



## NOTICE TO MEMBERS

No. 2016 – 090

July 13, 2016

### **SELF-CERTIFICATION**

#### **AMENDMENTS TO SECTIONS A-308 AND A-401 OF THE RULES AND TO THE DEFAULT MANUAL OF THE CANADIAN DERIVATIVES CLEARING CORPORATION**

On October 30, 2015, the Board of Directors of the Canadian Derivatives Clearing Corporation (CDCC) approved amendments to Sections A-308 and A-401 of the Rules and to the Default Manual of CDCC. CDCC wishes to inform the Clearing Members that these amendments have been self-certified pursuant to the self-certification process set forth in the *Derivatives Act* (C.Q.L.R., c I-14.01) and approved by the Ontario Securities Commission in accordance with the “Rule Change Requiring Approval in Ontario” process.

The purpose of the amendments is to clarify the language of its Rules and Default Manual governing the default management process, in accordance with the requirement of Principle 1 – Legal Certainty under the PFMIIs.

You will find attached hereto the amendments set to come into force and to be incorporated into the version of the Rules and Default Manual of CDCC that will be made available on the CDCC website at [www.cdcc.ca](http://www.cdcc.ca) as of July 13, 2016.

If you have any questions or concerns regarding this notice, please contact CDCC’s Corporate Operations department or direct your e-mail inquiries to [cdcc-ops@cdcc.ca](mailto:cdcc-ops@cdcc.ca).

Glenn Goucher  
President and Chief Clearing Officer

## APPENDIX 1

### (BLACKLINE)

#### AMENDMENTS TO SECTION A-401 AND A-308 OF THE CANADIAN DERIVATIVES CLEARING CORPORATION

##### ~~SECTION A-308 RESTRICTIONS ON CERTAIN TRANSACTIONS AND POSITIONS~~

~~1) If the Board shall at any time determine that the financial or operational condition of a Clearing Member makes it necessary or advisable, for the protection of the Corporation, other Clearing Members or the general public, to impose restrictions on such Clearing Member's Transactions with the Corporation, the Board shall have the authority:~~

- ~~a) to prohibit or to impose limitations on the acceptance and/or clearance of Opening Purchase Transactions, Opening Writing Transactions or newly concluded OTCI transaction by such Clearing Member;~~
- ~~b) to require such Clearing Member to reduce or eliminate existing Long Positions or Short Positions in such Clearing Member's accounts with the Corporation; and/or~~
- ~~c) to require such Clearing Member to transfer any account maintained by such Clearing Member with the Corporation, any Transaction maintained in any such account, or any account carried by such Clearing Member, to another Clearing Member.~~

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

1) 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;

~~b)~~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;

~~e) — requiring such Clearing Member to~~

- d) transferring, whether by way of transfer, by way of assignment, by way of termination, close-out and re-establishment or otherwise, any ~~account~~ Client Account maintained by such Clearing Member with the Corporation, any position maintained in ~~any~~ such account and any Margin Deposits held by the Corporation in respect of such account, ~~or any account carried by such Clearing Member, to~~ 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.

2) Upon the suspension of the Clearing Member and in addition to a measure made available to the Corporation under A-401 (1) 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 ~~Non-Conforming~~ suspended Clearing Member against the obligations of ~~the Non-Conforming~~ 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 ~~Non-Conforming~~ 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.

~~(2)~~ —The actions contemplated by the Rules in respect of ~~Non-Conforming Members~~ suspended Clearing Members may be taken in any sequence the Corporation deems appropriate.

## APPENDIX 2

### (BLACKLINE)

## Default Manual

This Default Manual (the “Manual”) is intended to summarize the Rules of the Canadian Derivatives Clearing Corporation (“CDCC” or the “Corporation”) and confirm certain details concerning the actions the Corporation may take with respect to Clearing Members in financial difficulty, potentially in default or in default of obligations under the Rules. This ~~manual~~ Manual describes the Corporation’s possible course of action, including management of a default situation, authority, communication with a Clearing Member and implementation. **In case of conflict between the provisions set out in this Manual and the Rules of the Corporation, the Rules will prevail.** Terms with capitals which are not defined in this Manual have the meanings ascribed to them in the Rules.

A fundamental objective of a central counterparty is to ensure the integrity of payments and/or physical delivery of securities, even in the unlikely event of a Clearing Member default. Since the default of one or more Clearing Members may have an impact on the continuity of clearing operations, the Corporation must ensure that efficient mechanisms and processes are in place, capable of limiting the adverse impacts of such an event, with respect to monitoring and the determination of a Clearing Member’s Non-Conforming Member status and a Clearing Member’s suspension. As such, this Manual is meant to:

1. describe the grounds and events which may trigger the implementation of the default management procedure and the enforcement actions that may be taken by the Corporation throughout the process;
2. describe the governance process followed by the Corporation ~~subsequent to Clearing Member default; and~~
3. ~~2. enumerate the actions taken~~ describe the risk mitigation tools that can be used by the Corporation ~~through the course of default management;~~
- ~~3. describe the financial resources employed; and~~
- ~~4. describe the responsibilities of non-defaulting Clearing Members during this process.~~

## Section 1: ~~Overview~~Triggers and Implementation of Default ~~Process~~Management Procedure

In the following section, the ~~Corporation's overall~~grounds and events which may trigger the implementation of the default management ~~processes~~procedure and the enforcement actions that may be taken by the Corporation throughout the process are described. Key ~~sub~~-sections include Objectives of Default Management, ~~Definition of Default~~Triggers Leading to Non-Conforming or suspension status, Implications of Default, ~~Forms of~~Status Associated with Default ~~as specified by Rules~~, Corporation Prerogatives in the Default Mitigation Process, and Waterfall - Financial Remedies to cover Default-Induced Losses. ~~In subsequent sections, the Manual will describe the specific actions to be taken by the Corporation during the default identification process, all the way through the steps taken to mitigate losses, wind down defaulted Clearing Member positions, protect the functioning of the markets and the clearing process, coverage of losses, etc. Prior to that, a general overview of the default process is set forth below:~~ Cover Default-Induced Losses.

### 1.1. OBJECTIVES OF DEFAULT MANAGEMENT

Participants in the default management process should at all times bear in mind the objectives of the default management exercise. These are delineated below:

- To minimize Clearing Member losses deriving from an inability of the Corporation to make settlement payments, protect Clearing Member Margin Deposit, or otherwise manage its responsibilities in a manner consistent with orderly markets.
- To ensure the continued effective functioning of the clearing process both during and after the event of default.
- To use all available powers and resources to protect the financial assets and positions of Clearing Members not contributing to the condition of default. This includes, wherever possible, the comprehensive and efficient transfer of ~~all solvent~~ Client Accounts associated with a defaulting Clearing Member, including any position maintained in such account and any Margin Deposits held by the Corporation in respect of such account, to another Clearing Member.
- To minimize the market impact of the default management process.
- To ensure the continued solvency of the Corporation, and timely access to liquidity both during and after the default management process.
- To ~~facilitate the management of any~~communicate with regulatory ~~action associated with~~authorities on actions taken throughout the default management process.

Corporation management, staff and agents should conduct themselves at all times during the default management process in a manner consistent with these objectives, and in general without regard to other considerations.

