



NOTICE TO MEMBERS

N°: 136-23

November 15, 2023

REQUEST FOR COMMENTS

AMENDMENTS TO THE DEFAULT MANUAL OF THE CANADIAN DERIVATIVES CLEARING CORPORATION REGARDING THE AUCTION TOOL USED TO ORGANIZE A DEFAULT AUCTION DURING A DEFAULT MANAGEMENT PERIOD

On October 26, 2023, the Board of Directors of the Canadian Derivatives Clearing Corporation (“CDCC”) approved certain amendments to its Default Manual (the “Manual”) to allow for the modification of the procedure followed by CDCC to organize a Default Auction during a Default Management Period.

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 as 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 the Rules and the Operations Manual of CDCC. Amendments are submitted to the AMF in accordance with the self-certification process and to the OSC in accordance with the process provided in the Recognition Order.

Comments on the proposed amendments must be submitted before December 15, 2023. Please submit your comments to:

Dima Ghozaïel

Legal Counsel

Canadian Derivatives Clearing Corporation

1800-1190 av. des Canadiens-de-Montréal, P.O. Box 37

Montreal, Quebec H3B 0G7

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

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Executive Director, Legal Affairs
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For any question or clarification, Clearing Members may contact Dima Ghozaiel, Legal Counsel, by email at dima.ghozaiel@tmx.com.

George Kormas
President



AMENDMENTS TO THE DEFAULT MANUAL OF THE CANADIAN DERIVATIVES CLEARING CORPORATION REGARDING THE IMPLEMENTATION OF AN AUCTION TOOL USED TO ORGANIZE A DEFAULT AUCTION DURING A DEFAULT MANAGEMENT PERIOD

I. DESCRIPTION

Canadian Derivatives Clearing Corporation (“CDCC”) wishes to amend its Default Manual (the “Manual”) to allow for the modification of the procedure followed by CDCC to organize a Default Auction during a Default Management Period.

In order to allow CDCC to manage the Default Management Process in a more efficient way, CDCC has developed and wishes to implement an online default management auction platform (the “Auction Platform”) to streamline the existing Default Auction procedure.

The Auction Platform allows CDCC to create and manage auctions as well as input and share Auction Portfolios with Auction Participants with enhanced confidentiality and information security. Auction Participants are able to view positions being auctioned, submit and manage bids for each Auction Portfolio. The Auction Platform also calculates the auction results.

Unless otherwise defined herein, any defined term used in this analysis will have the meaning described in the Manual, or the rules of CDCC (the “Rules”).

II. PROPOSED AMENDMENTS

CDCC hereby proposes amendments to Sections 3.3.1 of the Manual to modify the Default Auction Procedure in order to introduce the Auction Platform and to further clarify and emphasize that both the default and recovery simulations are mandatory (the “Proposed Amendments”).

Under the current pre-auction procedure, all Eligible Clearing Members are invited to confirm their participation in the Default Auction by replying to the invitation notification received by email from CDCC. Only Clearing Members who confirmed their participation would receive the auction package. After the launch of the new Auction Platform, Clearing Members would be able to confirm their participation in the Default Auction by directly logging into the Auction Platform.

Also, recovery simulations being mandatory was less evident to Clearing Members under the current Rules, despite recovery being a seamless extension of the default process. Therefore, a clarification is necessary.

The changes proposed by CDCC have no impact on the Rules or CDCC's Operations and Risk Manuals.

The proposed amendments are provided herein in Appendix "A".

III. ANALYSIS

a. Background

Under the current Default Pre-Auction Procedure, CDCC presently utilizes Excel files to share Auction Portfolios with the Auction Participants. The files are sent by email to each Auction participant individually, using a pre-established list of contacts. Auction participants would then submit their bids by completing and sending the bidding file by email to CDCC.

