Office of the Superintendent of Financial Institutions Canada | Bureau du surintendant des institutions financières Canada

Guideline Impact Analysis Statement

Margin Requirements for Non-Centrally Cleared Derivatives

Date: February 2016

I. Background

In March 2015, the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) released a framework for *Margin Requirements for non-centrally cleared derivatives* in order to mitigate the systemic risk posed by non-centrally cleared derivatives. This framework requires the mandatory exchange of initial and variation margin for non-centrally cleared derivatives beginning on September 1, 2016.

II. Problem Identification

Non-centrally cleared derivatives contribute significantly to systemic risk in the financial sector. Margin performs an important risk mitigation function and can offer enhanced protection against counterparty credit risk by ensuring that collateral is available to offset losses caused by the default of a derivative's counterparty. OSFI does not have a guideline that requires the exchange of margin for non-centrally cleared derivatives transactions.

III. Objectives

This guidance aims to mitigate systemic risk in the financial sector and promote central clearing of derivatives, where practicable. OSFI's objective is to provide comprehensive and clear guidance to institutions outlining the margin requirements that will take effect starting on September 1, 2016 in a manner that supports the financial stability objectives of the international framework while giving due recognition to constraints imposed by Canada's place in the global market. The guidance also takes into consideration the potential operational burden in relation to small and medium sized institutions which may have non-material exposure.

Given the cross-border nature of the derivatives market, this guideline may also support equivalency or comparability assessments of Canadian derivatives regulatory requirements by other jurisdictions.

IV. Options and Assessment

Option 1 *– Reflect the BCBS-IOSCO publication in formal OSFI guidance*

This option entails the creation of a guideline that would contain the margin requirements that OSFI would use to ensure the mitigation of systemic risk in the derivatives market and promote central clearing. This option would also allow OSFI to provide an exemption to small and medium sized institutions that face little risk due to their limited exposure to non-centrally cleared derivatives.

Option 2 – *Make no changes – rely only on BCBS-IOSCO publications to communicate requirements*

The advantage of this option is that OSFI would not have to devote resources to producing its own guidance. However, institutions would be left without comprehensive guidance on OSFI's application of and expectations surrounding the margin requirements. Further, the BCBS-IOSCO publication includes several areas of national discretion where institutions would not have any guidance. This would be inefficient for both institutions and OSFI, as OSFI would be required to devote resources on an ongoing basis in order to respond to enquiries from the industry related to implementation issues that could have been addressed in a guideline.

V. Consultations

OSFI issued draft Guideline E-22 for public consultation in October 2015. OSFI received comments from thirteen stakeholders. A summary of material comments received from industry stakeholders and an explanation of how they have been addressed has been provided along with the final Guideline.

VI. Recommendations

OSFI is of the view that a comprehensive domestic margin requirements guideline is the most appropriate option for ensuring that institutions understand and apply the guidance correctly. It is recommended that a guideline be created to offer enhanced protection against counterparty credit risk consistent with the BCBS-IOSCO framework and to convey OSFI's expectations around the application of these requirements in Canada.

VII. Implementation & Evaluation

The final Guideline will be effective September 1, 2016. OSFI expects FRFIs to comply with all applicable requirements in the Guideline and will use supervisory judgement in addressing FRFIs' compliance.