

**INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA (IIROC) –
NEW METHODOLOGY FOR MARGINING EQUITY SECURITIES –
DEALER MEMBER RULE 100 AND FORM 1**

I OVERVIEW

When a margin rate for a security is established, it is intended that it is sufficient to cover the risk of loss associated with the security, specifically market risk. The existing methodology for determining a listed equity security's margin rate is based on its market price per share.

A CURRENT RULES

The existing capital and margin requirements for equity securities and related derivatives are set out in Dealer Member Rule 100. These rules specify that:

- For listed and unlisted equity securities, the margin rates be based on the individual security's market price per share; and
- For related derivatives, the margin rates for the underlying equity security be used in determining the margin requirement.

The existing rules also set out a series of "strategy-based" rules that are available for offset positions held in both Dealer Member and customer accounts. These strategy-based offset rules allow for a lowering of the margin requirement associated with two or more positions related to the same underlying security where the positions in combination result in lower market risk.

B THE ISSUE

Studies undertaken by Corporation staff, indicate that market price per share is not an accurate indicator of a listed equity security's market risk. While determining margin rates on this basis may be operationally easy to apply, its use has resulted in margin deposits and "strategy-based" margin rules that do not reflect the true economic risk of positions in and offsets involving equity securities. To address these issues, the FAS Capital Formula Subcommittee reviewed various methodologies with the requirements that the methodology selected would have to accurately track an individual security's market risk by measuring both price risk and liquidity risk, and be reasonably simple to implement both from an operational and investor education standpoint.

C OBJECTIVE(S)

The new margin rate approach selected, referred to as the "basic margin rate" methodology, is essentially a methodology for determining a customized margin rate for each listed equity security. The objective of this methodology (set out in Attachment #1) is to determine an overall margin rate for each equity security that will more accurately address its market risk. The proposed methodology will replace the existing market price per share based rates as the standard margin rate methodology to be used by all Members and their customers for all Canadian and U.S. listed equity securities. The proposed methodology will determine the appropriate margin rate based on the two components of an individual security's market risk: (i) price risk and (ii) liquidity risk. The proposed methodology is set out in Dealer Member Rule 100.2(f) as amended.

The objective of the accompanying amendments is to accommodate the elimination of both the market price per share margining methodology and the list of securities eligible for reduced margin. Changes have also been proposed to the margin requirements for convertible debentures and convertible preferred shares to make the requirements more consistent with those for related debt and equity securities of the same issuer.

The proposed amendments are set out in Attachment #1.

D EFFECT OF PROPOSED RULES

The effect of these proposals could be significant both in terms of member versus non-member competition and operations/compliance costs. The effect of these proposals on the listed equity markets generally is expected to be neutral to positive based on the previous experience with implementing the List of Securities Eligible for Reduced Margin in August 2000 and the results of six years of market impact test work performed.

Member versus non-member competition

The existing market price per share based margin rates have been around for several decades. During this period more sophisticated and less conservative risk measurement philosophies have been developed and adopted by other financial institution regulators and derivatives clearing corporations. The use of these new risk measurement philosophies has made it less attractive, from a capital usage standpoint, for Canadian securities dealers to maintain their equity securities trading positions on the books of the dealer. Many have opted to move these positions to a related bank¹ or to a related foreign securities dealer², where the capital requirements are less onerous. The following is a summary of the current Corporation requirements and some of the risk measurement alternatives that are available with respect to the margining of positions in and offsets involving listed equity securities, some of which the Corporation has already adopted:

	Basic IIROC requirements	Alternative requirements (current, proposed and under consideration)
Margin requirements that apply to unhedged positions	<ul style="list-style-type: none"> ▪ Market price per share based margin rates 	<ul style="list-style-type: none"> ▪ Proposed “basic margin rate” methodology based on measured market risk (<i>this proposal</i>) ▪ VaR modeling (<i>see VaR modeling proposal</i>) ▪ TIMS or SPAN for positions in and offsets involving exchange-traded derivatives (<i>implemented as an option on January 1, 2005 through establishment of IDA Regulation 100.10(k) - now IIROC Dealer Member Rule 100.10(k)</i>) ▪ Position Risk Requirement or similar portfolio margining approach

¹ Canadian banks are permitted to use Value at Risk (VaR) modeling to determine the capital requirements on their equity securities trading book.

² United Kingdom securities dealers are permitted to the Position Risk Requirement (PRR) approach to margining their equity securities trading book, which is a portfolio risk approach.

	Basic IIROC requirements	Alternative requirements (current, proposed and under consideration)
Margin requirements that apply to hedged offset positions	<ul style="list-style-type: none"> ▪ “Strategy-based” requirements 	<ul style="list-style-type: none"> ▪ Enhanced “strategy-based” rules of more general application (<i>implemented on January 1, 2005 as a result of extensive rewrite of IDA Regulations 100.9 and 100.10 - now IIROC Dealer Member Rules 100.9 and 100.10</i>) ▪ VaR modeling (<i>see separate VaR modeling proposal</i>) ▪ TIMS or SPAN for positions in and offsets involving exchange-traded derivatives (<i>implemented as an option on January 1, 2005 through establishment of IDA Regulation 100.10(k) - now IIROC Dealer Member Rule 100.10(k)</i>) ▪ Position Risk Requirement or similar portfolio margining approach

The intention of the proposed move to the “basic margin rate” methodology is to adopt a more sophisticated risk measurement philosophy without introducing undue complexity to Dealer Members and their clients. As a result, the “basic margin rate” methodology, as its name suggests, will be a relatively simple margining approach that will be used:

- By Dealer Members with relatively small proprietary trading books or books that utilize straightforward hedging strategies; and
- To margin retail customer account positions.

A by-product of adopting this approach will be to remove some of the existing conservatism in the margin rates that apply to listed equity securities, which will in turn positively impact member versus non member competition in the area of proprietary trading.

Operations costs/impacts

During the development of this proposal, efforts were made to address the operations cost concerns with respect to implementing this methodology. To help address these concerns Corporation staff will calculate margin rates under this new methodology centrally. Once calculated, the rates will be made available electronically to all Dealer Members in a downloadable form such that where “table driven” software is utilized, little or no modifications will be required to be made to margining systems to use this new methodology.

It is likely that there will be operational impacts of this proposal upon implementation. Studies performed over a six year period indicate that an average of in excess of 90% of the securities listed on the Toronto Stock Exchange will experience a margin rate change on the date this proposal is implemented.

Once the proposal is implemented, operational impacts of this proposal will be less significant. Studies performed over a six year period indicate that an average of approximately 70% of the securities listed on the Toronto Stock Exchange will not experience a period to period margin rate change at any given time.

Effect on the listed equity markets generally

In terms of the specific capital market effects of using the proposed “basic margin rate” methodology, we believe the overall effects will be either neutral or positive. The quarterly List

of Securities Eligible for Reduced Margin (LSERM) has been prepared using this methodology for approximately five years and the methodology is performing well with this select group of securities. The only concerns received to date from Dealer Members is that the list should be prepared on a more timely basis after each quarter end³ and that they be notified in advance of any securities with margin rate increases⁴. We've received relatively few complaints from the investing public. We are aware of no significant market effects resulting from the introduction of the LSERM.

We believe the specific effects of moving to the "basic margin rate" approach for all Canada and United States listed equity securities are:

- Likely to be positive in terms of reduced proprietary inventory requirements (estimated capital savings are between \$200 to \$300 million for the industry based on equity levels held on Dealer Member proprietary accounts as at December 31, 2004); and
- Likely to be neutral or positive in terms of increased customer margin account loan values (estimated at \$500 million for the industry based margin loan levels as at December 31, 2004), depending upon whether Dealer Members adjust their house rates to pass along a reduced margin requirements to their retail customers.

II DETAILED ANALYSIS

A PRESENT RULES, RELEVANT HISTORY AND PROPOSED AMENDMENTS

PRESENT RULES

The existing margin requirements for equity securities are set out in Dealer Member Rule 100. The requirements permit that regulatory value be extended to equity securities of issuers that meet basic financial solvency requirements (such as adequate minimum pre-tax profit, net tangible asset and working capital requirements). As the issuers of most unlisted equity securities are not subject to ongoing financial solvency requirement reviews⁵ they are not generally extended regulatory value. Listed equity securities are generally extended regulatory value with the exception of TSX Venture Exchange Capital Pool Company listings and TSX Venture Exchange NEX Board listings, market tiers which do not have adequate initial and ongoing financial listing standards.

The requirements specify that the margin rates for equity securities be based on the market price per share of the security being margined. Further, in the case of related equity derivative instruments, that the margin requirements be based on the requirements for the underlying equity security. In the case of offsets involving equity securities, the current rules also set out a series of "strategy-based" offset rules that are available to both a Dealer Member and its customers. These offset rules allow for a lowering of the margin requirement associated with

³ Currently it takes Corporation staff about five weeks to prepare this list as the current process for preparing the list is largely a manual process. This time period will be shortened considerably once our margin rate vendor, completes a number of modifications to their margin software, which is designed to calculate margin rates on an automated basis.

⁴ This concern has already been addressed to some extent as it is current practice to inform Dealer Members ten business days in advance of any margin rate increases resulting from the publication of the quarterly List of Securities Eligible for Reduced Margin.

⁵ The exceptions are securities quoted on the Nasdaq National Market[®] and The Nasdaq SmallCap MarketSM and other senior unlisted securities of issuers for which there is a related junior listed security.

two or more positions related to the same underlying security where the positions in combination represent a lower market risk.

PROPOSED AMENDMENTS – DETAILS OF “BASIC MARGIN RATE” METHODOLOGY

To measure both price risk and liquidity risk and arrive at a customized margin rate for each security, the FAS Capital Formula Subcommittee has developed a methodology whereby:

- (i) the price risk component of market risk is determined for each individual security based on historic price volatility measures;
- (ii) the liquidity risk component of market risk is determined for each individual security based on average traded volumes and public float values; and
- (iii) a custom margin rate is determined for each individual security by adding together the price risk and liquidity risk components calculated in (i) and (ii) above.

Price risk calculation

It is proposed that price risk will be estimated using historical price volatility measures and will be calculated using the simplifying assumption that prices are normally distributed. The security’s price volatility will be calculated for 20, 90 and 260 trading day periods and the greatest of these three calculations will be used as an estimate of the current price volatility. A margin interval will be calculated for the security based on the price volatility calculated and the number of days of price risk coverage required. The number of days coverage is dependent on the relative liquidity of the security. Rather than publishing the exact calculated margin interval as the margin rate to be used for each security, margin rate categories will be used. There will be eight categories (15%, 20%, 25%, 30%, 40%, 60%, 75% and 100%) for Dealer Member long positions and six⁶ categories (25%, 30%, 40%, 60%, 75% and 100%) for customer long positions. An additional 150% margin rate category is proposed for Dealer Member and customer short positions.

Liquidity risk calculation

It is proposed that an individual security’s liquidity risk will be determined by its average daily traded volume and dollar value of public float. As the measurement of liquidity risk is not an exact science, other liquidity risk measures such as daily turnover percentage⁷ could have been used as risk parameters. Average daily traded volume and dollar value of public float were selected as liquidity risk parameters as, based on our studies, they provided the best means to delineate highly liquid from less liquid issues⁸.

The assessment of liquidity risk is important because any margin rate set must be sufficient to cover price risk over the period of time it might take to liquidate a security position. The proposal sets out four liquidity levels that will in turn be used to determine liquidity risk: “higher than typical”, “typical”, “lower than typical” and “low” as follows:

⁶ A seventh category, a 20% margin rate category, may be used for client security positions where measured price volatility is sufficiently low and an exchange traded single stock futures contract trades on the security.

⁷ “Daily turnover” percentage is daily issue trade volume divided by the issue outstanding share amount.

⁸ In comparison, when “daily turnover” was studied as a possible parameter for determining liquidity risk, the turnover percentages were so similar for all listings that it became very difficult to delineate highly liquid from less liquid issues.

- A security whose liquidity is determined to be “higher than typical” will require fewer days coverage than normal and, as a result, a price risk margin interval will be calculated to yield either two or three business days price risk coverage;
- A security whose liquidity is determined to be “typical” will require four business days price risk coverage;
- A security whose liquidity is determined to be “lower than typical” will result in either a specific liquidity premium being added in the determination of the overall margin rate or in the overall margin rate being set at 75% for that security; and
- A security whose liquidity is determined to be “low” will attract either a 75% or 100% margin rate depending upon whether or not the issuer’s dollar value of public float level is in excess of \$5 million.

“Basic margin rate” proposal general assumptions

The proposal also includes some general assumptions that will be used in the determination of a security’s margin rate under the “basic margin rate” methodology as follows:

- The minimum margin rate for long positions has been set at 15% for Dealer Member positions and 20% for customer positions where an individual equity’s options or futures contract has been listed by a Canadian or U.S. derivatives exchange, otherwise 25%;
- The maximum margin rate has been set at 150% for short positions;
- Daily price change percentages to be used in the determination of price risk are assumed to be normally distributed;
- The Canadian equity markets are assumed to be sufficiently liquid to accurately measure price risk;
- Preferred and senior shares are to be margined at a rate no higher than that calculated for related junior issues on the assumption that they exhibit, at worst, no higher market risk; and
- The existing “strategy-based” offset rules for equities and equity related derivatives will be retained.

“Basic margin rate” proposal back-testing

The proposed “basic margin rate” methodology uses a market risk assessment approach that is similar to the approach embedded in TIMS and SPAN, risk assessment methodologies that are in widespread use by derivatives clearing houses⁹ around the world. As a result, the proposal back-testing focused on ensuring that actual price movements over the period of margin rate coverage were less than the margin rate set using the proposed “basic margin rate” methodology rather than justifying the predictive use of historical pricing information.

The back testing results were in line with expectations as they indicated that:

⁹ In Canada, the Canadian Derivatives Clearing Corporation uses TIMS and SPAN in determining their clearing fund requirements with respect to derivative contract clearing and settlement.

- Days where coverage period price changes are in excess of a security's margin rate (i.e., violation days) are not uncommon under the current market price per share based methodology;
- The average violation day percentages are higher under the proposed "basic margin rate" methodology than under the current market price per share based methodology – this was expected because calculated margin rates are generally lower under the proposed "basic margin rate" methodology; and
- The average violation day percentages under the proposed "basic margin rate" methodology indicate that the required level of confidence with respect to margin rate adequacy (99% confidence) is being achieved by the methodology.

"Basic margin rate" proposal impact testing

The proposed "basic margin rate" methodology was tested over a six year period to determine its impact on affected capital markets, Dealer Members and their customers. The testing was comprised of:

- A comparison between current margin rates and proposed margin rates;
- A comparison between proposed margin rates for the previous quarter end and proposed margin rates for the current quarter end;
- An analysis of the impact of the proposed margin rates on short positions, focusing mainly on those issues with measured price volatility in excess of 100%; and
- A firm by firm impact assessment (for a sample of Dealer Members) of the impact of the proposed margin rates on proprietary inventory and customer account positions.

Debentures, warrants and foreign-based equities were excluded from the analysis in order to prevent any skewing of the results.

