NOTICE TO MEMBERS

No. 2018 - 118

October 2, 2018

SELF-CERTIFICATION

AMENDMENTS TO THE RISK MANUAL OF THE CANADIAN DERIVATIVES CLEARING CORPORATION INTRODUCING AN AMENDED METHODOLOGY TO COMPUTE MISMATCHED SETTLEMENT RISK

On February 6, 2018, the Board of Directors of the Canadian Derivatives Clearing Corporation ("CDCC") approved amendments to CDCC's Risk Manual. 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 Change Requiring Approval in Ontario" process.

CDCC is proposing amendments to its Risk Manual in order to introduce an amended methodology to compute mismatched settlement risk. The proposed methodology enhancement will ensure that sufficient financial resources are available to CDCC with respect to those settlements and improve the risk assessment of the Clearing Members.

You will find attached hereto the amendments set to come into force and to be incorporated into the version of CDCC's Risk Manual that will be made available on the CDCC website at www.cdcc.ca on October 5, 2018, before market opening.

If you have any questions or concerns regarding this notice, please contact Martin Jannelle at 514-787-6578 or at martin.jannelle@tmx.com.

Glenn Goucher
President and Chief Clearing Officer

RISK MANUAL

~~JUNE 4~~, 2018

Section 1: Margin Deposits

[...]

1.1 MARGIN REQUIREMENT

The Margin Requirement is composed of the Initial Margin and the Variation Margin.

1.1.1 Initial Margin

The Initial Margin is composed of the Base Initial Margin (or Adjusted Base Initial Margin, as the case may be) and the Additional Margins. In order to cover the Initial Margin described below, Clearing Members shall deliver to CDCC an acceptable form of Deposits in accordance with Section 2 of this Manual.

[...]

1.1.1.2 Additional Margins

In addition to the Base Initial Margin (or Adjusted Base Initial Margin, as the case may be), the Corporation requires Margin Deposits for the following Additional Margins:

(1) Additional Margin for Concentration Risk

(2) Additional Margin for Specific Wrong-Way Risk

(3) Additional Margin for Mismatched Settlement Risk

(4) Additional Margin for Intra-day Variation Margin Risk

(5) Additional Margin for Variation Margin Delivery Risk

(6) Additional Capital Margin

(7) Additional Margin for Uncovered Risk of Limited Clearing Members

(8) any other additional Margins as set out in the Rules (other than Margin required pursuant to Rule D-607).

[...]

ADDITIONAL MARGIN FOR MISMATCHED SETTLEMENT RISK

The Mismatched Settlement Risk is the risk arising from a lag between the settlement of positions ~~which~~ that result in a Margin offset. More specifically, CDCC faces a risk that a Clearing Member settles a position that provides either a Base Initial Margin offset with other positions ~~or a Variation Margin credit~~ on the rest of the portfolio.

Given the fact that Margin offsets are granted when Fixed Income portfolios have both long and short positions without taking into account the settlement dates, the Additional Margin charge will be calculated ~~on~~

~~a gross basis~~ for the positions that could cause mismatched settlement exposure prior to a default.

In order to address the Mismatched Settlement Risk[1], CDCC will perform forward looking analysis to forecast material changes in the Base Initial Margin~~in Margin Requirements~~[2] as a result of ~~end of day~~ settlements of~~for~~ Fixed Income Transactions.

The Additional Margin for Mismatched Settlement Risk will be calculated by using the maximum of several scenarios representing the potential cases that may trigger a Mismatched Settlement Risk following the settlement of positions ~~A or B~~, minus the total Base Initial Margin ~~Requirement~~ for Fixed Income Transactions.~~:~~

~~Where A represents the maximum of the Margin Requirement for buy transactions that settle on the current Business Day (t) or Margin Requirement for sell transactions that settle on the current Business Day (t), to which is added the remaining Margin Requirement for Fixed Income Transactions that settle on t+1 and beyond.~~

~~Where B represents the maximum of the Margin Requirement for buy transactions that settle on the next Business Day (t+1) or Margin Requirement for sell transactions that settle on the current Business Day (t) and the next Business Day (t+1), to which is added the remaining Margin Requirement for Fixed Income Transactions that settle on the second Business Day following the Transaction (t+2) and beyond.~~

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1 The Additional Margin for Mismatched Settlement Risk is not applied for physical delivery of Government of Canada Bond Futures (CGB, CGZ, CGF and LGB).

~~2 For the purposes of this "Additional Margin for Mismatched Settlement Risk" section, the Margin Requirement includes the Base Initial Margin (or Adjusted Base Initial Margin, as the case may be) and the Variation Margin.~~

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RISK MANUAL

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Given the fact that Margin offsets are granted when Fixed Income portfolios have both long and short positions without taking into account the settlement dates, the Additional Margin charge will be calculated for the positions that could cause mismatched settlement exposure prior to a default.

In order to address the Mismatched Settlement Risk[1], CDCC will perform forward looking analysis to forecast material changes in the Base Initial Margin as a result of settlements of Fixed Income Transactions.

The Additional Margin for Mismatched Settlement Risk will be calculated by using the maximum of several scenarios representing the potential cases that may trigger a Mismatched Settlement Risk following the settlement of positions, minus the total Base Initial Margin for Fixed Income Transactions.

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