

IIROC NOTICE

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Amendments to Notes and Instructions to Schedules 1 and 7 of Form 1 regarding agency tri-party arrangements

Executive Summary

The applicable securities regulatory authorities have approved amendments to Notes and Instructions to Schedules 1 (Analysis of Loans Receivable, Securities Borrowed and Resale Agreements) and 7 (Analysis of Overdrafts, Loans, Securities Loaned and Repurchase Agreements) of Form 1, regarding the margin requirements for certain agency tri-party repurchase and resale arrangements and certain agency tri-party securities borrow and loan arrangements (collectively, the **Amendments**), which were published for comment in [Notice 19-0027](#).

The main purpose of the Amendments is to allow Dealer Members to be able to treat the agent in these arrangements as equivalent to principal for margin purposes. The Amendments will more closely align a Dealer Member's margin requirements for these arrangements to its potential risk of loss to such arrangements.



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1. Discussion of Amendments

1.1 Relevant background

On October 1, 2015, we implemented amendments to Schedules 1, 7 and 7A of Dealer Member Form 1 in [Notice 15-0206](#) to allow Dealer Members to treat certain agency tri-party securities borrow and loan arrangements, for margin purposes, as if it was an equivalent principal arrangement executed between the Dealer Member and the agent. The rationale for allowing this margin treatment is that agency tri-party arrangements where the parties are a Dealer Member, a client counterparty and the counterparty's agent which also acts as the custodian (referred to as the "custodian agent"), have added risk protection features that result in no greater risk of loss to the Dealer Member than if the Dealer Member had entered into a principal arrangement with the counterparty's custodian agent.

Subsequent to the changes made in 2015 and as a result of the evolution of tri-party arrangements, we were asked by Dealer Members to allow the equivalent to principal margin treatment for agency tri-party:

- (i) securities repurchase and resale arrangements where the counterparty's agent and the custodian are the same entity, and
- (ii) securities borrow and loan arrangements and securities repurchase and resale arrangements where the counterparty's agent and custodian are different entities.

We reviewed these additional types of agency tri-party arrangements and determined they had adequate risk protection features (similar to the agency tri-party securities borrow and loan arrangements we considered in 2015) that mitigate a Dealer Member's risk of loss through the use of a custodian agent, or an agent and separate custodian, to allow the equivalent to principal margin treatment for them.

1.2 Current Notes and Instructions to Schedules 1 and 7 of Form 1

Form 1 is a special purpose report that is used by IIROC to monitor the financial solvency of Dealer Members. To monitor financial solvency, IIROC reviews the risk adjusted capital levels and early warning test results of each Dealer Member. The current Notes and Instructions to Schedules 1 and 7 of Form 1 set out specific margin requirements for certain agency securities borrow and loan arrangements to allow a Dealer Member to be able to treat the third party custodian agent in the these arrangements as "equivalent to principal".

For a Dealer Member, the main benefit in being able to treat the third party custodian agent as equivalent to principal is the lower margin requirements for these agency arrangements because the third party custodian agent is typically an "acceptable institution" under IIROC's counterparty risk classification, which is IIROC's lowest counterparty risk category. A secondary benefit is that a Dealer Member will not need to "look through" the third party custodian agent to determine the entity that is the ultimate counterparty in order to determine its counterparty risk classification. The risk protection



features of these agency arrangements in the situation where a Dealer Member borrows securities under an agency securities borrow arrangement are as follows:

- the third party custodian agent is typically an acceptable institution
- pursuant to the written agreement executed:
 - the loan collateral provided by the Dealer Member is held by the third party custodian agent and, if the loan collateral includes securities, the third party custodian agent cannot re-hypothecate those securities
 - there are provisions for the third party custodian agent to liquidate the loan collateral to satisfy the Dealer Member's obligations and for any excess value to be returned by the third party custodian agent to the Dealer Member in the event of the Dealer Member's default
 - the agreement qualifies as an "Eligible Financial Contract" under Canada's Bankruptcy and Insolvency Act and therefore the loan collateral does not form part of either the third party custodian agent's or the ultimate counterparty's estate in the event of an insolvency of either of them
 - the third party custodian agent is a "financial intermediary" in relation to the Eligible Financial Contract General Rules under Canada's Bankruptcy and Insolvency Act.