CDCC received feedback from its Clearing Members and regulators regarding the confidentiality of the information within the existing process. In fact, certain CDCC regulators suggested that CDCC should consider developing a secure web-based portal for information exchange, bidding and margin calculation in order to automate the internal process to address sources of operational risk identified during default simulations, reduce operational risk and facilitate the bidding process for auction participants. In light of the concerns raised, CDCC has developed an Auction Platform to increase confidentiality and the protection of sensitive information.

b. Objectives

CDCC proposes to amend the Rules to modify the Default Auction procedure in order to set clear the Default Management procedures to ensure orderly execution of a Default Auction during a Default Management Period. Also, the proposed modifications will increase the confidentiality and the protection of sensitive information by ensuring that the information is shared in a secure manner. The proposed modifications will streamline the existing Default Auction process while maintaining the current Default Auction methodology and allowing for less manual input. The proposed modifications will increase the utility and the effectiveness of the Default Auction process and better serve the interests of CDCC's members.

c. Comparative Analysis

CDCC conducted a comparative analysis of publicly available information on clearing activities and concluded that the new Auction Platform is a common tool used by traditional clearing houses

such as CME Clearing and ICE to support a Default Auction. Both CME Clearing¹ and ICE Clear² have developed their own online auction platforms where their clearing members can view and submit bids for auction portfolios. Also, the auction results are calculated and shared on their auction platform.

d. Analysis of Impacts

i. Impacts on Market

The proposed amendments will have no impact on the Market.

ii. Impacts on Technology

The proposed amendments have no impact on the clearing system (SOLA). Indeed, it is a hosted web platform for both CDCC users and Clearing Members. User acceptance testing is planned prior to the implementation to ensure that the new Default Auction process can be executed successfully. The Auction Platform will also be tested in default and recovery auction to educate Clearing Members on the new process. Default and recovery simulation is mandatory and Clearing Members will be invited to test the new Auction Platform after the launch.

iii. Impacts on Trading Functions

The proposed amendments will have no impact on the Bourse trading systems or rules.

iv. Public Interest

CDCC is of the view that the proposed amendments are not contrary to the public interest. In fact, the public and Clearing Members are generally requesting clear rules that are consistent with the best practices of other clearing houses and are PFMI compliant.

Moreover, CDCC considers these amendments to be in the interest of the public as they would allow CDCC to better manage a default with the streamlined process without changing the existing Default Auction methodology. It increases the resilience of CDCC to manage a default and strengthens the entire Canadian markets.

IV. PROCESS

The proposed amendments, including this analysis, must be approved by CDCC's board of directors and submitted to the Autorité des marchés financiers, in accordance with the regulatory self-certification process, and to the Ontario Securities Commission in accordance with the rules

¹ <https://www.cmegroup.com/cme-platforms-auction-policy.html>

² https://www.ice.com/publicdocs/clear_europe/circulars/C16138%20attach.pdf

stated in Appendix “A” of Schedule “A” of CDCC Recognition Order dated June 15, 2023 (as amended from time to time). The Proposed Amendments and analysis will also be submitted to the Bank of Canada in accordance with the Oversight Agreement. Subject to public comments and following regulatory approval, the Proposed Amendments are expected to take effect in January 2024.

Appendix A
PROPOSED AMENDMENTS TO THE MANUAL
BLACKLINED VERSION

Section 3: Risk Mitigation Tools

3.3 DEFAULT AUCTION

3.3.1 PRE-AUCTION PROCEDURE

Before proceeding with the suspended Clearing Member's portfolio auction, the Corporation must:

- Identify the Clearing Members which ~~are eligible~~can be invited to participate in the auction.
 - Determine which positions of the suspended Clearing Member will be part of the auction and distribute such positions into different portfolios (thereafter "Auction Portfolios").
 - Determine the value of the surviving Clearing Members' financial resources at risk in each Auction Portfolio.
- a) Invitation to participate in the auction
- For each Auction Portfolio, the Corporation will identify a set of "Eligible Clearing Members" which are Clearing Members that clear the asset class³ contained in such Auction Portfolio (including hedged positions and Hedge Open Positions if applicable), either directly, through their CDCC membership, or indirectly⁴, through a pre-existing clearing relationship with another CDCC Clearing Member whose membership covers the relevant asset class(es) with CDCC.
 - Participation in the Default Auction is voluntary for all Eligible Clearing Members. However, participation in the Corporation's ~~annual~~-default and recovery simulation is mandatory for all Clearing Members.

