NOTICE TO MEMBERS

N°: 008-25

January 16, 2025

SELF-CERTIFICATION

AMENDMENTS TO THE DEFAULT MANUAL OF THE CANADIAN DERIVATIVES CLEARING CORPORATION REGARDING THE CORPORATION'S DEFAULT RISK CAPITAL AMOUNT AVAILABLE DURING A DEFAULT MANAGEMENT PROCESS

On October 26, 2023, the Board of Directors of the Canadian Derivatives Clearing Corporation ("**CDCC**") approved an increase in CDCC's amount of Default Risk Capital available during a default management process and an amendment to CDCC's Default Manual to that effect.

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 submitted to the Ontario Securities Commission in accordance with the Rule Protocol Regarding the Review and Approval of CDCC Rules by the Commission.

You will find attached hereto the amendments set to come into force and to be incorporated into the version of the Default Manual of CDCC that will be made available on the CDCC website at www.cdcc.ca on **January 31, 2025**, after market close.

The amendments described in the present notice were published for public comment by CDCC on May 24, 2024 (see Notice 066-24). Further to the publication of this notice, CDCC received comments. A summary of the comments received as well as responses from CDCC to these comments is attached hereto. Minor modifications have been made to the Default Manuel since the publication of the notices which were submitted to the regulators.

If you have any questions or concerns regarding this notice, please contact Sophie Brault, Legal Counsel, by email at sophie.brault@tmx.com.

George Kormas
President

DEFAULT MANUAL

January 31~~November 22~~, 2025~~4~~

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SECTION 1 : DEFAULT MANAGEMENT PROCESS - TRIGGERS AND IMPLEMENTATION

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1.6 Default Waterfall: Application of Financial Resources to Cover Default-Related Losses

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ii Resources of the Corporation (Default Risk Capital - DRC)

- CDCC has capital reserves set aside specifically for the purpose of absorbing any loss outstanding after the exhaustion of the suspended Clearing Member's resources. This capital, which is ~~currently~~ $15 million, is referred to herein as "Default Risk Capital" or "DRC".

If, after applying these resources of the suspended Clearing Member and of CDCC, a shortfall still remains, CDCC will, as indicated below, use the required Clearing Fund deposits (referred therein as "Clearing Fund Requirement") of the other Clearing Members to cover the loss.

In the event the Corporation's DRC is partially used or exhausted in its entirety, the Corporation shall fully replenish its DRC by executing against or having recourse to its recapitalization plan.

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DEFAULT MANUAL

January 31, 2025

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CDCC – Amendments to the default manual

Summarized comments from ISDA and FIA re: RFC 066-24 CDCC's responses

No.	Summary of comments	Summary of responses
We have a number of comments on the proposed approach, and would like to use this opportunity to stress the importance of appropriately sized SITG, in a manner that aligns the CCP's and its clearing members' incentives. This response covers the positions of our members on the buy-side and sell-side.		
1.	We welcome that CDCC's proposed approach would result in an increase of the amount of SITG compared to the current approach. However, the proposed nominal amount (at $15M) remains small in comparison to peers, based on the metrics provided by CDCC in the consultation.	As indicated in the regulatory analysis, CDCC determined the amount based on peer benchmarking. The amount of $15M represents 30% of CDCC's revenues. The ratio is consistent with ratios used by similar CCPs.
2.	We also question the justification of the proposed size of SITG based on a percentage of the CCP's annual revenue. Because SITG is a subset of the CCP's own funds, it should at least be compared to the present value of a stream of future revenues rather than a flow of annual revenues.	The present value of a stream of future revenues is subject to a number of factors and assumptions which may or may not have a direct impact on the SITG sizing. Therefore, we believe using "annual revenues" is more appropriate. We will continue to adopt an industry-comparable framework and methodology to reflect the true spirits of SITG.
3.	In any case, we would suggest putting forward a methodology that justifies why the proposed size of SITG adequately aligns the CCP's and its clearing members' incentives.	CDCC will formalize the review and update process of SITG in the future through its current governance process. As per the framework used by CDCC in the regulatory analysis, such a future process could be based on observations and peer comparisons rather than a simple mathematical formula, the whole without the need for CDCC to raise the fees significantly.

