled differently because of the fundamental differences between them.

b) Marketplaces Represent Additional Revenue for CDS

The introduction of multiple marketplaces in Canada resulted in a significant increase in the number of overall trades and in turn increased CDS revenues for clearing services. The CDS fee model applies a fee per transaction irrespective of the size of a trade. With the advent of multiple trading venues, large parent orders are broken down into smaller sized child orders that are sent and executed on multiple venues. Whereas CDS would have received only one fee for the original parent order before, it now receives multiple fees. Since the introduction of multiple marketplaces in 2008, the number of trades and resulting CDS revenue has increased by 336%.⁷ Given the additional fragmentation that each marketplace reflects, each new marketplace represents a potential business opportunity for CDS. Understanding this, we question whether it would be more appropriate for marketplaces to be compensated proportionately for the CDS clearing revenue represented by the number of trades occurring on each marketplace. At the very least, marketplaces should not have to pay any fees for providing this business opportunity for CDS.

c) CDS Already Charges a Fee for Marketplace Network Connectivity

The purpose of Proposed Fees is to recover costs associated with the set-up and bring-on costs of a new marketplace. As mentioned above, the only service that CDS provides to a marketplace is the provision of a network connection into its systems. The cost of maintaining this service in turn is borne by the marketplace and paid for on a monthly basis. In the case of Nasdaq CXC, the fee for this service is close to 3K per month or 36K annually. Given today’s practice, we question why the collection of these fees is not sufficient to recovery any costs associated with setting up a new marketplace. In fact, using a 3k monthly fee, the 80k proposed costs would be fully recovered in just over two years.

⁶ CDS Notice and Request for Comment - Proposed Amendments to the CDS Fee Schedule – CDS Marketplace Set-Up Fees July 7th 2016 Page 1.

⁷ IIROC Report of Marketshare by Marketplace comparing the number of overall trades in 2007 with the number of total trades in 2015.

QUESTIONS AROUND COSTS OF THE PROPOSED FEES MODEL

In the Notice, CDS states that the process of setting up, connecting and bringing a new exchange or ATS online is both complex and resource intensive.⁸ Given our experience establishing connectivity to CDS, we do not understand how any associated costs can justify the amount of the Proposed Fees. In addition, if as CDS states that the resources required for set-up differ by marketplace, we ask why a fixed fee is being proposed to apply to all marketplaces.

CDS states that the scope of the system changes and set up for a new marketplace include resources allocated in support of the following services:

- The evaluation and analysis required to ensure that a prospective Participant, or other market participant, satisfies CDS's operational, systemic, and financial requirements.
- The tasks associated with the actual physical connection of the prospective Participant to CDS's proprietary network, including the provision of dedicated communication lines and associated switches.
- The set-up of a prospective Participant's ledger and account structure within CDS's systems.
- The set-up of a prospective Participant's authorized users for direct access to CDS's online systems.
- The administrative tasks associated with providing access to any ancillary services that the prospective Participant requires (including, for example, cross-border access or additional data services)
- Ensuring that a Participant's personnel are familiar with, and trained in, their operational interaction with CDS and the use of CDSX and its related functions⁹

We note that based on our understanding that the majority of these services are only applicable to the onboarding and approval of CDS Participants and not to marketplaces. A marketplace is not required to meet any of CDS's operational, systemic or financial requirements. There is no set up requirements for a ledger or account structure or authorized users for direct access to CDS's online systems. There are no administrative tasks required for providing access to any ancillary services and no need for a marketplace's personnel to be familiar with the operational interaction with CDS and the use of CDSX. The only resources required on the part of CDS are those needed for the provisioning of a dedicated network connection, the cost of which is borne by the marketplace on a monthly basis.

Given our understanding of the costs associated with the set-up of a marketplace, we request that CDS provide more information around the resources, time and other costs related to set up in order to better understand the basis for the Proposed Fees.

⁸ *CDS Notice and Request for Comment - Proposed Amendments to the CDS Fee Schedule – CDS Marketplace Set-Up Fees* July 7th 2016 Page 1.

⁹ *CDS Notice and Request for Comment - Proposed Amendments to the CDS Fee Schedule – CDS Marketplace Set-Up Fees* July 7th 2016 Pages 1-2.

CDS lists the specific tasks related to bring-on of an exchange or ATS on page 3 of the Notice. For an ATS and an Exchange that do not list securities, these tasks are:

ALTERNATIVE TRADING SYSTEMS		
DEPARTMENT	SERVICES	NOTES
BUSINESS DEVELOPMENT	Initial review application, primary contact for exchanges	Approval, sign up forms, system set ups – Market IDs, trade entry file, and testing
RISK	Review application	Analyze, review, approve each application
LEGAL	Review and Approval	Review contractual documentation including where applicable fee collection agreements and pre-authorized debit agreements (Foreign applicants require additional resources and time)
FINANCE	Payment process	Billing/Invoicing/Pre-Authorized Debits set up
NETWORK	Establish connections and test connectivity	Set up of Logical Units, network connections and testing of connectivity
IT	Develop/implement/process files and test connections	Set up, installations, testing connectivity, file transmissions, implementations and move to production.
REGULATORY	Review marketplace eligibility for CDS connection	Where required, obtain regulatory approval to connect the marketplace.

