

IIROC NOTICE

Rules Notice
Request for Comments
Dealer Member Rules

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12-0042
February 3, 2012

**Plain language rule re-write project –
Dealer Member Margin Rules,
Rules 5100 through 5800**

Summary of the nature and purpose of the proposed Rules

On June 24, 2010, the Board of Directors (“the Board”) of the Investment Industry Regulatory Organization of Canada (“IIROC”) approved the publication for comment of the proposed 5000 series of plain language rules (collectively referred to as the “proposed Rules”).

IIROC has undertaken a project to rewrite its rules in plain language. The primary objective of this project is to develop a set of rules that is clearer and more concise and organized, without changing the rules themselves. In addition, we have identified a number of rules that also require substantive revisions.

The new rules will be submitted to the Board and issued for public comments in 8 tranches. The fifth tranche submitted to the Board and issued for public comments includes the following eight sets of substantive and non-substantive change rules:

Rule number and title	Rule type
Rule 5100, “Margin requirements – Application and definitions”;	Substantive
Rule 5200, “Margin requirements for debt securities and mortgages”;	Substantive
Rule 5300, “Margin requirements for equity securities and index products”;	Substantive
Rule 5400, “Margin requirements for other investment products”;	Non-substantive
Rule 5500, “Margin requirements for underwriting commitments and when issued trading”;	Non-substantive
Rule 5600, “Margin requirements for offset strategies involving debt and equity securities and related instruments”; and	Non-substantive
Rule 5700, “Margin requirements for offset strategies involving derivative products”	Substantive
Rule 5800, “Account related agreements”;	Non-substantive

The existing margin rules have been identified as requiring substantive revision in order to:

- eliminate unnecessary rule provisions;
- clarify IIROC’s expectations with respect to certain rules;
- ensure that the rules reflect current industry practices;
- ensure consistency with other IIROC Dealer Member rules; and
- streamline the decision making and rule interpretation process.

Intention and organization of each of the proposed Rules

The intention of proposed Rule 5100, “Margin requirements – Definitions and application”, is to bring together all margin related definitions into one rule and to provide guidance on the application of the margin requirements. The rule brings together the current definitions and application provisions set out in IIROC Dealer Member Rules 1.1, 17.11, 27.1, 100.1, 100.2, 100.4C, 100.4E, 100.4F, 100.4G, 100.4H, 100.4I, 100.5, 100.7, 100.9, 100.10, 100.11, 100.12, 100.18 and 100.19 and Form 1, Schedule 4. There are no substantive changes being introduced in this rule.

The intention of proposed Rule 5200, “Margin requirements for debt securities and mortgages”, is to bring together all of the current margin requirements relating to un-hedged positions in fixed income investment products. The requirements are largely unchanged but have been re-organized in order to present separately and in a more organized fashion the margin requirements for government debt, corporate debt and debt in default. This rule brings together the current requirements set out in IIROC Dealer Member Rules 100.2(a), 100.2(b), 100.2(c), 100.2(e), 100.2(h) and 100.3.

The intention of proposed Rule 5300, “Margin requirements for equity securities and index products”, is to bring together all of the current margin requirements relating to un-hedged positions in equity and index investment products. The requirements are largely unchanged but have been re-organized in order to present separately and in a more organized fashion the margin requirements for equity securities, installment receipts, convertible and exchangeable equities, control blocks, rights and warrants and index



products. This rule brings together the current requirements set out in IIROC Dealer Member Rules 100.2(f), 100.7, 100.9, 100.10, 100.12, 100.18 and 100.21.

The intention of proposed Rule 5400, “*Margin requirements for other investment products*”, is to bring together all of the current margin requirements relating to un-hedged positions in other investment products. The requirements are largely unchanged but have been re-organized in order to present separately and in a more organized fashion the margin requirements for securities subject to redemption call or offer, units, precious metals certificates and bullion, swap contracts, mutual fund positions and foreign exchange positions. This rule brings together the current requirements set out in IIROC Dealer Member Rules 100.2(d), 100.2(g), 100.2(i), 100.2(j), 100.2(k), 100.2(l) and 100.13. There are no substantive changes being introduced in this rule.

The intention of proposed Rule 5500, “*Margin requirements for underwriting commitments and when issued trading*”, is to bring together all of the current requirements relating to primary distributions and trading in advance of the commencement of secondary market trading. The sections describing the margin requirements for underwritings have been revised in an attempt to clarify. Specifically, the requirements for underwritings where a new issue letter has not been obtained [Section 5620] are now presently separately from the requirements for underwritings where a new issue letter has been obtained [Section 5621]. The sections describing the margin requirements for when issued trading are unchanged. This rule brings together the current requirements set out in IIROC Dealer Member Rules 100.5, 100.6, 100.10 and 100.19. There are no substantive changes being introduced in this rule.