Comparison of current margin rates to proposed margin rates - TSX listed securities

For the six years studied, the average margin requirement¹⁰ weighted by traded value declined by 7.77% for Dealer Member positions (from 26.93% to 19.16%) and declined by 4.86% for customer positions (from 31.60% to 26.73%) under the proposed methodology. This translates to an average estimated proprietary inventory capital usage savings of \$356 million and an average increase in customer account security loan value of \$516 million for the periods studied. Estimates are even higher as at December 31, 2004 at \$501 million and \$655 million, respectively.

Of note, a significant number of securities experienced a margin rate change when the proposed methodology was adopted in each of the quarters tested. On average:

- 3.52%¹¹ of the value held in Dealer Member accounts (3.52% in the case of customer accounts) experienced a margin rate reduction at least 20%;
- 81.20% of the value held in Dealer Member accounts (89.56% in the case of customer accounts) experienced a margin rate reduction of less than 20%;

¹⁰ For each quarter the individual security margin rates were weighted by traded value and then to arrive at an overall average, a straight average was taken of the weighted rates calculated for the quarters tested.

¹¹ The traded value weighted average for the past six years was used.

- 8.40% of the value held in Dealer Member accounts (2.68% in the case of customer accounts) experienced no change in margin rates; and
- 6.89% of the value held in Dealer Member accounts (4.24% in the case of customer accounts) experienced an increase in margin rates.

In terms of the number of issues affected with significant rate changes, if the proposed methodology had been adopted as at December 31, 2004, 336¹² securities with prices over \$2.00 (currently margined at either 50% or 30% (25% for firms)) would have had margin rates of 75% or greater. On the other hand, 296¹³ securities with prices less than \$2.00 (currently margined at 60% or higher) would have had margin rates of 40% or less.

Comparison of current margin rates to proposed margin rates - TSX Venture listed securities

For the period studied, the average margin requirement decreased by 1.85% for Dealer Member positions (from 69.18% to 67.33%) and decreased by 1.75% for customer positions (from 69.19% to 67.44%) under the proposed methodology.

Of note, there are a relatively fewer (relative to the TSX listed securities) number of securities that will have major rate changes. This is mainly because under both the current and proposed methodologies, the majority of securities will be margined at 100%.

Comparison of current quarter proposed margin rates to previous quarter proposed margin rates - TSX listed securities

On average, the number of margin rate changes from quarter to quarter under the proposed methodology was greater than under the current methodology¹⁴. Specifically:

- 2.99%¹⁰ of the value held in Dealer Member accounts (2.66% in the case of customer accounts) experienced a margin rate reduction at least 20%;
- 10.43% of the value held in Dealer Member accounts (4.07% in the case of customer accounts) experienced a margin rate reduction of less than 20%;
- 69.21% of the value held in Dealer Member accounts (85.43% in the case of customer accounts) experienced no change in margin rates; and
- 14.69% of the value held in Dealer Member accounts (5.17% in the case of customer accounts) experienced a margin rate increase.

In terms of numbers of issues affected a quarter-to-quarter trend analysis performed for both Dealer Member and customer account positions showed the following:

- The average number of issues whose margin rates declined by at least 20% were 112 and 107, respectively,
- The average number of issues whose margin rates increased by at least 20% were 82 and 77, respectively, and

¹² These securities represent less than 1% of traded value for the quarter ended December 31, 2004.

¹³ These securities represent less than 1% of traded value for the quarter ended December 31, 2004.

¹⁴ This conclusion ignores the regular rate changes that currently take place for listed equity securities with a market value of less than \$2.00.

- The average number of issues whose margin rates did not change were 1,162 and 1,250, respectively.

These results confirmed staff's expectation that on an ongoing basis the number of securities experiencing margin rate changes would be relatively low (i.e., around 20%) but this would still create an operational issue to be addressed on a quarterly basis as all margin rate changes would take place at the same time.

Comparison of current quarter proposed margin rates to previous quarter proposed margin rates - TSX Venture listed securities

A quarter-to-quarter comparison was not prepared for securities trading on the TSX Venture Exchange. This is because, as stated previously, the majority of securities will be margined at 100%.

Impact of proposed margin rates on the margining of short positions

Tests were conducted to determine the adequacy of the proposed margin treatment for short positions. As it is proposed that the current methodology be retained for short positions in securities with prices of less than \$2.00 per share, the primary focus of the testing was on securities priced at \$2.00 or more per share. There are very few such securities (i.e., on average less than three issues per quarter) that had calculated margin intervals of greater than 100%. As a result, it was felt necessary to add only one additional margin rate category for short positions in listed securities, a 150% category.

The following table summarizes the proposed revisions for short positions:

Price per Share	Listed Securities	Unlisted Securities
\$2.00 and more	basic margin rate methodology with additional 150% margin rate category for volatile issues	200% or margin rate for related junior security if issuer has listed class of securities

Firm by firm impact assessment

To determine the likely impact of the proposed basic margin rate methodology on Dealer Members and their customers, an impact assessment survey was performed involving eight Dealer Member participants on the FAS Capital Formula Subcommittee. As part of the survey each participant calculated both their proprietary inventory capital requirements and their client account requirements using the proposed basic margin rate methodology.

(a) Dealer Member proprietary inventory capital requirements

On average, the study indicated that as at June 30, 2003, the eight Dealer Members surveyed would have had a 16% lower capital requirement under the proposed basic margin rate methodology as compared to the current requirements. This compares to a 9% lower requirement for the TSX as a whole as at June 30, 2003. The larger than market average reduction is reasonable given the tendency at most firms to hold only the most liquid equity positions (the positions that benefit the most from the proposed basic margin rate methodology) in their proprietary inventory.

Dealer Member proprietary inventory				
Dealer Member	Current capital requirement (000's)	Proposed capital requirement (000's)	Increase/ (Decrease) (000's)	Increase/ (Decrease) (%)
1	\$37,119	\$32,423	-\$4,696	-12.65%
2	\$127,444	\$103,987	-\$23,457	-18.41%
3	\$193,164	\$160,121	-\$33,043	-17.11%
4	\$1,846	\$1,755	-\$91	-4.93%
5	\$42,223	\$37,775	-\$4,448	-10.53%
6	\$2,977	\$1,977	-\$1,000	-33.57%
7	\$650	\$509	-\$141	-21.69%
8	\$414	\$414	Nil	0.00%
Weighted average				-16.48%

(b) Client account margin requirements

During the development of the survey, it was determined that it would be difficult to precisely assess the impact of the proposed basic margin rate methodology on the levels of customer account margin. The reason for this is that most customer accounts have significant excess margin in their accounts and therefore a change in margin rates is unlikely to significantly affect the under-margined account levels. The survey therefore focused on measuring changes in loan values and credit requirements for customer account long positions and short positions, respectively.

On average, the study indicated that as at June 30, 2003, loan values for long positions in customer accounts at the eight Dealer Members surveyed increased 5% under the proposed basic margin rate methodology as compared to the current requirements. This lower increase for customer account long position loan value is to be expected as the loan value amounts reported include amounts for acceptable institutions and acceptable counterparties where either no margin or market value deficiency margin is applied in determining long position loan value. The results for firms #6 and #8 are more reflective of the impact the proposed basic margin rate methodology will have on retail customers as both of these firms cater almost exclusively to retail clients. These two firms averaged an 11% increase in customer account long position loan value.

Loan values of customer account long positions				
Dealer Member	Current loan value (000's)	Proposed loan value (000's)	Increase/ (Decrease) (000's)	Increase/ (Decrease) (%)
1	N/A	N/A	N/A	N/A
2	\$474,328	\$506,116	\$31,788	6.70%
3	\$1,057,862	\$1,077,548	\$19,686	1.86%
4	\$363,025	\$373,485	\$10,460	2.88%
5	N/A	N/A	N/A	N/A

Loan values of customer account long positions				
Dealer Member	Current loan value (000's)	Proposed loan value (000's)	Increase/ (Decrease) (000's)	Increase/ (Decrease) (%)
6	\$501,298	\$556,043	\$54,744	10.92%
7	\$6,029	\$6,404	\$376	6.22%
8	\$128,445	\$143,072	\$14,627	11.39%
Weighted average				5.20%

On average, the study indicated that as at June 30, 2003, credit requirements for short positions in customer accounts at the eight Dealer Members surveyed was unchanged under the proposed basic margin rate methodology as compared to the current requirements. This is to be expected as most shorting activity occurs in highly active and price volatile securities, which in general will not experience significant rate reductions under the proposed basic margin rate methodology.

Credit requirements for customer account short positions				
Dealer Member	Current credit requirement (000's)	Proposed credit requirement (000's)	Increase/ (Decrease) (000's)	Increase/ (Decrease) (%)
1	N/A	N/A	N/A	N/A
2	\$182,917	\$190,806	\$7,889	4.31%
3	\$448,107	\$449,585	\$1,478	0.33%
4	\$411,168	\$407,397	-\$3,770	-0.92%
5	N/A	N/A	N/A	N/A
6	\$3,727	\$3,709	-\$18	-0.48%
7	\$2,503	\$2,413	-90,700	-3.60%
8	71,066	70,947	-119,125	-0.17%
Weighted average				0.48%

(c) Summary of impact of proposed margin rates on Dealer Members and their customers

While the survey work performed was at one point in time and involved relatively few Dealer Members, the result were in line with the market impact testing. In general, the survey indicates that there will not be significant capital impacts on Dealer Members (both in terms of requirements for proprietary inventory and under-margined customer accounts) when the proposed basic margin rate methodology is implemented. Rather, we believe the main impacts of changing margin rate methodologies will be operational in terms of systems changes and credit risk assessment changes.

Impact of periodic changes to margin rates under proposed “basic margin rate” methodology

As previously stated, it is likely that there will be operational impacts of this proposal upon implementation. However, it has also been stated that it is not likely that there will be any significant ongoing operational impacts of this proposal. This statement has been made based on six-years of studies of the ongoing rate changes that will take place under the proposed “basic margin rate” methodology and based on the fact that the current market price per share based methodology also requires the making of a number of ongoing margin rate changes.

Specifically, under the current market price per share based methodology, listings whose traded price per share is in the range from pennies per share to slightly above \$2.00 per share may experience significant rate changes as the current approach for determining margin rates for long positions is as follows:

Traded price per share	Current margin rate
Greater than or equal to \$2.00 per share and on LSERM	25.00%
Greater than or equal to \$2.00 per share	50.00%
Greater than or equal to \$1.75 per share and less than \$2.00 per share	60.00%
Greater than or equal to \$1.50 per share and less than \$1.75 per share	80.00%
Less than \$1.50 per share	100.00%

Under the current margin rate approach, the number of rate changes that take place during any calendar quarter is difficult to determine. To get an idea of the number of issues that may be subject to frequent margin rate changes under the current margin rate approach the following table summarizes the margin rates applicable to securities trading at less than or equal to \$2.50 per share as at December 31, 2004:

Margin rate	Number of TSX issues	Three month TSX traded value (in millions)
30.00%	17	\$1,997
50.00%	45	\$730
60.00%	34	\$468
80.00%	29	\$294
100.00%	312	\$1,884
Subtotal of listings trading at less than or equal to \$2.50 per share	437	\$5,373
Totals for listings on TSX	1,749	\$428,536
Percentage of totals	24.99%	1.25%

Depending upon price movements these issues may experience either no or multiple margin rate changes during the calendar quarter.

Under the proposed basic margin rate methodology, it is not likely that margin rate changes will occur during the quarter. Instead, issue margin rates will all change at the same time. For

example, as at December 31, 2004, 365 TSX listings (representing 20.87% of the number of TSX issues and 2.01% of the TSX traded value) would have had margin rate changes.

Margin rate changes	Number of TSX issues	Three month TSX traded value (in millions)
Margin rate decrease >= 20%	125	\$3,844
Margin rate decrease < 20%	127	\$2,714
Margin rate increase < 20%	48	\$1,449
Margin rate increase >= 20%	65	\$603
Subtotal of listings with a margin rate change	365	\$8,610
Totals for listings on TSX	1,749	\$428,536
Percentage of totals	20.87%	2.01%

While the numbers / percentages are not significantly different from the current margin rate approach, the rate changes will all occur at the same time which may necessitate changes to each Dealer Member's credit assessment process. Of course, to lessen the severity and frequency of customer account margin calls (caused by changes in margin rates), Dealer Members may continue to establish their own house margin rates.

PROPOSED AMENDMENTS – AMENDMENTS REQUIRED TO IMPLEMENT “BASIC MARGIN RATE” METHODOLOGY

The following is a detailed description of each of the amendments that are required to implement the proposed “basic margin rate” methodology:

AMENDMENT #1 – COMMERCIAL/CORPORATE BONDS, DEBENTURES AND NOTES

[Dealer Member Rule 100.2(a)(v)]

Note to Rule Amendment Paper - Amendment #1 was implemented by the IDA on September 17, 2007 through the issuance IDA Bulletin #3669. The amendments therefore have already been incorporated into IROC Dealer Member Rule 100. A modified discussion of these amendments has been left in this paper so that the collective effect of the new methodology for margining equity securities, both previously implemented and proposed, can be considered.

The notes to previous IDA Regulation 100.2(a)(v) set out specific margin requirements for convertible debentures. These requirements referenced the list of securities eligible for reduced margin. These requirements were also found to be excessive in the case of convertible debentures trading below par value and insufficient, in the case of convertible debentures trading above par value.

Specifically, under the previous IDA regulation, convertible debentures trading at less than par value were subject to a minimum additional margin requirement of 10% of par value over and above the regular requirement that would apply to a debenture. This additional requirement was not justified from a risk perspective because “out-of-the money” convertible debentures have the same risk characteristics as a debenture. In addition, under the previous IDA regulation, convertible debentures trading at greater than par value are never subject to the same margin requirement as the underlying security. This was also not supported from a risk

perspective because a “deep-in-the-money” convertible debenture will have the same downside price risk as the underlying security.

The amendments implemented by the IDA in 2007 remove the reference to the list of securities eligible for reduced margin and correct identified problems with the margin requirement calculation for convertible securities. The specific wording of the revised requirements, as set out in IIROC Dealer Member Rules 100.2(a)(v)(1) and 100.2(a)(v)(2), is as follows:

- “(1) If convertible and selling over par, the margin required shall be the lesser of:
- (a) the sum of:
 - (i) the above rates multiplied by par value; and
 - (ii) the excess of market value over par value;
 - and
 - (b) the maximum margin requirement for a convertible security calculated pursuant to Rule 100.21.
- (2) If convertible and selling at or below par, the margin required shall be the above rates multiplied by market value.”

AMENDMENT #2 - STRIPPED COUPONS AND RESIDUAL DEBT INSTRUMENTS

[Dealer Member Rule 100.2(a)(xi)]

Note to Rule Amendment Paper - Amendment #2 was implemented by the IDA on September 17, 2007 through the issuance IDA Bulletin #3669. The amendments therefore have already been incorporated into IIROC Dealer Member Rule 100. A modified discussion of these amendments has been left in this paper so that the collective effect of the new methodology for margining equity securities, both previously implemented and proposed, can be considered.

The previous IDA regulation set out the margin requirements for stripped coupons and residual debt instruments. The amendments implemented by the IDA in 2007 clarify (not amend) the margin requirements for these securities.

