



NOTICE TO MEMBERS

No. 2016 – 098-16

August 9, 2016

REQUEST FOR COMMENTS

PROPOSED AMENDMENTS TO SECTIONS A-1A04 AND A-401 OF THE RULES OF THE CANADIAN DERIVATIVES CLEARING CORPORATION IN ORDER TO ESTABLISH AND DOCUMENT CDCC'S CONSULTATION POWER

Summary

On July 28, 2016, the Board of Directors of Canadian Derivatives Clearing Corporation (CDCC) approved amendments to Sections A-1A04 and A-401 of CDCC's Rules. The purpose of the proposed amendments is to establish and document the consultation power granted to CDCC in the course of its Default Management process.

Please find enclosed an analysis document as well as the proposed amendments.

Process for Changes to the Rules

CDCC is recognized as a clearing house under section 12 of the *Derivatives Act* (Québec) by the Autorité des marchés financiers (AMF) and is a recognized clearing agency under section 21.2 of the *Securities Act* (Ontario) by the Ontario Securities Commission (OSC).

The Board of Directors of CDCC has the power to approve the adoption or amendment of Rules and Operations Manual of CDCC. Amendments are submitted to the AMF in accordance with the self-certification process and the Ontario Securities Commission in accordance with the process provided in its Recognition Order.

Comments on the proposed amendments must be submitted within 30 days following the date of publication of the present notice. Please submit your comments to:

Ms. Marlène Charron-Geadah
Legal Counsel
Canadian Derivatives Clearing Corporation
Tour de la Bourse
P.O. Box 61, 800 Victoria Square
Montréal, Québec H4Z 1A9
E-mail: legal@m-x.ca

A copy of these comments shall also be forwarded to the AMF and to the OSC to:

Mrs. Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
Tour de la Bourse, P.O. Box 246
800 Victoria Square, 22nd Floor
Montréal, Québec H4Z 1G3
E-mail: consultation-en-cours@lautorite.qc.ca

Manager, Market Regulation
Market Regulation Branch
Ontario Securities Commission
Suite 2200,
20 Queen Street West
Toronto, Ontario, M5H 3S8
Fax: 416-595-8940
email: marketregulation@osc.gov.on.ca

For any question or clarification, Clearing Members may contact CDCC's Corporate Operations.

Glenn Goucher
President and Chief Clearing Officer



**AMENDMENTS TO SECTIONS A-1A04 AND A-401 OF THE RULES OF THE CANADIAN
DERIVATIVES CLEARING CORPORATION**

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I. SUMMARY

CDCC is proposing to clarify in its Rules its intent to enter into consultation with the Bank of Canada before declaring a Clearing Member Non-Conforming or using enforcement measures permitted under such status.

II. ANALYSIS

a. Background

As part of a well-established practice of communicating with its regulators throughout the default management process, CDCC management has been committed to timely inform its regulators of the developments and decisions taken by the default management committee. This, in line with the language of section A-1A04 Non-Conforming Member, which provides that the Corporation may notify the appropriate regulatory organization of the Clearing Member or the regulatory agency of the Corporation.

b. Description and Analysis of Impacts

The proposed rule change will not affect the rights and obligations of the Clearing Members nor will it restrict CDCC's ability to act in the course of a default management process. This proposed rule change intends on providing some transparency to the market as to CDCC's intent and ability to enter into consultation with the Bank of Canada in respect of a Clearing Member's anticipated or actual *default*, prior to declaring such Clearing Member Non-Conforming or using enforcement measures permitted under such status.

c. Proposed Amendments

See Appendix 1.

d. Benchmarking

N/A.

III. PRIMARY MOTIVATION

Canada has recently adopted a Recovery and Resolution regime governing certain financial institutions deemed systemically important for the Canadian economy (D-SIB). While this new regulatory regime does not affect or restrain CDCC's discretionary power in terms of default management, it grants the D-SIB regulators certain powers and tools to guarantee the defaulting D-SIB's obligations and to transfer certain assets to a receiving entity (through a bridge bank). As part of a default management process involving a defaulting D-SIB, in order to protect financial markets stability, CDCC, the Bank of Canada and the D-SIB regulators are expected to establish a communication protocol to exchange timely information. The rule change proposal therefore formalizes CDCC's intentions.

IV. IMPACTS ON TECHNOLOGICAL SYSTEMS

The proposed rule change will have no technological impact.

V. OBJECTIVES OF THE PROPOSED MODIFICATIONS

The rule gives transparent indication of CDCC's intentions of entering into consultation with the Bank of Canada, prior to declaring a Clearing Member Non-Conforming or using enforcement measures permitted under such status.

VI. PUBLIC INTEREST

In CDCC's opinion, the proposed amendment is not contrary to the public interest.

