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Contact:  
Answerd Ramcharan  
Specialist, Regulatory Policy  
(416) 943-5850  
aramcharan@ida.ca

For distribution to relevant parties within your firm

**BULLETIN #3618**  
April 11, 2007

## **By-Laws and Regulations**

### **Amendments to Statements B and C of Form 1 – Custodial Agreements**

The Board of Directors of the Association has approved amendments to the Notes and Instructions to Statement B of Form 1, Statement C and its accompanying Notes and Instructions to Form 1 (the amendments). The amendments are effective April 1, 2007 and are enclosed.

The objective of the amendments is to modify the capital requirements that result when a Member has failed to enter into a written custodial agreement with an entity that would otherwise qualify as an acceptable securities location. The revised capital requirements are more reflective of the risk of loss to Members as a result of lodging securities with these entities and not having a written custodial agreement with them. Previously, the capital requirements for not having a written custodial agreement with these entities were overly conservative as Members had to provide, out of their capital, the market value of these lodged securities plus the securities' normal margin to cover this risk.

Kenneth A. Nason  
*Association Secretary*

**INVESTMENT DEALERS ASSOCIATION OF CANADA**

**AMENDMENTS TO STATEMENTS B AND C OF FORM 1 –  
CUSTODIAL AGREEMENTS**

THE BOARD OF DIRECTORS of the Investment Dealers Association of Canada hereby makes the following amendments to the By-laws, Regulations, Forms and Policies of the Association:

1. The Notes and Instructions to Statement B of Form 1 and Statement C (and accompanying notes) of Form 1 are hereby repealed and replaced as set out in Attachment #2.

PASSED AND ENACTED BY THE Board of Directors this 23rd day of October 2002, to be effective on a date to be determined by Association staff.

**STATEMENT B  
NOTES AND INSTRUCTIONS**

EACH MEMBER SHALL HAVE AND MAINTAIN AT ALL TIMES RISK ADJUSTED CAPITAL IN AN AMOUNT NOT LESS THAN ZERO.

**Line 4 - Minimum capital**

“Minimum capital” is \$250,000 (\$75,000 for Type 1 introducing brokers).

**Line 9 - Syndicate and joint trading accounts**

This line should include margin requirement for syndicate accounts where the firm is the lead underwriter and joint trading accounts. If the firm has “drawn down” a portion of the new issue positions from the syndicate account to its inventory accounts, those portions should be disclosed as firm’s inventory and be included in Schedules 2 and possibly 2B. If the firm is not the lead underwriter but a Banking Group member, margin requirement should be reported on Schedule 2.

If the other syndicate member is a Regulated Entity, a related company of the Member firm, or an Acceptable Institution, then no margin need be provided by the firm. In the case of an Acceptable Counterparty the amount of margin to be provided, **commencing on regular settlement date** (i.e. the contracted settlement date as specified for that issue), shall be the equity deficiency of (a) the net market value of all settlement date security positions in the entity’s accounts and (b) the net money balance on a settlement date basis in the same accounts. For all other parties the amount of margin to be provided by the firm, **commencing on regular settlement date**, shall be the margin deficiency, if any, that exists in the account.

**Line 13 - Contingent liabilities**

No firm may give, directly or indirectly, by means of a loan, guarantee, the provision of security or of a covenant or otherwise, any financial assistance to an individual and/or corporation unless the amount of the loan, guarantee, provision of security or of the covenant or any other assistance is limited to a fixed or determinable amount and the amount is provided for in computing Risk Adjusted Capital. The margin required shall be the amount of the loan, guarantee, etc. less the loan value of any accessible collateral, calculated in accordance with the rules and regulations of the Joint Regulatory Bodies. A guarantee of payment is not acceptable collateral to reduce margin required.

Details of the margin calculations for contingencies such as guarantees or returned cheques should be provided as an attachment to this Statement.

**Line 18 – Securities held at non-acceptable securities locations**

Capital Requirements

In general, the capital requirements for securities held in custody at another entity are as follows:

- (i) Where the entity qualifies as an acceptable securities location, there shall be no capital requirement, provided there are no unresolved differences between the amounts reported on the books of the entity acting as custodian and the amounts reported on the books of the Member firm. The capital requirements for unresolved differences are discussed separately in the notes and instructions for the completion of Statement B, Line 20 below.
- (ii) Where the entity does not qualify as an acceptable securities location, the entity shall be considered a non-acceptable securities location and the Member firm shall be required to deduct 100% of the market value of the securities held in custody with the entity in the calculation of its Risk Adjusted Capital.