AMENDMENT #3 - STOCKS

[Dealer Member Rule 100.2(f)]

Note to Rule Amendment Paper - Portions of Amendment #3 were implemented by the IDA on September 17, 2007 through the issuance IDA Bulletin #3669. These portions therefore have already been incorporated into IIROC Dealer Member Rule 100. A modified discussion of these amendments has been left in this paper so that the collective effect of the new methodology for margining equity securities, both previously implemented and proposed, can be considered.

Securities listed in Canada and the United States

[Dealer Member Rule 100.2(f)(i)]

The current Dealer Member Rule sets out the market price per share based capital and margin requirements for listed securities (other than bonds and debentures) including rights and warrants listed on any recognized stock exchange in Canada or the United States. The

proposed amendments seek to revise this Rule to replace market price per share based margining methodology with the “basic margin rate” margining methodology.¹⁵

As part of these amendments, the following text has been added:

“Positions in securities listed on markets or market tiers with initial or ongoing financial listing requirements that do not include adequate minimum pre-tax profit, net tangible asset and working capital requirements, as determined by the Corporation from time to time, may not be carried on margin.”¹⁶

This text replaces the previous list in IDA Regulation 100.2(f)(i) of specific markets and market tiers that are not eligible for margin with a general rule. The intention of this specific change was to make transparent the requirement of issuers to meet basic financial solvency requirements (such as adequate minimum pre-tax profit, net tangible asset and working capital requirements) before regulatory value can be extended to their equity security issuances. The Corporation will publish on a regular basis those markets and market tiers that are not eligible for margin due to presence of inadequate initial and ongoing financial listing requirements.

Index constituent securities listed outside of Canada and the United States

[Dealer Member Rule 100.2(f)(ii)]

This Rule extends 50% loan value to listed securities that are constituent securities of a major index on a recognized exchange other than in Canada and the United States. Previously, loan value was only extended outside of Canada and the United States to securities traded on the London and Tokyo stock exchanges. The Rule extends loan value to broad based index constituent securities that are listed on exchanges that qualify as “recognized exchanges and associations” for the purposes of determining “regulated entities” pursuant to Form 1.¹⁷

Bank issued warrants

[Dealer Member Rule 100.2(f)(iii)]

This Rule separates the existing requirements for bank issued warrants from the capital and margin requirements for other listed securities.¹⁸

Unlisted securities eligible for margin

[Dealer Member Rule 100.2(f)(iv)]

Renumbered Dealer Member Rule 100.2(f)(iv)¹⁹ [formerly IDA Regulation 100.2(f)(ii)], which applies to unlisted securities, incorporates both the proposed “basic margin rate” margining methodology and the existing traded price per share methodology. In essence, where a published rate using the “basic margin rate” methodology is available, this rate can be used;

¹⁵ The proposed amendments have not yet been implemented.

¹⁶ This portion of Amendment #3 was implemented by the IDA on September 17, 2007 through the issuance IDA Bulletin #3669 and forms part of current IIROC Dealer Member Rule 100.

¹⁷ This portion of Amendment #3 was implemented by the IDA on September 17, 2007 through the issuance IDA Bulletin #3669 and forms part of current IIROC Dealer Member Rule 100.

¹⁸ This portion of Amendment #3 was implemented by the IDA on September 17, 2007 through the issuance IDA Bulletin #3669 and forms part of current IIROC Dealer Member Rule 100.

¹⁹ This portion of Amendment #3 have not yet been implemented with the exception of the renumbering of the section that applies to unlisted securities eligible for margin as Dealer Member Rule 100.2(f)(iv).

where a rate is not available, the margin rate will be determined using the existing market price per share based requirements.

Securities eligible for reduced margin

[Repealed]

Previous IDA Regulation 100.2(f)(iv), which related to listed securities eligible for reduced margin, has been repealed. The remaining paragraphs of previous IDA Regulation 100.2(f) have been renumbered and have received only simplifying changes.²⁰

AMENDMENT #4 - MUTUAL FUNDS

[Dealer Member Rule 100.2(l)]

Existing Dealer Member Rule 100.2(l) which permits a 5% margin rate for money market mutual funds has been incorporated into the drafting of Dealer Member Rule 100.2(f)(iv) and therefore Dealer Member Rule 100.2(l) will be repealed.

AMENDMENT #5 - UNDERWRITING

[Dealer Member Rule 100.5]

Reduced “normal new issue margin” rates were introduced when changes were implemented to the capital requirements for underwriting commitments on March 1, 2005. These reduced rates were not intended to be permanent, but rather were intended to be an interim measure designed to permit the use of lower new issue margin rates until such time as the lower “basic margin rate” methodology rates were available for all listed equity securities. As a result, the removal of the definition of and references to the term “normal new issue margin” is being proposed.

AMENDMENT #6 - INVENTORY POSITIONS

[Dealer Member Rule 100.12]

Note to Rule Amendment Paper - Portions of Amendment #6 were implemented by the IDA on September 17, 2007 through the issuance IDA Bulletin #3669. These portions therefore have already been incorporated into IIROC Dealer Member Rule 100. A modified discussion of these amendments has been left in this paper so that the collective effect of the new methodology for margining equity securities, both previously implemented and proposed, can be considered.

Securities eligible for reduced margin

[Repealed]

Dealer Member Rule 100.12(a), which grants a 25% margin rate to securities against which options issued by the Options Clearing Corporation are traded, will be repealed.

²⁰ This portion of Amendment #3 was implemented by the IDA on September 17, 2007 through the issuance IDA Bulletin #3669 and forms part of current IIROC Dealer Member Rule 100.

Government-guaranteed securities

[Dealer Member Rule 100.12(a)]

Renumbered Dealer Member Rule 100.12(a) [formerly Dealer Member Rule 100.12(b)].

Floating rate preferred shares

[Dealer Member Rule 100.12(b)]

Renumbered Dealer Member Rule 100.12(b) [formerly Dealer Member Rule 100.12(c)], which refers to convertible floating rate preferred shares, has been amended to be consistent with the amendments made to the margin requirements for convertible debentures, as mentioned above in the amendments made to Dealer Member Rule 100.2(a)(v).²¹

Floating rate debt obligations

[Dealer Member Rule 100.12(c)]

Renumbered Dealer Member Rule 100.12(c) [formerly Dealer Member Rule 100.12(d)].

Bank warrants for government securities

[Dealer Member Rule 100.12(c)]

Renumbered Dealer Member Rule 100.12(c) [formerly Dealer Member Rule 100.12(d)].

Securities held in a registered trader's account

[Repealed]

This proposal seeks to repeal both existing Dealer Member Rule 100.12(f) and existing Line 7 of Schedule 2 of Form 1. The remainder of this section includes an excerpt from a previously submitted IDA rule amendment proposal which details the rationale for the registered trader rule amendment proposals:

“Existing Regulation 100.12(f) and Schedule 2 of Form 1 set out the margin reductions available for security positions held in a registered trader's account and the minimum margin requirements for registered traders, respectively.

In recent years, both the Toronto Stock Exchange and the Bourse de Montréal have introduced market-making reforms whereby responsibilities have been assigned to participating organizations rather than individual registered traders, specialists and market makers. As market-making risk has been transferred from individuals to Member firms, Regulation 100.12(f) and certain requirements in Schedule 2 of Form 1 are no longer necessary.

The main objective of this proposal is to repeal Regulation 100.12(f) and amending Schedule 2 of Form 1 to reflect the transfer of market-making responsibilities from individuals to Member firms by the Toronto Stock Exchange and the Bourse de Montréal.

The proposal seeks to:

- Eliminate the 25% reduced margin granted to registered traders for certain security positions for which they have on post trading privileges [Current Regulation 100.12(f)]; and

²¹ This portion of Amendment #6 was implemented by the IDA on September 17, 2007 through the issuance IDA Bulletin #3669 and forms part of current IIROC Dealer Member Rule 100.

- Eliminate the minimum margin requirement for Toronto Stock Exchange registered traders (\$50,000 per trader) and for Bourse de Montréal registered specialists (\$50,000 per specialist) [Current Form 1, Schedule 2, Line 7]

The net effect of these proposals, if implemented alone, would be an overall increase in margin requirements for security positions held by an active trader/specialist. The equity margin project proposals, which are pending final approval, are likely to reduce the margin requirements for security positions held in all account, including trader/specialist accounts, since margin rates will be based on the actual market risk of each individual listed security rather than traded price per share. To mitigate any increase in margin requirements, which will ultimately be decreased when the equity margin project proposals are implemented, it is intended that these market-making proposals and the equity margin project proposals will be implemented on the same date. As a result, the impact of these proposed amendments is not expected to be significant in terms of impact on market structure, competition, and costs of compliance and other rules.”

Index participation units and index baskets

[Repealed]

Previous IDA Regulation 100.12(g), which set out the capital requirements for Dealer Member account positions in index participation units and index baskets will be repealed as there is no longer a need to have different Dealer Member account and customer account requirements for these products.²²

Debt and equity security offsets with futures and forwards

[Regulation 100.12(e)]

Renumbered Dealer Member Rule 100.12(e) [formerly Dealer Member Rule 100.12(g)].

AMENDMENT #7 - SECURITIES HELD IN A REGISTERED TRADER’S ACCOUNT

[Form 1, Schedule 2]

Refer to discussion which proposes that Dealer Member Rule 100.12(f) be repealed. For the same reasons it is proposed that Line 7 of Schedule 2 of Form 1 be repealed.

B ISSUES AND ALTERNATIVES CONSIDERED

The main concern with the current “market price per share” approach to margining equity securities is that there is no evidence that market price per share is an accurate indicator of a security’s market risk. It is believed that the relative inaccuracy of the current approach was also recognized when the current requirements were originally implemented. This is because the current margin requirement methodology generally results in the use of conservative margin rates, even in today’s volatile markets, in relation to the market risk associated with the equity securities.

Another relatively minor concern with the current rules is the related “strategy-based” rules for offsets involving equity securities. These rules need to be updated to more closely track the market risk associated with the offsets as well as address some of the other inaccuracies in the rules. To a large extent, the proposed “basic margin rate” methodology will address these needs.

²² This portion of Amendment #6 was implemented by the IDA on September 17, 2007 through the issuance IDA Bulletin #3669 and forms part of current IIROC Dealer Member Rule 100.

The main objective of the "basic margin rate" methodology is to replace the existing margin rate methodology with a methodology that more accurately tracks market risk. In order to develop a replacement methodology, the FAS Capital Formula Subcommittee reviewed various methodologies with the requirements that: (i) the methodology selected would have to accurately track an individual security's market risk by measuring both price risk and liquidity risk²³; and (ii) the methodology selected would have to be reasonably simple to implement both from an operational and investor education standpoint. The methodology selected and referred to, as the "basic margin rate" methodology is essentially a methodology for determining a customized margin rate for each equity security.

As previously stated, there are alternatives to the "basic margin rate" methodology that we could have selected as a replacement to the current market price per share based methodology. Some of these alternatives are as follows:

- Value at risk (VaR) modeling
- TIMS or SPAN for positions in and offsets involving exchange-traded derivatives
- Position risk requirement (PRR) or similar portfolio margining methodology

These approaches were rejected as an appropriate replacement for the current market price per share based methodology not because they were inaccurate, but rather because they would be less straightforward to implement both from an operational and investor education standpoint.

Of note, the Corporation has already amended its rules to grant Dealer Members the option of using TIMS or SPAN to margin their proprietary inventory positions in and offsets involving exchange-traded derivatives and a separate proposal will be forthcoming to grant Member firms the option of using VaR modeling to margin their proprietary inventory. It is also likely that the optional use of a portfolio margining methodology will be studied at a future date. However, none of these methodologies are easily applicable retail customer account margining.

C COMPARISON WITH SIMILAR PROVISIONS

RULES IN OTHER JURISDICTIONS - UNITED STATES AND UNITED KINGDOM

Neither the United States nor the United Kingdom have similar "basic margin rate" rules to those being proposed that are made available for use in margining both dealer proprietary inventory and retail customer account positions. Both jurisdictions employ a version of a market price per share based margin requirement as their basic margining methodology to be used for retail customer account positions.

In the United Kingdom, a more sophisticated methodology, referred to as the Position Risk Requirement ("PRR"), may be used by a dealer in margining its own proprietary inventory. This PRR methodology allows for the reduction in the margin otherwise required for a basket of securities if a sufficient level of diversification across industries can be demonstrated.

In the United States, effective August 2004, certain securities dealers have been granted an option to use VaR modeling (as part of an alternative financial filing approach known as the Alternative Net Capital Requirement) as a basis for margining their own proprietary inventory. Dealers electing to use the VaR modeling alternative are subject to "enhanced net capital, early

²³ Since the main components of market risk are price risk and liquidity risk, and margin requirements should be designed to cover market risk, no other approaches were seriously considered.

warning, recordkeeping, reporting, and certain other requirements, and must implement and document an internal risk management system. Furthermore, as a condition to its use of the alternative method, a broker-dealer's ultimate holding company and affiliates must consent to group-wide Commission supervision. This supervision would impose reporting (including reporting of a capital adequacy measurement consistent with the standards adopted by the Basel Committee on Banking Supervision), recordkeeping, and notification requirements on the ultimate holding company.”

Methodologies similar to that being proposed are in widespread use by derivatives clearing houses around the world. In fact, the two major methodologies in use by clearinghouses, TIMS and SPAN, employ a similar margin interval approach to determining a market risk margin requirement. The following is a summary of the assumptions used by some well known derivative clearing houses along with those included in the Corporation’s proposed “basic margin rate” methodology:

Organization	Required Statistical Confidence Level²⁴	Required Number of Days Price Risk Coverage
CDCC	3	2
OCC	5	1
LCH	3	1 or 2
CME	2 to 3	1
IIROC	3	2, 3, 4 or more
Note: These parameters are adjusted from time to time by each of the clearinghouses.		

What distinguishes the assumptions in the Corporation’s proposed methodology from those of the clearinghouses is the assumption relating to the number of days of price risk coverage. There are two reasons for this difference:

1. Clearinghouses ask for clearing fund deposits to cover the risk they assume by guaranteeing the settlement of all transactions they clear. Although similar, this is not the same risk that regulatory margin rates are designed to cover. Regulatory margin rates are designed to cover price risk over the period of time it would take to close out a security position.
2. The clearinghouses referred to in the above table are derivatives clearing houses. Exchange traded derivatives are generally only listed on the most liquid securities. As a result, the number of days price risk coverage required is lower.

