NOTICE TO MEMBERS
No. 2016 – 156
December 5, 2016

REQUEST FOR COMMENTS

PROPOSED AMENDMENTS TO SECTIONS A-102, A-220 AND A-701 OF THE RULES OF THE CANADIAN DERIVATIVES CLEARING CORPORATION IN ORDER TO ESTABLISH A HIGHER STANDARD OF LEGAL CERTAINTY WITH RESPECT TO BANKRUPTCY REMOTENESS.

Summary

On November 2nd, 2016, the Board of Directors of the Canadian Derivatives Clearing Corporation (CDCC) approved amendments to Sections A-102, A-220 and A-701of CDCC's Rules. The purpose of the proposed amendments is to clarify the bankruptcy remoteness of the securities collateral which are considered Margin Deposit under its Rules and pledged for Margin purposes.

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 is 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 Rules and Operations Manual of CDCC. Amendments are submitted to the AMF in accordance with the self-certification process and the Ontario Securities Commission in accordance with the process provided in its Recognition Order.

Comments on the proposed amendments must be submitted within 30 days following the date of publication of the present notice. Please submit your comments to:

Ms. Marlène Charron-Geadah
Legal Counsel
Canadian Derivatives Clearing Corporation
Tour de la Bourse
P.O. box 61
800 Victoria Square, 3rd Floor
Montréal, Québec H4Z 1A9
email: legal@m-x.ca

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

Mrs. Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
Tour de la Bourse
P.O. box 246
800 Victoria Square, 22nd Floor
Montréal, Québec H4Z 1G3
email: consultation-en-cours @lautorite.qc.ca

Manager, Market Regulation
Market Regulation Branch
Ontario Securities Commission
Suite 2200,
20 Queen Street West
Toronto, Ontario M5H 3S8
Fax: 416-595-8940
email: marketregulation@osc.gov.on.ca

For any question or clarification, Clearing Members may contact CDCC's Corporate Operations.

Glenn Goucher
President and Chief Clearing Officer

AMENDMENTS TO SECTIONS A-102, A-220, A-701
OF THE CANADIAN DERIVATIVES CLEARING CORPORATION ("CDCC")

CONTENTS

I. SUMMARY

CDCC is proposing to amend its Rules so as to clarify the standard of bankruptcy remoteness applicable to the securities collateral which constitute Margin Deposits as defined under CDCC Rules. By this amendment, CDCC reaffirms its intent to hold and maintain any securities collateral deposited by a Clearing Member with the Corporation for the purpose of such Clearing Member's Margin Requirement in order to ensure that such securities (or its liquidation value) would be available for return to the Clearing Member in the unlikely event of CDCC's own insolvency.

II. ANALYSIS

a. Background

CDCC requires its Clearing Members to meet their Margin requirements through the pledging of securities (non-cash) collateral through CDSX in CDCC's account at CDS[1]. CDCC secures its rights and protects itself against the potential default and bankruptcy of its Clearing Members by obtaining a security interest on all Margin Deposits, including over the securities credited in its account at CDS. CDCC also ensures, through the use of the pledge mechanism (which entails the delivery by pledge of the securities collateral), that its Clearing Members remain protected in the unlikely event of its own bankruptcy.

While there is no unique definition of what is bankruptcy remote, it is generally understood in the industry, with respect to an asset, as the exclusion from an insolvent entity's "estate" in a receivership, insolvency, liquidation or similar proceeding ("Insolvency"). According to the FIA[2], Margin posted by a Clearing Member could be considered bankruptcy remote if the Clearing Member can conclude that the Margin is subject to arrangements that would prevent the margin from being (1) competing claims of (and, thus, distribution to) a CCP's creditors generally or (2) loss due to the CCP's default, including Insolvency (e.g., as a result of the CCP's exercise of re-use, repledge, rehypothecation or other transfer rights), such that, in either case, the Margin (or its liquidation value) would be unavailable for return to the Clearing Member in the CCP's.