However, the previous Notes and Instructions to Schedules 1 and 7 did not set out specific margin requirements for agency securities repurchase and resale arrangements or agency securities borrow and loan arrangements where the agent and the third party custodian are different entities. Therefore, for agency securities repurchase and resale arrangements that have similar risk protection features the Dealer Member's margin requirements had the potential to be significantly higher.

We reviewed the risk protection features of certain agency securities repurchase and resale and securities borrow and loan arrangements where the agent and the third party custodian are different entities and determined that the risk assumed by a Dealer Member when it enters into one of these arrangements is no greater than the risk assumed by the Dealer Member when it enters directly into an equivalent "principal" arrangement with the third party custodian agent or the agent where the agent and the custodian are different entities.

The purpose of these agency securities repurchase arrangements is for a Dealer Member to borrow cash, and the two typical agency securities repurchase arrangements are described as follows:

- Where agent is also the third party custodian
The Dealer Member, as seller (collateral provider), will deliver securities in exchange for cash provided by an agent, as buyer (cash provider), acting in its capacity as agent on behalf of certain principals pursuant to the terms of an industry master agreement (e.g. the Global Master Repurchase Agreement (GMRA)).
That master agreement will typically provide that the Dealer Member must deliver the purchased securities to the person identified to serve as custodian for the buyer, which in this case is the agent.



- Where agent and third party custodian are different entities

The Dealer Member, as seller (collateral provider), will deliver securities in exchange for cash provided by an agent, as buyer (cash provider), acting in its capacity as agent on behalf of certain principals pursuant to the terms of an industry master agreement (e.g. the Global Master Repurchase Agreement (GMRA)).

That master agreement will typically provide that the Dealer Member must deliver the purchased securities to the person identified to serve as custodian for the buyer, which in this case is another third party custodian.

Both the Dealer Member and the agent would further agree that the collateral will be delivered to the third party custodian pursuant to the terms of a separate custodial agreement (e.g. a “Collateral Management Agreement”, or a “Custodial Management Agreement”).

The risk protection features of these agency arrangements in the situation where a Dealer Member borrows cash under an agency securities repurchase arrangement where the agent and third party custodian are different entities are as follows:

- the agent is typically an acceptable institution and a “financial intermediary” in relation to the Eligible Financial Contract General Rules under Canada’s Bankruptcy and Insolvency Act
- the custodian is also typically an acceptable institution and a “financial intermediary” in relation to the Eligible Financial Contract General Rules under Canada’s Bankruptcy and Insolvency Act
- pursuant to the written agreement and accompanying collateral management agreement executed:
 - the purchased securities provided by the Dealer Member are held by the third party custodian and the third party custodian cannot re-hypothecate those securities
 - in the event of the Dealer Member’s default, there are provisions for the third party custodian to provide the purchased securities to the agent to liquidate the purchased securities to satisfy the Dealer Member’s obligations and for any excess value to be returned by the agent to the Dealer Member
 - the written agreement and accompanying collateral management agreement qualifies as an “Eligible Financial Contract” under Canada’s Bankruptcy and Insolvency Act and therefore purchased securities do not form part of either the agent’s, third party custodian’s or the ultimate counterparty’s estate in the event of an insolvency of any of them.

