INVESTMENT DEALERS ASSOCIATION OF CANADA

bulletin

ASSOCIATION CANADIENNE DES COURTIERS EN VALEURS MOBILIÈRES

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For distribution to relevant parties within your firm

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By-Laws and Regulations

Elimination of Standby Subordinated Debt for Regulatory Capital purposes and adoption of Provider of Capital Concentration Charge – Form 1 and Bylaws 1, 5.2 and 5.2A

The Board of Directors of the Association has approved amendments to Statements B and G of Form 1 and Bylaws 1, 5.2 and 5.2A as well as the establishment of a new schedule, Schedule 14 of Form 1, to be **effective April 1st, 2000.** The remainder of this bulletin provides a brief summary of the rule changes that have been made. For further details as to the history of the issue that brought about these changes and the specific amendments being made, Member Regulation Notice RN-006 should be consulted.

Amendments to Statement B - Attachment #1

The purpose of the major amendment to Statement B of Form 1 (see Attachment #1) is to eliminate standby subordinated debt as an acceptable form of regulatory capital. In brief, it has been determined that standby subordinated debt is no longer an acceptable form of regulatory capital since:

- The prevalence of cross-financial industry ownership results in situations where Member firms are capitalized by non-arms length standby subordinated debt provided by their parent bank. Should the Member firm get into financial difficulty this may also cause financial difficulty within the parent bank (this spread to financial difficulty within a financial institution group is referred to as "contagion"). As a result, whether or not standby subordinated debt provided by a non-arms length bank could ultimately be drawn has been called into question.
- The timely enforceability of all (i.e., arms length and non-arms length) standby subordinated debt facilities has also been called into question.

Therefore, to eliminate standby subordinated debt as an acceptable form of regulatory capital, Lines 2 and 3 of Statement B have been deleted and the remaining lines have been renumbered.

Further, in order to ensure that the elimination of standby subordinated debt is being honoured, an additional amendment to introduce an anti-avoidance rule, known as the "Provider of Capital Concentration Charge" has been adopted and included on Statement B as Line 17. Further details of this new concentration charge are set out in the description of new Schedule 14 provided later on in this bulletin.

Amendments to Statement G - Attachment #2

As with the major amendment made to Statement B, the purpose of the amendments to Statement G of Form 1 (see Attachment #2) is to eliminate standby subordinated debt as an acceptable form of regulatory capital. As a result, all references to standby subordinated debt have been removed from this statement page.

Amendments to Bylaws 1, 5.2 and 5.2A - Attachment #3

Even though standby subordinated debt has been eliminated as an acceptable form of regulatory capital, it was still felt appropriate to grant to Member firms the option to receive prior approval of their uniform subordinated loan agreement ("USLA") facilities should they so wish. As a result, amendments have been made to Bylaws 1, 5.2 and 5.2A (see Attachment #3) to accommodate this prior approval option as well as to speed up the approval process for these facilities. Further, in order to standardize the prior approval option, a "consent letter" has been developed which, when issued, would detail the Association's prior consent of the USLA facility. Obtaining this consent letter would enable the Member firm to draw down on the USLA facility at a future date and create capital without requiring any additional Association approval at the time of draw down.

Adoption of new Schedule 14 to Form 1, "Provider of Capital Concentration Charge" - Attachment #4

As stated previously, in order to ensure that the elimination of standby subordinated debt is being honoured, an anti-avoidance rule, known as the "Provider of Capital Concentration Charge" has also been adopted. This new rule has been set out in a new schedule to Form 1 (see Attachment #4). The concentration charge has been set out in the form of two tests:

1. A specific test to ensure that no Member firm maintains an exposure in the form of cash deposits and undersecured loans with any of its providers of capital in excess of $50 million; and

2. A general test to ensure that no Member firm maintains an exposure in the form of cash deposits, undersecured loans and security loans with any of its providers of capital in excess of the greater of $10 million and 20% of its net allowable assets.

These two tests have been designed to ensure that a Member firm cannot defeat the purpose of the elimination of standby subordinated debt as regulatory capital by repatriating the funds back to the provider of capital through some means such as redepositing the funds with the provider of capital or purchasing provider of capital issued securities.

Transitionary Provisions

Since standby subordinated debt is to be eliminated as regulatory capital effective April 1, 2000, no new standby subordinated debt agreements will be approved during the interim period from now until April 1st. However, during this interim period, the Association has agreed to provide the new consent letter to those Members who wish to have their USLA facilities approved in advance. As is the case now, this consent letter along with accompanying approved USLA will only be provided if the Creditor is considered suitable by Association staff.

Timothy P. Ryan
Association Secretary