

IIROC NOTICE

Rules Notice Guidance Note

Dealer Member Rules

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Regular settlement date to be used for certain foreign exchange hedge trades

Background

The objective of this Guidance Note is to determine for margin purposes the regular settlement date to be used for certain foreign exchange hedge trades. This Guidance Note will be effective on September 5, 2017.

The Notes and Instructions to Schedules 4 and 5 of Form 1 require Dealer Members to provide margin for trades with either *acceptable counterparties* or *regulated entities* (as defined in the General Notes and Definitions to Form 1) on a trade equity deficiency basis, commencing on the regular settlement date of the trade. Dealer Member Rule 800.27 (**DMR 800.27**) sets out “regular settlement dates” for trades involving certain debt and equity securities as follows:



Security type	Regular settlement date
Government of Canada treasury bills	Trade date (T) [DMR 800.27(a)]
Government of Canada bonds (other than treasury bills) having an unexpired term to maturity of three years or less	Two clearing days after trade date (T+2) [DMR 800.27(b)]
Government of Canada bonds (other than treasury bills) having an unexpired term to maturity of longer than three years	Two clearing days after trade date (T+2) [DMR 800.27(c)]
Provincial, municipal, corporation and other bonds or debentures	
Stock	
Other certificates of indebtedness	

The regular settlement date for foreign exchange spot trades is not specified in the IIROC rules. Most foreign spot trades settle on either trade date (**T**) or one clearing day after trade date (**T+1**).

Issue

When a Dealer Member executes an unhedged trade in a foreign currency denominated security, it assumes the following risks on trade date:

- security specific market risk
- foreign exchange risk, since the trade must be settled in a currency other than Canadian dollars.

To address the foreign exchange risk, many Dealer Members enter into a foreign exchange spot trade to lock-in the Canadian dollar amount of the transaction. In most cases the trade date and settlement date for the foreign exchange spot trade will be the same as those of security transaction being hedged (i.e., T and T+2, respectively, for a foreign exchange hedge of a stock trade).

For margin purposes, the question that arises is what is the “regular settlement date” for these foreign exchange hedge trades? Should it be: T+1, the settlement date for most foreign exchange spot trades; or the regular settlement date for the security transaction that is being hedged (i.e., T+2 for a foreign exchange hedge of a stock trade)?



Guidance

In the absence of a specifically defined “regular settlement date” in the IIROC rules for foreign exchange spot trades, we are of the view, that for margin purposes, that the “regular settlement date” to be used for the following foreign exchange spot trades is to be one of the following:

- T+2, where the trade has been entered into in order to hedge the foreign exchange risk associated with a trade in a foreign currency denominated security that is listed in DMR 800.27(c) and the trade date for the foreign exchange spot trade is the same as the trade date of the foreign currency denominated security
- T+2, where the trade has been entered into in order to hedge the foreign exchange risk associated with a trade in a foreign currency denominated security that is listed in DMR 800.27(b) and the trade date for the foreign exchange spot trade is the same as the trade date of the foreign currency denominated security
- T+1, in all other instances.

Subsequent to this “regular settlement date”, where the counterparty to the foreign exchange spot trade is either an *acceptable counterparty* or a *regulated entity*, the trade must be margined on an equity deficiency¹ basis, in accordance with the Notes and Instructions to Schedules 4 and 5 of Form 1.

¹ “Equity deficiency” is the difference between (a) the net market value of all settlement date security positions in the customer’s account(s) and (b) the net money balance on a settlement date basis in the same account(s).