1.3 Amendments

The following is a summary of the Amendments, which are shown as black-lined changes in **Appendix A**:

- (1) For agency securities borrow arrangements in which the agent and the third party custodian is the same entity (i.e. the third party custodian agent), we have:
 - repealed an additional agreement term requiring that the third party custodian agent meet the definition of “financial intermediary” in relation to the Eligible Financial Contract General Rules under Canada’s Bankruptcy and Insolvency Act and replaced it with an outside of



- agreement requirement that the third party custodian agent meet this definition, in order to make it easier for a Dealer Member to execute written agreements regarding these arrangements with foreign financial intermediaries [*Schedule 1, Note 6(b)*]
- modified the requirements that apply where it has been determined that the third party custodian agent must not be treated as “equivalent to principal” [*Schedule 1, Note 6(d)*]
- (2) For agency securities borrow arrangements in which the agent and third party custodian are different entities, we have:
- added written agreement and accompanying written collateral management or custodial agreement requirements [*Schedule 1, Note 6(c)*]
 - added an outside of agreement requirement that the agent and third party custodian meet the definition of “financial intermediary” in relation to the Eligible Financial Contract General Rules under Canada’s Bankruptcy and Insolvency Act in order to make it easier for a Dealer Member to execute written agreements regarding these arrangements with foreign financial intermediaries [*Schedule 1, Note 6(c)*]
 - added in the event of default requirements to protect excess collateral [*Schedule 1, Note 6(c)*]
 - added requirements that apply where it has been determined that the agent must not be treated as “equivalent to principal” [*Schedule 1, Note 6(d)*]
 - modified margin requirements so that they apply to situations where the agent and third party custodian are different entities [*Schedule 1, Note 6(e)*].
- (3) For agency securities resale arrangements in which the agent and third party custodian is the same entity (i.e. the third party custodian agent), we have:
- added written agreement requirements [*Schedule 1, Note 7(b)*]
 - added an outside of agreement requirement that the third party custodian agent meet the definition of “financial intermediary” in relation to the Eligible Financial Contract General Rules under Canada’s Bankruptcy and Insolvency Act in order to make it easier for a Dealer Member to execute written agreements regarding these arrangements with foreign financial intermediaries [*Schedule 1, Note 7(b)*]
 - added a requirement that cash proceeds from purchased securities must be held by the third party custodian agent [*Schedule 1, Note 7(b)*]
 - added flexibility on how a Dealer Member may hold and use the purchased securities [*Schedule 1, Note 7(b)*]
 - added in the event of default requirements to protect excess collateral [*Schedule 1, Note 7(b)*]
 - added requirements that apply where it has been determined that the third party custodian agent must not be treated as “equivalent to principal” [*Schedule 1, Note 7(d)*]
 - modified margin requirements so that they apply to third party custodian agent situations [*Schedule 1, Note 7(e)*].



- (4) For agency securities resale arrangements in which the agent and third party custodian are different entities, we have:
- added written agreement and accompanying written collateral management or custodial agreement requirements [*Schedule 1, Note 7(c)*]
 - added an outside of agreement requirement that the agent and third party custodian meet the definition of “financial intermediary” in relation to the Eligible Financial Contract General Rules under Canada’s Bankruptcy and Insolvency Act in order to make it easier for a Dealer Member to execute written agreements regarding these arrangements with foreign financial intermediaries [*Schedule 1, Note 7(c)*]
 - added requirement that cash proceeds from purchased securities must be held by the agent [*Schedule 1, Note 7(c)*]
 - added flexibility on how a Dealer Member may hold and use the purchased securities [*Schedule 1, Note 7(c)*]
 - added in the event of default requirements to protect excess collateral [*Schedule 1, Note 7(c)*]
 - added requirements that apply where it has been determined that the agent must not be treated as “equivalent to principal” [*Schedule 1, Note 7(d)*]
 - modified margin requirements so that they apply to situations where the agent and third party custodian are different entities [*Schedule 1, Note 7(e)*].
- (5) For agency securities loan arrangements in which the agent and third party custodian is the same entity (i.e. the third party custodian agent), we have:
- repealed an additional agreement term requiring that the third party custodian agent meet the definition of “financial intermediary” in relation to the Eligible Financial Contract General Rules under Canada’s Bankruptcy and Insolvency Act and replaced it with an outside of agreement requirement that the third party custodian agent meet this definition, in order to make it easier for a Dealer Member to execute written agreements regarding these arrangements with foreign financial intermediaries [*Schedule 7, Note 6(b)*]
 - added a requirement that loaned securities must be held by the third party custodian agent and there must be no right to re-hypothecate the loaned securities [*Schedule 7, Note 6(b)*]
 - added flexibility on how the Dealer Member may hold and use the loan collateral [*Schedule 7, Note 6(b)*].
- (6) For agency securities loan arrangements in which the agent and third party custodian are different entities, we have:
- added written agreement and accompanying written collateral management or custodial agreement requirements [*Schedule 7, Note 6(c)*]
 - added an outside of agreement requirement that the agent and third party custodian meet the definition of “financial intermediary” in relation to the Eligible Financial Contract General