However, there is one exception to the above general requirements. Where the entity would otherwise qualify as an acceptable securities location except for the fact that the Member firm has not entered into a written custodial agreement with the entity, as required by the by-laws, rules and regulations of the Joint Regulatory Authorities, the capital requirement shall be determined as follows:

- (a) Where setoff risk with the entity is present, the Member firm shall be required to deduct the

## Attachment #2

lesser of:

- (I) 100% of the setoff risk exposure to the entity; and
  - (II) 100% of the market value of the securities held in custody with the entity;
- in the calculation of its Risk Adjusted Capital;

and;

- (b) The Member firm shall be required to deduct 10% of the market value of the securities held in custody with the entity in the calculation of its Early Warning Reserve.

The sum of the requirements calculated in paragraphs (a) and (b) above shall be no greater than 100% of the market value of the securities held in custody with the entity. Where the sum amounts initially calculated in paragraphs (a) and (b) above are greater than 100%, the capital required under paragraph (b) and the amount reported as a deduction in the calculation of the Early Warning Reserve shall be reduced accordingly.

For the purposes of determining the capital requirement detailed in paragraph (a) above, the term "setoff risk", shall mean the risk exposure that results from the situation where the Member firm has other transactions, balances or positions with the entity, where the resultant obligations of the Member firm might be setoff against the value of the securities held in custody with the entity.

### Client Waiver

Where the laws and circumstances prevailing in a foreign jurisdiction may restrict the transfer of securities from the jurisdiction and the Member is unable to arrange for the holding of client securities in the jurisdiction at an acceptable securities location, the Member may hold such securities at a location in that jurisdiction if (a) the Member has entered into a written custodial agreement with the location as required hereunder and (b) the client has consented to the arrangement, acknowledged the risks and waived any claims it may have against the Member, in a form approved by the Joint Regulatory Authority. Such a consent and waiver must be obtained on a transaction by transaction basis.

### **Line 20 - Unresolved Differences**

Items are considered unresolved unless:

- (i) a written acknowledgement from the counterparty of a valid claim has been received, and
- (ii) a journal entry to resolve the difference has been processed as of the Due Date of the questionnaire.

This does not include journal entries writing off the difference to profit or loss in the period subsequent to the date of the questionnaire.

Provision should be made for the market value and margin requirements at the questionnaire date on out of balance short securities and other adverse unresolved differences (e.g. with banks, trust companies, brokers, clearing corporations), still unresolved as at a date one month subsequent to the questionnaire date or other applicable Due Date of the questionnaire.

The margin rate to be used is the one that is appropriate for inventory positions. For instance, if the calculation is for securities eligible for reduced margin, the margin rate is 25%, rather than 30%.

A separate schedule, in a form approved by the Joint Regulatory Authority, must be prepared detailing all unresolved differences as at the report date.

The following guidelines should be followed when calculating the required to margin amount on unresolved items:

<i>Type of Unresolved Difference</i>	<i>Amount Required to Margin</i>
Money balance - credit (potential gains)	None
- debit (potential losses)	Money balance

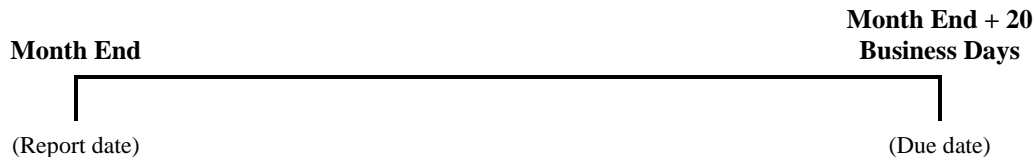
**Attachment #2**

<i>Type of Unresolved Difference</i>	<i>Amount Required to Margin</i>
Unresolved Long with Money on the Member's Book	[(Money Balance on the trade minus market value of the security)* plus the applicable inventory margin]
Unresolved Long without Money on the Member's Books	None
Unresolved Short with Money on the Member's Books	[(Market value of the security minus money balance on the trade)* plus the applicable inventory margin]
Unresolved Long/Short on the Other Broker's Books	None
Short Security Break (e.g. Mutual Funds, Stock Dividends) or Unresolved Short without Money on the Member's Books	[Market value of the security plus the applicable inventory margin]

\* also referred to as the Mark to Market Adjustment.

Where mutual fund positions are not reconciled on a monthly basis, margin shall be provided equal to a percentage of the market value of such mutual funds held on behalf of clients. Where no transactions in the mutual fund, other than redemptions and transfers, have occurred for at least six months and no loan value has been associated with the mutual fund, the percentage shall be 10%. In all other cases, the percentage shall be 100%.