The Canadian Depository for Securities Limited (CDS) implemented in October 2004 a similar market risk assessment tool, which they refer to as the “VaR method” [Note: This is not the same as VaR modeling] which is very similar to the proposed “basic margin rate” methodology. CDS uses this “VaR method” tool to determine its exposure to market risk with respect to the outstanding failed trade positions of its participants. CDS refers to the Corporation’s “basic margin rate” proposals in their “CDS Settlement Services Risk Model” discussion paper as follows:

“The VaR method of estimating market risk is an industry-standard methodology. CDS currently uses this approach to calculate the DetNet Participant Fund contributions. The VaR methodology employed is also used by the IDA to calculate the margin rates for securities in

²⁴ Expressed as number of standard deviations.

their “Equity Margin Project” proposal. CDS will adopt a VaR methodology similar to the one that underlies the proposed IDA Margin Guidelines. Since the IDA Margin Guidelines were developed for use by broker/dealers for their individual margin accounts, there will be some differences in CDS’ implementation. The major differences are:

- o The IDA Guidelines “band” the margin rates for ease of use. For example, if the IDA’s calculations result in a 5% haircut for a given security, the guidelines use 15% (i.e. any calculated haircut between 0% and 15% are scaled up to 15%). CDS will use the calculated amount instead of the assigned “banded” amount.
- o The IDA proposal assigns different holding periods and a “liquidity factor” to security margin rates based on the liquidity of the security. The guidelines assume that it might take 2 days to liquidate a position in a “higher-than-typical” security and up to 4 days in a “less-than-typical” security. CDS will apply a minimum standard 3-day holding period to all securities. Securities with less than average liquidity will be applied a 5-day or 10-day holding period. The details of the treatment of liquidity are under review. CDS will be conducting daily surveillance of Participants’ CNS and ACCESS outstanding positions to identify any situations that fall outside these parameters (e.g. CNS outstanding positions that represent an unusually large proportion of the daily trading volume of a security). CDS may use its discretionary authority to request more collateral from a Participant if the surveillance identifies cases that are not addressed by the standard calculations.
- o The IDA Margin Guideline are intended to cover three standard deviations of price risk, meaning that the margin rates that are calculated in the model expect to cover the portfolio value changes in excess of 99% of the time. CDS will use a 99% confidence interval in its calculations (which is approximately 2.3 standard deviations).

CDS will conduct on-going reviews of the VaR models using back-testing of the risks from the CNS Outstandings and the adequacy of the collateral in the Participant funds. The backtesting of collateral requirements will be conducted for each Participant in each CCP service. These backtesting results will be made available to Participants. To the extent that the backtesting indicates that the collateral would have been insufficient, CDS may request additional collateral in order to maintain the required 99% confidence factor.”

It should be noted that of the three areas of difference between the CDS “VaR method” and the proposed Corporation “basic margin rate” methodology, the only difference that might suggest that Corporation parameters are less stringent than those at CDS is in the way that CDS determines the required number of days price risk coverage. This was necessary for CDS as its risk model was designed to cover market risk associated with both listed and unlisted equity securities, while the Corporation proposals focus on addressing the market risk associated with only listed equity securities.

D SYSTEMS IMPACT OF RULE

A previous section has described the likely impacts of this proposal on Dealer Members both in terms of operational impacts and credit risk assessment impacts.

There will also be impacts at third party service bureaus. Most Dealer Members use one of three third party service bureaus (ADP, ADP Dataphile and IBM) to assist them in the preparation of books and records relating to customer account cash and security positions. When the rule changes are implemented these service bureaus will need to change their approach for determining margin rates from a formula driven approach (where margin rates are determined based on market price per share) to a table driven approach (where margin rates are published on a regular basis by the Corporation). While the table driven margin rate approach is currently

being used by all service bureaus on a limited basis²⁵, it is likely that some of the services bureaus will have to undertake significant programming changes to accommodate the proposed margin rate approach. Since programming changes will only take place once these proposals have been approved by the Corporation's recognizing regulators it is estimated that a one year implementation period will be required before the proposed "basic margin rate" methodology becomes effective.

The Bourse de Montreal is also in the process of passing these amendments. Implementation of these amendments will therefore take place once both the Corporation and the Bourse de Montreal have received approval to do so from their respective recognizing regulators.

E CLASSIFICATION OF PROPOSED AMENDMENTS

IIROC has determined that the proposed Rule amendments are a Public Comment Rule. Statements have been made elsewhere as to the nature and effects of the proposed Rule. The purposes of the proposed Rule are to:

- promote the protection of investors;
- foster fair, equitable and ethical business standards and practices; and

The proposed Rule does not impose any burden or constraint on competition or innovation that is not necessary or appropriate in furtherance of IIROC's regulatory objectives. It does not impose costs or restrictions on the activities of market participants that are disproportionate to the goals of the regulatory objectives sought to be realized.

F ANTICIPATED EFFECTIVE DATE

IIROC anticipates that the proposed Rule will be made effective on a date determined by IIROC staff after receipt by IIROC of approval by the requisite provincial securities commissions that allows for an appropriate Rule implementation period.

III COMMENTARY

A FILING IN OTHER JURISDICTIONS

The proposed amendment will be filed with each of IIROC's Recognizing Regulators, in accordance with s.3 of the Protocol.

B EFFECTIVENESS

As stated above, the objective of the proposed "basic margin rate" methodology is to determine an overall margin rate for each equity security that will more accurately address a security's market risk than the existing market price per share based methodology. The

²⁵ When the List of Securities Eligible for Reduced Margin (LSERM) was introduced for the quarter ended June 30, 2000 each of the service bureaus had to make system changes to accommodate rates provided in a table. While the changes made may have been workable for the 400-500 listings that appear on the quarterly LSERM they may no longer be workable for the approximately 30,000 listings that will have custom margin rates set under the proposal.

proposed methodology seeks to measure market risk on a security specific basis by separately measuring price and liquidity risk and then combining these measured risks into a custom margin rate for each security. It is believed this approach, setting margin rates based on a security's market risk, will be effective.

C PROCESS

This proposal was developed and recommended for approval by the FAS Capital Formula Subcommittee and reviewed and recommended for approval by the FAS Executive Committee and the Financial Administrators Section.

IV SOURCES

- IIROC Dealer Member Rule 100 and Form 1
- IDA Equity Margin Project Discussion Paper, Draft #14, dated May 11, 2005
- New York Stock Exchange and Securities Exchange Commission, Uniform Net Capital Rule, 15c3-1
- U.S. Securities Exchange Act of 1934, Alternative Net Capital Computation for Broker Dealers that Elect to be Supervised on a Consolidated Basis, Section 204.15c3-1(a)(7)
- United Kingdom Securities and Futures Authority, Rule 10-70 through 10-90, Financial Resources Requirement, Position Risk Requirement and Equity Method
- Canadian Depository for Securities Limited, "Settlement Services Risk Model" discussion paper dated June 25, 2003

V REQUIREMENT TO PUBLISH FOR COMMENT

IIROC proposes to publish for comment the accompanying proposed amendments. The IIROC Board has determined that the proposed amendments are in the public interest. Comments are sought on the proposed amendments. Comments should be made in writing. One copy of each comment letter should be delivered within 30 days of the publication of this notice, addressed to the attention of Richard Corner, Vice President, Member Regulation Policy, Investment Industry Regulatory Organization of Canada, Suite 1600, 121 King Street West, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of the Manager of Market Regulation, Ontario Securities Commission, 20 Queen Street West, 19th Floor, Box 55, Toronto, Ontario, M5H 3S8.

Those submitting comment letters should be aware that a copy of their comment letter will be made publicly available on the IIROC website (www.iiroc.ca under the heading "IIROC Rulebook - Dealer Member Rules - Policy Proposals and Comment Letters Received").

Questions may be referred to:

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**INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA
NEW METHODOLOGY FOR MARGINING EQUITY SECURITIES
DEALER MEMBER RULE 100 AND FORM 1**

BOARD RESOLUTION

THE BOARD OF DIRECTORS of the Investment Industry Regulatory Organization of Canada hereby makes the following amendments to the Dealer Member Rules and Forms of the Corporation:

1. Dealer Member Rule 100.2(a)(v) remains unchanged.
2. Dealer Member Rule 100.2(a)(xi) remains unchanged.
3. Dealer Member Rule 100.2(f) is repealed and replaced as follows:

“(f) Stocks

(i) Listed on a recognized exchange in Canada or the United States

For positions in securities listed (other than bonds and debentures but including rights and warrants other than Canadian bank warrants) on any recognized stock exchange in Canada or the United States:

Long positions - margin required

The published long position basic margin rate for the security as approved by a recognized self-regulatory organization, multiplied by the market value of the security position.

Positions in securities listed on markets or market tiers with initial or ongoing financial listing requirements that do not include adequate minimum pre-tax profit, net tangible asset and working capital requirements, as determined by the Corporation from time to time, may not be carried on margin.

Short positions - credit required

The greater of:

- (A) 100% plus the published short position basic margin rate percentage for the security as approved by a recognized self-regulatory organization, multiplied by the market value of the security position

and

- (B) Where the security is trading at less than \$2.00 per share, the calculated minimum price based requirement as follows:

Securities selling at \$1.50 to \$1.99 - \$3.00 per share

Securities selling at \$0.25 to \$1.49 - 200% of market value

Securities selling at less than \$0.25 - market value plus \$0.25 per share

For the purposes of Rule 100, the term “basic margin rate” means a customized security specific margin rate calculated based on the measured price and liquidity risk for the security. Similar to the calculation of the “floating margin rate” for index products, measured price risk is based on the maximum standard deviation

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of percentage changes in daily closing prices over the most recent 20, 90 and 260 trading days. Measured liquidity risk is based on the security's public float value and average daily volume levels. The risk assessments are combined into an overall market risk assessment and, based on that assessment, one of the following margin rates is assigned:

- 15% (only Dealer Member account positions are eligible);
- 20% (only customer account positions, where a related option or future is listed on an exchange, and Dealer Member account positions are eligible);
- 25%, 30%, 40%, 60%, 75% and 100%
- 150% (where necessary for short security positions)

(ii) **Index constituent securities listed on certain other exchanges**

For positions in securities (other than bonds and debentures but including warrants and rights), 50% of market value provided:

- (A) the exchange on which the security is listed is included on the list of exchanges and associations that qualify as "recognized exchanges and associations" for the purposes of determining "regulated entities"; and
- (B) the security is a constituent security on the exchange's major broadly based index.

(iii) **Warrants issued by a Canadian chartered bank**

For positions in warrants issued by a Canadian chartered bank which entitle the holder to purchase securities issued by the Government of Canada or any province (other than firm positions to which Rule 100.12(d) applies) the margin shall be the greater of:

- (A) the margin otherwise required by this Rule according to the published basic margin rate for the warrant; or
- (B) 100% of the margin required in respect of the security to which the holder of the warrant is entitled upon exercise of the warrant; provided that in the case of a long position the amount of margin need not exceed the market value of the warrant.

(iv) **Unlisted securities eligible for margin**

Subject to the existence of an ascertainable market among brokers or dealers, for positions in the following unlisted securities:

- (A) Securities of insurance companies licensed to do business in Canada;
- (B) Securities of Canadian banks;
- (C) Securities of Canadian trust companies;
- (D) Securities of mutual funds qualified by prospectus for sale in any province of Canada, with the exception of money market mutual funds (as defined in National Instrument 81-102) which may be margined using a rate of 5%;
- (E) Other senior securities of listed companies;
- (F) Securities which qualify as legal for investment by Canadian life insurance companies, without recourse to the basket clause;
- (G) Unlisted securities in respect of which application has been made to list on a recognized stock exchange in Canada and approval has been given subject to the filing of documents and production of evidence of satisfactory

distribution may be carried on margin for a period not exceeding 90 days from the date of such approval;

the margin or credit required shall be determined based on the published basic margin rate for the most junior listed security of the same issuer company as approved by a recognized self-regulatory organization, multiplied by the market value of the security position. Where a published rate is unavailable, the following requirements will apply:

Long positions - margin required

Securities selling at \$2.00 or more - 50% of market value

Securities selling at \$1.75 to \$1.99 - 60% of market value

Securities selling at \$1.50 to \$1.74 - 80% of market value

Securities selling under \$1.50 may not be carried on margin.

Short positions - credit required

Securities selling at \$2.00 or more - 150% of market value

Securities selling at \$1.50 to \$1.99 - \$3.00 per share

Securities selling at \$0.25 to \$1.49 - 200% of market value

Securities selling at less than \$0.25 - market value plus \$0.25 per share

(v) **Other unlisted stocks**

For positions in all other unlisted stocks not mentioned above:

Long positions - margin required

100% of market value

Short positions - credit required

Securities selling at \$0.50 or more - 200% of market value

Securities selling at less than \$0.50 - market value plus \$0.50 per share

(vi) **Index participation units and qualifying baskets of index securities**

(A) For index participation units:

(I) In the case of a long position, the floating margin rate percentage (calculated for the index participation unit based on its regulatory margin interval) multiplied by the market value of the index participation units;

(II) In the case of a short position, 100% plus the floating margin rate percentage (calculated for the index participation unit based on its regulatory margin interval) multiplied by the market value of the index participation units;

(B) For a qualifying basket of index securities:

(I) In the case of a long position, the floating margin rate percentage (calculated for a perfect basket of index securities based on its regulatory margin interval), plus the calculated incremental basket margin rate for the qualifying basket of index securities, multiplied by the market value of the qualifying basket of index securities;

(II) In the case of a short position, 100% plus the floating margin rate percentage (calculated for a perfect basket of index securities based on

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its regulatory margin interval), plus the calculated incremental basket margin rate for the qualifying basket of index securities, multiplied by the market value of the qualifying basket of index securities;

For the purposes of this subparagraph, the definitions in Rule 100.9(c)(x), Rule 100.9(c)(xii), Rule 100.9(c)(xx) and Rule 100.9(c)(xxiv) apply.”

4. Dealer Member Rule 100.2(l) is repealed.
5. Dealer Member Rule 100.5 is amended by:
 - (a) Repealing subparagraph 100.5(a)(vii); and
 - (b) Throughout the remainder of the regulation, replacing the words “normal new issue margin” with the words “normal margin”.
6. Dealer Member Rule 100.12 is amended by:
 - (a) Repealing subparagraph 100.12(a);
 - (b) Renumbering subparagraph 100.12(b) to 100.12(a);
 - (c) Renumbering subparagraph 100.12(c) to 100.12(b) and replacing the text “paragraphs (i), (ii) and (iii) of Rule 100.2(f)” with the text “paragraphs (i) or (ii) of Rule 100.2(f)”;
 - (d) Renumbering subparagraphs 100.12(d) and (e) to 100.12(c) and (d);
 - (e) Repealing subparagraph 100.12(f); and
 - (f) Renumbering subparagraph 100.12(g) to 100.12(e).
7. Line 7 of Schedule 2 of Form 1 and the accompanying notes to Line 7 are repealed and the remaining lines and notes and renumbered accordingly.

BE IT RESOLVED that the Board of Directors adopt, on this 16th day of July, 2008, the English and French versions of these amendments. The Board of Directors also authorizes IIROC Staff to make the minor changes that shall be required from time to time by the securities administrators with jurisdiction. These amendments shall take effect on the date determined by IIROC Staff.

**INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA
NEW METHODOLOGY FOR MARGINING EQUITY SECURITIES
DEALER MEMBER RULE 100 AND FORM 1**

CLEAN COPY OF AMENDMENTS

Dealer Member Rule 100.2(a)(v) – Amendment #1

Note to Rule Amendment - Amendment #1 was implemented by the IDA on September 17, 2007 through the issuance IDA Bulletin #3669. The amendments therefore have already been incorporated into IROC Dealer Member Rule 100. A revised clean copy of these amendments has been left in this paper so that the collective effect of the new methodology for margining equity securities, both previously implemented and proposed, can be considered.