Section A-701(4) of CDCC Rules specifically precludes CDCC from re-hypothecating or transferring Margin deposits of a Clearing Member which has not been designated as Non-Conforming Member in connection with the Corporation's own obligations. CDCC does not, as a result of the pledge of the securities collateral by a Clearing Member, become the beneficial owner of the securities collateral merely because same is held in CDCC's securities account at CDS pursuant to a security interest or pledge granted by the Clearing Member. A Clearing Member's interest in the collateral held by CDCC at the CDS level remains protected because such Clearing Member (and not CDCC) is the beneficial owner of such collateral. A record of the pledge transaction

[1] The proposed amendments do not affect the possibility for Margin Requirements to be met with cash.

[2] "Arrangements necessary to support a positive bankruptcy remoteness conclusion under the cleared transaction rules of US Basel III with respect to collateral posted by a Clearing Member to a Central Counterparty", October 31, 2013, FIA ADVISORY.

remains in CDSX and such record identifies the Clearing Member as being the pledgor, and thus the beneficial owner, so long as CDCC does not seize such assets. CDCC is a secured creditor with respect to the securities collateral pledged to it for margin purposes without rehypothecation rights. Following the basic principle of bankruptcy law according to which assets which are not the property of the bankrupt do not vest in the trustee; in the event of the bankruptcy of CDCC, the collateral would not vest in CDCC's trustee because it would not from part of the property of the bankrupt. It would therefore be returned to the Clearing Member who is not under a Non-Conforming status.

While the general principles describe above are not disputed, certain market participants may however demand a higher degree of protection and legal certainty in particular with respect to the transfer of securities collateral in the form of securities entitlements (as defined under the Securities Transfer Act[3] ("STA")). The Securities Transfer Act establishes the legal regime governing the creation, validity and effectiveness of property rights in securities entitlements. Securities entitlement is used under the STA to refer collectively to the rights of an entitlement holder against a securities intermediary and the property rights in relation to a financial asset. The proposed amendments, by referring CDCC as a securities intermediary in accordance with the STA, support the conclusion (in accordance to section 107 of the QSTA) that all interests in financial assets, including securities collateral, held by a securities intermediary (CDCC) are not the property of the securities intermediary and would not be subject to claims of creditors of the securities intermediary. This in our view should satisfy for all purposes the Bankruptcy remoteness conclusion.

b. Description and Analysis of Impacts

The proposed amendments will not have any impact on the markets. They are proposed out of abundance of precaution.

c. Proposed Amendments

The proposed amendments are presented in Appendix 1.

d. Benchmarking

They are no direct equivalent language in other clearing houses rules.

III. PRIMARY MOTIVATION

CDCC is proposing these amendments out of abundance of precaution, notably in response to certain participants who may demand a higher standard of legal certainty with respect to bankruptcy remoteness.

[3] See for our purposes an *Act respecting the transfer of securities and the establishment of security entitlements*, generally referred to as the Quebec Securities Transfer Act which is found its equivalent in most Canadian jurisdictions. In Canada, all jurisdictions but for Prince Edouard Island (currently under consultation) have adopted a Securities Transfer Act in line with the Uniform Securities Transfer Act, which incorporated into Canadian law the Section 8 of the Uniform Commercial Code in the United States.

IV. IMPACTS ON TECHNOLOGICAL SYSTEMS

The proposed amendments will have no impact on the systems of the Bourse, the Bourse's approved participants or any other market participants.

V. OBJECTIVES OF THE PROPOSED MODIFICATIONS

The proposed amendments intend on clarifying the bankruptcy remoteness of the securities collateral that are considered Margin Deposit under its Rules.

VI. PUBLIC INTEREST

In CDCC's opinion, the proposed amendments are not contrary to public interest.

VII. MARKET IMPACTS

The proposed amendments will have no impact on the market.

VIII. PROCESS

The proposed amendments will be submitted for approval to the CDCC Board. After the approval has been obtained, the proposed amendments, including this analysis, will be transmitted to the Autorité des marchés financiers in accordance with the self-certification process, and to the Ontario Securities Commission in accordance with the "Rule Change Requiring Approval in Ontario" process. The proposed amendments and analysis will also be submitted for approval to the Bank of Canada in accordance with the Regulatory Oversight Agreement.

