



**Comments Received in Response to Rules Notice [18-0153](#) – Rules Notice – Request for Comments – Dealer Member Rules – Proposed Amendments to Dealer Member Rules and Form 1 regarding the securities concentration test and designated rating organizations**

On August 9, 2018, we issued Notice 18-0153 requesting comments on the Proposed Amendments to Dealer Member Rules and Form 1 regarding the securities concentration test and designated rating organizations. IIROC received four comment letters from the following commenters:

Casgrain & Company Limited  
Desjardins Securities Inc.  
Investment Industry Association of Canada  
Leede Jones Gable Inc.

Copies of these comment letters are publicly available on IIROC's website ([www.iiroc.ca](http://www.iiroc.ca)). The comments we received and our responses to them are summarized in the table below.

Summary of Comment	IIROC Response
<b>General Comments</b>	
<p>1. Commenters generally recognized the policy rationale for the proposed amendments detailed in Notice <a href="#">18-0153</a> (<b>2018 proposed amendments</b>), and supported the use of Designated Rating Organization (DRO) credit ratings as a risk-weighting methodology for debt securities margined at <math>\leq 10\%</math>.</p> <p>However, commenters are concerned about the potential high operational cost and complexity to implement and maintain the 2018 proposed amendments. One commenter recommended that IIROC simply amend the current securities concentration rules to include all debt securities in the current calculation, with the exception of certain government-issued debt securities. The commenter noted that such a methodology, which would not use DRO credit ratings, would be cost-effective because most brokerage accounting systems already separate debt securities by asset class.</p>	<p>In the sections below, we summarized the commenters' concerns regarding the 2018 proposed amendment.</p> <p>Over the last five years, we have reviewed several alternatives with the FOAS Capital Formula Subcommittee, including the previously published proposal detailed in Notice <a href="#">14-0298</a>, which did not rely on DRO credit ratings.</p> <p>We received consistent feedback from our consultations, and published comment letters, that a DRO risk-weighting methodology for debt securities is the preferred approach to</p>

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	<p>bring debt securities into the securities concentration test.</p> <p>We also note that government debt securities are excluded from the proposed securities concentration test, with the exception of lower-rated government debt issued by governments outside of Canada, the United Kingdom, and the United States.</p>
<b>Potential high operational cost and complexity to implement and maintain the 2018 proposed amendments</b>	
Operational impacts – service provider updates	
<p>2. Commenters noted that they anticipate relatively high operational costs to update and coordinate the automation of their service provider systems to capture and aggregate debt securities by issuer to comply with the 2018 proposed amendments.</p> <p>The Investment Industry Association of Canada (IIAC), which prepared its comment letter in collaboration with a working group of IIAC Members active in fixed income markets, noted that the operational impact of aggregating debt issues for securities concentration reporting will be further complicated by the requirements to:</p> <ul style="list-style-type: none"> <li>• filter out certain issuer debt securities for the purpose of determining the overall exposure</li> <li>• apply a DRO risk-weighting methodology to determine the overall issuer exposure</li> </ul> <p>Another commenter stated that Dealer Members will need to decide if it is more cost efficient to produce the new reports internally, either manually or partially automated.</p>	<p>We recognize that including a new security type into the securities concentration test will require implementation costs to update the related reporting systems.</p> <p>We developed key revisions to the 2018 proposed amendments to provide some operational flexibility in the application of the proposed debt security test, which should reduce complexity and related costs. For example, the proposed 2-step concentration test for debt securities allows Dealer Members with non-material exposures to measure an aggregated debt issuer exposure according to a fixed risk-weight adjustment factor without the need for additional complexity, unless their exposures materially increase.</p> <p>We also proposed other revisions, and provided a key clarification, that should reduce perceived complexity and associated expense without limiting the effectiveness of the debt concentration test, such as:</p> <ul style="list-style-type: none"> <li>• streamlined the qualifications for exclusion from proposed Schedule 9B by eliminating the requirement that</li> </ul>