- (v) Commercial and corporate bonds, debentures and notes (not in default) and non-negotiable and non-transferable trust company and mortgage loan company obligations registered in the Dealer Member's name maturing:
- | | |
|--------------------------|-------------------------|
| within 1 year | 3% of market value (*) |
| over 1 year to 3 years | 6% of market value (*) |
| over 3 years to 7 years | 7% of market value (*) |
| over 7 years to 11 years | 10% or market value (*) |
| over 11 years | 10% of market value (*) |
- (1) If convertible and selling over par, the margin required shall be the lesser of:
- (a) the sum of:
 - (i) the above rates multiplied by par value; and
 - (ii) the excess of market value over par value;
 and
 - (b) the maximum margin requirement for a convertible security calculated pursuant to Rule 100.21.
- (2) If convertible and selling at or below par, the margin required shall be the above rates multiplied by market value.
- (3) If selling at 50% of par value or less and if rated "B" or lower by either Canadian Bond Rating Service or Dominion Bond Rating Service, the margin requirement shall be 50% of market value.
- (4) In the case of U.S. pay securities if selling at 50% of par value or less and if rated "B" or lower by either Moody's or Standard & Poor's, the margin requirement shall be 50% of market value.
- (5) If convertible and a residual debt instrument (zero coupon), the margin requirement shall be the lesser of:
- (a) the greater of:
 - (i) the margin requirement for a convertible debt instrument calculated pursuant to this Regulation 100.2(a)(v); and

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- (ii) the margin requirement for a residual debt instrument (zero coupon) instrument calculated pursuant to Regulation 100.2(a)(xi);
- and;
- (b) the maximum margin requirement for a convertible security calculated pursuant to Rule 100.21.
- (6) Where such commercial and corporate bonds, debentures and notes are obligations of companies whose notes are acceptable notes as defined in Rule 100.2(a)(vi) then the margin requirements in such Rule shall apply.

Dealer Member Rule 100.2(a)(xi) - Amendment #2

Note to Rule Amendment - Amendment #2 was implemented by the IDA on September 17, 2007 through the issuance IDA Bulletin #3669. The amendments therefore have already been incorporated into IROC Dealer Member Rule 100. A revised clean copy of these amendments has been left in this paper so that the collective effect of the new methodology for margining equity securities, both previously implemented and proposed, can be considered.

(xi) **Stripped coupons and the residual debt instruments:**

The percentage of market value which is

- (A) for instruments with a term to maturity of less than 20 years, 1.5 times
- (B) for instruments with a term to maturity of 20 years or more, 3 times

the margin rate applicable to the debt instrument which has been stripped or to which the detached coupon or other evidence of interest relates, provided that in determining the term to maturity of a coupon or other evidence of interest the payment date for such interest shall be considered the maturity date. Margin in respect of residual debt instruments which are convertible into other securities shall be determined in accordance with paragraph (5) of Rule 100.2(a)(v).

Dealer Member Rule 100.2(f) – Amendment #3

Note to Rule Amendment - Portions of Amendment #3 were implemented by the IDA on September 17, 2007 through the issuance IDA Bulletin #3669. These portions therefore have already been incorporated into IROC Dealer Member Rule 100. A revised clean copy of these amendments has been left in this paper so that the collective effect of the new methodology for margining equity securities, both previously implemented and proposed, can be considered.

(f) **Stocks**

(i) **Listed on a recognized exchange in Canada or the United States**

For positions in securities listed (other than bonds and debentures but including rights and warrants other than Canadian bank warrants) on any recognized stock exchange in Canada or the United States:

Long positions - margin required

The published long position basic margin rate for the security as approved by a recognized self-regulatory organization, multiplied by the market value of the security position.

Positions in securities listed on markets or market tiers with initial or ongoing financial listing requirements that do not include adequate minimum pre-tax profit, net tangible asset and

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working capital requirements, as determined by the Corporation from time to time, may not be carried on margin.

Short positions - credit required

The greater of:

- (A) 100% plus the published short position basic margin rate percentage for the security as approved by a recognized self-regulatory organization, multiplied by the market value of the security position

and

- (B) Where the security is trading at less than \$2.00 per share, the calculated minimum price based requirement as follows:

Securities selling at \$1.50 to \$1.99 - \$3.00 per share

Securities selling at \$0.25 to \$1.49 - 200% of market value

Securities selling at less than \$0.25 - market value plus \$0.25 per share

For the purposes of Rule 100, the term “basic margin rate” means a customized security specific margin rate calculated based on the measured price and liquidity risk for the security. Similar to the calculation of the “floating margin rate” for index products, measured price risk is based on the maximum standard deviation of percentage changes in daily closing prices over the most recent 20, 90 and 260 trading days. Measured liquidity risk is based on the security’s public float value and average daily volume levels. The risk assessments are combined into an overall market risk assessment and, based on that assessment, one of the following margin rates is assigned:

- 15% (only Dealer Member account positions are eligible);
- 20% (only customer account positions, where a related option or future is listed on an exchange, and Dealer Member account positions are eligible);
- 25%, 30%, 40%, 60%, 75% and 100%
- 150% (where necessary for short security positions)

(ii) Index constituent securities listed on certain other exchanges

For positions in securities (other than bonds and debentures but including warrants and rights), 50% of market value provided:

- (A) the exchange on which the security is listed is included on the list of exchanges and associations that qualify as “recognized exchanges and associations” for the purposes of determining “regulated entities”; and
- (B) the security is a constituent security on the exchange’s major broadly based index.

(iii) Warrants issued by a Canadian chartered bank

For positions in warrants issued by a Canadian chartered bank which entitle the holder to purchase securities issued by the Government of Canada or any province (other than firm positions to which Rule 100.12(d) applies) the margin shall be the greater of:

- (A) the margin otherwise required by this Rule according to the published basic margin rate for the warrant; or
- (B) 100% of the margin required in respect of the security to which the holder of the warrant is entitled upon exercise of the warrant; provided that in the case of a long position the amount of margin need not exceed the market value of the warrant.

(iv) Unlisted securities eligible for margin

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Subject to the existence of an ascertainable market among brokers or dealers, for positions in the following unlisted securities:

- (A) Securities of insurance companies licensed to do business in Canada;
- (B) Securities of Canadian banks;
- (C) Securities of Canadian trust companies;
- (D) Securities of mutual funds qualified by prospectus for sale in any province of Canada, with the exception of money market mutual funds (as defined in National Instrument 81-102) which may be margined using a rate of 5%;
- (E) Other senior securities of listed companies;
- (F) Securities which qualify as legal for investment by Canadian life insurance companies, without recourse to the basket clause;
- (G) Unlisted securities in respect of which application has been made to list on a recognized stock exchange in Canada and approval has been given subject to the filing of documents and production of evidence of satisfactory distribution may be carried on margin for a period not exceeding 90 days from the date of such approval;

the margin or credit required shall be determined based on the published basic margin rate for the most junior listed security of the same issuer company as approved by a recognized self-regulatory organization, multiplied by the market value of the security position. Where a published rate is unavailable, the following requirements will apply:

Long positions - margin required

Securities selling at \$2.00 or more - 50% of market value

Securities selling at \$1.75 to \$1.99 - 60% of market value

Securities selling at \$1.50 to \$1.74 - 80% of market value

Securities selling under \$1.50 may not be carried on margin.

Short positions - credit required

Securities selling at \$2.00 or more - 150% of market value

Securities selling at \$1.50 to \$1.99 - \$3.00 per share

Securities selling at \$0.25 to \$1.49 - 200% of market value

Securities selling at less than \$0.25 - market value plus \$0.25 per share

(v) **Other unlisted stocks**

For positions in all other unlisted stocks not mentioned above:

Long positions - margin required

100% of market value

Short positions - credit required

Securities selling at \$0.50 or more - 200% of market value

Securities selling at less than \$0.50 - market value plus \$0.50 per share

(vi) **Index participation units and qualifying baskets of index securities**

- (A) For index participation units:

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- (I) In the case of a long position, the floating margin rate percentage (calculated for the index participation unit based on its regulatory margin interval) multiplied by the market value of the index participation units;
 - (II) In the case of a short position, 100% plus the floating margin rate percentage (calculated for the index participation unit based on its regulatory margin interval) multiplied by the market value of the index participation units;
- (B) For a qualifying basket of index securities:
- (I) In the case of a long position, the floating margin rate percentage (calculated for a perfect basket of index securities based on its regulatory margin interval), plus the calculated incremental basket margin rate for the qualifying basket of index securities, multiplied by the market value of the qualifying basket of index securities;
 - (II) In the case of a short position, 100% plus the floating margin rate percentage (calculated for a perfect basket of index securities based on its regulatory margin interval), plus the calculated incremental basket margin rate for the qualifying basket of index securities, multiplied by the market value of the qualifying basket of index securities;

For the purposes of this subparagraph, the definitions in Rule 100.9(c)(x), Rule 100.9(c)(xii), Rule 100.9(c)(xx) and Rule 100.9(c)(xxiv) apply.

Dealer Member Rule 100.2(I) - Amendment #4

[Proposed Dealer Member Rule 100.2(I) is repealed.]

Dealer Member Rule 100.5 - Amendment #5

100.5. Underwriting

- (a) In this Rule 100.5 the expression:
- (i) “appropriate documentation” with respect to the portion of the underwriting commitment where expressions of interest have been received from exempt purchasers means, at a minimum:
 - (A) that the lead manager has a record of the final affirmed exempt purchaser allocation indicating for each expression of interest:
 - (I) the name of the exempt purchaser;
 - (II) the name of the employee of the exempt purchaser accepting the amount allocated; and
 - (III) the name of the representative of the lead underwriter responsible for affirming the amount allocated to the exempt purchaser, time stamped to indicate date and time of affirmation
- and;
- (B) that the lead manager has notified in writing all the banking group participants when the entire allotment to exempt purchasers has been affirmed pursuant to Rule 100.5(a)(i)(A) so that all banking group participants may take advantage of the reduction in the capital requirement.

Under no circumstances may the lead manager reduce its own capital requirement on an underwriting commitment due to such expressions of interest from exempt purchasers without providing notification to the rest of the banking group.

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- (ii) a “commitment” pursuant to an underwriting agreement or banking group agreement to purchase a new issue of securities or a secondary issue of securities means, where all other non-pricing agreement terms have been agreed to, where two of the following three pricing terms have been agreed to:
 - (A) issue price;
 - (B) number of shares;
 - (C) commitment amount [issue price x number of shares].
- (iii) “disaster out clause” means a provision in an underwriting agreement substantially in the following form:

“The obligations of the Underwriter (or any of them) to purchase (the Securities) under this agreement may be terminated by the Underwriter (or any of them) at its option by written notice to that effect to the Company at any time prior to the Closing if there should develop, occur or come into effect or existence any event, action, state, condition or major financial occurrence of national or international consequence or any law or regulation which in the opinion of the Underwriter seriously adversely affects, or involves, or will seriously adversely affect, or involve, the financial markets or the business, operations or affairs of the Company and its subsidiaries taken as a whole.”
- (iv) “market out clause” means a provision in an underwriting agreement which permits an underwriter to terminate its commitment to purchase in the event of unsalability due to market conditions, substantially in the following form:

“If, after the date hereof and prior to the Time of Closing, the state of financial markets in Canada or elsewhere where it is planned to market the Securities is such that, in the reasonable opinion of the Underwriters (or any of them), the Securities cannot be marketed profitably, any Underwriter shall be entitled, at its option, to terminate its obligations under this agreement by notice to that effect given to the Company at or prior to the Time of Closing.”
- (v) “new issue letter” means an underwriting loan facility in a form satisfactory to the Corporation. Where the provider of the new issue letter is other than an acceptable institution, the funds that can be drawn pursuant to the letter must either be fully collateralized by high grade securities or held in escrow with an acceptable institution.

Under the terms of the new issue letter, the letter issuer will:

 - (A) provide an irrevocable commitment to advance funds based only on the strength of the new issue and the Dealer Member firm;
 - (B) advance funds to the Dealer Member firm for any portion of the commitment not sold:
 - (I) for an amount based on a stated loan value rate;
 - (II) at a stated interest rate; and
 - (III) for a stated period of time.

and;

 - (C) under no circumstances, in the event that the Dealer Member firm is unable to repay the loan at the termination date, resulting in a loss or potential loss to the letter issuer, have or seek any right of set-off against:
 - (I) collateral held by the letter issuer for any other obligations of the Dealer Member firm or the firm’s customers;
 - (II) cash on deposit with the letter issuer for any purpose whatsoever; or

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(III) securities or other assets held in a custodial capacity by the letter issuer for the Dealer Member firm either for the firm’s own account or for the firm’s customers.

in order to recover the loss or potential loss.

(vi) “normal margin” means margin otherwise required by the Rules.

(b) Where a Dealer Member has a commitment pursuant to an underwriting agreement or banking group agreement to purchase a new issue of securities or a secondary issue of securities, the following margin rates are hereby prescribed:

	<i>Without New Issue Letter</i>	<i>With new issue letter</i>
(1) Underwriting agreement does not include market out clause or disaster out clause	Normal margin required from the date of commitment.	<p>10% of normal margin from the date of the letter to the business day prior to settlement date or when the new issue letter expires, whichever is earlier;</p> <p>10% of normal margin from settlement date to 5 business days after settlement date or when the new issue letter expires, whichever is earlier, where the new issue letter has been drawn;</p> <p>25% of normal margin for the next succeeding 5 business days or when the new issue letter expires, whichever is earlier, where the new issue letter has been drawn;</p> <p>50% of normal margin for the next succeeding 5 business days or when the new issue letter expires, whichever is earlier, where the new issue letter has been drawn;</p> <p>75% of normal margin for the next succeeding 5 business days or when the new issue letter expires, whichever is earlier, where the new issue letter has been drawn;</p> <p>Otherwise, normal margin required.</p>
(2) Underwriting agreement includes disaster out clause	50% of normal margin from the date of the commitment until settlement date or the expiry of the disaster out clause, whichever is earlier; margin required as in (1) above thereafter.	10% of normal margin from the date of the commitment until settlement date or the expiry of the disaster out clause, whichever is earlier; margin required as in (1) above thereafter.
(3) Underwriting agreement includes market out clause	10% of normal margin required from the date of commitment until settlement date or the expiry of the market out clause, whichever is earlier; margin required as in (1) above thereafter.	5% of normal margin required from the date of commitment until settlement date or the expiry of the market out clause, whichever is earlier; margin required as in (1) above thereafter.

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- | | | |
|--|--|---|
| <p>(4) Underwriting agreement includes disaster out clause and market out clause</p> | <p>10% of normal margin required from the date of commitment until settlement date or the expiry of the market out clause, whichever is earlier; margin required as in (1) (2) and (3) above thereafter.</p> | <p>5% of normal margin required from the date of commitment until settlement date or the expiry of the market out clause, whichever is earlier; margin required as in (1) (2) and (3) above thereafter.</p> |
|--|--|---|

If the margin rates prescribed above in respect of commitments for which a new issue letter is available are less than the margin rates required by the issuer of such letter, the higher rates required by the issuer shall be applied.