## DEFINITION OF DEFAULT

### 1.2. TRIGGERS LEADING TO NON-CONFORMING OR SUSPENSION STATUS

Critical to the process of default management is, of course, defining the ~~condition of default~~grounds and events which can lead a Clearing Member to default on its obligation and result in the Corporation declaring such member Non-Conforming or suspending it, where warranted. As a general rule, the Corporation views any situation which would, in ~~the its~~ judgment ~~of the Corporation~~, impede a Clearing Member's ability to meet its obligations, as specified in the Rules, as grounds to declare ~~default~~. ~~The most direct example of such a condition occurs when a Clearing Member fails to meet settlement requirements to CDCC. Additional examples of default conditions include but are not limited to, Clearing Members (or their Affiliates) that have:~~a Clearing Member Non-Conforming. Sections A-1A04 and A-1A05 of the Rules provide the details of the grounds and events that can lead the Corporation to declare a member Non-Conforming or suspend it.

- ~~● Failed to post required Margin.~~
- ~~● Failed to pay the contribution to the Clearing Fund.~~
- ~~● Failed to pay fees, interest, penalty, damages and any expenses as prescribed by the Corporation.~~
- ~~● Failed to meet a financial payment or any other financial obligation, including, most notably, those associated with other central clearing organizations ("CCOs").~~
- ~~● Generated any conditions that might indicate financial insolvency (i.e. bankruptcy filing, receivership, or forfeiture of control of property).~~
- ~~● Violated membership standards of other Self Regulated Organizations ("SROs") or regulatory bodies or any other event that indicates that a future default event is imminent, that the Corporation views to be of material importance.~~

~~Note: Failure to deliver a physical quantity may or may not constitute a default, depending upon the specific circumstances of the failure.~~

~~In general, the condition of default is one which must be determined by the Corporation's management in the case of the declaration of Non-Conforming Member status and by the Board in the case of the suspension of a Clearing Member.~~

For the avoidance of doubt, as indicated in the Rules, the Corporation may in advance of, or in anticipation of a default or breach of eligibility or standard requirement, declare a Clearing Member Non-Conforming.

Where the Non-Conforming Clearing Member is insolvent or is unable or likely to be unable to meet its obligations under the Rules on a continuing basis, and has no reasonable prospect of returning to good standing or curing its default within a reasonable timeframe, the Corporation may then suspend the Non-Conforming Clearing Member. The Corporation will act accordingly for any default, whether actual or imminent, that is of such a gravity that suspension would be warranted, taking into consideration the protection of the integrity of the market.

### **1.3. IMPLICATIONS OF DEFAULT**

A Clearing Member's default is among the most serious ~~issues~~issue faced by the Corporation, as it can have myriad consequences, and in the most extreme cases, can threaten both the continued effective functioning/integrity of the markets, as well as the viability of the Corporation itself. More ~~narrowly~~specifically, a Clearing Member default can result in losses to the Corporation, other Clearing Members and their Clients, can impact the funding liquidity of these entities and can disrupt the routine functioning of the markets. As such, the Corporation must have adequate financial and risk management resources, in order to identify potential conditions of default, assess potential damage, mitigate market and financial impacts, and apply appropriate financial remedies to minimize losses for both itself and its stakeholders.

The Corporation must therefore commit appropriate resources and have in place proper procedures to ensure that the Clearing Members meet all standards of membership. The Rules, notably Rule A-1A – Membership in the Corporation, Rule A-3 – Capital Requirements, Rule A-6 – Clearing Fund Deposits and Rule A-7 – Margin Requirements, provide for such oversight authority, and must be adhered to with extreme rigor.

### **1.4. FORMS OF STATUS ASSOCIATED WITH DEFAULT** ~~AS SPECIFIED BY RULES~~

The Rules specify two distinct status levels associated with the ~~condition of~~ default of a Clearing Member. The first such form is Non-Conforming ~~Member~~-status. At any point when the Clearing Member is or may ~~be~~become insolvent or ~~become~~ unable to meet its obligations, management may declare that Clearing Member to be a Non-Conforming Member. ~~This action~~Section A-1A04 of the Rules provides the grounds on which the Corporation may do so. Upon a declaration of Non-Conforming status, the Corporation is empowered with the authority, as further specified below, to undertake a wide range of mitigating actions.

~~If, however, in its judgment, the suspension of a Non-Conforming Member may~~Considering the gravity of the situation, the likelihood of a remediation of the default by the Clearing Member and in order to protect the integrity of the market, the Board ~~can~~may, in its sole discretion, choose to suspend the Non-Conforming Member. ~~Suspension is the second and more serious level of default.~~

The Corporation's management is responsible to declare a Clearing Member Non-Conforming whereas a suspension decision must be taken by the Board. Please refer to sections A-1A04 and A-1A05 of the CDCC Rules which lay out the specificities of Non-Conforming and suspension statuses.

## **1.5. CORPORATION PREROGATIVES IN THE DEFAULT MITIGATION PROCESS**

### **Imposition of Additional Margin Call in Pre-Default**

In accordance with Section A-702, the Corporation, following a management decision, may, without advance notice and at its sole discretion, impose an additional Margin on Clearing Member, whether Non-Conforming or not, for an indeterminate period. While this may be necessary under a wide range of circumstances, it is particularly relevant in situations where the Corporation has reason to believe a default is imminent but has yet to take a decision on Non-Conforming status.

The Clearing Member will be informed and will have to meet its additional Margin requirements within the same deadlines as regular Margin calls. This additional Margin will be added to the amount of Margin.

### **Implementation of Default Mitigation Process: Non-Conforming and Suspension**

In the event that the Corporation or the Board, as applicable, chooses to place a Clearing Member, in either Non-Conforming Member status or suspension, it must, as soon as practicable, act to assess the situation and ensure that any and all remedies available to it are at its immediate disposal. ~~It~~ The Corporation must use any and all commercially reasonable efforts to manage the default process.

For further clarity, the Corporation may simultaneously declare a Member Non-Conforming and suspend such Member, without applying first the measures available under the Non-Conforming status.

Taking into consideration the context and materiality of the trigger event, the ability of the Clearing Member to correct the situation within reasonable delay, the Corporation or the Board, as applicable, may therefore choose to undertake any of the following ~~sets~~ set of actions in its efforts to mitigate associated damage.

### **Enforcement Actions Pursuant to a Non-Conforming Status**

- Prohibit and/or impose limitations on the acceptance and / or clearance of Transactions by the defaulting Clearing Member.
- Requiring such Clearing Member to reduce or close out existing Transactions in such Clearing Member's accounts with the Corporation.



- Prevent or restrict the defaulting Clearing Member's right to withdraw any excess in Margin Deposits pursuant to Section A-607 or Section A-704.
- Transferring, requiring to transfer or transferring on its behalf, all or any portion of a defaulting Clearing Member's 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.
- Undertake any legal action against the defaulting Clearing Member that in the judgment of the Corporation may help to mitigate default-related losses.
- Sanction, reprimand, fine or impose a penalty on the defaulting Member.
- Suspend the Non-Conforming Member.

#### Enforcement Actions Pursuant to a Suspension

In addition to the actions that the Corporation may take under the Non-Conforming Status, CDCC may;

- Place all accounts on liquidation only status. Seize all Margin Deposits posted to the Corporation by the defaulting Clearing Member's, including the contribution to the Clearing Fund and use it to satisfy such Clearing Member's obligation.
- Seize control of all Open Positions held by the defaulting Clearing Member.
- Gain access, and, if necessary, control of the defaulting Clearing Member prescribed records, so as to ensure the continued efficient processing of business, and to ensure the defaulting entity continues to comply with all Rules and mandates.
- ~~Transfer all or any portion of a defaulting Clearing Member's accounts to another Clearing Member.~~
- ~~Seize all Margin Deposits posted to the Corporation, including the defaulting Clearing Member's contribution to the Clearing Fund.~~
- ~~Undertake any legal action against the defaulting Clearing Member that in the judgment of the Corporation may help to mitigate default related losses.~~
- Neutralize market exposures through the use of hedging instruments where, as determined by the Corporation, market conditions do not allow for an orderly auctioning or closeout of a defaulting Clearing Member's Open Positions in a timeframe which is consistent with the Corporation's risk management model.

