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On the Margin of Success: The Legal and Regulatory Protections for Customer Margin in the Canadian Derivatives Markets

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Abstract

This article analyzes the new legal regime for protecting margin that is posted by cleared derivatives (or cleared swaps) customers in the Canadian derivatives markets. In response to the global financial crisis of 2008, Canada passed legislation to reform these markets. One of the major reforms was the introduction of mandatory clearing for standardized over-the-counter (OTC) swaps through a central counter party clearing system (CCP). This reform requires customers that enter into cleared swaps contracts to post margin with a clearing intermediary in order to comply with the rules of the clearing system. The Canadian Securities Administrators OTC Derivatives Committee (CSA) has created a Model Law (the Model Provincial Rule, or MPR) for the provinces to implement in order to increase legal certainty for cleared swaps customers that post margin with an intermediary.


However, there is still legal uncertainty under the MPR as to how the margin of cleared swaps customers will be treated under Canadian law in the event of a clearing intermediary or a clearing member insolvency. It is uncertain whether the current laws for transferring collateral and creating security interests in some of the provinces (e.g. Ontario) will provide sufficient protection to cleared swaps customers in an insolvency situation. Furthermore, this article considers whether the MPR is compatible with the Payment Clearing and Settlement Act and the Bankruptcy and Insolvency Act (which are both federal statutes) and whether the possibility for reconciliation exists. It considers the viability of creating a federal regulator for the Canadian derivatives markets in order to simplify the regulatory process and minimize legal risk.

Furthermore, this article discusses other issues that could improve legal certainty in the Canadian derivatives markets. It argues that cleared swaps customers should receive insurance coverage under the Canadian Investor Protection Fund. It also considers the advantages of adopting portfolio margining as a technique for reducing the amount of margin that customers are required to post for their derivatives trades. Overall, this article analyzes the areas of contention in the MPR and it provides several recommendations for increasing legal certainty.

Keywords: Margin Segregation, Central Counterparty (CCP), Model Provincial Rule, OTC Derivatives, Legal Segregation and Operationally Commingled (LSOC), Payment Clearing and Settlement Act, Title Transfer Collateral Arrangements, Security Interest Arrangements, Porting, Rehypothecation, PPSA

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