VII. MARKET IMPACTS

An examination of how the proposed change will enhance market efficiency.

VIII. PROCESS

The proposed amendment is submitted for approval by the CDCC Board. After the approval has been obtained, the proposed amendment, including this analysis, will be transmitted to the Autorité des marchés financiers in accordance with the self-certification process, and to the Ontario Securities Commission in accordance with the "Rule Change Requiring Approval in Ontario" process. The proposed amendment and analysis will also be submitted for approval to the Bank of Canada in accordance with the Regulatory Oversight Agreement.

IX. EFFECTIVE DATE

The proposed rule change should be implemented in Q3 2016, subject to the regulatory approval.

X. ATTACHED DOCUMENTS

Appendix 1: Proposed New Sections A-1A04 and A-401 (Blackline and Clean).

APPENDIX 1

(BLACKLINE)

SECTION A-1A04 and A-401

RULE A-1A MEMBERSHIP IN THE CORPORATION

(...)

SECTION A-1A04 NON-CONFORMING MEMBER

- 1) A Clearing Member who is or may become insolvent or unable to meet its obligations shall immediately notify the Corporation of its situation by telephone. Such notice shall be confirmed by the Clearing Member by notice in writing to the Corporation sent by facsimile transmission within the next business day.
- 2) A Clearing Member who, in the judgement of the Corporation or pursuant to notification to the Corporation under Subsection (1), is or may be insolvent or unable to meet its obligations, becomes a Non-Conforming Member.
- 3) Without limiting the application of this Rule, any one of the following events, whether actual or anticipated by the Corporation, constitutes a reasonable ground for the Corporation to determine in its judgement that a Clearing Member is a Non-Conforming Member:
 - a) breach of any term, eligibility, qualification, standard or condition of the Application for Membership or any other violation of these Rules;
 - b) breach of a rule of an Exchange, a Central Securities Depository, an applicable self-regulatory organization or regulatory agency, or of any other recognized, designated or foreign investment exchange or clearing agency;
 - c) refusal of an application for membership, breach of the terms of membership or contractual agreement, or suspension, termination or expulsion from membership of an Exchange, a Central Securities Depository, an applicable self-regulatory organization, Market Centres and/or Delivery Agents, the Registry, or any other recognized, designated or foreign investment exchange or clearing agency;
 - d) refusal of a licence, breach of the terms of its licence or withdrawal or suspension of such licence by a regulatory agency;
 - e) contemplated, threatened or actual action by a regulatory agency, a court of justice or administrative authority against or in respect of the Clearing Member under any provision or process of law or regulation;
 - f) default in a payment, deposit, delivery or acceptance of delivery required or payable under the Application for Membership or these Rules;
 - g) an order, arrangement, proposal, distress or execution is presented, made or approved in any jurisdiction to or by a court of competent jurisdiction relating to the bankruptcy, insolvency, winding up of the Clearing Member or the appointment of an administrator,

receiver manager, trustee, or person with similar power in connection with the Clearing Member;

- h) the determination on reasonable grounds by the Corporation that the Clearing Member is in such financial or operating condition that its continuation as a Clearing Member in good standing would jeopardize the interests of the Corporation or other Clearing Members;
 - i) any of the conditions set out in paragraphs (a) to (h) applies to an Affiliate of a Clearing Member, having, in the reasonable judgement of the Corporation, a material impact on the financial condition of the Clearing Member; or
 - j) such other event as the Board or, if time does not permit action by the Board, the Corporation in its sole discretion reasonably determines to constitute reasonable grounds for such determination.
- 4) If a Clearing Member is late in making a payment at Settlement Time, the Corporation shall impose fines and may deem that Clearing Member a Non-Conforming Member, in accordance with Section 7 of the Operations Manual. In addition, the Board may take disciplinary measures set forth in Rule A-5 against the Non-Conforming Member.
- 5) Except where the Corporation has been notified under Subsection (1), the Corporation shall, in writing or by telephone, notify a Clearing Member that it has become a Non-Conforming Member. Before doing so, the Corporation may enter into consultations with the Bank of Canada. The Corporation may also, in its sole discretion, notify the Board, all Clearing Members, the Exchanges, the appropriate self-regulatory organization or regulatory agency that the Clearing Member is a member of, the regulatory agency of the Corporation, and such other Entities as the Corporation may consider appropriate.
- 6) The Corporation can revert the status of a Non-Conforming Clearing Member to a Clearing Member in good standing if the Clearing Member resolves, to the satisfaction of the Corporation, the issue(s) which led to its Non-Conforming status.

(...)

RULE A-4 ENFORCEMENT

SECTION A-401 ACTION AGAINST A NON-CONFORMING OR SUSPENDED MEMBER

1) The actions contemplated by the Rules in respect of a Non-Conforming Member or Suspended Member may be taken in any sequence the Corporation deems appropriate.

