RULE L3—PROCEDURES PERTAINING TO COLLATERAL

IMPLEMENTED

March 12, 2018

Amendments:


2. Amendment to subsections 4(c) and 7(e) respectively, to reflect change in confidence level from 97% to 99% and in the Business Days for the calculation of the ACSS collateral pool from 255 Business Days to 510 Business Days. Approved by the Board November 29, 2018 and effective February 13, 2019.
Introduction

1. This Rule outlines the procedures for pledging Collateral for ACSS purposes.

Scope

2. This Rule applies to the pledging of Collateral for ACSS purposes by Direct Clearers and Group Clearers.

Definitions

3. In this Rule, unless the context otherwise requires:
   a. “ACSS Collateral Pool” means the aggregate amount of Collateral, as determined in accordance with subsection 4(c)(i) of this Rule, that is required to be pledged by all Direct Clearers under s.31(1) of By-Law No. 3 – Payment Items and ACSS;
   b. “Collateral” means any form of security that is designated by the Bank of Canada, in written communications with Direct Clearers, to be acceptable as security for advances of funds by the Bank of Canada and includes securities of a type designated by the Bank of Canada as acceptable as collateral for advances and funds on deposit with the Bank of Canada;
   c. “Collateral Pool Pledge” means the amount of Collateral, as determined in accordance with this Rule, that each Direct Clearer is required to continuously pledge to the Bank of Canada and allocate for ACSS purposes under s.31(1) of By-Law No. 3 – Payment Items and ACSS;
   d. “Direct Clearer” means a Member, other than the Bank of Canada, that on its own behalf Exchanges Items and makes entries into the ACSS. For greater certainty, references to Direct Clearers in this Rule include Group Clearers;
   e. “Default” means the default of a Direct Clearer within the meaning of paragraph 53(1)(a) or (b) of By-Law No. 3 – Payment Items and ACSS;
   f. “Multilateral Net Debit Position” or “MNDP” means the Clearing Balance of a Direct Clearer or Indirect Clearer that is in a net owing position, as that Clearing Balance is established by the ACSS in the case of a Direct Clearer or by an Indirect Clearer’s Clearing Agent.

Initial calculation and monthly recalculation of collateral

4. a. Procedures for initial calculation:
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i. On the date of implementation of this Rule, the CPA shall calculate, in accordance with subsection 4(c), the amount of the ACSS Collateral Pool and the amount of Collateral Pool Pledge of each Direct Clearer;

ii. On the Business Day immediately following its calculation of the amounts pursuant to subsection 4(a)(i), the CPA shall notify the Bank of Canada of the amounts and shall notify each Direct Clearer of the amount of the ACSS Collateral Pool and the amount of the Direct Clearer’s Collateral Pool Pledge;

iii. Each Direct Clearer shall pledge and allocate to the Bank of Canada Collateral in an amount at least equal to the amount of its Collateral Pool Pledge by no later than the completion of settlement (in accordance with Section 14 of Rule B1) of the ACSS Cycle on the Business Day immediately following notification from the CPA pursuant to subsection 4(a)(ii) of the amount of the Direct Clearer’s Collateral Pool Pledge, or by such later time as may be communicated by the CPA to the Direct Clearer.

b. Procedures for monthly recalculation:

i. On the second Monday of each month following the month of the initial calculation of the ACSS Collateral Pool and the Collateral Pool Pledges pursuant to subsection 4(a)(i), the CPA shall recalculate the amount of the ACSS Collateral Pool and the amount of Collateral Pool Pledge of each Direct Clearer;

ii. On the Tuesday immediately following its monthly recalculation of the amounts pursuant to subsection 4(b)(i), the CPA shall notify the Bank of Canada of the recalculated amounts and shall notify each Direct Clearer of the recalculated amount of the ACSS Collateral Pool and the recalculated amount of the Direct Clearer’s Collateral Pool Pledge;

iii. Each Direct Clearer shall pledge and allocate to the Bank of Canada Collateral in an amount at least equal to the recalculated amount of its Collateral Pool Pledge by no later than completion of settlement (in accordance with Section 14 of Rule B1) of the ACSS Cycle on the Wednesday immediately following notification from the CPA pursuant to subsection 4(b)(ii) of the recalculated amount, or by such later time as may be communicated by the CPA to the Direct Clearer;