IX. EFFECTIVE DATE

Subject to public comments and regulatory approval, the proposed rule amendments will take effect immediately thereafter.

X. ATTACHED DOCUMENTS

Appendix 1 (Blackline)
Appendix 2 (Clean)

APPENDIX 1

(BLACKLINE)

SECTION A-102, A-220 AND A-701

PART A – GENERAL

RULE A-1 DEFINITIONS

Section A-102 Definitions

"Financial Asset" – has the meaning assigned to this term by the QSTA.

"Margin" – means any and all the deposits required or made pursuant to Rule A-7 Margin Requirements.

"Margin Deposit" ~~–~~means~~,~~ collectively,

a) ~~a)~~ any and all Securities, Cash, Instruments, cheques, Underlying Interest, Underlying Interest Equivalent, Long Positions and Short Positions;

b) ~~b)~~ any and all of the deposits required or made pursuant to Rule A-6 Clearing Fund Deposits, Rule A-7 Margin Requirements, and Rule B-4 Delivery and Payment with Respect to Options Exercised, Rule C-5 Delivery of Underlying Interest of Futures and Rule D-3 Physical Delivery of Underlying Interest on Over-the-Counter Instruments, including Margins, Base Deposits, Additional Deposits, Variable Deposits, Put Escrow Receipts, Call Underlying Interest Deposits, and Futures Underlying Interest Deposits, and any other form of deposit accepted from time to time are accepted by the Corporation; and

c) ~~c)~~ any and all ~~securities pledged or assigned to~~ Financial Assets transferred to the Corporation through the facilities of a Central Securities Depository~~;~~ or held by any other type of Securities Intermediary;

deposited by or on behalf of ~~the~~a Clearing Member with the Corporation or another person (including a Central Securities Depository or any other type of Securities Intermediary, a financial institution or the Bank of Canada) for purpose of the performance of the obligations of the Clearing Member under the Rules.

"Securities Intermediary" – has the meaning assigned to this term by the QSTA.

"QSTA" means the *Act respecting the transfer of securities and the establishment of security entitlements* (Quebec)

SECTION A-220 GOVERNING LAW

The Rules shall be governed by and construed in accordance with the laws of the province of Quebec and the federal laws of Canada applicable therein. Each Clearing Member, by virtue of its membership in the Corporation, attorns to the jurisdiction of the courts of Quebec.

The term "pledge" (and any correlative term) in the Rules and any Application for Membership includes a security interest and hypothec and any provision whereby a pledge is or shall be granted includes the grant of a security interest and hypothec.

RULE A-7 MARGIN REQUIREMENTS

SECTION A-701 MARGIN MAINTENANCE AND PURPOSE

1) Prior to the Settlement Time on every Business Day, every Clearing Member shall be obligated to deposit Margin with the Corporation, as determined by the Corporation, in respect of

   a) each Long Position,

   b) each Short Position,

   c) each Assigned Position,

   d) each exercised Option position, and

   e) each tendered Futures position.

   in each account maintained by such Clearing Member with the Corporation at the opening of such Business Day, including each such position that arises out of a Transaction having a Settlement Time on such Business Day, but excluding Short Positions and Assigned Positions for which either the Underlying Interest or the Underlying Interest Equivalent as specified in Section A-708 has been deposited with the Corporation. When determining whether additional Margin is required from a Clearing Member, the Corporation shall take into account, subject to Subsection A-704(2), all Margin Deposits deposited by or on behalf of such Clearing Member with the Corporation (and not returned to such Clearing Member).

