CANADIAN DERIVATIVES CLEARING CORPORATION

Central clearing and the Canadian repo market

TMX

An overview of the Canadian repo market

A stable and well-functioning repurchase agreement (repo) market is central to the health of Canada's financial system because it underpins the availability of short-term liquidity at effective prices. Borrowers are able to access short-term cash by putting up securities as collateral, which is integral to their ongoing ability to operate efficiently.

Canada's repo market is the fifth largest in the world, according to a 2017 report by the Committee on the Global Financial System, with more than $250 billion outstanding in repo and reverse repo, accounting for roughly 2% of the global total. Several recent studies, including those by Deloitte and the Investment Industry Association of Canada, have concluded that Canada's repo market is in generally good health.

The top 10 banks regulated by the Office of the Superintendent of Financial Institutions as measured by outstanding repo value accounted for 97% of the market. Repo market participants also have a responsibility to use and improve its functionality by providing feedback and staying actively involved in related discussions.

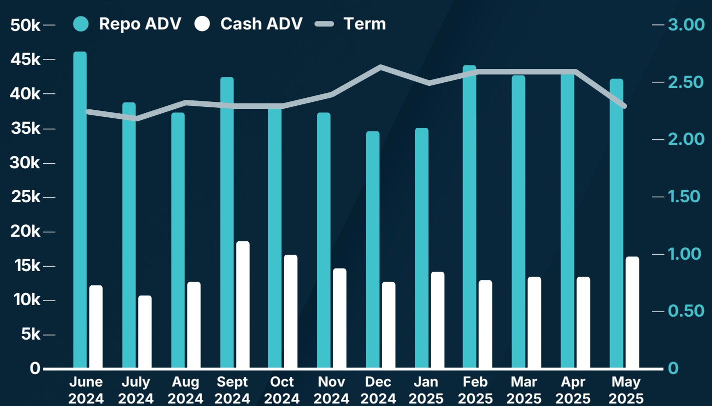
At present, about 15%[1] of the Canadian outstanding repo market is cleared centrally, as compared to about 50% in the United Kingdom and Japan.

Canada's cleared repo market has also grown in recent months. The average daily value of repo transactions cleared by CDCC grew by about 1% between May 2024 and April 2025.

This has largely been due to greater demand for secured funding, and uncleared margin rules that make over-the-counter derivatives trading less attractive. In addition, sell-side demand has grown in anticipation of Bank of Canada interest rate movements. Lastly, a number of banks have increased volumes as they seek capital efficiencies relative to bilateral trading.

CLEARED REPO VOLUMES AT CDCC ARE TRENDING UPWARDS

Increase in monthly ADV of +1% observed over the last 12 months.



The role of the CDCC

The Canadian Derivatives Clearing Corp. (CDCC), part of TMX Group Inc., serves as a central clearing counterparty (CCP) in the repo market and we have been the exclusive provider of central clearing facilities for Canadian repo since 2012.

Our place in Canada's financial markets is unique: We are the only integrated central clearing counterparty in North America that clears and settles futures, options and options on futures. We have a track record that spans more than 35 years as the central clearing counterparty and guarantor of exchange-traded derivative products in Canada. Our responsibility is to ensure the integrity and stability of the markets that we support.

The repo market is well-suited to central clearing

Canada's repo market has several key characteristics that make it ideal for central clearing. First, it has a robust valuation methodology that enables a central counterparty like CDCC to confidently determine margin and default fund requirements. Second, there is healthy liquidity in the Canadian repo market to allow for the centrally managed close-out and hedging of outstanding positions in the unlikely event of a default. And lastly, repo contracts can be standardized to a large extent, which aligns well with a CCP's trade processing arrangements.

1 % cleared is based on data by CDCC and CIRO.

Why choose a CPP?

There is a range of benefits for market participants who choose to use a clearing counterparty to clear their repo transactions.

Multilateral netting

If a bank transacts in both a repo and reverse repo for the same security and term, but with different counterparties, both a liability and an asset are created on the bank's balance sheet. However, if a CCP clears the transaction and replaces both trades with a new contract, the bank in question simply records offsetting trades with the same counterparty. This allows the parties to net the trades and avoid the need to create separate assets and liabilities on their balance sheets.

Central clearing of repos also allows for settlement netting (the netting of principal cash flows on a given settlement date) and, reflecting the netting of exposures, offers margin efficiencies.

However, for banks and dealers, the advantages of using a CCP in repo transactions aren't limited only to avoiding repo-related balance sheet inefficiencies.

KEY BENEFITS

Diversity of counterparties and guaranteed performance

The CCP guarantees counterparty performance, which means market participants may be able to transact with a broader range of counterparties and manage their counterparty risk.

Standardized securities financing transactions

CCPs offer a substantially simpler and more efficient trade lifecycle. A simple, standardized clearing model also creates long-term efficiencies in operational processes.

Settlement discipline

Central clearing drives greater transparency and materially reduces failed transactions.

Pricing and access/capacity benefits in contrast to a bilateral model

Buy-side participants, including money-market funds that need to place cash on an overnight basis, can realize both pricing and capacity benefits. That represents a significant improvement over the bilateral repo model, where holding cash is a low-yielding activity that consumes a sizeable portion of an organization's balance sheet capacity.