**Unresolved Differences in Accounts:** Report all differences determined on or before the report date that have not been resolved as of the due date.



**Include** differences determined on or before the report date that have not been resolved as of the due date.

**Do not include** differences as of the report date that have been resolved on or before the due date.

For each account listed, set out the number of unresolved differences and the money value of both the debit and credit differences. The Debit/Short value column includes money differences and market value of security differences, which represent a potential loss. The Credit/Long value column includes money differences and market value of security differences, which represent a potential gain. In determining the potential gain or loss, the money balance and the security position market value of the same transaction should be netted. Debit/short and credit/long balances of different transactions cannot be netted.

All reconciliation must be properly documented and made available for review by the Vice-President, Financial Compliance and Member's Auditor.

**Unresolved differences in Security Counts:** Report all security count differences determined on or before the report date that have not been resolved as of due date. The amount required to margin is the market value of short security differences plus the applicable inventory margin.

**Line 21 - Other**

This item should include all margin requirements not mentioned above as outlined in the bylaws, rules and regulations of the Joint Regulatory Bodies and the Canadian Investor Protection Fund.

DATE: \_\_\_\_\_

**PART I**  
**JOINT REGULATORY FINANCIAL QUESTIONNAIRE AND REPORT**

\_\_\_\_\_  
(Firm Name)

**STATEMENT OF EARLY WARNING EXCESS AND EARLY WARNING RESERVE**

REFERENCE	CURRENT YEAR
1. B-27 RISK ADJUSTED CAPITAL	\$ _____
2. LIQUIDITY ITEMS -	
<b>DEDUCT:</b>	
A-19 (a) Other allowable assets	-----
Sch.6A (b) Tax recoveries	-----
(c) Securities held at non-acceptable securities locations	-----
<b>ADD:</b>	
A-66 (d) Long term liabilities	-----
Sch.6A (e) Tax recoveries - income accruals	-----
3. EARLY WARNING EXCESS	\$ _____
4. <b>DEDUCT: CAPITAL CUSHION -</b>	
B-22 Total margin required \$_____ multiplied by 5%	\$_____
5. EARLY WARNING RESERVE [line 3 less line 4]	\$ _____

**NOTES:**

The Early Warning system is designed to provide advance warning of a Member firm encountering financial difficulties. It will anticipate capital shortages and/or liquidity problems and encourage firms to build a capital cushion.

**Line 1** - If Risk Adjusted Capital of the firm is less than:

- (a) 5% of total margin required (line 4 above), then the firm is designated as being in Early Warning category **Level 1**, or
- (b) 2% of total margin required (line 4 above), then the firm is designated as being in Early Warning category **Level 2**,

and the applicable sanctions outlined in the bylaws, rules and regulations of the Joint Regulatory Bodies and the Canadian Investor Protection Fund will apply.

**Lines 2(a) and (b)** - These items are deducted from RAC because they are illiquid or the receipt is either out of the firm's control or contingent.

**Line 2(c)** - Pursuant to the Notes and Instructions for the completion of Statement B, Line 18, where the entity would otherwise qualify as an acceptable securities location except for the fact that the Member firm has not entered into a written custodial agreement with the entity, as required by the by-laws, rules and regulations of the Joint Regulatory Authorities, the Member firm will be required to deduct an amount up to 10% of the market value of the securities held in custody with the entity, in the calculation of its Early Warning Reserve. Please refer to the detailed calculation formula set out to the Notes and Instructions for the completion of Statement B, Line 18 to determine the capital requirement to be reported on Line 2(c).

## **Attachment #2**

**Line 2(d)** - Long term liabilities are added back to RAC as they are not current obligations of the firm and can be used as financing.

**Line 2(e)** - This add back ensures that the firm is not penalized at the Early Warning level for accruing income. The net result is that the firm is in the same position as if the revenue were treated on a cash basis.

**Line 3** - If Early Warning Excess is negative, the firm is designated as being in Early Warning category **Level 2** and the sanctions outlined in the applicable bylaws, rules and regulations of the Joint Regulatory Bodies and the Canadian Investor Protection Fund will apply.

**Line 5** - If the Early Warning Reserve is negative, the firm is designated as being in Early Warning category **Level 1** and the sanctions outlined in the applicable bylaws, rules and regulations of the Joint Regulatory Bodies and the Canadian Investor Protection Fund will apply.