- Render a determination as to which Firm Accounts and Market Maker Accounts of the defaulting Clearing Member (subject to the objective of protecting to the largest extent possible, all ~~solvent~~ Client Accounts) ~~might~~may have offsets which could be netted for risk reduction purposes.
- Place all accounts of the defaulting Clearing Member on liquidation only status.
- With respect to such accounts, effect liquidation of Open Positions, either directly by Corporation staff, or as appropriate, through ~~outside~~appointed agents.
- Schedule an auction to transfer all remaining Open Positions to other Clearing Members at best available prices.
- Potentially postpone delivery obligations if, in the judgement of the Corporation, not doing so would expose the Corporation and surviving Clearing Members to increased risk of financial loss.
- Apply any and all available financial remedies, as further described below:
  - ~~Prohibit and/or impose limitations on the acceptance and / or clearance of Transactions by the defaulting Clearing Member.~~
  - ~~Sanction, reprimand, fine or impose a penalty on the defaulting Member.~~

~~In any situation where the Corporation has reason to believe that a pending default may lead to losses, it must act, according to its own judgment, as directed by the management or the Board, as applicable, to apply the mitigants referenced above, as well as others deemed appropriate, to ensure minimal damage to itself, its stakeholders and the markets. The Corporation must use any and all commercially reasonable efforts to manage the default process.~~

## **1.6. WATERFALL - FINANCIAL REMEDIES TO COVER DEFAULT-INDUCED LOSSES**

~~In the event that a Clearing Member has been declared a Non-Conforming Member or has been suspended, the Corporation, as specified above, must make all commercially reasonable efforts to eliminate or otherwise limit the loss to the Corporation associated with the default process. However, there are, of course, no means available to ensure in all cases that the Corporation can be made whole, its best efforts in this regard notwithstanding. In the event that the management of the default process generates~~implementing the default management process, the Corporation will aim at minimizing, to the extent possible and on best efforts basis, the losses to the Corporation and its stakeholders. If there are nonetheless losses to the Corporation, the Corporation must apply, in specified order, a series of financial remedies to ensure its ongoing viability and financial solvency. Following is a description of these financial resources, as presented in the order in which the Corporation would apply them to cover unsatisfied claims associated with the liquidation of a defaulting Clearing Member.

Note that these financial remedies fall into two categories. The first such grouping is a list of the assets posted by the defaulting Clearing Member itself. The Corporation, in its efforts to cover its obligations, would first exhaust this pool of assets, before applying certain of its own resources, and those of the other Clearing Members, in the resolution of the shortfall.

~~In the event that after the application of the defaulting Clearing Member's assets, a financial shortfall persists, then the Corporation must apply certain of its own assets and those of the remaining Clearing Members to satisfy the residual obligation. The various pools available to resolve any financial loss, and the order in which the Corporation would utilize them, is set forth immediately below.~~

### Defaulting Clearing Member Resources

**Defaulting Clearing Member Margin Deposit.** The first line of financial protection, ~~of course,~~ is the Margin Deposit posted by the defaulting Clearing Member as part of the Corporation's routine collateralization process.

**Defaulting Clearing Member's Contribution to the Clearing Fund.** As specified by the Rules, each Clearing Member must post an additional contribution to ~~the a separate~~ Clearing Fund. Once the Corporation has exhausted the defaulting Clearing Member's Margin Deposit, it will next apply these resources to the loss mitigation effort.

If after applying these resources of the defaulting Clearing Member, a shortfall still remains, the Corporation would ~~look to the following,~~ [as indicated below, use the Resources of the Corporation and](#) common resources of the system to cover the loss.

### Resources of the Corporation and the System

**Corporation Capital Resources.** The Corporation would first look to its own capital, but only to its capital reserves set aside for this purpose, which are currently a maximum of \$5 million.

**Other Clearing ~~Member~~Members Clearing Fund Deposits.** The Corporation would next apply the remaining balances in the Clearing Fund, on a pro-rata basis as determined by the size of each Clearing Member's contribution.

**Assessment of Other Clearing Members.** If after applying all of the remedies specified above, a loss still persists, then the Corporation, as specified in Section A-610 of its Rules, may request that the remaining Clearing Members replenish their Clearing Fund contributions to their original levels and use on a pro rata basis according to CDCC's exposure to each remaining Clearing Member, an amount that in total satisfies the outstanding obligation.

The Corporation must act with rigor to ensure it follows these policies, ~~executes~~[execute](#) them effectively and ~~communicates~~[communicate](#) with all relevant parties in an effective fashion. In the event that the Corporation is later able to recover any loss incurred from the defaulting Clearing

Member, it shall first reimburse any contributions to the Clearing Fund of the remaining Clearing Members that were used to cover the loss, before reimbursing CDCC's own capital reserves used.

## Section 2: Default Management Governance Procedures

In this section, the Corporation outlines the specific actions to be taken by its staff, management and the Board, in order to ensure that it quickly identifies, reacts to, and effectively manages a condition of default. The two sub-sections are:

### ~~CORPORATION PREROGATIVES/RESPONSIBILITIES PRIOR TO THE DECLARATION OF NON CONFORMING MEMBER OR SUSPENSION~~

1. Governance Structure; and
2. Roles and Responsibilities upon a Declaration of Non-Conforming or Suspension.

#### 2.1. GOVERNANCE STRUCTURE

The Corporation's procedures for the management of a default are governed, under the auspices of its Board and by two Committees, presented below in their hierarchical order:

- Default Management Committee (DMC)
- Emergency Committee (EC)

In the default process, it is important for the Corporation to react in as timely a fashion as possible to identify the potential for a default by a Clearing Member. As such, under the authority of the President or his designee, if at any point the Corporation receives information which would, in its view, acting reasonably, likely lead to a default event by any Clearing Member, it will ~~convene a meeting~~, as soon as practicable, convene a meeting of the Default Management Committee, ~~which (DMC).~~ The DMC is comprised of the individuals holding the following positions:

- President and Chief Clearing Officer, CDCC
- Vice-President & Chief Risk Officer, CDCC
- Director Risk Management, CDCC Risk Management
- Director Corporate Operations, CDCC Operations
- Director Strategic Initiatives, CDCC
- Vice-President Legal Affairs, CDCC Legal
- Manager, Release Management, TMX-IT

Each of these individuals, in managing their departments, must act with due rigor to assess issues, identify associated magnitudes, recommend actions and inform management, to the Board and other Corporation stakeholders, as appropriate.

The responsibility of the DMC is to take decisions related to the default management process, e.g. the determination of the Non-Conforming status, actions to be implemented to limit losses to the Corporation and the conforming Clearing Members. The DMC can count on the participation of a sub-committee to help performing its mandate, namely the Emergency Committee (EC).