The intention of proposed Rule 5600, “*Margin requirements for offset strategies involving debt and equity securities and related instruments*”, is to bring together all of the current requirements for basic offset strategies involving debt and equity securities. For offsets involving only debt securities, the margin requirements for government debt offsets, corporate debt offsets and offsets involving government debt and corporate debt are presented separately. Further, in order to quickly find the requirement that relates to a particular offset strategy, offset reference tables have been included at the front of each section of the rule. This rule brings together the current requirements set out in IIROC Dealer Member Rules 100.2A, 100.4A, 100.4B, 100.4C, 100.4D, 100.4E, 100.4F, 100.4G, 100.4H, 100.4I, 100.4K and 100.13. There are no substantive changes being introduced in this rule.

The intention of proposed Rule 5700, “*Margin requirements for offset strategies involving derivative products*”, is to bring together all of the current requirements for offset strategies involving derivative products. The requirements have been categorized as general requirements, exchange-traded option requirements and over-the counter option requirements. Specific to the requirements for exchange-traded options, the option offset rules have been rewritten such that one rule applies to both client and Dealer Member offset strategies for both equity and index options. This rule brings together the current requirements set out in IIROC Dealer Member Rules 100.8, 100.9, 100.10 and 100.11.

The intention of proposed Rule 5800, “*Account related agreements*”, is to bring together all of the current transaction and account related agreements, including required minimum agreement terms, into one rule. The rule addresses cash and securities loan, cross-guarantee, guarantee, hedge, limited recourse call loan,



subordinated loan and underwriting agreements. The rule brings together the current requirements set out in IIROC Dealer Member Rules 29, 100.4H, 100.5, 100.15, 100.15A and 2200. There are no substantive changes being introduced in this rule.

Issues and specific proposed amendments

Current rules

Other than the proposed substantive revisions set out below, the proposed 5000 series of rules does not create any new obligations for Dealer Members.

Proposed rules

In addition to the plain language rewrite of the existing requirements to create proposed Rules 5100 through 5800, the following substantive amendments are proposed:

- *When to extend margin to clients* – A new provision has been added to specifically set out the steps a Dealer Member must take in deciding whether to allow a client to trade on margin. [5111(1)]
- *When a margin rate or requirement is not specified with the IIROC rules* – A new provision has been added to require that a Dealer Member obtain a margin ruling from IIROC staff when the margin treatment for a particular investment product is not specified within the IIROC rules. [5120(1)]
- *Definition of the term “exempt purchaser”* – A definition for the term “exempt purchaser” has been introduced to codify the category of accredited investors for which reduced margin can be provided where there are documented expressions of interest for an underwriting commitment.
- *Government debt redemptions* – A new provision (based on the current general requirements for redemptions set out in Rule 100.13) has been added to specifically set out the margin requirements for government debt called for redemption. The provision effectively allows the debt to be margined as short-term debt. [5210(4)]
- *Other non-commercial debt redemptions* – A new provision (based on the current general requirements for redemptions set out in Rule 100.13) has been added to specifically set out the margin requirements for other non-commercial debt called for redemption. The provision effectively allows the debt to be margined as short-term debt. [5214(2)]
- *Commercial debt margin requirements* – Currently, there are separate sets of margin rates for two distinct categories of commercial debt [current Rules 100.2(a)(v) and 100.2(a)(vi)], yet the margin rates themselves are materially the same, with the exception of the rates that apply to short-term debt. The proposed rules adopt one set of rates for the margining of commercial debt. [5220(1)]
- *Bank paper margin requirements* – Currently, the margin requirements for bank paper do not contemplate the situations where the bank paper issue has a low credit rating and/or where the bank paper has declined significantly in value. The proposed rules establish a 50% margin requirement for bank paper trading at or below 50% of par or with a low credit rating (which is the same as the current requirement for other corporate debt). [5222(1)]



- *Corporate strip and residual margin requirements* – The margin rates applicable to corporate strips and residuals have been amended to reflect the changes to the commercial debt margin requirements [the amendments detailed in 5220(1) as discussed above]. [5223(1)]
- *Government guaranteed equity security margin requirements* – The existing margin treatment for Dealer Member inventory positions in government guaranteed equity securities has been extended to client account positions. [5313(1)]
- *Floating rate preferred share margin requirements* – The existing margin treatment for Dealer Member inventory positions in floating rate preferred shares has been extended to client account positions. [5314(1)]
- *Requirement for client to write listed options in a margin account* - A new requirement to write exchange traded options for a client in a margin account has been added. This is already a requirement for over-the-counter options and reflects current practice. [5710(1)]
- *Requirement for client account option offset strategies* - A new requirement for customers with offset strategies involving long and short options, that the short option must expire on or before the long option, has been added. This is a current requirement for specific offset strategies, but not all. [5712(1)]

The full text of the proposed plain language 5000 series of Dealer Member Rules is attached.

