



NOTICE TO MEMBERS

No. 2015 – 061

May 22, 2015

SELF-CERTIFICATION

AMENDMENTS TO THE RISK MANUAL OF CDCC TO ADDRESS COLLATERAL HAIRCUT

On July 14, 2014, the Board of Directors of the Canadian Derivatives Clearing Corporation (CDCC) approved amendments to the Risk Manual of CDCC. CDCC wishes to inform the Clearing Members that this amendments have been self-certified pursuant to the self-certification process set forth in the *Derivatives Act* (R.S.Q., 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 enhance the approach used to assess its haircut. Such approach should ensure conformity with the PFMI requirements and limit the procyclicality of haircuts.

You will find attached hereto the amendments set to come into force and to be incorporated into the version of the Risk Manual of CDCC that will be made available on the CDCC website at www.cdcc.ca as of May 25, 2015.

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.

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President and Chief Clearing Officer

Canadian Derivatives Clearing Corporation

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Risk Manual

ACCEPTABILITY OF UNDERLYING INTERESTS

ACCEPTABLE UNDERLYING INTERESTS OF EQUITY OPTIONS

- *Section B-603* of the Rules sets out the eligibility criteria for Equity Options.
- *Section B-604* of the Rules sets out the ineligibility criteria for Equity Options.

CDCC reviews and publishes quarterly the eligibility threshold and deficiency threshold in terms of market capitalization and volume (expressed as an average daily volume of the last 20 business days) for clearing Equity Options.

ACCEPTABLE UNDERLYING INTERESTS OF SHARE FUTURES

- *Section C-1503* of the Rules sets out the eligibility criteria for Share Futures.
- *Section C-1504* of the Rules sets out the ineligibility criteria for Share Futures.

CDCC reviews and publishes quarterly the eligibility threshold and deficiency threshold in terms of market capitalization and volume (expressed as an average daily volume of the last 20 business days) for clearing Share Futures.

ACCEPTABLE UNDERLYING INTERESTS OF OTCI

- *Section D-104* of the Rules sets out the acceptance criteria for OTCI.

CDCC reviews and publishes quarterly on its website a list of the single name equities and ETFs that are Acceptable Underlying Interests for clearing OTCI.

Between two quarterly publications of the list of Acceptable Underlying Interests, a Clearing Member who wishes to clear OTCI for which an Underlying Interest is not included on the list must obtain the Corporation's prior approval. The Underlying Interest must at least meet the acceptance criteria prescribed in *Section D-104* of the Rules.

ACCEPTABLE UNDERLYING INTERESTS OF CASH BUY OR SELL TRADES

For the application of *Sections D-104* and *D-603* of the Rules, Securities are acceptable for Cash Buy or Sell Trades clearing if they meet the following criteria:

- The issuer must be eligible, which includes the following issues:
 - Bonds and Treasury bills issued by the Government of Canada, including real return issues;
 - Canada Mortgage and Housing Corporation debt securities;
 - Bonds issued by Business Development Bank of Canada;
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- Bonds issued by Export Development Canada;
- Bonds issued by Farm Credit Canada; and
- Bonds issued by Canada Post;
- Bonds issued by certain provincial governments and provincial Crown corporations determined as acceptable by CDCC¹, excluding real return issues, zero coupon bonds, and bonds with a maturity of less than one year.
- The bonds must be repayable at maturity;
- The bonds must be denominated in Canadian dollars;
- The coupon type must be fixed, real return, step-up or zero (Treasury bills are eligible);
- The net amount outstanding² must be greater than or equal to \$250 million;
- The bonds' prices must be issued by a source that is acceptable to the Corporation.

ACCEPTABLE UNDERLYING INTERESTS OF REPURCHASE TRANSACTIONS

For the application of the provisions of *Sections D-104* and *D-603* of the Rules, Securities are eligible for clearing of Repurchase Transaction if they meet the following criteria:

- The Underlying Interest must be an Acceptable Underlying Interests of Cash Buy or Sell Trades;
- The Purchase Date of the Repurchase Transaction must be no earlier than the Novation Date;
- The Repurchase Date of the Repurchase Transaction must not be more than 365 days later than the Purchase Date of the Repurchase Transaction and must be no later than the maturity date of the Acceptable Security.