In reviewing this list, we fail to understand how many of these tasks are required for a new marketplace and ask for more details from CDS around how they apply. There is no application or legal agreement that is required to be signed as part of the onboarding of a marketplace connection – a connection order form is all that is required. Regulatory approval from the OSC is required before a marketplace can establish a connection to CDS. The finance requirements for billing are similar to those for the onboarding of any new customer. And, the IT and Network requirements appear similar to those to set up any new connectivity either between a participant and a marketplace or a vendor to a marketplace. As an operator of two trading books we understand these requirements to be minimal.

In the case of listings exchanges the additional tasks that are required according to CDS are in the area of business development and are highlighted below.

EXCHANGE (WITH LISTED ISSUERS)		
DEPARTMENT	SERVICES	NOTES
BUSINESS DEVELOPMENT	Initial review application, primary contact for exchanges	Approval, sign up forms, system set ups – Market IDs, trade entry file, dividend file, buy-in file/process, price file and testing.

Allowing for the fact that some additional resources may be required to set up a listings exchange (the processing of dividend, buy-in and price files) we struggle to understand how the business development costs for these services can aggregate to 70k. Again, we request that CDS provide more details around the tasks, time and the costs that are specifically required when a trading venue that has already established a connection with CDS is converted to a to a listing exchange.

CDS compares its cost structure to set up a new marketplace with the initial costs applied by the Investment Industry Regulatory Organization of Canada (“IIROC”) which are 91.5k. We find this comparison difficult to understand. In IIROC’s case, fees are applied to recover the cost from two labor intensive services; preparing and negotiating the Regulation Services Agreement (“RSA”) and the IT costs required to integrate a new marketplace into IIROC’s real time surveillance systems. The RSA contractually obligates IIROC to perform certain market and member regulation services performed by the marketplace and for this reason a substantial amount of time may be required before it is finalized. In the case of IT services, whereas CDS only is required to provide a network connection, IIROC, in addition to setting up a connection of its own, must develop all requirements in accordance to a marketplace’s specifications to perform real time surveillance. All marketplace functionality must be certified and be built into each IIROC surveillance alert. In the case of a listings exchange, IIROC needs to be able to monitor new listings on its system which requires additional work and resources. For these reasons we fail to see how CDS costs can be justifiably compared with IIROC set up costs except through the understanding that CDS now operates as a for-profit commercial entity.

INTERNATIONAL COMPARISONS

The comparisons made to other international clearing agencies (DTCC, HKSCC, ASC and Euroclear) with the exception of ASX, appear to apply to clearing agency members such as CDS Participants and not to marketplaces. In the case of ASX, the application fee applied to an Approved Market Operator (a competing marketplace) is 12% that of the Proposed CDS fee. Presuming that similar resources would be required for an AMO to connect to ASX Clear we do not understand why the CDS Proposed Fees are 70k above that which would be levied by the ASX today.

IMPACT ON COMPETITION

CDS claims that the Proposed Fees will not have a material impact on competition for trade execution services or result in an unreasonable financial burden on perspective marketplaces.¹⁰ We disagree. The introduction of the Proposed Fees represents an additional burden for each new entrant. Since the introduction of competition for execution services was permitted in Canada, the barrier of entry for a new marketplace has risen. Regulatory application fees for new marketplaces were introduced by the OSC in 2013 (the Alberta Securities Commission has been approved to introduce similar fees by the end of this year) and marketplaces are no longer afforded the benefits of order protection when they launch. Without order protection participants are not required to access better quotations on a marketplace making it more difficult for a marketplace’s market share to grow. Adding an additional 80k to a new entrants’ application fees represents a 56% increase for an ATS today and a 78% increase for a listing exchange – both we believe represent unreasonable financial burdens.¹¹

¹⁰ *CDS Notice and Request for Comment - Proposed Amendments to the CDS Fee Schedule – CDS Marketplace Set-Up Fees* July 7th 2016 Pages 7-8.

¹¹ 80k represents a 56% increase of the combined OSC and IIROC application fees for an ATS (50K plus 91.5K). For an exchange the additional 150k represents a 78% increase (100k plus 91.5k).

CONCLUSION

We believe the Proposed Fees by CDS are unfair and unreasonable for several reasons including that marketplaces do not impose comparable costs on CDS or share in comparable benefits from CDS as CDS Participants. The only direct service provided by CDS to a new marketplace is the network connectivity used to facilitate the clearing and settlement of customer trades for which CDS already charges a fee. Given the proliferation of new marketplaces has resulted in over a 330% increase in CDS clearing revenue, we question why these revenues are not shared by marketplaces and at a minimum, used to offset any costs by CDS relate to marketplaces.

CDS justifies the Proposed Fees on the basis of cost recovery, but there are minimal incremental costs CDS incurs for marketplaces. In the case of the additional 70K fee proposed for a listing exchange over other marketplaces CDS offers virtually no explanation for why the minimal additional work necessary could justify this fee. Finally, we believe that Proposed Fees that will be required for a new entrant represents an unreasonable financial burden that will impact competition. We encourage the Securities Commissions to not permit the Proposed Fees until CDS provides sufficient justification for Proposed Fees.

We thank the Securities Commissions for their consideration of these comments and would welcome the opportunity to discuss further our views with staff.

Sincerely,

Nasdaq CXC