Rule-making process

IIROC Staff involved representatives of Dealer Members in the rule development process, through preliminary consultations. Every rule in the proposed 5000 series of rules was available to all Dealer Members for their input through a Members-only website. The Financial Administrators Section and its Capital Formula Sub-committee also reviewed and provided comment on all substantive change rules within the proposed 5000 series of rules. A number of changes to the draft proposal were made in response to the comments IIROC received through these consultations.

The proposed Rules were approved for publication by the IIROC Board of Directors on June 24, 2010.

The text of proposed plain language 5000 series of rules is set out in Attachment A. The text of the existing Dealer Member Rules to be repealed is set out in Attachment B. A table of concordance is included as Attachment C.

Issues and alternatives considered

An alternative to the inclusion of the substantive amendments being proposed was to leave the rules substantively as they were prior to the plain language rewrite. IIROC staff considered other pending projects and proposals as well as the extent of the potential substantive changes identified in order to decide which of the substantive changes would be proposed as part of the plain language rule rewrite project. Those substantive changes that were originally identified as part of the plain language rule rewrite project, but which were ultimately excluded from the plain language rewrite project will be pursued as separate rulemaking projects.



Proposed Rule classification

Statements have been made elsewhere as to the nature and effects of the proposed Rules. The purposes of the proposed Rules are to:

- Ensure compliance with securities laws;
- Prevent fraudulent and manipulative acts and practices;
- Promote just and equitable principles of trade and emphasize the duty to act fairly, honestly and in good faith;
- Foster cooperation and coordination with entities engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities;
- Foster fair, equitable and ethical business standards and practices; and
- Promote the protection of investors.

IIROC staff proposes that the margin rules should be rewritten to reflect actual IIROC expectations, to enhance the clarity of the rule, to ensure consistency with other IIROC Dealer Member rules and to streamline the decision making and rule interpretation process. These amendments are in addition to the plain language rewrite of the existing rule provisions. The Board has determined that the proposed amendments are not contrary to the public interest.

Due to the extent and substantive nature of these proposed amendments, they have been classified as Public Comment Rule proposals.

Effects of proposed Rule on market structure, Dealer Members, non-members, competition and costs of compliance

With the proposed 5000 series of plain language Rules, Dealer Members and investors will benefit from the enhanced clarity and certainty in the proposed Rules relating to margin requirements.

The proposed Rules will not have any significant effects on Dealer Members or non-Dealer Members, market structure or competition. Furthermore, it is not expected that there will be any significant, increased costs of compliance as a result of the proposed Rules.

The proposed Rules do not impose any burden or constraint on competition or innovation that is not necessary or appropriate in the furtherance of IIROC's regulatory objectives. The proposed Rules do not impose costs or restrictions on the activities of market participants that are disproportionate to the goals of the regulatory objectives sought to be realized.

Technological implications and implementation plan

There should not be significant technological implications for Dealer Members as a result of the proposed amendments. The proposed 5000 series of plain language Rules will be implemented at the same time as the rest of the plain language rules.



Request for public comment

Comments are sought on the proposed amendments. Comments should be made in writing. Two copies of each comment letter should be delivered within 90 days of the publication of this notice. One copy should be addressed to the attention of:

Richard J. Corner
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Investment Industry Regulatory Organization of Canada
(416) 943-6908
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A second copy should be addressed to the attention of:

Manager of Market Regulation
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario
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marketregulation@osc.gov.on.ca

Those submitting comment letters should be aware that a copy of their comment letter will be made publicly available on the IIROC website (www.iiroc.ca under the heading “IIROC Rulebook - Dealer Member Rules - Policy Proposals and Comment Letters Received”).

Questions may be referred to:

Richard J. Corner
Vice President, Member Regulation Policy
Investment Industry Regulatory Organization of Canada
(416) 943-6908
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Attachments

- [Attachment A](#) - Text of the proposed 5000 series of rules
- [Attachment B](#) - Text of the existing relevant provisions of Dealer Member Rules 1, 17, 27, 100, and 2200
- [Attachment C](#) - Table of concordance