- (c) Where a Dealer Member has a commitment pursuant to an underwriting agreement or banking group agreement to purchase a new issue of securities or a secondary issue of securities and the Dealer Member has determined through obtaining appropriate documentation:
- (i) that the allocation between retail and exempt purchasers has been finalized;
 - (ii) that expressions of interest received from the entire allotment to exempt purchasers have been verbally affirmed but not yet ticketed;
 - (iii) that there is unlikely to be a significant renege rate on the expressions of interest received from exempt purchasers; and
 - (iv) that the Dealer Member is not significantly leveraging its underwriting activities through the use of the capital requirement reduction provided on that portion of the underwriting commitment where expressions of interest have been received from exempt purchasers.

the following margin rates are hereby prescribed for the portion of the commitment allocated to exempt purchasers:

- | | <i>Without New Issue Letter</i> | <i>With new issue letter</i> |
|---|--|------------------------------|
| <p>(1) Underwriting agreement does not include market out clause or disaster out clause</p> | <p>From the date that the expressions of interest received from the entire allotment to exempt purchasers have been verbally affirmed but not yet ticketed until the date the sales are contracted:</p> <p>20% of normal margin is required, provided the current market value of the commitment is at or above 90% of new issue value (90% x issue price x number of shares);</p> <p>40% of normal margin is required, provided the current market value of the commitment is at or above 80% of new issue value (80% x issue price x number of shares) but less than 90% of new issue value;</p> <p>Otherwise normal margin is required.</p> | <p>As in (b) above</p> |
| <p>(2) Underwriting agreement includes disaster out clause</p> | <p>From the date that the expressions of interest received from the entire allotment to exempt purchasers have been verbally affirmed but</p> | <p>As in (b) above</p> |

not yet ticketed until the date the sales are contracted:

20% of normal margin is required, provided the current market value of the commitment is at or above 90% of new issue value (90% x issue price x number of shares);

40% of normal margin is required, provided the current market value of the commitment is at or above 80% of new issue value (80% x issue price x number of shares) but less than 90% of new issue value;

Otherwise normal margin is required.

(3) Underwriting agreement includes market out clause	As in (b) above	As in (b) above
(4) Underwriting agreement includes disaster out clause and market out clause	As in (b) above	As in (b) above

(d) Where:

(i) the normal margin required on any one commitment is reduced due to either:

(A) the use of a new issue letter in accordance with (b) above; or

(B) qualifying expressions of interest received from exempt purchasers that have been verbally affirmed but not yet contracted in accordance with (c) above.

and;

(ii) the margin required in respect of such commitment (in the case of (d)(i)(A) where a new issue letter is undrawn), determined in accordance with (b)(1), (2), (3) or (4) or (c)(1), (2), (3) or (4) as applicable and as if the margin reduction set out in (d)(i)(A) or (d)(i)(B) were not available, exceeds 40% of such Dealer Member's net allowable assets,

such excess shall be added to total margin required pursuant to Form 1. The amount to be deducted may be reduced by the amount of margin provided for as required by (b) or (c) above on the individual underwriting position to which such excess relates.

(e) Where:

(i) the normal margin required on some or all commitments is reduced due to either:

(A) the use of a new issue letter in accordance with (b) above; or

(B) qualifying expressions of interest received from exempt purchasers that have been verbally affirmed but not yet contracted in accordance with (c) above.

and

(ii) the aggregate margin required in respect of such commitments (in the case of (d)(i)(A) where a new issue letter is undrawn), determined in accordance with (b)(1), (2), (3) or (4) or (c)(1),

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(2), (3) or (4) as applicable and as if the margin reduction set out in (d)(i)(A) or (d)(i)(B) were not available, exceeds 100% of such Dealer Member's net allowable assets,

such excess shall be added to total margin required pursuant to Form 1. The amount to be deducted may be reduced by the amount of margin provided for as required by (b) and (c) above on individual underwriting positions and by the amount required to be deducted from risk adjusted capital pursuant to (d) above.

- (f) In determining the amount of a Dealer Member's commitment pursuant to an underwriting agreement or banking group agreement for the purposes of clauses (b), (c), (d) and (e) above, receivables from members of the banking or selling groups in respect of firm obligations to take down a portion of a new issue of securities (i.e. not after-market trading) may be deducted from the liability of the Dealer Member to the issuer.
- (g) Margining of private placements of restricted equity securities during the distribution period
For a private placement of a equity security subject to a four-month trading restriction (issued pursuant to National Instrument 45-102 or a similar provincial securities legislation exemption), the margin rate to be used during the distribution period shall be the greater of:
 - (i) The margin rate that would be otherwise applicable to the security if the restriction were not present, subject to the margin rate reductions available in this Rule 100.5; and
 - (ii)
 - (a) where it is five business days or less subsequent to the offering commitment date, 25%;
 - (b) where it is greater than five business days subsequent to the offering commitment date, 50%.

The margin rate to be used commencing on the offering settlement date shall be 100%.

Dealer Member Rule 100.12 – Amendment #6

Note to Rule Amendment - Portions of Amendment #6 were implemented by the IDA on September 17, 2007 through the issuance IDA Bulletin #3669. These portions therefore have already been incorporated into IIROC Dealer Member Rule 100. A revised clean copy of these amendments has been left in this paper so that the collective effect of the new methodology for margining equity securities, both previously implemented and proposed, can be considered.

100.12. Notwithstanding Rule 100.2, margin on securities owned or sold short by a Dealer Member shall be provided at the following rates:

- (a) **Government-guaranteed securities** - 25% of the market value of shares in respect of which the payment of all dividends and the redemption amount or other return of capital to the holder is unconditionally guaranteed by the Government of Canada or of a province of Canada.
- (b) **Floating rate preferred shares**
 - (i) 50% of the margin rate that applies to the related junior security of the issuer multiplied by the market value of the floating rate preferred shares;
 - (ii) If the floating rate preferred shares are selling over par and are convertible into other securities of the issuer, the margin required shall be the lesser of:
 - (A) the sum of:
 - (I) the effective rate determined in Rule 100.12(b)(i) multiplied by par value; and
 - (II) the excess of market value over par value;

and

(B) the maximum margin requirement for a convertible security calculated pursuant to Rule 100.21.

(iii) 50%, if the issuer of the shares is in default of the payment of any dividend on the shares, in which case the foregoing clauses shall not apply.

For the purposes of this Rule 100.12(b), the term "floating rate preferred share" means a special or preferred share described in paragraphs (i) or (iv) of Rule 100.2(f), by the terms of which the rate of dividend fluctuates at least quarterly in tandem with a prescribed short term interest rate.

(c) Floating rate debt obligations

50% of the percentage rates of margin otherwise required, except, if margin is otherwise required in respect of excess market value over par, 100% of the rates of margin otherwise required shall apply to the excess market value.

For the purposes of this Rule 100.12(c), the term "floating rate debt obligation" means a debt instrument described in Rule 100.2(a)(i), (ii), (iii), or (vi) or in Rule 100.2(b) by the terms of which the rate of interest is adjusted at least quarterly by reference to interest rate for periods of 90 days or less.

(d) Bank warrants for government securities

100% of the margin required in respect of the securities to which the holder of the warrant is entitled upon exercise of the warrant provided that, in the case of a long position, margin need not exceed the market value of the warrant.

For the purposes of this Rule 100.12(d), bank warrants for government securities means warrants issued by a Canadian chartered bank which are listed on any recognized stock exchange or other listing organization referred to in Rule 100.2(f)(i) and which entitle the holder to purchase securities issued by the Government of Canada or any province thereof.

(e) Debt and equity security offsets with futures and forwards

A Dealer Member's long or short position (including forward commitments) in bonds, debentures or treasury bills issued or guaranteed by the Government of Canada or in securities (other than bonds and debentures) posted for trading on the Toronto Stock Exchange which is covered by a position on a commodity futures exchange shall be exempt from the capital charges otherwise provided herein. Capital charges based on the applicable rates shall be on the net long or short position (including forward commitments).

Amendment #7 – Form 1, Schedule 2

DATE: _____

SCHEDULE 2

**PART II
JOINT REGULATORY FINANCIAL QUESTIONNAIRE AND REPORT**

(Firm Name)

ANALYSIS OF SECURITIES OWNED AND SOLD SHORT AT MARKET VALUE

Category	-----Market Value-----		Margin required
	Long	Short	
1. Money market	\$ _____	\$ _____	\$ _____
Accrued interest	_____	_____	NIL
TOTAL MONEY MARKET	_____	_____	
2. Bonds	_____	_____	_____
Accrued interest	_____	_____	NIL
TOTAL BONDS	_____	_____	
3. Equities	_____	_____	_____
Accrued interest on convertible debentures	_____	_____	NIL
TOTAL EQUITIES	_____	_____	
4. Options	_____	_____	_____
5. Futures	NIL	NIL	_____
6. Other	_____	_____	_____
Accrued interest	_____	_____	NIL
TOTAL OTHER	_____	_____	
7. TOTAL	_____	\$ _____ A-52	\$ _____ B-7
8. LESS: Securities, including accrued interest, segregated for client free credit ratio calculation <i>[see instructions]</i>	_____	_____	_____
		A-8 & D-7	
9. NET TOTAL	\$ _____ A-7		

SUPPLEMENTARY INFORMATION

10. Market value of securities included above but held on deposit with Acceptable Clearing Corporations or Regulated Entities as variable base deposits or margin deposits	\$ _____
11. Margin reduction from offsets against Trader reserves, PDO guarantees or General allowances	\$ _____

[see notes and instruction]

**SCHEDULE 2
NOTES AND INSTRUCTIONS**

1. All securities are to be valued at market (see General Notes and Definitions) as of the reporting date. The margin rates to be used are those outlined in the bylaws, rules and regulations of the Joint Regulatory Bodies and the Canadian Investor Protection Fund.
2. Schedule 2 summarizes **all** securities owned and sold short by the categories indicated. Details that must be included for each category are total long market value, total short market value and total margin required as indicated.
3. Where the firm utilizes the computerized options margining program of a recognized Exchange operating in Canada, the margin requirement produced by such program may be used provided the positions in the firm's records agree with the positions in the Exchange computer. No details of such positions are to be reported if the programs are employed. Details of any adjustments made to the margin calculated by an Exchange computer-margining program must be provided. For the purposes of this paragraph, recognized Exchange means The Montreal Exchange.
4. The Examiners and/or Auditors of the Joint Regulatory Bodies may request additional details of securities owned or sold short as they, in their discretion, believe necessary.
5. Where there are margin offsets between categories, the residual should be shown in the category with the larger initial margin required before offsets.

Line 1 - Money market shall include Canadian & US Treasury Bills, Bankers Acceptances, Bank paper (Domestic & Foreign), Municipal and Commercial Paper or other similar instruments.

Supplementary instructions for reporting money market commitments:

"Market Price" for money market commitments [fixed-term repurchases, calls, etc.] shall be calculated as follows:

- (a) 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.
- (b) 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 (a) and commitment price is to be determined in the same manner using the yield stated in the repurchase commitment.
- (c) Repurchase with borrower call features - the market price is the borrower call price. No margin is required where the total consideration for which the holder can put the security back to the dealer is less than the total consideration for which the dealer may put the security back to the issuer. However, where a holder consideration exceeds dealer consideration [the dealer has a loss], the margin required is the lesser of:
 - (1) the prescribed rate appropriate to the term of the security, and
 - (2) the spread between holder consideration and dealer consideration [the loss] based on the call features subject to a minimum of $\frac{1}{4}$ of 1% margin.

Line 8 - The securities to be included are bonds, debentures, treasury bills and other securities with a term of 1 year or less, or guaranteed by the Government of Canada or a Province of Canada, the United Kingdom, the United States of America and any other national foreign government (provided such other foreign government is a party to the Basle Accord), which are segregated and held separate and apart as the Member firm's property.

Line 11 - Include margin reductions from offsets against IA reserves only to the extent there is a written agreement between the firm and the trader permitting the firm to recover realized or unrealized losses from the IA reserve account. Include margin reductions arising from guarantees relating to inventory accounts by Partners, Directors, and Officers of the firm (PDO Guarantees). Include margin reductions arising from offsets against non-specific allowances of the firm.

**INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA
NEW METHODOLOGY FOR MARGINING EQUITY SECURITIES
DEALER MEMBER RULE 100 AND FORM 1**

BLACK-LINE COPY OF AMENDMENTS

Dealer Member Rule 100.2(a)(v) – Amendment #1

Note to Rule Amendment - Amendment #1 was implemented by the IDA on September 17, 2007 through the issuance IDA Bulletin #3669. A black-line of these amendments is therefore unnecessary.

Dealer Member Rule 100.2(a)(xi) - Amendment #2

Note to Rule Amendment - Amendment #2 was implemented by the IDA on September 17, 2007 through the issuance IDA Bulletin #3669. A black-line of these amendments is therefore unnecessary.

Dealer Member Rule 100.2(f) – Amendment #3

(f) **Stocks**

(i) **Listed on ~~an~~ a recognized exchange in Canada or the United States**

For positions in securities listed (other than bonds and debentures but including rights and warrants other than Canadian bank warrants) on any recognized stock exchange in Canada or the United States:

~~Long Positions – Margin Required~~

~~Securities selling at \$2.00 or more – 50% of market value~~

~~Securities selling at \$1.75 to \$1.99 – 60% of market value~~

~~Securities selling at \$1.50 to \$1.74 – 80% of market value~~

~~Securities selling under \$1.50 may not be carried on margin~~

Long positions - margin required

The published long position basic margin rate for the security as approved by a recognized self-regulatory organization, multiplied by the market value of the security position.

Positions in securities listed on markets or market tiers with initial or ongoing financial listing requirements that do not include adequate minimum pre-tax profit, net tangible asset and working capital requirements, as determined by the Corporation from time to time, may not be carried on margin.

~~Short Positions – Credit Required~~

~~Securities selling at \$2.00 or more – 150% of market value~~

Short positions - credit required

The greater of:

(A) 100% plus the published short position basic margin rate percentage for the security as approved by a recognized self-regulatory organization, multiplied by the market value of the security position

and

(B) Where the security is trading at less than \$2.00 per share, the calculated minimum price based requirement as follows:

Securities selling at \$1.50 to \$1.99 - \$3.00 per share

Securities selling at \$0.25 to \$1.49 - 200% of market value

Securities selling at less than \$0.25 - market value plus \$0.25 per share

For the purposes of Rule 100, the term “basic margin rate” means a customized security specific margin rate calculated based on the measured price and liquidity risk for the security. Similar to the calculation of the “floating margin rate” for index products, measured price risk is based on the maximum standard deviation of percentage changes in daily closing prices over the most recent 20, 90 and 260 trading days. Measured liquidity risk is based on the security’s public float value and average daily volume levels. The risk assessments are combined into an overall market risk assessment and, based on that assessment, one of the following margin rates is assigned:

- 15% (only Dealer Member account positions are eligible);
- 20% (only customer account positions, where a related option or future is listed on an exchange, and Dealer Member account positions are eligible);
- 25%, 30%, 40%, 60%, 75% and 100%
- 150% (where necessary for short security positions)

(ii) Index constituent securities listed on certain other exchanges

For positions in securities (other than bonds and debentures but including warrants and rights), 50% of ~~the~~ market value provided:

- (A) the exchange on which the security is listed is included on the list of exchanges and associations that qualify as “recognized exchanges and associations” for the purposes of determining “regulated entities”; and
- (B) the security is a constituent security on the exchange’s major broadly based index.

