BEST PRACTICES FOR VALUATION OF COLLATERAL SECURITIES IN CANADIAN REPO TRANSACTIONS

FOR DISCUSSION / COMMENT

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Prepared jointly by CIMPA Collateral Valuations and Haircuts Subgroup Substream and Bank of Canada
Adnann Syed, Allasdair Graham, Andre Zanga, Maksym Padalko

WHY THE BEST PRACTICES ON VALUATIONS?

Core Funding Role

The repo market is key liquidity enabling part of the Canadian financial system

Collateral Valuation Importance

Accurate collateral valuation ensures adequate exposure coverage, competitive funding costs, and builds market trust and resilience

Risk Control and Stability

Robust valuation practices act as critical risk controls to help maintain confidence and stability in the Canadian repo market

Facilitate Entry by International Investors

Help new Canadian repo market participants streamline their collateral management systems

PURPOSE AND APPLICABILITY OF THE BEST PRACTICES

Recommend clear, consistent guidance on pricing and valuation of collateral in Canadian repo transactions

Focus on fixed-income securities in Canadian domestic repo market only. Excludes equity repos for now. NHA MBS securities to be incorporated later

Best practices apply to both non-centrally cleared bilateral and triparty repo transactions

Covers both regular repo (short-term financing with substitutable general collateral) and sell/buyback repo (longer term, typically same securities) transactions

Best Practices should be considered as non-binding guidelines. We strongly encourage CIMPA participants to share within their firms and adopt the guidelines where feasible

1. USE OF RELIABLE AND INDEPENDENT PRICING DATA

Independent Collateral Valuation

Both parties should independently value collateral using high-quality pricing sources for transparency and accuracy

Multiple Pricing Sources

Access to at least two independent pricing providers with waterfall methodology and governance controls around stale prices

Model-based Valuation for Illiquid Securities

Fair-value models with transparent assumptions and additional haircuts support valuation when market prices are unavailable

Repo Dealer as Valuation Agent

Acceptable in dealer-client bilateral repo for the dealer to act as valuation agent provided that pricing source transparency and dispute resolution mechanism are in place

CCMS as Pricing Source

Members of the triparty repo service should use CCMS standard prices for valuation purposes for consistency and efficiency

2. CLEAN, DIRTY, MID, AND BID PRICING PRACTICES

Importance of Price Agreement

Clear agreements on price types prevent disputes and ensure consistent margining practices

Dirty vs Clean Prices

Repo collateral valuation should continue to use dirty prices (clean price plus accrued interest) for collateral valuation

Mid Price Usage

Mid prices are used in the market for neutral valuations that are symmetrical for collateral buyer and seller. May be appropriate for cases where bid prices are overly volatile day-to-day due to data quality.

Bid Pricing Applications

Bid pricing is used for conservative risk management as it approximates collateral liquidation values. Currently used by CCMS for triparty repos, Bank of Canada repo operations and CDCC centrally cleared repos

Recommendation: Use bid prices for bilateral repo participants to align with Bank of Canada, CCMS and CDCC

3. END-OF-DAY VERSUS INTRADAY PRICING

Intraday Pricing in Clearing

Intraday pricing is used for repos cleared through CDCC, enabling timely margin calls and centralized risk management

CCMS triparty uses previous day closing prices for both existing and new repos

End-of-Day Pricing Use

Uncleared bilateral and triparty repos use previous end-of-day prices to balance timeliness with operational efficiency

New Repo vs. Outstanding Repos

For bilateral repos, new repo collateral is valued using same day dirty price. Outstanding repo collateral is valued using previous end of day (16:00 EST) price.

Same day collateral pricing considerations

Not recommending same-day or intraday margining. May increase collateral requirements, costs and system requirements

Recommendation

For bilateral repos, continue to use previous end of day dirty prices using 16:00 EST prices for margining purposes and in case of triparty for new transactions. Incremental risk may be mitigated via haircuts and counterparty credit monitoring

4. COUPON TREATMENT AND COLLATERAL VALUATION ON COUPON DATES

Coupon Payment Adjustments

In Canada, collateral securities are considered legally transferred. Paid coupons must be returned to sellers via passthrough (ie manufactured payment) for regular repos or by Repurchase Amount adjustments at maturity typical for sell/buybacks.

Collateral Overvaluation on Coupon Date Due to Coupon Payment

Collateral to be overvalued on coupon date due to coupon in the dirty price (previous end-of-day) which belongs to collateral seller. Risk may be reduced by haircuts, accepting the one-day risk, or value collateral based on end of day T-1 clean price and interest on T.

Recommendation: Methodology Agreement

Counterparties must decide on the coupon treatment methodology – passthrough, collateral substitution prior to the record date or maturity adjustments for both repo types. For regular repos the recommendation is to use Day T Accrued Interest, i.e., Dirty Price for Day T = Clean Price for end of day T-1 plus Accrued Interest for Day T.

5. MAGIN/HAIRCUT METHOD

Initial Margin or Haircuts Method

In Canada, both Method A (Initial Margin Approach) and Method B (Haircut Approach) are used

Methodology Agreement

Both calculations generate similar collateral amounts for smaller margin/haircuts rates

Slightly higher differences between the two methodologies at higher repo rates

Recommendation: Method B is more popular. Recommend counterparties clearly establish the methodology at repo relationship initiation

NEXT STEPS

Subgroup co-chairs to circulate draft version of best practices note to all CIMPA participants

CIMPA participants should request their firm's *Repo Experts* review the note for comment, to be provided by 30 April.

Revised note to be tabled at next CFIF meeting for committee endorsement

Final version of best practices for Repo Valuation and Pricing to be published on CFIF or CIMPA websites as a Best Practice