➔

- 2) In addition to a measure made available to the Corporation under the Rules and the Application for Membership to remedy a specific or general default of a Clearing Member, where a Clearing Member is a Non-Conforming Member, the Corporation may take any one of the actions prescribed by the Rules in respect of such Clearing Member including, but not limited to:
- a) prohibiting and/or imposing limitations on the acceptance and/or clearance of Transactions by such Clearing Member;
 - b) increasing the Margin Requirements for such Clearing Member or requiring additional Margin Deposits;

- c) requiring such Clearing Member to reduce or close out (or closing out on behalf of such Clearing Member) existing Transactions in such Clearing Member's accounts with the Corporation and, upon such close out, converting all amounts into Canadian currency and calculating one net amount (taking into account the Corporation's rights with respect to the Margin Deposit of such Clearing Member) owing to such Clearing Member by the Corporation or by such Clearing Member to the Corporation;
- d) transferring, whether by way of transfer, by way of assignment, by way of termination, close-out and re-establishment or otherwise, any Client Account maintained by such Clearing Member with the Corporation, any position maintained in such account and any Margin Deposits held by the Corporation in respect of such account, to another Clearing Member;
- e) sanctioning, reprimanding, fining or imposing a penalty on the Clearing Member;
- f) preventing or restricting the Clearing Member's right to withdraw any excess in Margin Deposits pursuant to Section A-607 or Section A-704; and
- g) suspending the Non-Conforming Member.

~~The actions contemplated by the Rules in respect of a Non-Conforming Member may be taken in any sequence the Corporation deems appropriate.~~

- 3) Upon the suspension of the Clearing Member and in addition to a measure made available to the Corporation under A-401 (2+) or under the Rules, the Corporation may take any one of the actions prescribed by the Rules in respect of such Clearing Member including, but not limited to:
 - a) applying the Margin Deposit (including, without limitation, Margin and Clearing Fund) of the suspended Clearing Member against the obligations of such Member to the Corporation, subject to Subsection A-402(3) and, for such purpose, selling, transferring, using or otherwise dealing or disposing of any property deposited as Margin Deposit at any time, without prior notice to the Clearing Member;
 - b) transferring, terminating, closing out or liquidating any or all of the Clearing Member Transactions or Open Positions, and upon such close out, converting all amounts into Canadian currency and calculating one net amount (taking into account the Corporation's rights with respect to the Margin Deposit of such Clearing Member) owing to such Clearing Member by the Corporation or by such Clearing Member to the Corporation.

~~The actions contemplated by the Rules in respect of suspended Clearing Members may be taken in any sequence the Corporation deems appropriate.~~

- 4) Before exercising any actions contemplated under this Section, however, CDCC may enter into consultations with the Bank of Canada and specify the actions it considers exercising with respect to the Non-Conforming or Suspended Member.

(CLEAN)

SECTION A-1A04 and A-401

RULE A-1A MEMBERSHIP IN THE CORPORATION

(...)

SECTION A-1A04 NON-CONFORMING MEMBER

- 1) A Clearing Member who is or may become insolvent or unable to meet its obligations shall immediately notify the Corporation of its situation by telephone. Such notice shall be confirmed by the Clearing Member by notice in writing to the Corporation sent by facsimile transmission within the next business day.
- 2) A Clearing Member who, in the judgement of the Corporation or pursuant to notification to the Corporation under Subsection (1), is or may be insolvent or unable to meet its obligations, becomes a Non-Conforming Member.
- 3) Without limiting the application of this Rule, any one of the following events, whether actual or anticipated by the Corporation, constitutes a reasonable ground for the Corporation to determine in its judgement that a Clearing Member is a Non-Conforming Member:
 - a) breach of any term, eligibility, qualification, standard or condition of the Application for Membership or any other violation of these Rules;
 - b) breach of a rule of an Exchange, a Central Securities Depository, an applicable self-regulatory organization or regulatory agency, or of any other recognized, designated or foreign investment exchange or clearing agency;
 - c) refusal of an application for membership, breach of the terms of membership or contractual agreement, or suspension, termination or expulsion from membership of an Exchange, a Central Securities Depository, an applicable self-regulatory organization, Market Centres and/or Delivery Agents, the Registry, or any other recognized, designated or foreign investment exchange or clearing agency;
 - d) refusal of a licence, breach of the terms of its licence or withdrawal or suspension of such licence by a regulatory agency;
 - e) contemplated, threatened or actual action by a regulatory agency, a court of justice or administrative authority against or in respect of the Clearing Member under any provision or process of law or regulation;
 - f) default in a payment, deposit, delivery or acceptance of delivery required or payable under the Application for Membership or these Rules;
 - g) an order, arrangement, proposal, distress or execution is presented, made or approved in any jurisdiction to or by a court of competent jurisdiction relating to the bankruptcy, insolvency, winding up of the Clearing Member or the appointment of an administrator, receiver manager, trustee, or person with similar power in connection with the Clearing Member;