¹~~To be acceptable by CDCC, the issuer should be rated by two or more credit agencies (among Moody's Investors Service, Standard and Poor's, Fitch Ratings and the Dominion Bond Rating Service). The final rating considered by CDCC corresponds to the second highest among ratings assigned by these agencies. Such final credit rating of the issuer must be investment grade and not lower than 6 notches below the credit rating assigned to the Government of Canada by the same credit agency. To be acceptable by CDCC, the credit rating of the issuer must be investment grade and not lower than 6 notches below the credit rating of the Government of Canada, as stated by Standard & Poor's (or another recognized rating agency). For example, if the Government of Canada has an AAA rating, the lowest rating eligible would be A-.~~

² The net amount outstanding is defined as the outstanding amount issued on the market minus the stripped coupon bonds and issuer repurchases.

FORMS OF COLLATERAL

The forms of collateral that may be deposited with CDCC are prescribed in Section A-608 and Section A-709 of the Rules.

The different forms of collateral are valued by accounting for their potential loss in the event that liquidation is required. Accordingly, the value of the Margin Deposits is discounted in relation to their market value. This discount, commonly called the Haircut, applies to Valued Securities, Canada Mortgage Bonds and Government Securities, as prescribed in Section A-709 of the Rules.

For the purposes of application of the provisions of Section A-608 and Section A-709 of the Rules, CDCC proceeds as follows:

CASH

Cash amounts are accepted only in Canadian dollars.

GOVERNMENT SECURITIES AND CANADA MORTGAGE BONDS

CDCC accepts Acceptable Treasury Bills and other Government of Canada and United States Government bonds, in addition to the bonds of certain Canadian provinces, as Margin Deposits. For each issue accepted in advance, a concentration limit equal to \$250 million or 10% of the total issue outstanding, whichever is less, is applied. The concentration limit is in effect for all Government Securities and Canada Mortgage Bonds at the Corporation level. Acceptance of the issues is conditional on the availability of a price from a source that CDCC determines to be acceptable and reliable. The Government Securities and Canada Mortgage Bonds accepted as Margin are reviewed by CDCC on a regular basis.

VALUED SECURITIES

CDCC accepts Valued Securities listed on any duly recognized Canadian Exchange against their total Margin requirements. These Securities should respect the criteria set forth in Section A-709 of CDCC's Rules.

CALCULATING THE HAIRCUTS FOR GOVERNMENT SECURITIES AND CANADA MORTGAGE BONDS

The Haircuts are calculated based on the following methodology and assumptions:

- Valuation of the market, credit, liquidity and foreign exchange risks based on historical daily returns;
 - The volatility estimator uses the EWMA approach as defined in the Margin Interval (MI) Calculation section. Confidence interval over 99% obtained by using 3 standard
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~~deviations,~~ and the assumption that the bond can be liquidated at a reasonable price in “~~n~~” days. (~~N~~ “~~n~~” ~~will~~ ~~is~~ ~~be~~ determined according to the type of products and prevailing market conditions – see the Margin Interval (MI) Calculation section). In addition, a minimal floor for the EWMA volatility estimator is calculated as an average the 25th percentile of a daily EWMA volatility estimator observed over the last 10 years;

- Liquidity risk valued according to the bid-ask spread of the issues using the same EWMA volatility estimator and the floor (if this spread is unavailable, the liquidation window will be expanded and will depend on market conditions); and
- Bonds of the same issuer and comparable maturities.

Once the quantitative analysis is performed, CDCC reserves the right to increase the Haircuts based on qualitative criteria, such as:

- Comparative analysis of CDCC’s Haircuts in relation to the Haircuts of the Bank of Canada;
 - Comparative analysis of CDCC’s Haircuts in relation to the Haircuts of other clearing houses;
 - The congruence of the different Haircuts to the credit rating spreads of the different issuers;
 - Any other factor considered relevant.
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