

Chapter 15

Mind the Gap: Undercollateralization in the Global and Canadian OTCD Markets

Jorge Cruz Lopez
Bank of Canada, Canada

ABSTRACT

We provide estimates of the collateral gap in the global and Canadian OTCD markets. Using the latest available data as of December 31 2011, it is estimated that current exposures after netting are \$3.9T globally and \$71B in Canada. The estimated amount of available collateral after correcting for re-hypothecation in each market is \$767B and \$48B, respectively. Thence, the current gap in variation margins stands at \$3.1T globally and at \$23B in Canada. The initial margin that would be required to centrally clear OTCD is estimated at \$4T globally and \$104B in Canada. The rate of collateralization has increased globally, but specially in Canada. In 2001, 92% of global and 72% of Canadian current exposures were undercollateralized; currently, the figures are 80% for global and 30% for Canadian current exposures. The high level of collateralization and the lack of re-hypothecation could make the Canadian market more resilient to systemic shocks. Further, it is likely that the upcoming regulatory reforms will have a more subtle impact on Canadian banks than on banks elsewhere.

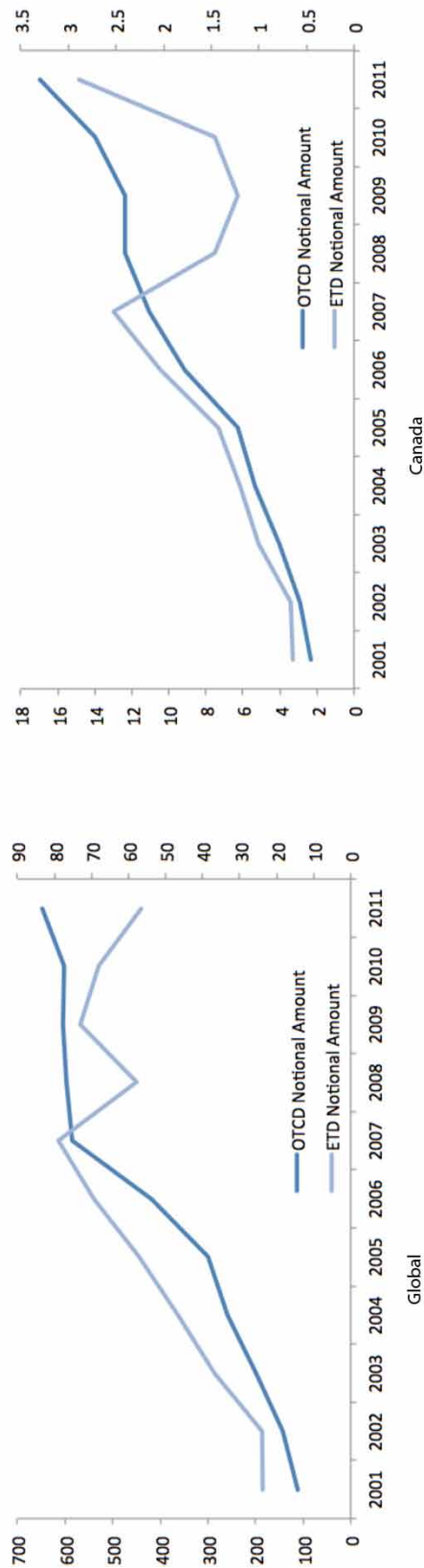
INTRODUCTION

The global Over-the-Counter derivatives (OTCD) market has experienced very rapid growth in recent years; particularly during the first six years of the last decade (see Figure 1). A significant part of this growth was the product of financial deregulation during the late 1990s and early 2000s, which allowed investors to trade customized bilateral contracts that required little or no collateral to guarantee their performance¹. Exchange traded derivatives (ETD), on the other hand, experienced a more moderate growth due to their more strict and standardized terms, which required firms to fully collateralize their exposures; thus, making them relatively more costly to trade.

DOI: 10.4018/978-1-4666-8745-5.ch015

Figure 1. Notional values of the OTCD and ETD Markets (in USD trillions)

Note: OTCD and ETD amounts are represented in the left and right axis, respectively. Global values were obtained from the Bank for International Settlements (2012a). Canadian figures correspond to the six largest banks (RBC, TD, BMO, CIBC, BNS and NBC). Canadian values from 2007 to 2011 were obtained from the Office of the Superintendent of Financial Institutions (OSFI, 2012). Values from 2001 to 2006 were obtained assuming that the share of these six banks represents on average 2.10% and 2.7% of the global OTCD and ETD market, respectively. This assumption is consistent with the data reported by CMIC (2011) and the average share of the Canadian markets since 2007.



11 more pages are available in the full version of this document, which may be purchased using the "Add to Cart" button on the publisher's webpage:

www.igi-global.com/chapter/mind-the-gap-undercollateralization-in-the-global-and-canadian-otcd-markets/135710

Related Content

Data Mining and the Banking Sector: Managing Risk in Lending and Credit Card Activities

Åkos Felsövényi and Jennifer Couran (2008). *Advances in Banking Technology and Management: Impacts of ICT and CRM* (pp. 298-308).

www.irma-international.org/chapter/data-mining-banking-sector/4712

Ideas for Improving the Finance Function

(2022). *Building the High-Performance Finance Function* (pp. 43-55).

www.irma-international.org/chapter/ideas-for-improving-the-finance-function/298719

Macroeconomic Sensitivity, Risk-Return Trade-Off and Volatility Dynamics Evidence From Developed and Developing Markets

Faisal Khan, Hashim Khan, Saif Ur-Rehman Khan, Muhammad Jumaa and Sharif Ullah Jan (2019). *International Journal of Corporate Finance and Accounting* (pp. 1-16).

www.irma-international.org/article/macroeconomic-sensitivity-risk-return-trade-off-and-volatility-dynamics-evidence-from-developed-and-developing-markets/227417

Racial Differences in Financial Socialization and Financial Behaviors of U.S. College Students

Michael S. Gutter, Zeynep Copur and Amanda Blanco (2015). *Banking, Finance, and Accounting: Concepts, Methodologies, Tools, and Applications* (pp. 776-796).

www.irma-international.org/chapter/racial-differences-in-financial-socialization-and-financial-behaviors-of-us-college-students/115363

The Effect of Corporate Governance on Bank Performance Evidence From UAE

Muhamad AbdulAziz Muhamad Saleh Jumaa (2020). *International Journal of Corporate Finance and Accounting* (pp. 16-38).

www.irma-international.org/article/the-effect-of-corporate-governance-on-bank-performance-evidence-from-uae/261857