The EC, chaired by the VP and Chief Risk Officer, is composed of all DMC members plus the following specialists (and/or any other representatives or designees deemed appropriate to involve in the process):

- ~~Managing Director~~
- ~~President and Chief Clearing Officer~~ CDCC Treasurer
- ~~Secretary~~ MX Vice-President, Regulatory Division
- ~~Assistant Secretary~~ TMX Vice-President, Corporate Communications & Public Affairs
- ~~Treasurer~~ MX Vice-President, Market Operations, Services and Connectivity
- ~~Director of Risk Management~~ Corporate Operations
- ~~Director of Corporate Operations~~ Managers, Risk Management

~~At this meeting, the Default Management Committee will strike an Emergency Committee which will include the Director of Risk Management as Chairman, and whose members will also include the Director of Corporate Operations and/or the Treasurer. It will be the responsibility of the Emergency Committee~~ EC ~~to provide an ongoing assessment of the situation, and to report back, as appropriate, to the Default Management Committee~~ DMC ~~and the Board, so as to ensure these bodies are in a position to render informed decisions throughout the process.~~

~~In addition to the process of organizing these three committees, the Corporation has the following set of prerogatives and responsibilities, and will act according to the following protocols, in managing any situation, which, in its judgment places it in a condition where the risks of default are elevated.~~

#### **~~Criteria for Implementing Introductory Default Procedures~~**

~~Following is a subset of the types of events which would set the default management procedures, including the convening of CDCC committees, into motion. Note that none of these events, individually or in combination, necessarily implies that a declaration of default by CDCC, in either of its specified forms, is imminent. The events may, however, impel the Corporation to set introductory default procedures, as specified above, in motion. Pursuant to subsection A-1A04(1) of the Rules, a Clearing Member may also become a Non-Conforming Member by notice to the Corporation that it is or may become insolvent or unable to meet its obligations.~~

#### **~~Violation of Standards of Membership~~**

~~Rules A-1A and A-3 establish the standards of membership and the minimum capital requirements that must be respected at all times.~~

~~The Corporation may address a Clearing Member's breaches of standards of membership without declaring such Clearing Member to be a Non-Conforming Member or suspended by, for example, making an additional Margin call and/or imposing clearing restrictions.~~

### **~~Failed and Partially Failed Deliveries of Acceptable Securities~~**

~~Section A-804 addresses failed deliveries and partial deliveries of Acceptable Securities. Failed deliveries and partial deliveries of Acceptable Securities do not automatically trigger Non-Conforming Member status or a suspension. Section A-804 sets out the applicable mechanisms for this type of situation. Ultimately, if the Clearing Member is not in good standing with the Corporation, the Corporation may consider it necessary to declare the Clearing Member to be in default.~~

~~Section B-407 addresses the failed delivery of any Underlying Interest of an Exchange-traded Option.~~

~~Section C-512 addresses the failed delivery of any Underlying Interest of an Exchange-traded Future other than an Acceptable Security.~~

~~Section D-304 addresses the failed delivery of any Underlying Interest of an OTCI that is not a Fixed Income Transaction.~~

### **~~Settlement Failure at Other Recognized CCOs~~**

~~If the Corporation learns that a Clearing Member has failed to meet its obligations to another CCO, it must operate as though there is an imminent threat of failure to the Corporation itself, and may, at the Corporation's discretion, invoke introductory default procedures.~~

### **~~Default on any Principal Obligation~~**

~~If a Clearing Member fails on a general obligation, such as a coupon payment on its own outstanding debt, it may be considered to be insolvent or unable to meet its obligations and the Corporation may, at its discretion, invoke introductory default procedures.~~

### **~~Civil or Criminal Indictment of Clearing Member and/or Principals~~**

~~Action by a regulatory agency, administrative authority or court against a Clearing Member and/or its key principals may or may not place it in a condition of financial impairment. As a matter of sound practice, the Corporation should, under these circumstances, effect introductory default procedures.~~

~~Note that the above supplied list is not intended to be exhaustive, but rather merely illustrative of the types of events which should trigger the introductory implementation of default procedures.~~

### **~~Pre-default Actions and Remedies~~**

~~Prior to the declaration of either form of default, the Corporation has a number of remedies to further protect itself from associated consequences. The principal one of these is the imposition of additional Margin requirements, clearing restrictions and penalties, concepts that are further described below:~~

### **Imposition of Additional Margin Call**

~~In accordance with Section A 702, the Corporation may, without advance notice and at its sole discretion, impose an additional Margin call on a Clearing Member for an indeterminate period. While this is true under a wide range of circumstances, it particularly pertains to situations where the Corporation has reason to believe a default is imminent, and has begun the implementation of preliminary default procedures.~~

#### ***Authority***

~~Management of the Corporation.~~

#### ***Communication***

~~The Clearing Member will be informed and will have to meet its additional Margin requirements within the same deadlines as regular Margin calls.~~

~~Moreover, in accordance with Section A 303, the Clearing Member must notify the Corporation if it does not meet the Corporation's capital requirements and those imposed by the Investment Industry Regulatory Organization of Canada ("IIROC") or the Office of the Superintendent of Financial Institutions. Ultimately, if this situation is not resolved, the Corporation reserves the right to suspend the Clearing Member after receiving the approval of the Board. For more details, please refer to the section below on Clearing Member suspension.~~

#### ***Implementation***

~~This additional Margin will be added to the amount of Margin.~~

### **Imposition of Clearing Restrictions**

~~In accordance with Section A 308—Restrictions on Certain Transactions and Positions, the Board may impose clearing restrictions on a Clearing Member considered to be in difficulty.~~

~~When the decision takes effect, the Corporation will notify the Clearing Member of restrictions that will be applied immediately. However, the Clearing Member may execute certain Transactions, with the Corporation's consent, to maintain its position in good standing.~~

#### ***Communication***

~~The Clearing Member will be informed and must conform to the clearing restrictions within reasonable deadlines.~~

~~Ultimately, if the situation is not resolved, the Board may suspend the Clearing Member. For further information, please consult the section below on Clearing Member suspension.~~

#### ***Implementation***

~~The Corporation may establish clearing restrictions on certain Transactions.~~

## Forms of Default

~~As indicated above, the Corporation recognizes two forms of default, Non-Conforming Member status and suspension. The first of these is the weaker form of the two, can be implemented by the Corporation, and is viewed by the Corporation to be a temporary status, which is either rectified by the Non-Conforming Member in a timely and comprehensive fashion, or face further actions by the Corporation. Specifically, the next step in the process would be to declare a suspension of the Non-Conforming Member. This is the final, in many ways irrevocable step in the default declaration process and must be effected by the Board.~~

## DECLARATION OF NON-CONFORMING MEMBER STATUS

### 2.2. ROLES AND RESPONSIBILITIES UPON A DECLARATION OF NON-CONFORMING OR SUSPENSION

The Rules provide for two ~~categories of~~ statuses associated with the default for a Clearing Member: Non-Conforming Member status and suspension. Non-Conforming Member status can be determined by the Corporation's management, while a suspension must be ratified by the Board.

## DECLARATION OF NON-CONFORMING MEMBER STATUS

### Grounds

Section A-1A04 addresses the grounds upon which the Corporation may declare the Non-Conforming Member status. ~~The grounds for declaring Non-Conforming Member status are set out in Subsection A-1A04(3) but are not exhaustive. The next step following Non-Conforming Member status is suspension. The grounds are however not exhaustive.~~

~~A Clearing Member which is or may become insolvent or is unable to meet its obligations shall immediately inform the Corporation of this situation by telephone. Alternatively, the Corporation must inform the Clearing Member in writing or by telephone when it has become a Non-Conforming Member.~~

~~The measures prescribed by the Rules regarding Non-Conforming Members may be taken in the order that the Corporation considers appropriate. The measures are set out in Rule A-401 and include:~~

- ~~• Prohibiting and/or imposing limitations on the acceptance and/or clearance of Transactions by the Clearing Member;~~
- ~~• Requiring this Clearing Member to reduce or close out existing Transactions in such Clearing Member's accounts with the Corporation;~~
- ~~• Requiring the Clearing Member to transfer to another Clearing Member any account it holds with the Corporation, any position maintained in such account, or any account established by the Clearing Member;~~
- ~~• Applying the Margin Deposit and Clearing Fund deposit of the Non-Conforming Member in accordance with the Rules;~~



- ~~Sanctioning, fining or imposing a penalty on the Non-Conforming Member;~~
- ~~Suspending the Non-Conforming Member.~~

### Communication

The Clearing Member should notify the Corporation if it is insolvent or unable to honour its obligations under the Rules.

