

IIROC NOTICE

Rules Notice

Notice of Approval/Implementation Dealer Member Rules [IIROC Rules]

Please distribute internally to:

Internal Audit
Legal and Compliance
Operations
Regulatory Accounting
Senior Management

Contact:

Catherine Drennan

Manager, Financial Information, Member Regulation Policy

416-943-6977

cdrennan@iiroc.ca

19-0212

December 12, 2019

Amendments to IIROC Dealer Member Rule 1200.3 and Notes to Statement D of Form 1 regarding free credit cash segregated in trust for clients

Executive Summary

The applicable securities regulatory authorities have approved amendments to IIROC Dealer Member Rule (**DMR**) 1200.3 [IIROC Rule section 4384]¹ and Notes to Statement D (Statement of Free Credit Segregation Amount) of Form 1 (**Notes to Statement D**), regarding free credit cash segregated in trust for clients (collectively, the **Amendments**), which were published for comment in [Notice 19-0155](#).

The main purpose of the Amendments is to remove the inconsistency between the language used to describe the same trust arrangement in DMR 1200.3 and Notes to Statement D, and to ensure that the trust arrangement is appropriately identified at the acceptable institution.

We are concurrently publishing a Guidance Note, which clarifies our expectations for the trust account agreement with the acceptable institution (see [Notice 19-0213](#)).

¹ To assist readers, we reference applicable IIROC Rules provisions (see [Notice 19-0144](#) – IIROC Dealer Member Plain Language Rule Book Implementation). Since the IIROC Rules are not yet effective, we shared these references in grey. The shading will be removed when the IIROC Rules are effective.



1. Discussion of Amendments

1.1 Relevant background

Dealers may use client free credit cash balances in their business within certain limits prescribed by DMR 1200 and Statement D of Form 1. The limits are based on a Dealer's early warning reserve and client margin loans. If the free credit balances exceed the limits, the Dealer is required to segregate the excess amount in one or both of these options:

- a separate investment such as bank paper or government securities
- a separate bank account "in trust" for the clients.

The purpose of segregating free credit cash balances is to protect clients in the event of a Dealer's insolvency. If the Dealer became insolvent, the segregated cash would become the property of the trustee in bankruptcy and be included in the customer pool.

A Dealer normally holds free credit cash in a separate account at an acceptable institution when segregation is required. This account is labelled as being "in trust" for the benefit of clients, creating an implicit trust to protect the client funds from misuse by the acceptable institution and preserve the funds in the event of a Dealer's insolvency.

A formal explicit trust is not intended and would require a Dealer to have formal written trust agreements with each client.

1.2 Current DMR 1200.3 and Notes to Statement D

DMR 1200 and Notes to Statement D describe the "in trust" arrangement for segregating free credit client cash.

DMR 1200.3 currently requires the Dealer to segregate free credits in excess of the free credit limit in a separate account in trust for clients at an acceptable institution.

Notes to Statement D currently state "the trust must be an obligation binding the Dealer member (the trustee) to deal with the free credits over which it has control (the trust property), for the benefit of the client (the beneficiary). The trust property must be clearly identified as such, even if residing with an acceptable institution."



1.3 Inconsistency between DMR 1200.3 and Notes to Statement D

The description of the type of trust account required to segregate clients free credit balances is inconsistent between the Notes to Statement D and DMR 1200.3.

The main inconsistencies are:

- DMR 1200.3 does not clarify that the trust property must be *identified* as being held for the benefit the client but the Notes to Statement D have this clarification.
- The Notes to Statement D have language which could be construed as a requirement for an explicit trust but DMR 1200.3 allows an implicit trust.

1.4 Amendments

The amendments to both Notes to Statement D and DMR 1200.3 clarify that an explicit trust agreement is not required for the segregation of clients free credit cash, so long as

- cash is held in trust for clients in a separate account with an acceptable institution
- the account is labelled as “trust account”.

This will align Notes to Statement D with DMR 1200.3 in the requirement of an implied trust for client free credit balances, rather than an explicit trust.

A summary of the Amendments is shown as blacklined changes in **Appendix A**.

2. Implementation

The Amendments will be effective March 12, 2020.²

3. Appendices

[Appendix A](#) - Blackline comparison of the Amendments

[Appendix B](#) - Clean copy of the Amendments

[Appendix C](#) - Blackline comparison of the Amendments to Form 1 and section 4384 of the IIROC Rules

[Appendix D](#) - Clean copy of the Amendments to Form 1 and section 4384 of the IIROC Rules

² For greater clarity, the Amendments in Appendix A and B are effective March 12, 2020. The Amendments will be included in the IIROC Rules and Form 1 effective on June 1, 2020 as shown in Appendix C and D.