- h) the determination on reasonable grounds by the Corporation that the Clearing Member is in such financial or operating condition that its continuation as a Clearing Member in good standing would jeopardize the interests of the Corporation or other Clearing Members;
 - i) any of the conditions set out in paragraphs (a) to (h) applies to an Affiliate of a Clearing Member, having, in the reasonable judgement of the Corporation, a material impact on the financial condition of the Clearing Member; or
 - j) such other event as the Board or, if time does not permit action by the Board, the Corporation in its sole discretion reasonably determines to constitute reasonable grounds for such determination.
- 4) If a Clearing Member is late in making a payment at Settlement Time, the Corporation shall impose fines and may deem that Clearing Member a Non-Conforming Member, in accordance with Section 7 of the Operations Manual. In addition, the Board may take disciplinary measures set forth in Rule A-5 against the Non-Conforming Member.
 - 5) Except where the Corporation has been notified under Subsection (1), the Corporation shall, in writing or by telephone, notify a Clearing Member that it has become a Non-Conforming Member. Before doing so, the Corporation may enter into consultations with the Bank of Canada. The Corporation may also, in its sole discretion, notify the Board, all Clearing Members, the Exchanges, the appropriate self-regulatory organization or regulatory agency that the Clearing Member is a member of, the regulatory agency of the Corporation, and such other Entities as the Corporation may consider appropriate.
 - 6) The Corporation can revert the status of a Non-Conforming Clearing Member to a Clearing Member in good standing if the Clearing Member resolves, to the satisfaction of the Corporation, the issue(s) which led to its Non-Conforming status.

(...)

RULE A-4 ENFORCEMENT

SECTION A-401 ACTION AGAINST A NON-CONFORMING OR SUSPENDED MEMBER

- 1) The actions contemplated by the Rules in respect of a Non-Conforming Member or Suspended Member may be taken in any sequence the Corporation deems appropriate.
- 2) In addition to a measure made available to the Corporation under the Rules and the Application for Membership to remedy a specific or general default of a Clearing Member, where a Clearing Member is a Non-Conforming Member, the Corporation may take any one of the actions prescribed by the Rules in respect of such Clearing Member including, but not limited to:
 - a) prohibiting and/or imposing limitations on the acceptance and/or clearance of Transactions by such Clearing Member;
 - b) increasing the Margin Requirements for such Clearing Member or requiring additional Margin Deposits;
 - c) requiring such Clearing Member to reduce or close out (or closing out on behalf of such Clearing Member) existing Transactions in such Clearing Member's accounts with the Corporation and, upon such close out, converting all amounts into Canadian currency and calculating one net amount (taking into account the Corporation's rights with respect to the

Margin Deposit of such Clearing Member) owing to such Clearing Member by the Corporation or by such Clearing Member to the Corporation;

- d) transferring, whether by way of transfer, by way of assignment, by way of termination, close-out and re-establishment or otherwise, any Client Account maintained by such Clearing Member with the Corporation, any position maintained in such account and any Margin Deposits held by the Corporation in respect of such account, to another Clearing Member;
 - e) sanctioning, reprimanding, fining or imposing a penalty on the Clearing Member;
 - f) preventing or restricting the Clearing Member's right to withdraw any excess in Margin Deposits pursuant to Section A-607 or Section A-704; and
 - g) suspending the Non-Conforming Member.
- 3) Upon the suspension of the Clearing Member and in addition to a measure made available to the Corporation under A-401 (2) or under the Rules, the Corporation may take any one of the actions prescribed by the Rules in respect of such Clearing Member including, but not limited to:
- a) applying the Margin Deposit (including, without limitation, Margin and Clearing Fund) of the suspended Clearing Member against the obligations of such Member to the Corporation, subject to Subsection A-402(3) and, for such purpose, selling, transferring, using or otherwise dealing or disposing of any property deposited as Margin Deposit at any time, without prior notice to the Clearing Member;
 - b) transferring, terminating, closing out or liquidating any or all of the Clearing Member Transactions or Open Positions, and upon such close out, converting all amounts into Canadian currency and calculating one net amount (taking into account the Corporation's rights with respect to the Margin Deposit of such Clearing Member) owing to such Clearing Member by the Corporation or by such Clearing Member to the Corporation.
- 4) Before exercising any actions contemplated under this Section, however, CDCC may enter into consultations with the Bank of Canada and specify the actions it considers exercising with respect to the Non-Conforming or Suspended Member.