



Canadian Derivatives Clearing Corporation

Changes to the OTC Marketplace

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Introduction



- Derivatives role in crises
- Global regulatory response
 - ❑ American
 - ❑ European
- Canadian situation
- CDCC initiatives
- Summary

Derivatives Role in Crisis



- Not cause but contributor
- Discussion focused around OTC
 - ❑ CDS, CDO
- Everything else (CMBs, swaps etc...)
- Regulatory focus
 - ❑ Systemic risk
 - ❑ Counterparty credit risk
 - ❑ Transparency (pricing and positions)
 - ❑ Liquidity

Regulatory Response



- Rapidly evolving and, significantly, well coordinated
- G20 commitments
 - ❑ Central Banks: Coordinated liquidity and policy
 - ❑ Regulators: IOSCO
 - ❑ Policy Makers: Finance departments
- Most visible: U.S. and European

U.S. Status



- Obama plan to Congress August 11
 - ❑ Position reiterated September 15

- Comprehensive and overarching
 - ❑ Mandate exchange traded and centrally cleared for OTC 'standardizable' contracts
 - ❑ Reporting, record keeping and registration by product or customer

- G15 (global banks) make commitments to clearing majority of CDS and swaps by end of year (letter to Dudley-footnote)

European Status



- Commission meeting September 25 in Brussels
Policy paper published by October
 - ❑ Central clearing strategy

- OTC clearing organizations, July 1 CDS

- Standardizable – US vs Euro
 - ❑ Cleared by any regulated clearinghouse
 - ❑ Degree to which straight through processing occurs- from trade, clear and settle

Canadian Situation



- Little visibility into regulatory thought process
 - Regulators represented through CSA at G20
- Policy Makers (Finance – watching developments)
- BoC visibly engaged
 - Governor Carney Beijing speech August 12th
 - Continuously open funding markets
 - Sustainable securitization
 - New bank capital requirements
 - Macroprudential approach to regulation
 - A system that can withstand failure
- IIAC and Repo

CDCC Background



Role of the CDCC:

Issuer, clearinghouse and guarantor of exchange-traded derivatives in Canada

Brief History:

- ❑ Founded in 1975 as Trans Canada Options
- ❑ Name changed to CDCC in 1996 to reflect its increased product coverage
- ❑ Changed to for-profit status in 1999 after market re-organization and became a wholly-owned subsidiary of MX
- ❑ AA rating established by Standard & Poor's in 2002

Current Business:

- ❑ Exchange traded derivatives
- ❑ OTC clearing through its *Converge*® service offering

Risk Management at CDCC



Risk Management Process

- Clearing Member (Counterparty) selection
- Standardized Margining (credit risk mitigant)
- Risk Mutualization (systemic risk mitigant)

Default Management Process

- Liquidation / transfer of positions
- Member drawdown
- CDCC resources

Regulatory Infrastructure and status under PCSA

- Providing certainty in default scenarios

CDCC Infrastructure



- Regulatory changes
- Technology changes
- Customer focus
- DCO status
- Expanded membership
- TMX commitment

CDCC Planned Initiatives



- Repo solution
 - ❑ Meets accounting requirements and provides for balance sheet netting
 - ❑ Increased volumes in the absence of structural constraints (GoC, Proxies, Mortgage bonds)
 - ❑ Plug and play for existing members
- FX options and forwards
- Options on fixed income securities
- Options on equity baskets
- Swaps

Benefits of Centralized Clearing



Improved return on capital driven by:

- Direct operational benefits:
 - ISDA documentation unnecessary
 - Multilateral netting
 - Centralized business processes
 - Efficient use of capital and collateral
 - Freeing up lines of credit
 - Risk mutualization
 - Scalability
- Benefits to participating firms:
 - Reduced credit and operational risks (reduced credit risk capital charges)
 - Decreased operational costs
 - Increased transactional volumes

Summary



- OTC market evolution part of larger reform effort of financial system
- Swinging pendulum – return to risk
- Canadian solution to reflect a Canadian market situation
- No market or regulatory arbitrage
- Sunlight is the disinfectant; regulation is the immunization
- The lessons of history – learn or repeat



TMX | **CDCC**