

INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA
PROPOSED AMENDMENTS TO THE IIROC RULES AND TO FORM 1 REGARDING THE FLOATING INDEX MARGIN RATE
METHODOLOGY

BLACK-LINE COPY OF THE PROPOSED AMENDMENTS TO THE IIROC RULES

Amendment #1 – IIROC Rule subsection 5130(4) is amended to replace the term “major broadly based index” with “major widely quoted market index” as follows:

“foreign listed equity securities eligible for margin”	Securities (other than bonds, debentures, rights and warrants) listed on an <i>acceptable exchange</i> outside of Canada and the United States that are constituent securities for the exchange’s major broadly-based <u>widely quoted market index</u> , and the <i>index</i> is on IIROC’s list of foreign market indices whose constituent securities are eligible for margin.
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Amendment #2 – IIROC Rule subsection 5130(9) is amended by:

- adding and amending the definition “broad based index”, currently found in the General notes and definitions of Form 1, and
- amending the following other definitions,

in alphabetical sequence:

“ <u>broad based index</u> ”	<p><u>An equity index in which:</u></p> <p>(i) <u>the basket of <i>equity securities</i> underlying the index consists of thirty or more securities,</u></p> <p>(ii) <u>the single largest basket security position by weighting comprises not more than 20% of the overall <i>market value</i> of the basket,</u></p> <p>(iii) <u>the average market capitalization associated with each security in the basket of <i>equity securities</i> underlying the index is at least \$100 million,</u></p> <p>(iv) <u>the basket securities shall be from a broad range of industries and market sectors as determined by IIROC to represent index diversification, and</u></p> <p>(v) <u>the index constituent securities are listed and traded on an <i>acceptable exchange</i>.</u></p>
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“cumulative relative weight percentage”	An overall relative weight percentage determined by calculating, in accordance with subsection 5360(5) <u>5360(7)</u> , the actual basket weighting for each security in a <i>qualifying basket of index securities</i> in relation to its latest published relative weighting in the <i>index</i> .
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“floating margin rate”	The floating margin rate set by IIROC in accordance with subsection 5360(3) <u>5360(5)</u> , <u>subject to the minimum floor margin rate in subsection 5360(2).</u>
“incremental basket margin rate”	The incremental basket rate for a <i>qualifying basket of index securities</i> calculated in accordance with subsection 5360(6) <u>5360(8)</u> .

"index"	<p>An equity index in which:</p> <p>(i) the basket of equity securities underlying the index consists of eight or more securities,</p> <p>(ii) the single largest security position by weighting comprises not more than 35% of the overall market value of the basket,</p> <p>(iii) the average market capitalization for each security position in the basket of equity securities underlying the index is at least \$50 million, and</p> <p>(iv) the securities constituting the foreign equity index are listed and traded on an exchange that meets the criteria for an acceptable exchange. <u>Either a broad based index or a sector index.</u></p>
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"qualifying basket of index securities"	A basket of equity securities with the characteristics in subsection 5360(4) <u>5360(6)</u> .
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"regulatory margin interval"	IIROC's regulatory margin calculation determined in accordance with subsection 5360(2) <u>5360(4)</u> .
" <u>sector index</u> "	<p>An equity index in which:</p> <p>(i) <u>the basket of equity securities underlying the index consists of eight or more securities,</u></p> <p>(ii) <u>the single largest basket security position by weighting comprises not more than 35% of the overall market value of the basket,</u></p> <p>(iii) <u>the average market capitalization associated with each security in the basket of equity securities underlying the index is at least \$100 million, and</u></p> <p>(iv) <u>the index constituent securities are listed and traded on an acceptable exchange.</u></p>

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"tracking error margin rate"	The last calculated <i>regulatory margin interval</i> for the tracking error resulting from a particular offset strategy, <u>subject to the minimum floor margin rate in subsection 5360(2).</u>
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Amendment #3 – IIROC Rule subsection 5360(1) is amended by adding references to both the "greater of" and minimum floor margin rates in the margin calculations, as follows:

5360. Index participation units and qualifying baskets of index securities

- (1) The minimum *Dealer Member inventory margin* and *client account margin* requirements for *index participation units* and *qualifying baskets of index securities* are as follows:

Minimum margin required	
Category (i) Index participation units	Category (ii) Qualifying basket of index securities
(a) The <u>greater of:</u>	(a) The sum of:

Minimum margin required	
Category (i) Index participation units	Category (ii) Qualifying basket of index securities
<p><u>(I) the floating margin rate percentage</u> (calculated for <i>index participation unit</i> based on its <i>regulatory margin interval</i>), <u>and</u> <u>(II) the minimum floor margin rate required</u> <u>under subsection 5360(2)</u>,</p> <p>multiplied by</p> <p>(b) The <i>market value of index participation units</i>.</p>	<p>(i) The <u>(I) the greater of:</u> <u>(A) the floating margin rate percentage</u> (calculated for a perfect basket of index securities based on its <i>regulatory margin interval</i>), <u>and</u> <u>(B) the minimum floor margin rate</u> <u>required under subsection 5360(2)</u>,</p> <p>and</p> <p>(ii) The <u>(i) The calculated incremental basket</u> <i>margin rate for the qualifying basket of</i> <i>index securities</i>,</p> <p>multiplied by</p> <p>(b) The <i>market value of qualifying basket of</i> <i>index securities</i>.</p>

Amendment #4 – IIROC Rule section 5360 is amended by adding new subsection 5360(2) as follows:

(2) The minimum floor *Dealer Member inventory margin* and *client account margin* rates for the purposes of subsection 5360(1) and offset strategies recognized in Rule 5700 are as follows:

<u>Qualifying index, individual and offset strategies</u>	<u>Category (i) Broad based index as defined in subsection 5130(9)</u>	<u>Category (ii) Sector index as defined in subsection 5130(9)</u>
<u>Floor rate percentage to be used in determining margin rate for unhedged positions in <i>index participation units</i> and <i>qualifying basket of index securities</i></u>	<u>10.00%</u>	<u>15.00%</u>
<u>Floor rate percentage to be used in determining <i>tracking error margin rate</i> for qualifying offset strategies involving <i>index products</i></u>	<u>2.00%</u>	<u>3.00%</u>

Amendment #5 – IIROC Rule section 5360 is amended by adding new subsection 5360(3) as follows:

(3) IIROC calculates a *regulatory margin interval* for index products on qualifying indices. A qualifying *index* for the purposes of subsections 5360(1) and 5360(2) must be a widely quoted market *index*, as determined by IIROC, that:

- (i) meets the minimum requirements for an *index* in subsection 5130(9), and
- (ii) is included on the list of floating and tracking error margin rates for qualifying Canadian and U.S. index products.

Amendment #6 – IIROC Rule subsection 5360(2) is amended by renumbering to subsection 5360(4) and adding clause 5360(4)(ii) as follows:

(24) IIROC calculates a *regulatory margin interval* according to the following formula:

- (i) Maximum standard deviation of percentage changes in daily closing prices over the most recent 20, 90, 260 trading days \times 3 (for a 99% confidence interval) \times Square root of 2 (for 2 days price risk coverage)
rounded up to the next ¼%.

(ii) In limited circumstances, to ensure appropriate margin requirements, IIROC may use discretion in calculating a *regulatory margin interval*. Dealer Members will be notified by IIROC if any adjustments to the *regulatory margin interval* calculation are made.

Amendment #7 – IIROC Rule subsection 5360(3) is amended by:

- renumbering to subsection 5360(5),
- clarifying language in clause 5360(5)(iii), and
- updating the reference in clause 5360(5)(iv),

as follows:

- (35) To calculate the *floating margin rate* for an *index participation unit* or a perfect basket of index securities:
- (i) IIROC uses the last calculated *regulatory margin interval*, which is effective for the *regular reset period* unless a *violation* occurs,
 - (ii) in normal circumstances, the *floating margin rate* is reset on the *regular reset date* to the *regulatory margin interval* calculated as at the *regular reset date*,
 - (iii) if a *violation* occurs, IIROC may reset the *floating margin rate* ~~is reset~~ on the date the *violation* occurs to the *regulatory margin interval* determined as at the date of the *violation*, and
 - (iv) the *regulatory margin interval* determined in clause ~~5360(3)~~ 5360(5)(iii) ~~must~~ will be effective for a minimum of 20 trading days and reset at the close of the 20th trading day to the *regulatory margin interval* determined as at that date if a reset results in a lower margin rate.

Amendment #8 – IIROC Rule subsections 5360(4) through 5360(6) are amended by renumbering sequentially and updating the references in clause 5360(7)(ii), as follows:

(46) A basket of *equity securities* is a *qualifying basket of index securities* if:

- (i) all of the securities in the basket are included in the composition of the same *index*,
- (ii) the basket comprises a portfolio with a *market value* equal to the *market value* of the *underlying securities* in the *index*,
- (iii) the *market value* of each *equity security* comprising the portfolio proportionally equals or exceeds the *market value* of its relative weight in the *index*, based on the latest published relative weights of securities comprising the *index*, and
- (iv) the required *cumulative relative weight percentage* of all *equity securities* comprising the portfolio:
 - (a) equals 100% of the cumulative weighting of the corresponding *index*, if the basket of *equity securities* underlying the *index* is comprised of less than 20 securities,
 - (b) equals or exceeds 90% of the cumulative weighting of the corresponding *index*, if the basket of *equity securities* underlying the *index* is comprised of 20 or more securities but less than 100 securities, and
 - (c) equals or exceeds 80% of the cumulative weighting of the corresponding *index*, if the basket of *equity securities* underlying the *index* is comprised of 100 or more securities,

based on the latest published relative weightings of the *equity securities* comprising the *index*.

- (v) If the cumulative relative weighting of all *equity securities* in the basket equals or exceeds the required *cumulative relative weight percentage* and is less than 100% of the cumulative weighting of the corresponding *index*, the deficiency in the basket must be filled by other *equity securities* included in the composition of the *index*.

(57) The *cumulative relative weight percentage* is determined:

- (i) by calculating for each security in a *qualifying basket of index securities*:
 - (a) its actual basket weighting, and
 - (b) its latest published relative weighting in the *index*,

and then,

- (ii) by summing the lesser of the two weighting percentages calculated for each security in sub-clauses ~~5360(5360(7)(i)(a)~~ and ~~5360(5360(7)(i)(b)~~ for all of the securities in the *qualifying basket of index securities*.

(68) The *incremental basket margin rate* for a *qualifying basket of index securities* is calculated as the sum:

<i>Market value</i> of each underweighted security in basket	x	Margin rate for that security	x	The % by which the security is underweighted (calculated according to the formula: published relative weighting of the security - actual basket weighting of the security)
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for each underweighted security in the basket.