- ~~Prevent or restrict the Non-Conforming Member's right to withdraw any excess in Margin Deposits~~  
However, in the event that the Clearing Member is declared as a Non-Conforming Member by the Corporation, the Corporation must inform the Clearing Member in writing or by telephone.

### **Authority**

The Corporation may decide on Non-Conforming Member status.

### **Required Response by Non-Conforming Members**

A Clearing Member which has experienced an event, technical or otherwise, ~~in~~ as a result of which it fails or finds itself likely to fail to meet any of its day to day operational needs for its business must inform the Corporation immediately of such event. Failure to notify the appropriate Corporation staff members immediately may result in ~~administrative~~ any actions contemplated under the Rules, including disciplinary actions. A Non-Conforming Member may in certain cases remedy its situation via wiring required funds or posting additional collateral to the Corporation.

Contemporaneous to the notification of Non-Conforming Member status to a Clearing Member, the Corporation will ask such Clearing Member to state in writing its assertions with respect to each of the following:

- Cause of the action which placed it in Non-Conforming Member status~~;~~
- Remedies for the immediate circumstance~~;~~ and
- Changes in its financial profile and operating protocols to guard against recurrence.

Corporation staff will work with the Non-Conforming Member~~;~~ to secure and assess its written response. Contemporaneously, the ~~Emergency Committee~~ EC will work with the ~~Default Management Committee~~ DMC to determine any potential immediate additional actions, including recommendations to the Board regarding suspension.

In the event that a remedy occurs in a timely fashion, the Corporation will review the Non-Conforming Member's written explanation and will then determine next steps, including the

potential removal of Non-Conforming Member status, or recommendations to the Board for suspension.

In executing these procedures, the Corporation must remain mindful of the narrow time window available to it to determine the next steps in the process. It is essential that all members of management and all Board members make themselves available as necessary to render timely and efficient decisions under these circumstances.

### **Communication**

~~The Clearing Member should notify the Corporation if it is insolvent or unable to honour its obligations under the Rules. The Corporation may notify the appropriate regulatory authorities.~~

~~However, in the event that the Clearing Member is declared as a Non-Conforming Member by the Corporation, the Corporation must inform the Clearing Member in writing or by telephone.~~

### **Implementation**

The Corporation must work in concert with the Non-Conforming Member and the appropriate regulatory authorities to rectify the Clearing Member's Non-Conforming Member status.

~~These actions~~ The enforcement actions available to the Corporation, as set out under section A-401 and as further explained in the Section 1 of this Manual, are not exhaustive, and are not necessarily presented in chronological order, and can be adapted as required by the Corporation according to the circumstances that prevail during the period the Clearing Member is a Non-Conforming Member.

- ~~● The situation has been confirmed with the Clearing Member.~~
- ~~● The Corporation may seize the Clearing Member's Margin Deposits.~~
- ~~● The Corporation may on its own accord restrict the Transactions of the Non-Conforming Member.~~
- ~~● If payments are to be made by the Non-Conforming Member to the Corporation, the Corporation may apply the seized Margin Deposits if it deems that they must be paid before the Clearing Member is suspended.~~
- ~~● The Corporation may also ask the Non-Conforming Member to close out its market positions.~~
- ~~● The Corporation may also require the Non-Conforming Member to transfer its Clients' positions.~~
- ~~● If the Clearing Member must execute deliveries, then the Corporation could make an agreement with the receiving Clearing Member and the Non-Conforming Member or take any other appropriate action so that the Clearing Member's obligations are honoured.~~

- ~~Assign the proceeds of the liquidation of the Clearing Fund and Margin Deposit of the Non-Conforming Member to any default related shortfall.~~
- ~~Impose sanctions, fines or penalties on the Non-Conforming Member of the Corporation.~~
- ~~Prevent or restrict the Clearing Member's right to withdraw any excess in Margin Deposits.~~
- ~~The Corporation may call an emergency meeting of the Board to determine whether a Non-Conforming Member warrants suspension.~~

## Notifications

Once the Corporation has declared a Clearing Member to be a Non-Conforming Member, the Corporation will immediately consider its notice obligations. Those entities whose notification ~~rights must be~~ is considered include:

- The ~~general population of~~ Clearing Members.
- Appropriate regulatory authorities.
- Exchanges and central clearing organizations (CCOs).

While it will be the prerogative of the Corporation to determine the timing and content of its outside disclosures, it will nonetheless immediately inform any CCOs with which the Corporation has in place a Memorandum of Understanding for such information sharing.

## DECLARATION OF A SUSPENSION

### Grounds

~~Subject to the discretion and approval of the Board, a Clearing~~ A Non-Conforming Member may be suspended ~~after it has been declared a Non-Conforming Member~~ in accordance with Section A-1A04 or any other conditions that the Corporation may deem relevant. ~~These rules relate to Non-Conforming Member situations, but can also be applied to any situation involving~~ Section 1.2 of this Manual also discusses the triggers which may lead to a suspension. In effect, the Corporation, upon approval of the Board, may decide to suspend a Clearing Member without first declaring it Non-Conforming.

~~Once the Board approves a suspension, the Corporation ceases to act on behalf of the Clearing Member~~

### Communication

The Corporation will communicate to the Clearing Member a written statement setting out the grounds for its suspension.

### Authority

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The Board has the authority regarding the suspension and lifting of a Clearing Member's suspension.

### Implementation

Once the Board approves a suspension, the Corporation ceases to act on behalf of the Clearing Member.

According to Section A-1A05, the Corporation may then implement any of the enforcement actions set out under Section A-401 and as described in the Section 1 of this Manual.

As mentioned in Section A-1A05, the suspension may be total or may be for any function with respect to a particular security or class of securities, with respect to a particular Transaction or class of Transactions, or with respect to securities or Transactions generally.

The Board may lift a Clearing Member's suspension at any time.

### **Notifications**

Once the Board has declared a Clearing Member to be suspended, the Board will immediately consider its notice obligations. Those entities whose notification ~~rights must be~~is considered include:

- The general population of Clearing Members~~.~~
- Appropriate regulatory authorities~~.~~
- Exchanges and CCOs~~.~~

While it will be the prerogative of the Board to determine the timing and content of its outside disclosures, it will nonetheless immediately inform any CCOs with which the Corporation has in place a Memorandum of Understanding for such information sharing.

### ~~Implementation~~ Appeal

According to ~~Subsection A-1A05(2), the Corporation ceases to act on behalf of the suspended Non-Conforming Member.~~ Section A-1A07, the Clearing Member may appeal a suspension decision. Such appeal does not impede the actions of the Corporation in the default management process.

~~As mentioned in Subsection A-1A05(3), the suspension may be total or may be for any function with respect to a particular security or class of securities, with respect to a particular Transaction or class of Transactions, or with respect to securities or Transactions generally.~~

~~The Board may lift a Clearing Member's suspension at any time. As mentioned in Section A-1A07, the Clearing Member may appeal its suspension.~~

### Section 3: Risk Mitigation Tools

Once ~~the Board decides on the Clearing Member's status, the Corporation may take several courses of action. The list set out below is neither exhaustive nor necessarily in chronological order, and the actions can be adapted by the Corporation according to the circumstances prevailing at the time of a suspension~~a Clearing Member has been suspended, the Corporation shall take specific actions in order to protect the Corporation and the non-defaulting Clearing Members. Conceptually, these actions can be aggregated into three categories and are normally executed in the order presented. While some actions might have been initiated by the Corporation pursuant to a declaration of Non-Conforming status, including, namely, the transfer of Client Accounts, this section details how the Corporation will implement the risk mitigation tools, upon the suspension of the Clearing Member.