iv. In the event that the day on which the amounts of ACSS Collateral Pool and Collateral Pool Pledges are to be recalculated pursuant to subsection 4(b)(i), notified pursuant to subsection 4(b)(ii) or pledged pursuant to subsection 4(b)(iii) falls on a day that is not a Business Day, the CPA shall adjust the dates of recalculation, notification or pledging accordingly and
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shall notify the Bank of Canada and each Direct Clearer in advance of the adjustment;

v. Immediately preceding the start of each year, the CPA shall provide the Bank of Canada and each Direct Clearer with a schedule of the monthly recalculation of the ACSS Collateral Pool and Collateral Pool Pledges for that year.

c. Methodology and formulas for calculation and recalculation

Calculation and recalculation of the amount of the ACSS Collateral Pool and the Collateral Pool Pledge of each Direct Clearer pursuant to subsections 4(a)(i) and 4(b)(i) shall be in accordance with the following methods and formulas:

i. the ACSS Collateral Pool is equal to the amount of the largest MNDP of any Direct Clearer at the end of any ACSS Cycle during the 510 Business Days immediately preceding the day of calculation, as adjusted to achieve a confidence level of 99% that the amount will be sufficient to cover any single Default of a Direct Clearer;

ii. a Direct Clearer’s Collateral Pool Pledge is equal to the amount of the ACSS Collateral Pool multiplied by the Direct Clearer’s average MNDP over the previous 255 Business Day period, divided by the sum of the average of MNDPs for all Direct Clearers over that period:

\[
\text{Collateral Pool Pledge} = A \times \frac{B}{C}
\]

where

\( A \) = ACSS Collateral Pool

\( B \) = Direct Clearer’s Average MNDP

\( C \) = Sum of average MNDP of all Direct Clearers

Recalculation of Collateral upon a Default

5. a. Upon the Default of a Direct Clearer, the CPA shall recalculate the amount of the Collateral Pool Pledge of each of the remaining Direct Clearers.

b. Upon recalculating the amount of each remaining Direct Clearer’s Collateral Pool Pledge pursuant to subsection 5(a), the CPA shall notify the Bank of Canada of the recalculated amounts and notify each remaining Direct Clearer of the recalculated amount of the Direct Clearer’s Collateral Pool Pledge.

c. Upon receiving notification from the CPA pursuant to subsection 5(b), each remaining Direct Clearer shall pledge and allocate such Collateral as may be
necessary to make its Collateral Pool Pledge in the recalculated amount, within such time as is stipulated by the CPA in the notification.

d. The CPA shall recalculate the amount of the Collateral Pool Pledge of each remaining Direct Clearer pursuant to subsection 5(a) in accordance with the following formula:

   i. The amount of the remaining Direct Clearer’s Collateral Pool Pledge shall be equal to the amount of the ACSS Collateral Pool, multiplied by the average MNDP of the remaining Direct Clearer over the 5 Business Day period immediately preceding the day of the recalculation, divided by the sum of the average of MNDP’s of all Direct Clearers, except for the defaulting Direct Clearer, over that period:

   \[
   \text{Collateral Pool Pledge} = A \times \frac{B}{C}
   \]

   where

   \( A = \text{ACSS Collateral Pool} \)

   \( B = \text{Direct Clearer’s Average MNDP} \)

   \( C = \text{Sum of average MNDP of all remaining Direct Clearers} \)

Recalculation of Collateral upon withdrawal of a Direct Clearer

6. a. If a Direct Clearer has its status as a Direct Clearer revoked or ceases to act as a Direct Clearer pursuant to By-Law No. 3 – Payment Items and ACSS or Rule D1, the CPA shall recalculate the amount of the Collateral Pool Pledge of each of the remaining Direct Clearers.

b. Upon recalculating the amount of each remaining Direct Clearer’s Collateral Pool Pledge pursuant to subsection 6(a), the CPA shall notify the Bank of Canada of the recalculated amounts and notify each remaining Direct Clearer of the recalculated amount of the Direct Clearer’s Collateral Pool Pledge.

c. Upon receiving notification from the CPA pursuant to subsection 6(b), each remaining Direct Clearer shall pledge and allocate such Collateral as may be necessary to make its Collateral Pool Pledge in the recalculated amount, within such time as is stipulated by the CPA in the notification.