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	<p>“no DRO has a lower current credit rating”</p> <ul style="list-style-type: none"> <li>• eliminated the adjusted concentration charge rate methodology for debt securities</li> <li>• clarified that a Dealer Member will not necessarily need to subscribe to all DROs that cover a debt security(ies) to comply with the multiple DRO current credit rating methodology.</li> </ul> <p>We believe these Proposed Amendments will reduce complexity and the projected operational costs for implementation and compliance. At a minimum, these Proposed Amendments should provide Dealer Members more flexibility to develop operational solutions, whether through their service providers or internally, to meet the proposed requirements.</p>
<b>High DRO risk-weightings, and complexity of adjusted concentration rated for investment grade debt</b>	
Recalibrate the DRO risk-weight adjustments	
<p>3. Commenters suggested that we recalibrate the DRO risk-weighting adjustment factors to reflect better the default probability of an issuer. Specifically, two commenters noted that the proposed 80% adjustment factor for BBB-rated debt securities appeared too high.</p>	<p>We recalibrated the risk-weighting adjustment factors as indicated in proposed Schedule 9B Note 5. We reduced the adjustment factor for BBB-rated debt securities to 60%.</p>
Adjusted concentration charge rate	
<p>4. A commenter expressed support for the DRO risk-weighting methodology, but questioned the need for the adjusted concentration charge rate. The commenter believes this rate, when applied to the 150% concentration charge rate, is excessive and does not take into account the very high quality of the asset. Other comments suggested that the adjusted concentration charge rate methodology adds undue complexity to the concentration calculations.</p>	<p>The Proposed Amendments eliminate the adjusted concentration charge rate methodology, which now results in a 150% concentration charge rate for all concentration exposures tested.</p>

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<b>Concentration charge on short positions</b>	
<p>5. Two commenters questioned why we have included short positions in debt securities margined at <math>\leq 10\%</math> into the securities concentration test. These commenters note that the risk profile for short debt securities is different from long debt securities and other exposures subject to securities concentration testing. One of the commenters suggested that if IIROC decides to include short debt security exposures in the securities concentration test that we consider evaluating the short position exposure according to loan value rather than market value for the purpose of the concentration charge. .</p>	<p>We recognize that short debt security exposures have a different risk profile than long debt exposures, or other securities subject to the securities concentration test. However, short debt security exposures are still a source of concentration risk.</p> <p>We propose to include short debt security exposures in proposed Schedule 9B according to loan value rather than market value.</p>
<b>Netting allowances for client positions</b>	
<p>6. A commenter expressed support for the proposed additional netting allowances for Dealer Member inventory positions. The commenter believes it would reduce the operational impact of the 2018 proposed amendments if we extend these netting allowances to client account positions.</p>	<p>The Proposed Amendments extend the inventory netting allowance detailed in proposed Schedule 9B Note 4 to apply to individual client accounts.</p>
<b>Capital markets impact and implementation timeframe</b>	
<b>Impact on market functioning</b>	
<p>7. Two commenters cautioned that the 2018 proposed amendments could have the unintended consequence of impairing the trading and liquidity of the Canadian debt securities market. One comment letter cited this potential impact in lower rated debt securities, and a second commenter cited the potential impact on their firm's ability to make market in highly rated short-term corporate debt transactions/deals. This commenter also noted that the 2018 proposed amendments could affect corporate issuer syndication participations.</p>	<p>We understand that such concerns could arise, given that debt securities have not previously been subject to the securities concentration test.</p> <p>We considered potential capital market impacts when we developed the 2018 proposed amendments, which included a survey of Dealer Member debt security exposures.</p> <p>A key part of the Proposed Amendments is the recalibration of the risk-weight adjustment factors. We applied risk-weightings to all debt securities margined at <math>\leq 10\%</math>, including low</p>

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	<p>rated, or unrated debt securities. We also clarified that short-term debt securities rated above “R-2, F3, P-3, A-3” are eligible for a 40% adjustment factor.</p> <p>We also note that new issue positions carried in inventory are not subject to the securities concentration test until twenty days after new issue settlement date.</p>
Monitoring	
8. A commenter suggested that, following implementation, IIROC or the Canadian Securities Administrators ( <b>CSA</b> ) should monitor the effects on the functioning of the debt markets and be prepared to recalibrate the risk-weightings, if necessary, to achieve balance between sound member regulation and efficient market functioning.	We will be in a better position to monitor and analyze our Dealer Members’ debt security exposures after we implement the Proposed Amendments. This should also allow us to assess what, if any, impacts the new requirements may have on capital markets.
Implementation timeline	
9. Commenters believe that it will take a minimum of twelve months to coordinate with their service providers to implement the 2018 proposed amendments.	We will recommend a twelve month timeframe for implementation, once approved by the Recognizing Regulators.

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