- ~~● The Clearing Member is notified of its suspension.~~
- ~~● The Corporation will open a Liquidating Settlement Account to manage the positions and the Margin Deposits of the suspended Clearing Member.~~
- ~~● For the purpose of the Liquidating Settlement Account Margin Deposits with respect to a Client Account will only secure the performance by the Clearing Member of its obligations in respect of that Client Account. Margin Deposits for Market Maker Accounts or Firm Accounts will secure a Clearing Member's obligations with respect to Client Accounts as well as Market Maker Accounts or Firm Accounts, as the case may be.~~
- ~~● The Corporation will restrict the Transactions of the suspended Clearing Member.~~
- ~~● The Corporation may seize the Clearing Member's Margin Deposits, and the positions will be transferred to the Liquidating Settlement Account. The Corporation, at its discretion, may send only the net positions to the Liquidating Settlement Account.~~
- ~~● The Corporation may convert the suspended Clearing Member's Margin Deposits into cash in order to cover any loss or amount owed by the suspended Clearing Member.~~
- ~~● The Corporation may liquidate, transfer or maintain the suspended Clearing Member's positions, depending on the market conditions. The positions may be liquidated directly on the market or among the offers received from Clearing Members contacted in advance by the Corporation, and transmitted to the Corporation regarding the portfolios to be liquidated.~~

### **Section 3: Default Management and Staff**

~~As indicated in Section 2, the Corporation's procedures for the management of a default are governed, under the auspices of the Board, by two Committees, presented below in their hierarchical order:~~

- ~~● Default Management Committee~~

- ~~● Emergency Committee~~

~~In this section, the Manual addresses the activities of the Emergency Committee, which is tasked with the specific, real time and day to day oversight of the default control process. Key members of this Committee include the individuals holding the following positions and/or their designees:~~

- ~~● Director of Risk Management, Committee Chairman~~

- ~~● Director of Corporate Operations~~

- ~~● Treasurer~~

~~Each of these individuals, in managing their departments, must act with due rigor to assess issues, identify associated magnitudes, recommend actions and inform management, the Board and other Corporation stakeholders, as appropriate.~~

~~The key responsibilities of each department are described below:~~

#### **RISK MANAGEMENT**

~~The Corporation's Risk Management Department will serve as the central coordinating unit in the management of the default control process. Its Director will be responsible, among other matters, for the following set of critical activities:~~

- ~~● Convening and coordinating meetings of the Emergency Committee.~~

- ~~● Acting as liaison to the Default Management Committee.~~

- ~~● Working with external entities to mitigate damage.~~

- ~~● Providing written documentation and status reports to appropriate parties.~~

- ~~● Coordinating and evaluating any interactions, written and oral, with the defaulting Clearing Member.~~

~~In addition, the Risk Management Department will be responsible for the following critical procedures:~~

#### **Introductory and On-Going Risk Assessment.**

~~At the earliest point deemed appropriate by any of the three committees described above, the Risk Management Department will perform a comprehensive analysis of the exposures inherent in the defaulting Clearing Member's portfolio. Moreover, as the liquidation and remedy process ensues, it will perform as many such assessments as are necessary to render decision makers informed as to the status of the defaulted portfolio. In doing so, it will utilize internal risk assessment systems, those, as appropriate, of the defaulting Clearing Member, general market intelligence, and other appropriate tools of risk assessment. Further, its assessment will consider the following key factors:~~

- ~~● Portfolio content in general.~~
- ~~● Prevailing and prospective market conditions.~~
- ~~● Portfolio liquidity characteristics.~~
- ~~● The presence of complex derivatives such as options.~~

~~Based upon all of the above, it will render an introductory and routine follow-up written assessments as to the potential magnitude of losses, the factors driving such losses, and its best thoughts as to appropriate market-based remedies. In cases of market disruption and/or the potential for large losses, the Department will issue these reports on a daily basis, or more frequently, as deemed appropriate.~~

~~In addition, and as discussed in further detail below, it will perform such analysis on the basis of the total portfolio content of the defaulting Clearing Member, as well as any subset of the portfolio which would remain in the event that Corporation governing bodies decide to transfer positions to other Clearing Members.~~

#### **~~Oversight of the Liquidation Process, Including Management of the Liquidating Settlement Account.~~**

~~As referenced above, the Corporation may decide to establish a separate Liquidating Settlement Account to manage any liquidation of positions resident in a suspended Clearing Member's portfolio. However, irrespective of whether the Corporation effects such a transfer, or, alternatively, decides to manage any liquidation process directly through the clearing accounts of the defaulting Clearing Member, the Risk Management Department will oversee the liquidation process on behalf of the Corporation.~~

~~In performing these duties, the Corporation may choose to engage outside agents to assist in the liquidation process, and in the event that it does choose such an option, the Risk Management Department will coordinate all activities in conjunction with these outside agents.~~

~~Finally, with respect to the liquidation process, the Risk Management Department will consider all alternatives involving exposure mitigation for the defaulted Clearing Member's portfolio, including those involving the hedging of rather than the liquidation of specific positions contained therein. Note in such cases that the Corporation may consider the use of instruments not part of the organization's clearing universe, including cash securities.~~

#### **LEGAL DEPARTMENT**

~~In the event of a Clearing Member default, the Legal Department, acting in conjunction with other key officers of staff of the Corporation, must as soon as practicable assess the legal status of the defaulted~~

~~Clearing Member's operations and solvency. Further, it must act with all due rigor and expediency to ensure that the Corporation's claims against the defaulting Clearing Member achieve the appropriate status in any broad-based liquidation of the defaulting clearing enterprise. Among other matters, the Legal Department must take into consideration in this regard the precise location and source of the insolvency within the defaulting Clearing Member's corporate group.~~

~~In many cases, a Clearing Member may be one of many subsidiaries of a large corporate enterprise; in others, the Clearing Member is a parent company itself. It is the responsibility of the Legal Department, based upon its knowledge of these structures, to determine and execute appropriate legal remedies to ensure that the Corporation's legal interests in any insolvency are fully and expeditiously represented.~~

~~In addition to the foregoing, the Legal Department is responsible for the following set of actions pursuant to the default mitigation process:~~

- ~~● Issuing any legal correspondence to the defaulting enterprise, including those associated with the freezing of assets and Margin Deposit, the demand for further financial considerations, the suspension of any and/or all clearing-related activities, etc.~~
- ~~● Filing any claims in bankruptcy or insolvency court.~~
- ~~● Assessing and following up on any jurisdictional issues attendant to the default.~~
- ~~● Managing all communications with outside parties, including the general body of Clearing Members, market participants, regulatory authorities, representatives of the media, etc.~~
- ~~In conjunction with the Compliance Department, interacting with regulatory agencies, particularly in such cases where laws and regulations may have been breached in the sequence of default-related events.~~ Prevention: Preventing controls are the starting point of the management of a default under the suspension status. They are focused on preventing new transactions to be cleared in the suspended Clearing Member's books.
- ~~Drafting and execution of all legal agreements, including Non-Disclosure Agreements, proxies and operating agreements with outside parties with whom the Corporation might engage in the default mitigation process.~~ Control: Such actions are focused on taking control over the suspended Clearing Member's assets and positions.
- ~~Liaising activities with the legal activities of other organizations, including Clearing Members, other CCOs, contractual counterparties, etc.~~ Risk mitigation: Such actions are focused on transferring risks, re-establishing a matched book, and neutralizing risks, at the lowest cost possible for the Corporation and the conforming Clearing Members, while managing the liquidity risk associated with the default management process.