Standardized default management procedures

In the unlikely event of a default, a CCP is in a strong position to quickly ascertain exposures and conduct an orderly wind-down via position netting and standardized default management procedures.

Other related benefits of centrally clearing repo transactions

Enhanced and standardized risk-management practices

Enhanced safety and stability via reduced concentration exposure and improved portability

Operational improvements and efficiencies (settlement cycles, payment flows, margin and valuation calculations)

Facilitating anonymous trading on exchange

Greater transparency

Providing a focal point for regulation and oversight

Improved and consistent access to funding for buy-side participants with different regulatory profile and a different risk appetite compared to typical CMS

Access to new clearing models that will mitigate the effect of clearing member concentration, reduce risk and enhance protection

Linking derivatives and securities finance for funding optimization strategies

Central clearing addresses the funding issues of meeting margins while being fully invested

Coordination of default management

The impact of regulatory reform on the repo market

Global regulatory reforms to discourage the build-up of leverage and over-reliance on short-term funding have increased costs for repo financing, while also limiting the collateral available for repo. This has forced market participants to look for alternatives for meeting their short-term financing, investing or liquidity needs.

As part of the G20's overhaul of banking regulations, in addition to changes in capital requirements, two entirely new liquidity requirements were designed by the Basel Committee on Banking Supervision: the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR).

LCR

The LCR was designed to ensure that banks hold a sufficient reserve of high-quality liquid assets (HQLA) to survive a period of significant liquidity stress lasting 30 calendar days. Internationally active banks must hold a stock of HQLA at least as large as expected total net cash outflows over the stress period, as summarized in the following formula:

$$\frac{\textbf{Stock of HQLA}}{\textbf{Total net cash outflows over the next 30 calendar days}} \geq \textbf{100\%}$$

The LCR became a minimum requirement for Basel member countries on Jan. 1, 2015, with the requirement set at 60% and rising by 10 percentage points annually before reaching 100% on Jan. 1, 2019. This phased implementation was put in place to avoid disruption to ongoing financing of economic activity.

NSFR

NSFR requires banks to have available stable funding that is at least 100% of required stable funding over a one-year time period, as expressed in the following formula:

> **NSFR = Available Stable Funding/Required Stable Funding > 100%**

In Canada, the Office of the Superintendent of Financial Institutions held public consultations in February 2019 before issuing the final version of its NSFR Disclosure Requirements Guideline. The guideline takes effect as of the quarterly reporting period ending Jan. 31, 2021.

NSFR has a number of impacts that should be considered in the context of repo transactions and collateral.

Because banks subject to NSFR will be required to hold long-term "stable" funding against short-term reverse repo assets, they will most likely flock to those combinations of counterparties and residual maturities that best fit within the NSFR construct. This, in turn, could create tighter conditions for desired funding structures bilaterally and make it less likely that all market participants will be able to smoothly fulfil their requirements bilaterally with their first choice of structure. Also, as firms take proactive steps to react to market pressures, the impact of NSFR will be uneven and likely felt ahead of the official implementation timetable. CCPs, on the other hand, are positioned to provide improved capacity access and help market participants meet specific reporting requirements. Further, CCPs can provide alternative sources of liquidity, especially in periods of market tensions. NSFR may also impact the demand for longer-term repo.

Uncleared Margin Rules (UMR)

UMR Phase 5 rules come into force as of September 2020 and are also expected to have an impact on the availability and price of repo collateral. Entities with a month-end aggregate average notional amount (AANA) of non-centrally cleared derivatives in excess of US$50 billion will be impacted by the rules. This means new documentation, custodial and operational requirements.

In addition, the final implementation phase kicks in on Sept. 1, 2021, when covered entities with an AANA of non-centrally cleared derivatives greater than US$8 billion will become subject to the UMR requirements. These include:

- Posting Variation Margin daily
- Pledging two-way Initial Margin (not transferred in title) in favour of the bilateral counterparty
- Initial Margin has to be segregated and held with a third-party custodian that is not affiliated with any of the counterparties
- Collateral cannot be re-used or re-hypothecated

The UMR requirements are likely to drive a renewed awareness of the relationship between collateral and balance sheet for covered entities. In addition, firms covered by UMR will need to balance internally their needs for cash for Variation Margin and bonds for Initial Margin.

By clearing repo transactions centrally, market participants can facilitate consistent capacity for cash or securities-driven repo in light of the upcoming UMR requirements.

In order to fulfil our central role of providing added stability, breadth and depth to the Canadian repo market, we at CDCC are looking to evolve its platform by exploring a number of innovative services. These include:

Broadening access to the CCP through a sponsored participation model, which would strengthen capacity creation and improve the breadth of the repo service.

Enhancing netting opportunities:

As potentially higher repo volumes are cleared at CDCC, we plan to work to create additional depth of cleared repo markets and add incremental value by providing further netting benefits.

We expect demand for term repo to grow in response to NSFR regulation. As a result, more netting opportunities will exist as term demand between lenders and borrowers will even out.

Increasing eligible underlying asset types in response to market demand, including potentially FRNs MBS, General Collateral repo, or other underlyings.

Engaging with regulators and introducing new trading products that can deliver efficiencies and liquidity to the marketplace.

CDCC

INNOVATING FOR THE FUTURE

Let's continue the conversation!

If you have a comment, question or suggestion related to Canada's repo market, or if you would like to learn more about the CDCC and its central clearing capabilities, please contact:

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