³ An asset class is a category of products sharing similar characteristics. Three different asset classes are cleared at CDCC, namely Futures, Options and Fixed Income.

⁴ An indirect participant must, as part of the CDCC annual due diligence process, demonstrate that it is an active participant in the relevant market with a pre-established relationship with another Clearing Member acting as its Clearing Member for that relevant asset class.

- ~~For each Auction Portfolio, the Corporation will invite all Eligible Clearing Members to confirm their intention to participate in the upcoming auction. Clearing Members who wish to participate in the auction shall send such confirmation in the prescribed time period specified in the invitation notification. Clearing Members who confirmed their intention to participate in the auction are referred to as “Auction Participants”.~~
- For each Auction Portfolio, the Corporation will notify all eligible Clearing Members of the upcoming auction. Clearing Members who wish to participate in the auction shall log in to the online CDCC default auction platform (the “Auction Platform”) in the prescribed time period specified in the notification. Clearing Members who participate in the auction via the Auction Platform are referred to as “Auction Participants”.
- All Auction Participants understand and acknowledge, for the purpose of the auction, that they will receive certain confidential information, including confidential information related to the suspended Clearing Member, and agree to treat such information with the highest standard of confidentiality.
- All Auction Participants shall participate in the auction in good faith, and any loss suffered by the Corporation as a result of any dishonest or fraudulent act of any of the Auction Participants whether committed alone or in collusion with others shall be charged to the wrongdoer.

**PROPOSED AMENDMENTS TO THE MANUAL
CLEAN VERSION**

Section 3: Risk Mitigation Tools

3.3 DEFAULT AUCTION

3.3.1 PRE-AUCTION PROCEDURE

Before proceeding with the suspended Clearing Member’s portfolio auction, the Corporation must:

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 - Determine which positions of the suspended Clearing Member will be part of the auction and distribute such positions into different portfolios (thereafter “Auction Portfolios”).
 - Determine the value of the surviving Clearing Members’ financial resources at risk in each Auction Portfolio.
- a) Invitation to participate in the auction
- For each Auction Portfolio, the Corporation will identify a set of “Eligible Clearing Members” which are Clearing Members that clear the asset class⁵ contained in such Auction Portfolio (including hedged positions and Hedge Open Positions if applicable), either directly, through their CDCC membership, or indirectly⁶, through a pre-existing clearing relationship with another CDCC Clearing Member whose membership covers the relevant asset class(es) with CDCC.
 - Participation in the Default Auction is voluntary for all Eligible Clearing Members. However, participation in the Corporation’s default and recovery simulation is mandatory for all Clearing Members.
 - For each Auction Portfolio, the Corporation will notify all eligible Clearing Members of the details of the upcoming auction. Clearing Members who wish to participate in the auction shall log in to the online CDCC default Auction Platform (the “Auction Platform”) in the prescribed time period specified in the notification. Clearing Members

⁵ An asset class is a category of products sharing similar characteristics. Three different asset classes are cleared at CDCC, namely Futures, Options and Fixed Income.

⁶ An indirect participant must, as part of the CDCC annual due diligence process, demonstrate that it is an active participant in the relevant market with a pre-established relationship with another Clearing Member acting as its Clearing Member for that relevant asset class.

who participate in the auction via the CDCC Auction Platform are referred to as “Auction Participants”.

- All Auction Participants understand and acknowledge, for the purpose of the auction, that they will receive certain confidential information, including confidential information related to the suspended Clearing Member, and agree to treat such information with the highest standard of confidentiality.
- All Auction Participants shall participate in the auction in good faith, and any loss suffered by the Corporation as a result of any dishonest or fraudulent act of any of the Auction Participants whether committed alone or in collusion with others shall be charged to the wrongdoer.