(iii) Warrants issued by a Canadian chartered bank

For positions in warrants issued by a Canadian chartered bank which entitle the holder to purchase securities issued by the Government of Canada or any province (other than firm positions to which Rule 100.12(~~ed~~) applies) the margin shall be the greater of:

- (A) the margin otherwise required by this Rule according to the ~~market value of~~ published basic margin rate for the warrant; or
- (B) 100% of the margin required in respect of the security to which the holder of the warrant is entitled upon exercise of the warrant; provided that in the case of a long position the amount of margin need not exceed the market value of the warrant.

(iv) Unlisted securities eligible for margin

Subject to the existence of an ascertainable market among brokers or dealers, for positions in the following unlisted securities ~~shall be accepted for margin purposes on the same basis as listed stocks:~~

- (A) Securities of insurance companies licensed to do business in Canada;
- (B) Securities of Canadian banks;
- (C) Securities of Canadian trust companies;

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(D) Securities of mutual funds qualified by prospectus for sale in any province of Canada, with the exception of money market mutual funds (as defined in National Instrument 81-102) which may be margined using a rate of 5%;

(E) Other senior securities of listed companies;

(F) Securities which qualify as legal for investment by Canadian life insurance companies, without recourse to the basket clause;

(G) Unlisted securities in respect of which application has been made to list on a recognized stock exchange in Canada and approval has been given subject to the filing of documents and production of evidence of satisfactory distribution may be carried on margin for a period not exceeding 90 days from the date of such approval;

~~(G) All securities listed on The Nasdaq Stock MarketSM (Nasdaq National Market[®] and The Nasdaq SmallCap MarketSM);~~

the margin or credit required shall be determined based on the published basic margin rate for the most junior listed security of the same issuer company as approved by a recognized self-regulatory organization, multiplied by the market value of the security position. Where a published rate is unavailable, the following requirements will apply:

Long positions - margin required

Securities selling at \$2.00 or more - 50% of market value

Securities selling at \$1.75 to \$1.99 - 60% of market value

Securities selling at \$1.50 to \$1.74 - 80% of market value

Securities selling under \$1.50 may not be carried on margin.

Short positions - credit required

Securities selling at \$2.00 or more - 150% of market value

Securities selling at \$1.50 to \$1.99 - \$3.00 per share

Securities selling at \$0.25 to \$1.49 - 200% of market value

Securities selling at less than \$0.25 - market value plus \$0.25 per share

(v) **Other unlisted stocks**

For positions in all other unlisted stocks not mentioned above:

~~Long Positions~~—positions - margin required:

100% of market value

~~Short Positions~~—positions - credit required:

Securities selling at \$0.50 or more — 200% of market value

Securities selling at less than \$0.50 — market value plus ~~\$.05~~\$0.50 per share

~~(vi) Securities eligible for reduced margin~~

~~On securities which are described in clauses (i), (ii), (iii) and (iv) of Rule 100.12(a) (securities eligible for reduced margin), margin shall be 30% of market value.~~

(vi) Index participation units and qualifying baskets of index securities

(A) For index participation units:

(i) In the case of a long position, the floating margin rate percentage (calculated for the index participation unit based on its regulatory margin interval) multiplied by the market value of the index participation units;

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- (II) In the case of a short position, 100% plus the floating margin rate percentage (calculated for the index participation unit based on its regulatory margin interval) multiplied by the market value of the index participation units;
- (B) For a qualifying basket of index securities:
 - (I) In the case of a long position, the floating margin rate percentage (calculated for a perfect basket of index securities based on its regulatory margin interval), plus the calculated incremental basket margin rate for the qualifying basket of index securities, multiplied by the market value of the qualifying basket of index securities;
 - (II) In the case of a short position, 100% plus the floating margin rate percentage (calculated for a perfect basket of index securities based on its regulatory margin interval), plus the calculated incremental basket margin rate for the qualifying basket of index securities, multiplied by the market value of the qualifying basket of index securities;

For the purposes of this subparagraph, the definitions in Rule 100.9(c)(x), Rule 100.9(c)(xii), Rule 100.9(c)(xx) and Rule 100.9(c)(xxiv) apply.

Dealer Member Rule 100.2(I) - Amendment #4

[Dealer Member Rule 100.2(I) is repealed.]

Dealer Member Rule 100.5 - Amendment #5

100.5. Underwriting

- (a) In this Rule 100.5 the expression:
 - (i) “appropriate documentation” with respect to the portion of the underwriting commitment where expressions of interest have been received from exempt purchasers means, at a minimum:
 - (A) that the lead manager has a record of the final affirmed exempt purchaser allocation indicating for each expression of interest:
 - (I) the name of the exempt purchaser;
 - (II) the name of the employee of the exempt purchaser accepting the amount allocated; and
 - (III) the name of the representative of the lead underwriter responsible for affirming the amount allocated to the exempt purchaser, time stamped to indicate date and time of affirmation
- and;
- (B) that the lead manager has notified in writing all the banking group participants when the entire allotment to exempt purchasers has been affirmed pursuant to Rule 100.5(a)(i)(A) so that all banking group participants may take advantage of the reduction in the capital requirement.

Under no circumstances may the lead manager reduce its own capital requirement on an underwriting commitment due to such expressions of interest from exempt purchasers without providing notification to the rest of the banking group.
- (ii) a “commitment” pursuant to an underwriting agreement or banking group agreement to purchase a new issue of securities or a secondary issue of securities means, where all other non-pricing agreement terms have been agreed to, where two of the following three pricing terms have been agreed to:

- (A) issue price;
 - (B) number of shares;
 - (C) commitment amount [issue price x number of shares].
- (iii) “disaster out clause” means a provision in an underwriting agreement substantially in the following form:
- “The obligations of the Underwriter (or any of them) to purchase (the Securities) under this agreement may be terminated by the Underwriter (or any of them) at its option by written notice to that effect to the Company at any time prior to the Closing if there should develop, occur or come into effect or existence any event, action, state, condition or major financial occurrence of national or international consequence or any law or regulation which in the opinion of the Underwriter seriously adversely affects, or involves, or will seriously adversely affect, or involve, the financial markets or the business, operations or affairs of the Company and its subsidiaries taken as a whole.”
- (iv) “market out clause” means a provision in an underwriting agreement which permits an underwriter to terminate its commitment to purchase in the event of unsalability due to market conditions, substantially in the following form:
- “If, after the date hereof and prior to the Time of Closing, the state of financial markets in Canada or elsewhere where it is planned to market the Securities is such that, in the reasonable opinion of the Underwriters (or any of them), the Securities cannot be marketed profitably, any Underwriter shall be entitled, at its option, to terminate its obligations under this agreement by notice to that effect given to the Company at or prior to the Time of Closing.”
- (v) “new issue letter” means an underwriting loan facility in a form satisfactory to the Corporation. Where the provider of the new issue letter is other than an acceptable institution, the funds that can be drawn pursuant to the letter must either be fully collateralized by high grade securities or held in escrow with an acceptable institution.
- Under the terms of the new issue letter, the letter issuer will:
- (A) provide an irrevocable commitment to advance funds based only on the strength of the new issue and the Dealer Member firm;
 - (B) advance funds to the Dealer Member firm for any portion of the commitment not sold:
 - (I) for an amount based on a stated loan value rate;
 - (II) at a stated interest rate; and
 - (III) for a stated period of time.
- and;
- (C) under no circumstances, in the event that the Dealer Member firm is unable to repay the loan at the termination date, resulting in a loss or potential loss to the letter issuer, have or seek any right of set-off against:
 - (I) collateral held by the letter issuer for any other obligations of the Dealer Member firm or the firm’s customers;
 - (II) cash on deposit with the letter issuer for any purpose whatsoever; or
 - (III) securities or other assets held in a custodial capacity by the letter issuer for the Dealer Member firm either for the firm’s own account or for the firm’s customers.
- in order to recover the loss or potential loss.

(vi) “normal margin” means margin otherwise required by the Rules.

~~(vii) “normal new issue margin” means:~~

- ~~(A) where the market value of the security is \$2.00 per share or more and the security qualifies for a reduced margin rate pursuant to Rule 100.12(a), 60% of normal margin for the period from the date of commitment to the business day prior to settlement date and 100% of normal margin from settlement date on;~~
- ~~(B) where the market value of the security is \$2.00 per share or more and the security does not qualify for a reduced margin rate pursuant to Rule 100.12(a), 80% of normal margin for the period from the date of commitment to the business day prior to settlement date and 100% of normal margin from settlement date on; or~~
- ~~(C) where the market value of the security is less than \$2.00 per share, 100% of normal margin.~~

(b) Where a Dealer Member has a commitment pursuant to an underwriting agreement or banking group agreement to purchase a new issue of securities or a secondary issue of securities, the following margin rates are hereby prescribed:

	<i>Without New Issue Letter</i>	<i>With new issue letter</i>
(1) Underwriting agreement does not include market out clause or disaster out clause	Normal new issue margin required from the date of commitment.	10% of normal new issue margin from the date of the letter to the business day prior to settlement date or when the new issue letter expires, whichever is earlier; 10% of normal new issue margin from settlement date to 5 business days after settlement date or when the new issue letter expires, whichever is earlier, where the new issue letter has been drawn; 25% of normal new issue margin for the next succeeding 5 business days or when the new issue letter expires, whichever is earlier, where the new issue letter has been drawn; 50% of normal new issue margin for the next succeeding 5 business days or when the new issue letter expires, whichever is earlier, where the new issue letter has been drawn; 75% of normal new issue margin for the next succeeding 5 business days or when the new issue letter expires, whichever is earlier, where the new issue letter has been drawn; Otherwise, normal new issue margin required.

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(2) Underwriting agreement includes disaster out clause	50% of normal new issue margin from the date of the commitment until settlement date or the expiry of the disaster out clause, whichever is earlier; margin required as in (1) above thereafter.	10% of normal new issue margin from the date of the commitment until settlement date or the expiry of the disaster out clause, whichever is earlier; margin required as in (1) above thereafter.
(3) Underwriting agreement includes market out clause	10% of normal new issue margin required from the date of commitment until settlement date or the expiry of the market out clause, whichever is earlier; margin required as in (1) above thereafter.	5% of normal new issue margin required from the date of commitment until settlement date or the expiry of the market out clause, whichever is earlier; margin required as in (1) above thereafter.
(4) Underwriting agreement includes disaster out clause and market out clause	10% of normal new issue margin required from the date of commitment until settlement date or the expiry of the market out clause, whichever is earlier; margin required as in (1) (2) and (3) above thereafter.	5% of normal new issue margin required from the date of commitment until settlement date or the expiry of the market out clause, whichever is earlier; margin required as in (1) (2) and (3) above thereafter.

If the margin rates prescribed above in respect of commitments for which a new issue letter is available are less than the margin rates required by the issuer of such letter, the higher rates required by the issuer shall be applied.

- (c) Where a Dealer Member has a commitment pursuant to an underwriting agreement or banking group agreement to purchase a new issue of securities or a secondary issue of securities and the Dealer Member has determined through obtaining appropriate documentation:
- (i) that the allocation between retail and exempt purchasers has been finalized;
 - (ii) that expressions of interest received from the entire allotment to exempt purchasers have been verbally affirmed but not yet ticketed;
 - (iii) that there is unlikely to be a significant renege rate on the expressions of interest received from exempt purchasers; and
 - (iv) that the Dealer Member is not significantly leveraging its underwriting activities through the use of the capital requirement reduction provided on that portion of the underwriting commitment where expressions of interest have been received from exempt purchasers.

the following margin rates are hereby prescribed for the portion of the commitment allocated to exempt purchasers:

	<i>Without New Issue Letter</i>	<i>With new issue letter</i>
(1) Underwriting agreement does not include market out clause or disaster out clause	From the date that the expressions of interest received from the entire allotment to exempt purchasers have been verbally affirmed but not yet ticketed until the date the sales are contracted: 20% of normal new issue margin is required, provided the current market value of the commitment is at or above 90% of new issue value (90% x issue price x number	As in (b) above

of shares);
 40% of normal ~~new-issue~~ margin is required, provided the current market value of the commitment is at or above 80% of new issue value (80% x issue price x number of shares) but less than 90% of new issue value;

Otherwise normal ~~new-issue~~ margin is required.

(2) Underwriting agreement includes disaster out clause From the date that the expressions of interest received from the entire allotment to exempt purchasers have been verbally affirmed but not yet ticketed until the date the sales are contracted:

20% of normal ~~new-issue~~ margin is required, provided the current market value of the commitment is at or above 90% of new issue value (90% x issue price x number of shares);

40% of normal ~~new-issue~~ margin is required, provided the current market value of the commitment is at or above 80% of new issue value (80% x issue price x number of shares) but less than 90% of new issue value;

Otherwise normal ~~new-issue~~ margin is required.

(3) Underwriting agreement includes market out clause As in (b) above As in (b) above

(4) Underwriting agreement includes disaster out clause and market out clause As in (b) above As in (b) above

(d) Where:

- (i) the normal ~~new-issue~~ margin required on any one commitment is reduced due to either:
 - (A) the use of a new issue letter in accordance with (b) above; or
 - (B) qualifying expressions of interest received from exempt purchasers that have been verbally affirmed but not yet contracted in accordance with (c) above.

and;

- (ii) the margin required in respect of such commitment (in the case of (d)(i)(A) where a new issue letter is undrawn), determined in accordance with (b)(1), (2), (3) or (4) or (c)(1), (2), (3) or (4)

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as applicable and as if the margin reduction set out in (d)(i)(A) or (d)(i)(B) were not available, exceeds 40% of such Dealer Member's net allowable assets,

such excess shall be added to total margin required pursuant to Form 1. The amount to be deducted may be reduced by the amount of margin provided for as required by (b) or (c) above on the individual underwriting position to which such excess relates.

(e) Where:

- (i) the normal ~~new issue~~ margin required on some or all commitments is reduced due to either:
 - (A) the use of a new issue letter in accordance with (b) above; or
 - (B) qualifying expressions of interest received from exempt purchasers that have been verbally affirmed but not yet contracted in accordance with (c) above.

and

- (ii) the aggregate margin required in respect of such commitments (in the case of (d)(i)(A) where a new issue letter is undrawn), determined in accordance with (b)(1), (2), (3) or (4) or (c)(1), (2), (3) or (4) as applicable and as if the margin reduction set out in (d)(i)(A) or (d)(i)(B) were not available, exceeds 100% of such Dealer Member's net allowable assets,

such excess shall be added to total margin required pursuant to Form 1. The amount to be deducted may be reduced by the amount of margin provided for as required by (b) and (c) above on individual underwriting positions and by the amount required to be deducted from risk adjusted capital pursuant to (d) above.

- (f) In determining the amount of a Dealer Member's commitment pursuant to an underwriting agreement or banking group agreement for the purposes of clauses (b), (c), (d) and (e) above, receivables from members of the banking or selling groups in respect of firm obligations to take down a portion of a new issue of securities (i.e. not after-market trading) may be deducted from the liability of the Dealer Member to the issuer.
- (g) Margining of private placements of restricted equity securities during the distribution period
For a private placement of a equity security subject to a four-month trading restriction (issued pursuant to National Instrument 45-102 or a similar provincial securities legislation exemption), the margin rate to be used during the distribution period shall be the greater of:
 - (i) The margin rate that would be otherwise applicable to the security if the restriction were not present, subject to the margin rate reductions available in this Rule 100.5; and
 - (ii)
 - (a) where it is five business days or less subsequent to the offering commitment date, 25%;
 - (b) where it is greater than five business days subsequent to the offering commitment date, 50%.