2) The Corporation shall apply the Non-Conforming Member's Margin Deposit (including, without limitation, Margin and Clearing Fund), subject to Subsection A-701(3), to the discharge of:

   a) the Non-Conforming Member's obligation with respect to any Transaction accepted by the Corporation, whether such failure is caused or not by the Non-Conforming Member;

   b) a failure or anticipated failure to make any payment to the Corporation required of a Non-Conforming Member, whether such failure is attributable to the Non-Conforming Member or not;

   c) any loss or expense anticipated or suffered by the Corporation upon the liquidation of the Non-Conforming Member's position;

   d) any loss or expense anticipated or suffered by the Corporation pertaining to the Non-Conforming Member's obligations in respect of exercised Options or tendered Futures or OTCI for which settlement has not yet been made or in connection with hedging transactions effected for the account of the Corporation pursuant to Rule A-4 in respect of the Non-Conforming Member's positions in Options, Futures and OTCI;

   e) any protective or hedging transaction effected for the account of the Corporation pursuant to Rule A-4 in respect of the Non-Conforming Clearing Member's positions in Options and Futures;

f) any protective or hedging transaction effected for the account of the Corporation pursuant to Rule A-4 in respect of the Non-Conforming Clearing Member's positions in any OTCI; or

g) any other situation determined by the Board.

3) Each Clearing Member grants to ~~and in favour of~~ the Corporation a first ranking pledge ~~of, lien on and security interest and hypothec in,~~over all property (including~~,~~ without limitation~~,~~ ~~property deposited as Margin Deposit (including, without limitation,~~ Margin and Clearing Fund) ~~deposited by the Clearing Member with the Corporation~~ that constitutes Margin Deposit or other property which may~~,~~ from time to time be in the possession or control of the Corporation, or in the possession or control of a person acting on behalf of the Corporation~~, to~~. This pledge shall secure the performance by the Clearing Member of all of its obligations to the Corporation and, to the extent such pledge relates to Clearing Fund deposits, it shall also secure the performance by another Clearing Member which is a Non-Conforming Member of its obligations to the Corporation, all subject to the provisions of Rule A-6 and the Default Manual, provided~~,~~ ~~however, that~~ that, except for Clearing Fund deposits, Margin Deposits with respect to a Client Account shall only secure the performance by the Clearing Member of its obligations in respect of that Client Account, and Margin Deposits with respect to a Market Maker Account shall only secure the performance by the Clearing Member of its obligations in respect of that Market Maker Account. Notwithstanding the foregoing, if the Clearing Member does not identify its Margin Deposits with respect to each of its accounts, the Corporation shall use all Margin Deposits without distinction as securing all the obligations of the Clearing Member in respect of all its accounts. The Clearing Member shall execute and deliver ~~to the Corporation~~(or cause to be executed and delivered) such other documents as the Corporation may from time to time request for the purpose of confirming or perfecting the pledge~~, lien, security interest and hypothec provided~~ granted to the Corporation by the Clearing Member; provided that the failure by the Corporation to request or by the Clearing Member to execute and deliver (or cause the execution and delivery of) such documents shall not limit the effectiveness of the ~~foregoing sentence~~pledge in favour of the Corporation.

4) Except as permitted under Subsection A-609(4) in respect of Clearing Fund deposits, and without limiting the right of the Corporation to invest the Margin Deposits in the form of cash under Subsections A-608(1) and A-709(1), the Corporation shall not grant a pledge~~, repledge, hypothecate, rehypothecate~~ over or transfer any property deposited as Margin Deposit by a Clearing Member which has not been designated as a Non-Conforming Member by the Corporation as ~~Margin Deposit as~~ security for, or in connection with, the Corporation's own obligations to any person.

5) Without limiting the rights of the Corporation under Subsection A-701(2), the Corporation may at ~~the~~its sole discretion ~~of the Corporation,~~grant a pledge over or transfer all property deposited with the Corporation as Margin Deposit (including, without limitation, Margin and Clearing Fund) by a Clearing Member which has been designated as a Non-Conforming Member ~~may be pledged, repledged, hypothecated, rehypothecated or transferred by the Corporation~~ as security for, or in connection with, the Corporation's own obligations to any person incurred in order to obtain liquidity or credit for the purpose of assisting the Corporation to honour its obligations on a timely basis further to the designation by the Corporation of such Clearing Member as being a Non-Conforming Member. In such circumstances, the Corporation shall grant a pledge over or transfer such Non-Conforming Member's Margin Deposits before ~~pledging~~doing so with respect to the Clearing Fund deposits of other Clearing Members, in accordance with Subsection A-609(4). The Corporation shall be deemed to continue to hold all Margin Deposit deposited with the Corporation, regardless of whether the Corporation has exercised its rights under this Subsection 701(5).