~~As is the case with the Risk Management Department, the Legal Department will draft written assessments and associated recommendations, pertaining to all legal issues faced by the Corporation as the result of the default.~~

## **AUDIT DEPARTMENT**

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~~Depending on the circumstances of the default, and in any situation where the Corporation deems it a probability that defaulting Clearing Member assets and Margin may be insufficient to cover the costs of a pending liquidation, the Audit Department must immediately seize whatever control of the books and records of the defaulting Clearing Member as are deemed necessary to manage the liquidation and transfer process on an account by account basis.~~

~~This set of activities is both time critical and essential to the default management process. The Corporation does segregate Firm Accounts and Market Maker Accounts from those of Client Accounts, and it is incumbent upon the Audit Department, working, as appropriate, with other Corporation Departments, to identify the account-based source and associated magnitude of the default inducing shortfall.~~ [section provides more information on the risk mitigation tools available to the Corporation.](#)

~~In doing so, the Audit Department will create a modified accounting ledger, which separates solvent accounts from non performing ones. If the default is determined by the Audit Department to have originated and remain isolated to Firm Accounts and Market Maker Accounts, then this ledger will simply be comprised of a separation of Client Accounts from Firm Accounts and Market Maker Accounts.~~

~~If, however, the source of the shortfall is determined to reside, in whole or in part, within Client Accounts, then the Audit Department must create a ledger with the following components:~~

- ~~● Firm Accounts and Market Maker Accounts.~~
- ~~● Solvent Client Accounts.~~
- ~~● Client Accounts in Debit/Deficit.~~

~~Working with the Risk Department, the Audit Department will then render a written assessment, with recommendations, to appropriate Corporation governing bodies as to the viability of transferring solvent Client Accounts, in whole or in part, to the books of other Clearing Members. Note that, as specified in the Objectives section of this Manual, the efficient and comprehensive transfer of all solvent Client Accounts is an identified objective of the default management exercise. As such, the Corporation will do everything in its power to transfer all solvent client accounts in an efficient manner, and will only stop short of this objective under the following set of circumstances:~~

- ~~● The Corporation is unable to find Clearing Members willing to assume the solvent Client Accounts of the defaulting Clearing Member.~~
- ~~● The Corporation, as determined by the Board, believes that the transfer of all solvent Client Accounts would either impede its viability, or disrupt the efficient functioning of its markets.~~

~~If, in the judgment of the Corporation, such a transfer is indeed deemed advisable, then the Audit Department will work in conjunction with other Departments to effect such a transfer in a timely and efficient manner.~~

~~In the event that the Corporation achieves a comprehensive transfer process, under which only insolvent Client Accounts and all Firm Accounts and Market Maker Accounts remain on the books of the~~

~~defaulting Clearing Member, then the Audit Department will act in such a way as to deem all remaining open positions as being proprietary in nature. It may also, at its discretion, work with the defaulting Clearing Member, the Legal Department and other appropriate entities, to seek further financial remedies from insolvent Clients.~~

~~Note that with respect to securities, cash and other Margin deposited and pledged or transferred as part of the Corporation's activities in the clearance and margining of Repurchase (Repo) Transactions, the Audit Department, working in conjunction with the Legal and Risk Departments, must render an assessment as to the advisability of retaining Margin collateral (used to protect the Corporation from losses associated from fluctuating price differentials between the cash and securities) applied to the Transaction, or returning it to its beneficial owners as part of the unwind of associated Transactions. While the Corporation reserves the right to either hold or release these assets, it will bear in mind the customer protection sections of the Objectives section of this manual, and as such, will only choose not to release them if it believes, in its judgment that, that such release would impede the viability of the Corporation or the effective functioning of its markets. As such, the decision to withhold the release of Repo related assets must be made by senior management or the Board, as deemed appropriate during the default management process.~~

## **FINANCIAL DEPARTMENT**

~~The main responsibility of the Financial Department in the event of a Clearing Member default is to manage the process of securing all cash and collateral needed by the Corporation to ensure that any losses pursuant to the default are managed to their absolute minimum. These sources of funds include:~~

- ~~● Defaulting Clearing Member Margin Deposit~~
- ~~● Defaulting Clearing Member Clearing Fund Contribution~~
- ~~● Other assets sourced from the defaulting Clearing Member working in conjunction with the Legal Department~~

~~The key areas of responsibility for the Legal, Audit, Financial and Risk Departments, who have the primary front line responsibilities in the default mitigation process, are summarized in the following table:~~

	<b>Legal</b>	<b>Audit</b>	<b>Financial</b>	<b>Risk</b>
<b>Role</b>	Determine legal status of Non-Conforming Member	Review books and records at Clearing Member, identify if fraud has occurred  Determine the cause of failure and isolate impaired accounts	Freeze all settlements of Non-Conforming Member  Convert all collateral to cash  Assist in potential remedies	Determine exposures on a net basis  Oversee netting of positions, and liquidation process
<b>Monitoring</b>	Review relationship	Create a ledger of all good Client	Work with other	Will consider the path to liquidating

	<b>Legal</b>	<b>Audit</b>	<b>Financial</b>	<b>Risk</b>
	<p>with any affiliates</p> <p>Review parental guarantees</p>	<p>Accounts, and move all Non-Conforming accounts to a Firm Account</p>	<p>CCOs</p> <p>Oversight of potential remedies</p>	<p>securities to minimize potential loss to CDCC</p> <p>May consider hedges and risk offsets</p> <p>May run an auction for non-liquidated positions</p> <p>May request assistance of outside parties</p> <p>Provide daily or more frequent updates to CDCC staff, Default Management Committee and Board</p>

#### **OTHER DEPARTMENTS**

The Corporation's other Departments will work in conjunction with the groups named above, as deemed appropriate under the specific circumstances of the default. The Corporate Operations Department will work specifically on all aspects of position and collateral management, as directed by the Emergency Committee.

## **~~Section 4: Financial Remedies to Cover Default Induced Shortfalls~~**

~~This section goes into further detail as to the financial remedies upon which the Corporation must rely, in the event that the liquidation of a defaulting Clearing Member generates losses beyond those that can be covered by the resources available to it from the defaulting entity, including:~~

- ~~● Defaulting Clearing Member Margin Deposit.~~
- ~~● Defaulting Clearing Member contribution to Clearing Fund.~~
- ~~● Any additional Margin assessments the Corporation obtains from the defaulting Clearing Member.~~
- ~~● Any additional collateral that the Corporation can obtain through legal and financial measures.~~

~~By this point in the process, the Corporation, according to the procedures set forth in previous sections, should have placed itself in a position where it has done all in its power to mitigate losses associated with the liquidation/transfer of the linkages to the defaulting Clearing Member. If, as the result of this process, the Corporation finds itself facing a residual shortfall, it must undertake the following steps, in the priority order set forth below:~~

### **~~CORPORATION CAPITAL~~**

~~The Corporation will commit capital reserves to any default induced shortfall currently up to a maximum of \$5 million, prior to effecting an assessment upon other Clearing Members. The amounts of such commitment, as well as their timing, must be approved by the Board.~~

