Member of the Investment Industry Regulatory Organization of Canada

April 16, 2015

Mr. Bruce Grossman
Senior Information Analyst
Member Regulation Policy
IIROC
121 King Street West, Suite 2000
Toronto, ON M5H 3T9

Dear Mr. Grossman,

Subject: Rules notice 14-0298 - *Proposed amendments to the Dealer Member Rules 100 and 1200 and to Form 1 relating to the client free credit cash usage limit, client free credit segregation, and securities concentration test* ("Proposed Amendments")

Casgrain & Company Limited appreciates the opportunity to provide comments to the Investment Industry Regulatory Organization of Canada ("IIROC") on its Proposed Amendments published on December 18, 2014 in its IIROC Notice 14-0298. Our comments are provided for all questions of IIROC Notice 14-0298:

A) Do you agree with the fundamental concept of the rule amendment that the client free credit cash usage limit should be based solely upon a liquid capital measure, and that the best liquid capital measure is early warning reserve (EWR)? Further, do you agree that the proposed change to the client free credit usage limit strikes a proper balance between margin lending usage and other usages?

   While we support IIROC's views that the usage of a capital ratio based on a capital liquid measure such as the EWR is an appropriate method to limit client free credit cash usage, we believe that restricting the usage of clients' free credit balance provides better protection for investors.

   For member dealers involved in margin lending who operate with lower levels of EWR compared to their client free credit, we are concerned that, although IIROC has in place strict and extensive requirements governing margin lending activity, the increase to 20 times the EWR could increase investors' risks as well as industry risk. However, we do recognize that the EWR can be a volatile measure and unduly limits the free credit usage. If this 20X the EWR is triggered, we suggest that IIROC considers requiring that the free credit cash usage calculation be performed at least twice a week compared to what is currently being suggested and that any deficiency be corrected in three business days instead of five business days. This is in light of the fact that it is a more risky situation for the member.

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B) Do the proposed changes to the eligibility criteria for securities that may be invested in for client free credit segregation purposes adequately meet the objective of raising the eligibility standards?

No, we believe that securities invested in for client free credit segregation should be limited to securities that the industry considers as risk free such as securities issued by governments (federal and provincial) or guaranteed by these governments. Canadian bank paper is not considered a risk-free product by the market and we are concerned that a bank-owned dealer may invest in its Parent Bank paper for segregation purposes. In addition, it is to be remembered that, the Financial Stability Board headed by the Governor of the Bank of England Governor Mark Carney (and former Bank of Canada Governor), is imposing extra capital and living will measures on financial institutions (including banks) which are considered Too Big to Fail. Such measures are imposed as banks are not considered risk-free credits.

C) The proposed amendments include changes to the client free credit cash usage monitoring requirements (e.g. minimum weekly calculations of client free credit limit and segregation requirements, and five business days for correcting any client free credit segregation deficiencies) that are intended to align these requirements with established IIROC internal control requirements regarding capital adequacy monitoring, and the treatment of segregation deficiencies. Do you have any specific issue or concern with the proposed client free credit cash usage monitoring requirements?

No, we are in agreement with IIROC's proposal. Moreover, Rule 1200.4 already provides the amount required to be segregated to be determined on a weekly basis.

D) Should the proposed amendments to the client free credit segregation requirements be accompanied by the proposed amendments to the securities concentration test? If so, do the proposed amendments adequately address concentration risk for debt securities with a normal margin rate of 10% or less, by focusing on corporate debt securities (excluding Canadian bank paper maturing within 1 year) and higher yield non-commercial debt securities?

We do not agree with IIROC's Proposed Amendments that client free segregation requirements be accompanied by the proposed amendments to include corporate debt securities with normal margin requirements of 10% or less as part in the concentration test for the following reasons:

- The main reason for IIROC's proposed amendments to the securities concentration test is to create a direct relationship with the client free credit segregation rule as concentration charges will affect a firm's EWR, which in turn is used to calculate the client free credit segregation requirement.