No.	Summary of comments	Summary of responses
4.	For this reason, comparisons between the proposed sizing of the layer of SITG with the size of the default fund would make more economic sense, and would be more informative to clearing members in terms of whether incentives on the CCPs are correctly set.	CDCC's benchmarking has determined that various principles could be used in order to determine the value of SITG. Given CDCC's magnitude compared to peers as well as its risk profile, using a percentage of annual revenues is totally appropriate.
5.	Given CDCC is a wholly owned subsidiary of the Montreal Exchange, we would point to our suggested best practices for CCPs in a vertical silo, i.e. that "the exchange should be incentivized by providing parts of the SITG resources". We would welcome some consideration of this in CDCC's approach to sizing its SITG.	CDCC confirms that its peer benchmarking did take into account both trading and clearing revenue. That is how CDCC determined that the 15M value was in line with comparable measures in the industry. While CDCC expressed that amount relative to its own revenue in its proposal, it intends to continue using trading and clearing revenue when updating its benchmark in the future.
6.	We would encourage CDCC to include provisions for a second tranche of skin in the game, positioned beneath member assessments in the default waterfall. Other jurisdictions, such as the EU and UK, include provisions for a second tranche of skin in the game in their regimes, and we consider that this approach should be implemented more widely.	CDCC is ready to consider such a second tranche in any future changes if applicable laws so require.
7.	We also question the proposed change with regards to automatic replenishment. Under the CDCC's current approach, the current SITG is described as "a 5+5 approach, where there is $5M currently at risk in the default waterfall with an additional $5M in pre-funded resources in place to automatically replenish the first	CDCC's peer benchmarking has determined that various principles and mechanisms could be used in order to determine the complete value of SITG. The proposed SITG does not incorporate any automatic replenishment.

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	layer if used". CDCC describes the proposed approach as resulting in a $5M increase over the current approach, to a SITG layer of $15M. However, it is unclear under the proposed approach whether and how CDCC would commit to replenish the SITG if it were to be used up.	
8.	We also note that the proposed amendments to the Default Manual, setting out that the layer of SITG "is determined by CDCC from time to time" leaves significant discretion to CDCC. We acknowledge that CDCC explains that "the amount of SITG should not be indicated in its Rules and Manuals but instead, be specified in CDCC Quantitative Disclosure documents posted on CDCC's website every quarter". However, with the proposed changes to the Default Manual, it is unclear how clearing members' views, as well as evolving circumstances, might be factored in by CDCC in subsequent discretionary revisions of its SITG Therefore, we would suggest that CDCC includes in its Default Manual clear indications as to the guiding principles it would follow when resizing its layer of SITG, following a risk-sensitive and dynamic approach, ensuring alignment of incentives between the CCP and its clearing members. The governance around any subsequent changes to the size of the layer of SITG should also clearly be laid out in the rules. In particular, the rules should specify that the risk committee and/or advisory committees will be consulted ahead of any change	CDCC will formalize the review and update process of SITG in the future through its current governance process and such process will be incorporated into its internal capital policy review process. CDCC is of the view that the amount of SITG should not be indicated in its Rules and Manuals but instead, be specified in CDCC Quantitative Disclosure documents posted on CDCC's website every quarter. Clearing Members can always ask for any relevant documentation pertaining to the framework used / to be used by CDCC.

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9.	Finally, while we appreciate that the language in the Default Manual refer to CDCC's resources "for the purposed of absorbing any loss outstanding after the exhaustion of the suspended Clearing Member's resources" – i.e. in default-loss scenarios – the consultation does not specify what CDCC's approach to exposing its SITG in NDLs scenarios is. Therefore, we would welcome clarifications as to CDCC's approach to using its SITG in non-default loss scenarios. In particular, we would note that if it intends to use its SITG for any NDL, it would have to immediately replenish these funds (although if the CCP is able to do so, it should have used such funds to cover the NDL instead). We also note that a NDL can happen together with a default loss, which should be factored into any plans for replenishing resources.	CDCC's Default Risk Capital is dedicated to absorb any outstanding losses arising from the management of a Clearing Member default. Even if a non-default event causes a default loss, default and non-default losses will be allocated based on the type of capital and its intended use. This aligns with other CCP practices, as most rules will restrict the use of DRC for non-default events.