The margin rate to be used commencing on the offering settlement date shall be 100%.

Dealer Member Rule 100.12 – Amendment #6

100.12. Notwithstanding Rule 100.2, margin on securities owned or sold short by a Dealer Member shall be provided at the following rates:

- ~~(a) Securities eligible for reduced margin
25% of the market value if such securities are:~~

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- ~~(i) On the list of securities eligible for reduced margin as approved by a recognized self-regulatory organization ("securities eligible for reduced margin") and such securities continue to sell at \$2.00 or more;~~
- ~~(ii) Securities against which options issued by The Options Clearing Corporation are traded;~~
- ~~(iii) Convertible into securities that qualify under item (i);~~
- ~~(iv) Non-convertible preferred and senior shares of an issuer any of whose securities qualify under item (i); or~~
- ~~(v) securities whose original issuance generated Tier 1 capital for a financial institution any of whose securities qualify under item (i) and the financial institution is under the regulatory oversight of the Office of the Superintendent of Financial Institutions of Canada.~~

~~For the purpose of this Rule 100.12(a), the Board of Directors hereby designates, as recognized self-regulatory organizations, the Canadian Venture Exchange, the Montreal Exchange and the Investment Industry Regulatory Organization of Canada.~~

- (b) Government-guaranteed securities** - 25% of the market value of shares in respect of which the payment of all dividends and the redemption amount or other return of capital to the holder is unconditionally guaranteed by the Government of Canada or of a province of Canada.

(c) Floating rate preferred shares

- (i) 50% of the margin rate that applies to the related junior security of the issuer multiplied by the market value of the floating rate preferred shares;
- (ii) If the floating rate preferred shares are selling over par and are convertible into other securities of the issuer, the margin required shall be the lesser of:
 - (A) the sum of:
 - (I) the effective rate determined in Rule 100.12(c)(i) multiplied by par value; and
 - (II) the excess of market value over par value;
 - and
 - (B) the maximum margin requirement for a convertible security calculated pursuant to Rule 100.21.
- (iii) 50%, if the issuer of the shares is in default of the payment of any dividend on the shares, in which case the foregoing clauses shall not apply.

For the purposes of this Rule 100.12(c), the term "floating rate preferred share" means a special or preferred share described in paragraphs (i), ~~or (ii) and (iii)~~ of Rule 100.2(f), by the terms of which the rate of dividend fluctuates at least quarterly in tandem with a prescribed short term interest rate.

(d) Floating rate debt obligations

50% of the percentage rates of margin otherwise required, except, if margin is otherwise required in respect of excess market value over par, 100% of the rates of margin otherwise required shall apply to the excess market value.

For the purposes of this Rule 100.12(d), the term "floating rate debt obligation" means a debt instrument described in Rule 100.2(a)(i), (ii), (iii), or (vi) or in Rule 100.2(b) by the terms of which the rate of interest is adjusted at least quarterly by reference to interest rate for periods of 90 days or less.

(ed) Bank warrants for government securities

100% of the margin required in respect of the securities to which the holder of the warrant is entitled upon exercise of the warrant provided that, in the case of a long position, margin need not exceed the market value of the warrant.

For the purposes of this Rule 100.12(ed), bank warrants for government securities means warrants issued by a Canadian chartered bank which are listed on any recognized stock exchange or other listing organization referred to in Rule 100.2(f)(i) and which entitle the holder to purchase securities issued by the Government of Canada or any province thereof.

~~(f) **Securities Held in Registered Trader's Account**~~

~~25% of the market value if such securities:~~

~~(i) Are not securities eligible for reduced margin for which the registered trader has responsibility or has "on post" trading privileges;~~

~~(ii) Have traded for a value of not less than \$2.00 per share for the previous calendar quarter.~~

~~The reduced margin rate is applicable only to a maximum total in all registered trader accounts of a Dealer Member of:~~

~~(i) \$100,000 of market value per security if 90,000 shares or more of the security were traded in the previous calendar quarter on a stock exchange recognized by the Corporation for margin purposes and the National Association of Securities Dealers Automated Quotations System; and~~

~~(ii) \$50,000 of market value per security if less than 90,000 shares of the security were traded in the previous calendar quarter on a stock exchange recognized by the Corporation for margin purposes and the National Association of Securities Dealers Automated Quotations System.~~

~~Margin for the excess position of market value on amounts over \$100,000 and \$50,000, respectively, shall be provided at the rate of 50% of market value for such securities. The total reduction in margin which is permitted by this Rule 100.12(f) shall not exceed 50% of the Dealer Member's net allowable assets.~~

(ge) Debt and equity security offsets with futures and forwards

A Dealer Member's long or short position (including forward commitments) in bonds, debentures or treasury bills issued or guaranteed by the Government of Canada or in securities (other than bonds and debentures) posted for trading on the Toronto Stock Exchange which is covered by a position on a commodity futures exchange shall be exempt from the capital charges otherwise provided herein. Capital charges based on the applicable rates shall be on the net long or short position (including forward commitments).

Amendment #7 – Form 1, Schedule 2

DATE: _____

SCHEDULE 2

**PART II
JOINT REGULATORY FINANCIAL QUESTIONNAIRE AND REPORT**

(Firm Name)

ANALYSIS OF SECURITIES OWNED AND SOLD SHORT AT MARKET VALUE

Category	-----Market Value-----		Margin required
	Long	Short	
1. Money market	\$ _____	\$ _____	\$ _____
Accrued interest	_____	_____	NIL
TOTAL MONEY MARKET	_____	_____	
2. Bonds	_____	_____	_____
Accrued interest	_____	_____	NIL
TOTAL BONDS	_____	_____	
3. Equities	_____	_____	_____
Accrued interest on convertible debentures	_____	_____	NIL
TOTAL EQUITIES	_____	_____	
4. Options	_____	_____	_____
5. Futures	NIL	NIL	_____
6. Other	_____	_____	_____
Accrued interest	_____	_____	NIL
TOTAL OTHER	_____	_____	
7. Registered traders, specialists and market makers [see instructions]	NIL	NIL	
8. TOTAL	_____	\$ _____	\$ _____
		A-52	B-7
9. LESS: Securities, including accrued interest, segregated for client free credit ratio calculation [see instructions]	_____		
	A-8 & D-7		
10. NET TOTAL	\$ _____		
	A-7		

SUPPLEMENTARY INFORMATION

~~11.10.~~ Market value of securities included above but held on deposit with Acceptable Clearing Corporations or Regulated Entities as variable base deposits or margin deposits \$ _____

~~12.11.~~ Margin reduction from offsets against Trader reserves, PDO guarantees or General allowances \$ _____

[see notes and instruction]

**SCHEDULE 2
NOTES AND INSTRUCTIONS**

1. All securities are to be valued at market (see General Notes and Definitions) as of the reporting date. The margin rates to be used are those outlined in the bylaws, rules and regulations of the Joint Regulatory Bodies and the Canadian Investor Protection Fund.
2. Schedule 2 summarizes **all** securities owned and sold short by the categories indicated. Details that must be included for each category are total long market value, total short market value and total margin required as indicated.
3. Where the firm utilizes the computerized options margining program of a recognized Exchange operating in Canada, the margin requirement produced by such program may be used provided the positions in the firm's records agree with the positions in the Exchange computer. No details of such positions are to be reported if the programs are employed. Details of any adjustments made to the margin calculated by an Exchange computer-margining program must be provided. For the purposes of this paragraph, recognized Exchange means The Montreal Exchange.
4. The Examiners and/or Auditors of the Joint Regulatory Bodies may request additional details of securities owned or sold short as they, in their discretion, believe necessary.
5. Where there are margin offsets between categories, the residual should be shown in the category with the larger initial margin required before offsets.

Line 1 - Money market shall include Canadian & US Treasury Bills, Bankers Acceptances, Bank paper (Domestic & Foreign), Municipal and Commercial Paper or other similar instruments.

Supplementary instructions for reporting money market commitments:

"Market Price" for money market commitments [fixed-term repurchases, calls, etc.] shall be calculated as follows:

- (a) 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.
- (b) 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 (a) and commitment price is to be determined in the same manner using the yield stated in the repurchase commitment.
- (c) Repurchase with borrower call features - the market price is the borrower call price. No margin is required where the total consideration for which the holder can put the security back to the dealer is less than the total consideration for which the dealer may put the security back to the issuer. However, where a holder consideration exceeds dealer consideration [the dealer has a loss], the margin required is the lesser of:
 - (1) the prescribed rate appropriate to the term of the security, and
 - (2) the spread between holder consideration and dealer consideration [the loss] based on the call features subject to a minimum of ¼ of 1% margin.

~~**Line 7** - (i) The minimum margin requirement for each TSE registered trader is \$50,000.~~

~~(ii) The minimum margin requirement for each ME registered specialist is the lesser of \$50,000 or an amount sufficient to assume a position of twenty board lots of each security in which such specialist is registered, subject to a maximum of \$25,000 per issuer.~~

~~(iii) The market maker minimum margin requirement is for the TSE \$50,000 for each specialist appointed and for the ME \$10,000 for each security and/or class of options appointed (not to exceed \$25,000 for each market maker in each preceding case). No minimum margin is required where the market maker does not have any appointment.~~

~~The above noted minimum margin for each registered trader, specialist, or market maker may be applied as an offset to reduce any margin on positions held long or short in the registered trading account of such registered trader, specialist or market maker. It cannot be used to offset margin required for any other registered trader, specialist or market maker or for any other security positions of the member.~~

~~The market values related to positions in registered traders, specialists and market maker accounts should be included in the appropriate categories in the preceding lines of the Schedule. Related margin in excess of the minimum margin reported on this line should also be included in the preceding lines.~~

~~**Line 98** - The securities to be included are bonds, debentures, treasury bills and other securities with a term of 1 year or less, or guaranteed by the Government of Canada or a Province of Canada, the United Kingdom, the United~~

Attachment #3

States of America and any other national foreign government (provided such other foreign government is a party to the Basle Accord), which are segregated and held separate and apart as the Member firm's property.

Line 1211 - Include margin reductions from offsets against IA reserves only to the extent there is a written agreement between the firm and the trader permitting the firm to recover realized or unrealized losses from the IA reserve account. Include margin reductions arising from guarantees relating to inventory accounts by Partners, Directors, and Officers of the firm (PDO Guarantees). Include margin reductions arising from offsets against non-specific allowances of the firm.

ANALYSIS OF IMPACT UPON IMPLEMENTATION**Impact based on number of listings affected (six year average)**

	Member firm rates		Customer account rates	
	Amount	Percent	Amount	Percent
Rate decrease >= 20%	472	29.01%	472	29.01%
Rate decrease < 20%	591	36.31%	631	38.79%
Rate unchanged	166	10.19%	131	8.07%
Rate increase < 20%	58	3.54%	52	3.19%
Rate increase >= 20%	341	20.94%	341	20.94%
Total number of listings	1,628	100.00%	1,628	100.00%

Impact based on traded value (six year average – dollar amounts in millions)

	Member firm rates		Customer account rates	
	Amount	Percent	Amount	Percent
Rate decrease >= 20%	\$10,228	3.52%	\$10,228	3.52%
Rate decrease < 20%	\$236,068	81.20%	\$260,393	89.56%
Rate unchanged	\$24,414	8.40%	\$7,793	2.68%
Rate increase < 20%	\$15,871	5.46%	\$8,167	2.81%
Rate increase >= 20%	\$4,151	1.43%	\$4,151	1.43%
Total traded value	\$290,732	100.00%	\$290,732	100.00%

ANALYSIS OF ONGOING IMPACT**Impact based on number of listings affected (six year average)**

	Member firm rates		Customer account rates	
	Amount	Percent	Amount	Percent
Rate decrease >= 20%	114	7.03%	106	6.51%
Rate decrease < 20%	154	9.43%	105	6.42%
Rate unchanged	1,088	66.86%	1,187	72.93%
Rate increase < 20%	115	7.07%	83	5.11%
Rate increase >= 20%	102	6.27%	93	5.69%
New listings	54	3.34%	54	3.34%
Total number of listings	1,627	100.00%	1,627	100.00%

Impact based on traded value (six year average – dollar amounts in millions)

	Member firm rates		Customer account rates	
	Amount	Percent	Amount	Percent
Rate decrease >= 20%	\$8,450	2.99%	\$7,520	2.66%
Rate decrease < 20%	\$29,528	10.43%	\$11,530	4.07%
Rate unchanged	\$195,858	69.21%	\$241,749	85.43%
Rate increase < 20%	\$36,406	12.86%	\$10,978	3.88%
Rate increase >= 20%	\$5,191	1.83%	\$3,654	1.29%
New listings	\$7,558	2.67%	\$7,558	2.67%

Attachment #4

	Member firm rates		Customer account rates	
	Amount	Percent	Amount	Percent
Total number of listings	\$282,991	100.00%	\$282,991	100.00%

SUMMARY OF “BASIC MARGIN RATE” PROPOSAL BACK-TESTING

The following table summarizes the back-testing performed to determining the adequacy of margin rates set using the proposed methodology as at December 31, 2004:

Liquidity risk category	Current margin rate approach			Proposed margin rate approach		
	Average sample¹ margin rate	Average number of sample violation days²	Average violation day percentage	Average sample¹ margin rate	Average number of sample violation days³	Average violation day percentage
“Higher than typical” (2 day coverage)	32.26%	0.00	0.00%	15.33%	0.07	0.11%
“Higher than typical” (3 day coverage)	47.99%	0.10	0.16%	19.17%	0.17	0.27%
“Typical” (4 day coverage)	59.54%	0.07	0.11%	32.08%	0.38	0.62%
“Lower than typical” (4 day coverage plus liquidity premium)	65.95%	0.17	0.27%	65.67%	0.23	0.38%
“Low” (either 75% or 100% margin rate)	Back testing work was not performed because liquidity of these issues is at such a low level that the accuracy of the actual pricing data in predicting actual realization value is suspect.					
<p>1. Back testing was performed on a sample of security issues in each of the liquidity risk categories. The total sample tested was 150 as follows:</p> <ul style="list-style-type: none"> ▪ “Higher than typical” (2 day coverage) – sample of 30 ▪ “Higher than typical” (3 day coverage) – sample of 30 ▪ “Typical” (4 day coverage) – sample of 60 ▪ “Lower than typical” (2 day coverage) – sample of 30 <p>2. To determine the number of violation days under the current method, the current margin rate for each trading day was compared to the absolute value of actual price change over the coverage period indicated by the issue’s liquidity risk categorization for each of the 62 trading days from January 1, 2005 to March 31, 2005.</p> <p>3. To determine the number of violation days under the proposed method, the proposed margin rate calculated as at December 31, 2004 was compared to the absolute value of actual price change over the coverage period indicated by the issue’s liquidity risk categorization for each of the 62 trading days from January 1, 2005 to March 31, 2005.</p>						