- Another reason invoked by IIROC is that these changes are needed because in its view, a dealer member may seek to maximize the spread on income yield by investing client free credit in corporate debt securities without any consideration for concentration risk. We do not share IIROC's views on this as not all dealer members rely on such a strategy. In addition, dealer members have in place proper market and credit risk management policies and procedures to properly address corporate debt securities concentration risk. As mentioned above, we feel that the best method to protect investors and the industry's reputation from the misusage of client free credit cash is to restrict it.

- For dealer members that do not have client free credit balances on their books due to the nature of their business (institutional RVP/DVP accounts), the proposed amendment to the securities concentration test puts them at a disadvantage as concentration capital charges on debt securities will negatively affect their EWR and other ratios based on risk adjusted capital and EWR while there will be no positive impact on the client free credit segregation requirements.

- The proposed amendment applies to all corporate debt securities that are margined at 10% or less, and not simply to the more volatile or riskier corporate debt securities.

In the event that IIROC still decides to follow through with its proposed amendments to the securities concentration test, we suggest that IIROC considers the following comments:

- Unlike equities where the number of any single security or group of related securities issued from the same issuer is generally limited, the global debt securities market is more vast. As part of its trading portfolio, the number of positions (long and short) a dealer member may have in debt securities of a single issuer is much larger than in positions in equities issued by the same issuer. Because regulatory offsets are based on maturity band and credit ratings, long or short positions in corporate debt securities of a same issuer will be more subject to trigger concentration charges due to their higher loan value, their weighting in calculating the aggregate amount loaned and the fact that they do not qualify easily for offset, although for market and credit risk purposes, a dealer member may be properly hedged on a VAR basis. It is worth mentioning that it is more difficult to offset positions in corporate debt securities of a single issuer compared to common stocks of a same issuer (in general there are few categories of equity securities issued by a same issuer), and where offset is possible, the margin required is greater than the margin on the long or short position, and not on the offset position. Therefore, we suggest that the calculation of the amount loaned for corporate debt securities of a same issuer be calculated on the net position regardless of the positions qualified for offset. Moreover, the EWR has already been impacted by the margin provided on these non-off-settable positions.

- Another reason for supporting the netting of short debt securities positions with long positions of a same issuer regardless of debt maturity , is that the market price risk (sensitivity to an increase in the pricing of a security) on a short equity position is theoretically unlimited, which may expose a dealer member to substantial financial losses. For a short debt securities position, the price risk is limited to the market's lower interest rate environment and the credit spread of the issuer (very unlikely that a corporate debt would trade at a negative yield to maturity). In addition, the credit risk on short debt securities positions is totally remote. These arguments support for allowing the netting of debt securities position of a same issuer regardless of its maturity in the calculation of the "amount loaned" under the securities concentration test.

  Asking this basic question outlines the situation:

  Are $12 M in common shares of a major Canadian bank riskier than $12 M in 5 year senior deposit notes of a major Canadian bank?

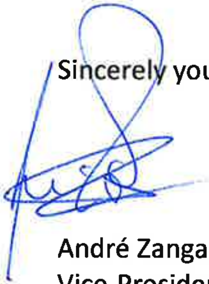
The answer underlies the basic principle in securities regulation that equities are riskier than debt and that is why we believe that corporate debt securities with a margin of 10% or less should be excluded from the concentration test as is currently the case.

- Another alternative would be to subject debt securities to the concentration charges test only if they are not investment grade (a credit rating lower than BBB) or if they trade at a deep discount such as 20% of face value.

- In its amendment proposal, IIROC proposes an adjustment factor in the calculation of the "amount loaned" to debt securities that mature within three years in recognition of their lower risk. We believe that for the above reasons, and the fact that positions in debt securities are significantly larger than in equity positions and that higher loan value securities are given higher weightings in calculating the aggregate amount loaned, the adjustment is too restrictive and should apply to all debt securities subject to concentration charges.

We thank you once again for the opportunity of providing comment on these important proposed amendments relating to the client free credit cash usage limit, client free credit segregation requirements, and securities concentration test. We remain available for further discussion at your convenience.

Sincerely yours,



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