### **~~CLEARING MEMBER ASSESSMENT CYCLE(S)~~**

~~In the event that a residual loss associated with the default of a Clearing Member exceeds that which can be covered by the combination of the collateral available in the defaulting Clearing Member's accounts, and the capital reserve contributed by the Corporation itself, the Corporation will then turn to its assessment powers against other Clearing Members, to satisfy this shortfall.~~

~~For the purposes of this exercise, Clearing Member assessments can take multiple forms, as specified below:~~

#### **~~Clearing Fund~~**

~~The Corporation maintains a Clearing Fund, which is capitalized by all Clearing Members, at levels designed to cover what is specified in Rule A-6.~~

~~In the event that the liquidation of a defaulting Clearing Member extends beyond the resources of this Clearing Member, and the capital reserves of the Corporation earmarked for this purpose, the Corporation will next access the resources of the Clearing Fund to satisfy the outstanding obligation. The Corporation will access these funds on a pro rata basis, according to the contribution of each Clearing Member.~~

#### **~~Additional Assessments:~~**

~~In cases of extreme market and financial duress, and specifically in those instances where all of remedies set forth above, including the application of the Clearing Fund in its totality fail to cover the losses of a defaulting Clearing Member, the Corporation may seek to engage in an additional round of assessment. A decision to do so must be approved by the Board. In the event that the Corporation chooses to engage in an additional assessment to satisfy a default, it will utilize the same URR methodology that applies to the calculation of Clearing Fund contributions, to apportion these liabilities.~~

## **LIQUIDITY FACILITIES**

~~While not a source of capital available for the offset of losses, the Corporation has available an array of liquidity facilities, which it may, at its discretion, call upon to assist with the funding of its loss mitigation activities. In the event of a default, The Corporation, as advised by the Emergency Committee must make a determination as to how to deploy these resources. Included among its alternatives are:~~

- ~~• Drawing upon the Corporation's commercial bank liquidity lines, in whole or in part.~~
- ~~• The raising of liquidity through out rights sales and/or Repurchase Transactions involving Securities of the defaulting Clearing Member.~~
- ~~• Through the exercising of its rights of re-pledging/re-hypothecation of defaulter Margin Deposits~~
- ~~• Through the exercising of its rights of re-pledging/re-hypothecation of defaulter and survivor Clearing Fund Deposits.~~

~~The management of this process is one that should ensue across the entire course of the liquidation efforts, and the Corporation must make routine, periodic judgments as to how and when this funding merits deployment.~~

### **3.1. TRANSFER OF CLIENT ACCOUNTS**

The Corporation will attempt to transfer Client Accounts, in whole or in part, to the books of other Clearing Members. Note that, as specified in the Objectives section of this Manual, the efficient and comprehensive transfer of all Client Accounts is an identified objective of the default management exercise. For the avoidance of doubt, this includes transferring any position maintained in such account, or any account carried by such Clearing Member and any Margin Deposits held by the Corporation in respect of such account, to another Clearing Member.

### **3.2. AUCTION PROCESSES AND LIQUIDATION**

In order to manage a default situation and following the suspension of a Clearing Member, the Corporation must re-establish a matched book. In order to do so, the Corporation can hold an auction for the suspended Clearing Member positions or liquidate its positions.

Immediately subsequent to the declaration of a suspension of a Non-Conforming Member, ~~and contemporaneous to the Audit Department's efforts to isolate associated sources,~~ the Corporation must ~~make a recommendation to the Board as to the advisability of~~ take the appropriate and following steps to conducting an auction designed to transfer the remaining collateral and positions to those of another Clearing Member. ~~If, in its judgment the Board determines that such a step is indeed called for, the steps in the process should follow the following sequence:~~

- The President of the Corporation will call the most senior ~~most~~ available representative of the defaulting Clearing Member, to notify the organization of its intent to hold an auction.
- The Corporation will execute a Non-Disclosure Agreement with the defaulting Clearing Member, enabling it, among other things, to show position and collateral information to potential auction participants.
- The Corporation will identify potential participants in the auction process. Note that these entities can include other Clearing Members and/or other investment enterprises.
- The Risk and ~~Audit~~Operations Departments will conduct an analysis to determine the ability of potential auction participants to participate in the auction without causing financial or operational impairment to their businesses. Only those enterprises that, in the judgment of the Corporation, ~~meet this suitability test,~~ will be eligible for participation in the auction. Note that in the event that ~~non~~Non-Clearing Member participants request to participate in the auction process, the Risk and ~~Audit~~Operations Departments must perform the suitability test not only on the potential participant, but upon its Clearing Member as well.
- ~~All potential~~Potential participants in the auction process must sign a Non-Disclosure Agreement, as a precursor to examining the portfolio and collateral content of the defaulting Clearing Member.
- The Corporation will then hold an individual auction separately for each asset class.
- Participants may bid on one or more asset classes, and will submit their bids on the basis of how much collateral they would require to assume the positions of the defaulting Clearing Member.
- The bids will be submitted on a sealed basis, and should be in the hands of the Corporation by the close of business on the date designated for auction.

- The Corporation will determine the winner of the auction on the basis of which participant has requested the least amount of collateral to support the position transfer process with priority to bidders whose risk profile improves (i.e. reduced or minimal marginal increase in risk exposure) subsequent to the inclusion of the defaulting Clearing Members positions.
- The Corporation will transfer all positions and collateral by the close of business the following day, as marked ~~to~~under the Corporation's routine settlement cycle.

In the event that the auction ~~processes~~process unfolds in such a way as to create a residual balance on the books of the defaulting Clearing Member, the Corporation will freeze this collateral, and await further instructions as to its disposition, from both the Legal Department and the Board. In the event that the auction proceeds in such a way as to generate a residual shortfall, then the Corporation, as determined by the Board, has the right to reject all bids, accept some bids and reject others, or accept the best bids submitted. Under these circumstances, the Corporation will then proceed with the implementation of additional mitigants, as set forth below:

- A negotiated allocation of existing Open Positions and associated Margin Deposits amongst surviving Clearing Members.
- By invoking Section A-404, CDCC may elect to closeout remaining Open Positions at a price(s) that it deems reasonable based on best available market information.

### 3.3. PORTFOLIO HEDGING

At any time during the default management process, the Corporation may, if it deems appropriate, hedge the portfolio of the suspended Clearing Member in order to limit the accumulation of market and credit losses. Note that in such cases the Corporation may consider the use of instruments not part of the organization's clearing universe, including cash securities.

### 3.4. LIQUIDITY MANAGEMENT

While not a source of capital available for the offset of losses, the Corporation has available an array of liquidity facilities, which it may, at its discretion, call upon to assist with the funding of its loss mitigation activities. In the event of a default, the Corporation must make a determination as to how to deploy these resources. Included among its alternatives are:

- Drawing upon the Corporation's commercial bank liquidity lines, in whole or in part.
- Raising of liquidity through out-rights sales and/or Repurchase Transactions involving Securities of the defaulting Clearing Member.
- Through the exercising of its rights of re-pledging/re-hypothecation of defaulter's Margin Deposits.

- Through the exercising of its rights of re-pledging/re-hypothecation of defaulter's and survivors' Clearing Fund Deposits.

The management of this process is one that should ensue across the entire course of the liquidation efforts, and the Corporation must make routine, periodic judgments as to how and when this funding merits deployment.

### **3.5. LOSS ABSORPTION MECHANISM**

In implementing the default management process, the Corporation will aim at minimizing, to the extent possible and on best efforts basis, the losses to the Corporation and its stakeholders. If there are nonetheless losses to the Corporation, the Corporation must apply, in specified order, a series of financial remedies to ensure its ongoing viability and financial solvency. The loss absorption mechanism, also referred as Waterfall, is described in Sub-section 1.6.



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