~~6)~~

~~7)~~6) Any account or sub-account of a Clearing Member with the Corporation that reflects Financial Assets deposited with the Corporation by or on behalf of such Clearing Member for Margin purposes and to which such Financial Assets are credited, shall be considered a securities account for purposes of the QSTA or any similar securities transfer law of any other jurisdiction.

APPENDIX 2

(CLEAN)

SECTION A-102, A-220 AND A-701

PART A – GENERAL

RULE A-1 DEFINITIONS

Section A-102 Definitions

"Financial Asset" – has the meaning assigned to this term by the QSTA.

"Margin" – means any and all the deposits required or made pursuant to Rule A-7 Margin Requirements.

"Margin Deposit" means collectively,

a) any and all Securities, Cash, Instruments, cheques, Underlying Interest, Underlying Interest Equivalent, Long Positions and Short Positions;
b) any and all of the deposits required or made pursuant to Rule A-6 Clearing Fund Deposits, Rule A-7 Margin Requirements, and Rule B-4 Delivery and Payment with Respect to Options Exercised, Rule C-5 Delivery of Underlying Interest of Futures and Rule D-3 Physical Delivery of Underlying Interest on Over-the-Counter Instruments, including Margins, Base Deposits, Additional Deposits, Variable Deposits, Put Escrow Receipts, Call Underlying Interest Deposits, and Futures Underlying Interest Deposits, and any other form of deposit accepted from time to time are accepted by the Corporation; and
c) any and all Financial Assets transferred to the Corporation through the facilities of a Central Securities Depository or held by any other type of Securities Intermediary;

deposited by or on behalf of a Clearing Member with the Corporation or another person (including a Central Securities Depository or any other type of Securities Intermediary, a financial institution or the Bank of Canada) for purpose of the performance of the obligations of the Clearing Member under the Rules.

"Securities Intermediary" – has the meaning assigned to this term by the QSTA.

"QSTA" means the *Act respecting the transfer of securities and the establishment of security entitlements* (Quebec)

SECTION A-220 GOVERNING LAW

The Rules shall be governed by and construed in accordance with the laws of the province of Quebec and the federal laws of Canada applicable therein. Each Clearing Member, by virtue of its membership in the Corporation, attorns to the jurisdiction of the courts of Quebec.The term "pledge" (and any correlative term) in the Rules and any Application for Membership includes a security interest and hypothec and any provision whereby a pledge is or shall be granted includes the grant of a security interest and hypothec.

RULE A-7 MARGIN REQUIREMENTS

SECTION A-701 MARGIN MAINTENANCE AND PURPOSE

1) Prior to the Settlement Time on every Business Day, every Clearing Member shall be obligated to deposit Margin with the Corporation, as determined by the Corporation, in respect of

   a) each Long Position,

   b) each Short Position,

   c) each Assigned Position,

   d) each exercised Option position, and

   e) each tendered Futures position.

   in each account maintained by such Clearing Member with the Corporation at the opening of such Business Day, including each such position that arises out of a Transaction having a Settlement Time on such Business Day, but excluding Short Positions and Assigned Positions for which either the Underlying Interest or the Underlying Interest Equivalent as specified in Section A-708 has been deposited with the Corporation. When determining whether additional Margin is required from a Clearing Member, the Corporation shall take into account, subject to Subsection A-704(2), all Margin Deposits deposited by or on behalf of such Clearing Member with the Corporation (and not returned to such Clearing Member).

