



Guideline Impact Analysis Statement

Subject: Derivatives Sound Practices

Category: Sound Business and Financial Practices

No: B-7

Effective Date: November 2014

I. Background

To assist federally-regulated financial institutions (FRFIs) in understanding the Office of the Superintendent of Financial Institutions' (OSFI's) expectations regarding derivatives activities, OSFI issued the Derivatives Best Practices Guideline B-7 in May 1995. Derivatives markets have experienced significant growth in recent years, both in size and in the number and complexity of products. While derivatives can be effective risk mitigation tools, the associated risks and exposures must be identified, measured, monitored and controlled as part of a FRFI's comprehensive risk management framework.

In response to the economic and financial crisis, G-20 leaders initiated a reform of the over-the-counter (OTC) derivatives market to improve transparency, mitigate systemic risk, and protect against market abuse. Included in the G-20 Leaders Statement at the Pittsburgh summit in 2009 was the following:

“All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements.”

The derivatives market is a truly global market that is part of the core business in the domestic and cross border operations of many FRFIs. Accordingly, it is imperative that there are comparable and equivalent regulations and rules across jurisdictions in order to provide a level playing field for all counterparties to function.

The existing guidance is being revised to set out OSFI's expectations for FRFIs with respect to derivatives activities, including the implementation of G-20 reforms. It applies to all FRFIs, i.e., Canadian incorporated FRFIs (and their consolidated subsidiaries) as well as the Canadian branch operations of foreign institutions.



II. Problem Identification

Guideline B-7, which has not been updated since its original publication in May 1995, does not fully align with other OSFI guidance or reflect current practices with respect to the risk management of derivatives activities. It also does not reflect OSFI's expectations regarding the implementation of G-20 reforms.

III. Objectives

The main objectives of the revised Guideline B-7 are to:

- Outline OSFI's current expectations with respect to the risk management of derivatives activities, recognizing the distinction between the requirements for dealers versus FRFIs that are primarily end-users of derivatives;
- Be more consistent with OSFI's [Supervisory Framework](#) and [Assessment Criteria](#) and other OSFI guidance;
- Provide clarity on OSFI's expectations for FRFIs with respect to the G-20 commitments of reporting derivatives data to a trade repository and central clearing of OTC derivatives;
- Be consistent with the global direction with respect to OTC derivatives market reforms;
- Support equivalency or comparability assessments of Canadian OTC derivatives regulatory requirements by foreign jurisdictions.

IV. Options and Assessment

Option 1 – Status Quo

Under this option, Guideline B-7 would not be revised and other steps would not be taken to achieve the objectives outlined in this Analysis Statement. The advantage of this option is that OSFI would not have to devote resources to updating its own guidance. However, FRFIs would be left without comprehensive and current guidance with respect to derivatives activities and would lack clarity on OSFI's expectations for the implementation of G-20 commitments. This could also impact FRFIs' ability to be granted equivalency or comparability by foreign jurisdictions.

Option 2- Revise Guideline B-7

Under this option, Guideline B-7 would be rewritten to reflect current practices with respect to the risk management of derivatives activities. It would allow OSFI the opportunity to detail its expectations for dealers vs. end-users of derivatives, thereby ensuring the nature, size, and complexity of FRFIs' derivatives activities is considered when evaluating a FRFI's risk management practices and measurement techniques.

The revised Guideline B-7 would also reflect OSFI's expectations for central clearing of standardized OTC derivatives and for reporting derivatives data to a trade repository. Given that the derivatives data reporting requirements will be coming into force in certain provinces on October 31, 2014, Guideline B-7 would provide clarity regarding their application to FRFIs by virtue of the Guideline. It would also ensure a level playing field for all counterparties.

This option would demonstrate that OSFI is ensuring its guidance remains relevant and consistent with the global direction and G-20 commitments.

V. Consultations

In June 2014, the draft Guideline was issued for directed consultation to industry associations representing banks, trust companies, property & casualty insurance companies and life insurance companies, as well as the other federal and provincial agencies that are part of the domestic inter-agency OTC derivatives working group. OSFI also met with representatives from several industry associations to discuss their comments in more detail. Comments received were taken into consideration in the draft version of the Guideline issued for public comment on October 1, 2014. OSFI received comments from four stakeholders, including three industry associations. All comments were taken into consideration and many were incorporated into the final version of the Guideline. The final Guideline is accompanied by a table of consolidated industry comments and corresponding OSFI responses.

VI. Recommendations

OSFI has chosen option 2 because it addresses all of the objectives outlined above and is the most effective means to communicate OSFI's current expectations. It retains the principles-based approach to guidance and recognizes the distinction between the requirements for dealers versus FRFIs that are primarily end-users of derivatives. Finally, revising Guideline B-7 should not impose significant incremental costs on FRFIs as the derivatives activities of FRFIs have long been subject to OSFI's oversight as part of its prudential mandate, and the nature, size, and complexity of FRFIs' derivatives activities is considered when evaluating a FRFI's risk management practices and measurement techniques.

VII. Implementation & Evaluation

The revised Guideline B-7 was effective on November 1, 2014, in order to coincide with the timing of the provincial derivatives data reporting requirements coming into effect. OSFI will monitor FRFIs' compliance with the reporting requirements. OSFI expects FRFIs to comply with all applicable requirements of Guideline B-7, and will use supervisory judgment in assessing FRFIs' compliance.