

MEMBER REGULATION



INVESTMENT
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CANADIENNE DES
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notice

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ATTENTION:
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Loan Value granted to Significant Security Positions Held in Member firm and Customer Accounts

This notice is being issued with the objectives of reminding Member firms of existing regulatory requirements and providing Member firms with guidance with respect to the unique credit issues that arise in the situation where loan value is being granted to a significant security position that is held in one or a small number of accounts. This situation has been referred to as “single account securities concentration” even though the concentration may involve more than one account. The notice will:

- Detail the current regulatory requirements with respect to the valuation and margining of securities;
- Define what is considered to be a significant security position;
- Detail the factors that indicate that single account securities concentration risk is present;
- Provide guidance as to when and how adjustments to loan value should be made to address the presence of single account securities concentration risk; and
- Detail the possible actions that may be taken by the IDA where a Member firm is unable to adequately support the loan value granted to a significant security position with single account securities concentration risk.

1. What are the current regulatory requirements with respect to the valuation of securities?

Pursuant to the Notes and Instructions to Schedules 2 and 4 of Form 1, all security positions, whether held in a Member firm account or a customer account, are to be valued at their current market value. In order to determine the market value assigned to a particular securities position, the market upon which the security trades and the relative liquidity of the position must be considered. These considerations are detailed in the General Notes and Instructions to Form 1 where the term “market value of securities” is defined as follows:

“(f) *“market value of securities” means:*

1. *for listed securities, the last bid price of a long security and, correspondingly, the last ask price of a short security, as shown on the exchange quotation sheets as of the close of business on the relevant date or last trading date prior to the relevant date, as the case may be, subject to an appropriate adjustment where an unusually large or unusually small quantity of securities is being valued. If not available, the last sale price of a board lot may be used. Where not readily marketable, no market value shall be assigned.*
2. *for unlisted and debt securities, a value determined as reasonable from published market reports or inter-dealer quotation sheets on the relevant date or last trading day prior to the relevant date, or based on a reasonable yield rate. Where not readily marketable, no market value shall be assigned.*
3. *for commodity futures contracts, the settlement price on the relevant date or last trading day prior to the relevant date.*
4. *for money market fixed date repurchases (no borrower call feature), the market price is the price determined by applying the current yield for the security to the term of maturity from the repurchase date. This will permit calculation of any profit or loss based on the market conditions at the reporting date. Exposure due to future changes in market conditions is covered by the margin rate.*
5. *for money market open repurchases (no borrower call feature), prices are to be determined as of the reporting date or the date the commitment first becomes open, whichever is the later. Market price is to be determined as in 4. and commitment price is to be determined in the same manner using the yield stated in the repurchase commitment.*
6. *for money market repurchases with borrower call features, the market price is the borrower call price”.*

2. What are the current regulatory requirements with respect to the margining of securities?

IDA Regulation 100 sets out the various margin rates for securities. These rates are the minimum regulatory rates that are required to be used for Member firm and customer account positions and they are set based on the type of security (i.e., debt or equity) and other factors such as a credit rating, traded price, market on which the security trades, et cetera.

In addition to the basic margin requirements, there are also requirements that address situations where the Member firm has credit risk exposures relating to sizeable security positions loaned against, either on a firm wide basis or on an account specific basis. These requirements address situations where:

- the loan value of securities issued by a particular company, either due to holdings in Member firm accounts or due to lending against the security in customer accounts, is too large in relation to a Member firm’s Risk Adjusted Capital. In this situation the Member firm is subject to a securities concentration charge, which is a charge against its capital; and
- a particular account position qualifies as control block position. In this situation, the position would “not be acceptable for margin purposes” pursuant to IDA Regulation 100.7 and therefore this position should have no loan value assigned to it. Control block positions where no loan value should be assigned include those where the control block position has been made eligible for distribution¹.

¹ A control block is eligible for distribution after Form 45-102F3 has been filed with the relevant securities commissions and a seven day hold period has expired. This filing is not considered to be sufficient evidence to

3. What would be considered to be a significant security position?

For the purposes of this notice, the term “significant security position” is any position that is listed on the management reports that are used for identifying those security positions that are the largest amount loaned exposures to the Member firm. It is these reports in which the loan value granted to security positions held in Member firm and customer accounts may materially affect the capital position of the Member firm if misstated.

4. When does a significant security position held in an account result in single account securities concentration risk?

There are a number of factors that may indicate that a significant security position is subject to single account securities concentration risk. These factors include the significant security position being:

- Held in one or a small number of Member firm and customer accounts
- Material in relation to the public float of the security issue
- Material in relation to the average daily trading volume of the security issue
- A material portion of the security holdings being used as collateral for margin lending within one or a few related accounts (including guarantee / guarantor accounts)

5. What adjustments to the loan value granted for a particular security position should be considered when single account securities concentration risk is present?

A Member firm should have credit policies in place that establish limits on the amount the firm is willing to lend to a customer or small number of customers with respect to an individual security issue. A Member firm should also, through established procedures, be able to identify specific accounts where single account securities concentration is present. Reliance on identifying single account securities concentrations through the completion of the securities concentration charge calculations (set out on Schedule 9 of Form 1) would not be considered to be an adequate procedure.

Where a Member firm has identified an account or accounts with single account securities concentration risk, it should be reducing the loan value granted to the significant security position taking into account factors including:

- The relative marketability of the significant security position,
- The relative credit quality of the significant security position, and
- The significant security position’s percentage of the overall loan value of securities held in the account or accounts.

Where a Member firm has determined that the loan value granted to a significant security position in an account should be reduced, Member firms should account for this by either: (i) reducing the loan value granted to the position and, in turn, increasing the capital they provide for the now under-margined account(s), or (ii) establishing a specific single account securities concentration risk reserve, as a charge against capital.

indicate that a particular control block is marketable. As a result, no loan value shall be assigned in this situation.

6. Possible actions that may be taken by the IDA where a Member firm is unable to adequately support the loan value granted to a significant security position with single account securities concentration risk

As stated previously, Member firms must have in place adequate policies and procedures with respect to identifying and managing the occurrence of single account securities concentration risk. In addition, where such risk is identified, the Member firm must have procedures in place to assess whether the amount of loan value granted to a particular significant security position held in an account or accounts continues to be appropriate.

Where a Member firm:

- Does not have in place these policies and procedures, or
- Cannot support the loan value granted to a particular significant security position, where single account securities concentration risk is present,

the IDA may decide to exercise, at its discretion, the Early Warning Level 2 restrictions set out in Bylaw No. 30. The restrictions that may be imposed include the requirement to segregate customer free credit balances up to an amount determined by the IDA to alleviate its regulatory concerns.