2) The Corporation shall apply the Non-Conforming Member's Margin Deposit (including, without limitation, Margin and Clearing Fund), subject to Subsection A-701(3), to the discharge of:

   a) the Non-Conforming Member's obligation with respect to any Transaction accepted by the Corporation, whether such failure is caused or not by the Non-Conforming Member;

   b) a failure or anticipated failure to make any payment to the Corporation required of a Non-Conforming Member, whether such failure is attributable to the Non-Conforming Member or not;

   c) any loss or expense anticipated or suffered by the Corporation upon the liquidation of the Non-Conforming Member's position;

   d) any loss or expense anticipated or suffered by the Corporation pertaining to the Non-Conforming Member's obligations in respect of exercised Options or tendered Futures or OTCI for which settlement has not yet been made or in connection with hedging transactions effected for the account of the Corporation pursuant to Rule A-4 in respect of the Non-Conforming Member's positions in Options, Futures and OTCI;

   e) any protective or hedging transaction effected for the account of the Corporation pursuant to Rule A-4 in respect of the Non-Conforming Clearing Member's positions in Options and Futures;

   f) any protective or hedging transaction effected for the account of the Corporation pursuant to Rule A-4 in respect of the Non-Conforming Clearing Member's positions in any OTCI; or

   g) any other situation determined by the Board.

3) Each Clearing Member grants to the Corporation a first ranking pledge over all property (including without limitation Margin and Clearing Fund) that constitutes Margin Deposit or other property which may from time to time be in the possession or control of the Corporation, or in the possession or control of a person acting on behalf of the Corporation. This pledge shall secure the performance by the Clearing Member of all of its obligations to the Corporation and, to the extent such pledge relates to Clearing Fund deposits, it shall also secure the performance by another Clearing Member which is a Non-Conforming Member of its obligations to the Corporation, all subject to the provisions of Rule A-6 and the Default Manual, provided that, except for Clearing Fund deposits, Margin Deposits with respect to a Client Account shall only secure the performance by the Clearing Member of its obligations in respect of that Client Account, and Margin Deposits with respect to a Market Maker Account shall only secure the performance by the Clearing Member of its obligations in respect of that Market Maker Account. Notwithstanding the foregoing, if the Clearing Member does not identify its Margin Deposits with respect to each of its accounts, the Corporation shall use all Margin Deposits without distinction as securing all the obligations of the Clearing Member in respect of all its accounts. The Clearing Member shall execute and deliver (or cause to be executed and delivered) such other documents as the Corporation may from time to time request for the purpose of confirming or perfecting the pledge granted to the Corporation by the Clearing Member; provided that the failure by the Corporation to request or by the Clearing Member to execute and deliver (or cause the execution and delivery of) such documents shall not limit the effectiveness of the pledge in favour of the Corporation.

4) Except as permitted under Subsection A-609(4) in respect of Clearing Fund deposits, and without limiting the right of the Corporation to invest the Margin Deposits in the form of cash under Subsections A-608(1) and A-709(1), the Corporation shall not grant a pledge over or transfer any property deposited as Margin Deposit by a Clearing Member which has not been designated as a Non-Conforming Member by the Corporation as security for, or in connection with, the Corporation's own obligations to any person.

5) Without limiting the rights of the Corporation under Subsection A-701(2), the Corporation may at its sole discretion grant a pledge over or transfer all property deposited with the Corporation as Margin Deposit (including, without limitation, Margin and Clearing Fund) by a Clearing Member which has been designated as a Non-Conforming Member as security for, or in connection with, the Corporation’s own obligations to any person incurred in order to obtain liquidity or credit for the purpose of assisting the Corporation to honour its obligations on a timely basis further to the designation by the Corporation of such Clearing Member as being a Non-Conforming Member. In such circumstances, the Corporation shall grant a pledge over or transfer such Non-Conforming Member’s Margin Deposits before doing so with respect to the Clearing Fund deposits of other Clearing Members, in accordance with Subsection A-609(4). The Corporation shall be deemed to continue to hold all Margin Deposit deposited with the Corporation, regardless of whether the Corporation has exercised its rights under this Subsection 701(5).

6) Any account or sub-account of a Clearing Member with the Corporation that reflects Financial Assets deposited with the Corporation by or on behalf of such Clearing Member for Margin purposes and to which such Financial Assets are credited, shall be considered a securities account for purposes of the QSTA or any similar securities transfer law of any other jurisdiction.