d. The CPA shall recalculate the amount of the Collateral Pool Pledge of each remaining Direct Clearer pursuant to subsection 6(a) in accordance with the following formula:

   i. The amount of the remaining Direct Clearer’s Collateral Pool Pledge shall be equal to the amount of the ACSS Collateral Pool, multiplied by the
Collateral Pool Pledge = \frac{A \times B}{C}

where

A = \text{ACSS Collateral Pool}
B = \text{Direct Clearer’s average MNDP}
C = \text{Sum of average MNDP of all remaining Direct Clearers}

Calculation and Recalculation of Collateral upon Appointment of a New Direct Clearer

7. a. Upon the appointment as a new Direct Clearer pursuant to section 26 or subsection 29(1) of By-law No. 3 – Payment Items and ACSS, of a Member that was previously an Indirect Clearer, the CPA:

i. shall calculate the amount of the Collateral Pool Pledge of the new Direct Clearer in accordance with the following formula:

the new Direct Clearer’s Collateral Pool Pledge is equal to the amount of the ACSS Collateral Pool multiplied by the new Direct Clearer’s average MNDP as an Indirect Clearer over the 255 Business Day period immediately preceding the day of calculation, divided by the sum of the average of MNDPs for all Direct Clearers over that period:

Collateral Pool Pledge = \frac{A \times B}{C}

where

A = \text{ACSS Collateral Pool}
B = \text{new Direct Clearer’s average MNDP as an Indirect Clearer}
C = \text{Sum of average MNDP of all Direct Clearers;}

and

ii. may, at its discretion, recalculate the amount of the ACSS Collateral Pool and the Collateral Pool Pledge of each of the other Direct Clearers, using the formulas and methods pursuant to subsection 4(c).

b. Upon the appointment as a new Direct Clearer pursuant to section 26 or subsection 29(1) of By-law No. 3 – Payment Items and ACSS, of a Member that was non previously an Indirect Clearer, the CPA:
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i. shall calculate the amount of the Collateral Pool Pledge of the new Direct Clearer; and

ii. may, at its discretion, recalculate the amount of the ACSS Collateral Pool and the Collateral Pool Pledge of each of the other Direct Clearers; using such formulas and methods as it reasonably deems to be appropriate in the circumstances subject to consultation with Bank of Canada.

c. Upon calculating the amount of the Collateral Pool Pledge of a new Direct Clearer pursuant to subsection 7(a)(i) or 7(b)(i), the CPA shall notify the new Direct Clearer and the Bank of Canada of the required amount of Collateral Pool Pledge and the new Direct Clearer shall pledge and allocate the required amount within such time as is stipulated by the CPA in the notification.

d. Upon recalculating the amount of Collateral Pool Pledge to be made by another Direct Clearer pursuant to subsection 7(a)(ii) or 7(b)(ii), the CPA shall notify the other Direct Clearer and the Bank of Canada of the recalculated amount of the Direct Clearer’s Collateral Pool Pledge and the Direct Clearer shall pledge and allocate the recalculated amount within such time as is stipulated by the CPA in the notification.

e. In order to facilitate the CPA’s calculation of a new Direct Clearer’s Collateral Pool Pledge pursuant to subsection 7(a)(i), a Member that applies to the Board to become a Direct Clearer shall, as part of the application procedures set out in sections 4 and 5 of Rule D1, provide the CPA with such information as the CPA may require regarding the Clearing Balances of the Member with its Clearing Agents over the 510 Business Day period immediately preceding the day of the calculation.

f. Notwithstanding the requirement to calculate the Collateral Pool Pledge of each Direct Clearer pursuant to subsection 4(b), the CPA shall only recalculate the new Direct Clearer’s Collateral Pool Pledge in accordance with 4(c)(ii) on the first monthly recalculation that follows the date on which that Direct Clearer has participated in ACSS for 255 Business Days.

Valuation of Collateral

8. All Collateral pledged by Direct Clearers pursuant to this Rule and By-law No. 3 – Payment Items and ACSS is subject to valuation by the Bank of Canada. All references to amounts of Collateral in this Rule and By-law No. 3 – Payment Items and ACSS, are to the value of the Collateral as determined by the Bank of Canada.