Rules under Canada's Bankruptcy and Insolvency Act in order to make it easier for a Dealer Member to execute written agreements regarding these arrangements with foreign financial intermediaries [*Schedule 7, Note 6(c)*]

- added a requirement that loaned securities must be held by the agent and there must be no right for the agent to re-hypothecate the loaned securities [*Schedule 7, Note 6(c)*]
- added flexibility on how the Dealer Member may hold and use the loan collateral [*Schedule 7, Note 6(c)*]
- added in the event of default requirements to protect excess collateral [*Schedule 7, Note 6(c)*]
- added requirements that apply where it has been determined that the agent must not be treated as "equivalent to principal" [*Schedule 7, Note 6(d)*]
- modified margin requirements so that they apply to situations where the agent and third party custodian are different entities [*Schedule 7, Note 6(e)*].

(7) For agency securities repurchase arrangements in which the agent and third party custodian is the same entity (i.e. the third party custodian agent), we have:

- added written agreement requirements [*Schedule 7, Note 7(b)*]
- added an outside of agreement requirement that the third party custodian agent meet the definition of "financial intermediary" in relation to the Eligible Financial Contract General Rules under Canada's Bankruptcy and Insolvency Act in order to make it easier for a Dealer Member to execute written agreements regarding these arrangements with foreign financial intermediaries [*Schedule 7, Note 7(b)*]
- added a requirement that purchased securities must be held by the third party custodian agent and there must be no right to re-hypothecate those securities [*Schedule 7, Note 7(b)*]
- added in the event of default requirements to protect excess collateral [*Schedule 7, Note 7(b)*].
- added requirements that apply where it has been determined that the third party custodian agent must not be treated as "equivalent to principal" [*Schedule 7, Note 7(d)*]

- modified margin requirements so that they apply to third party custodian agent situations [*Schedule 7, Note 7(e)*].

(8) For agency securities repurchase arrangements in which the agent and third party custodian are different entities, we have:

- added written agreement and accompanying written collateral management or custodial agreement requirements [*Schedule 7, Note 7(c)*]
- added an outside of agreement requirement that the agent and third party custodian meet the definition of "financial intermediary" in relation to the Eligible Financial Contract General



Rules under Canada’s Bankruptcy and Insolvency Act in order to make it easier for a Dealer Member to execute written agreements regarding these arrangements with foreign financial intermediaries [*Schedule 7, Note 7(c)*]

- added requirement that purchased securities must be held by the third party custodian and there must be no right to re-hypothecate those securities [*Schedule 7, Note 7(c)*]
- added in the event of default requirements to protect excess collateral [*Schedule 7, Note 7(c)*].
- added requirements that apply where it has been determined that the agent must not be treated as “equivalent to principal” [*Schedule 7, Note 7(d)*]
- modified margin requirements so that they apply to situations where the agent and third party custodian are different entities [*Schedule 7, Note 7(e)*].

2. Implementation

The Amendments are effective September 1, 2020.

3. Appendices

[Appendix A](#) - Blackline copy of Notes and Instructions to Schedules 1 and 7 of Form 1 reflecting Amendments

[Appendix B](#) - Clean copy of Notes and Instructions to Schedules 1 and 7 of Form 1 reflecting Amendments