

IIROC NOTICE

Rules Notice Request for Comments

Dealer Member Rules

Comments Due By: Sept 30, 2019

Please distribute internally to:

Internal Audit
Legal and Compliance
Operations
Regulatory Accounting
Senior Management

Contact:

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19-0155
Aug 29, 2019

Proposed amendments to IIROC Dealer Member Rule 1200.3 and Notes to Statement D of Form 1 regarding free credit cash segregated in trust for clients

Executive Summary

On June 25, 2019, the Board of Directors (the **Board**) of the Investment Industry Regulatory Organization of Canada (IIROC) approved the publication of proposed amendments to IIROC Dealer Member Rule (DMR) 1200.3 and Notes to Statement D (Statement of Free Credit Segregation Amount) of Form 1 (**Notes to Statement D**), regarding free credit cash segregated in trust for clients (collectively, the **Proposed Amendments**).

The main purpose of the Proposed Amendments is to remove the inconsistency between the language used to describe the same trust arrangement in DMR 1200.3 and Notes to Statement D, and to ensure that the trust arrangement is appropriately identified at the acceptable institution.

We have attached draft guidance which clarifies our expectations for the trust account agreement with the acceptable institution (the **Proposed Guidance**).



Impacts

We expect the impact on Dealer Members (**Dealers**) to be limited to a small number of Dealers that have segregated free credit cash at an acceptable institution. These Dealers may need to revise the name of the account holding the segregated cash and/or update the written agreement with the acceptable institution to ensure funds are protected.

The Proposed Amendments will create more consistency across Dealers concerning the treatment of segregated free credit cash.

How to Submit Comments

Comments are requested on all aspects of the Proposed Amendments, including any matter which they do not specifically address. Comments on the Proposed Amendments should be in writing and delivered by **Sept 30, 2019** to:

Catherine Drennan
Manager, Financial Information, Member Regulation Policy
Investment Industry Regulatory Organization of Canada
Suite 2000, 121 King Street West
Toronto, Ontario M5H 3T9
email: cdrennan@iiroc.ca

A copy should also be provided to the Recognizing Regulators by forwarding a copy to:

Market Regulation
Ontario Securities Commission
Suite 1903, Box 55
20 Queen Street West
Toronto, Ontario M5H 3S8
e-mail: marketregulation@osc.gov.on.ca

Commenters should be aware that a copy of their comment letter will be made publicly available on the IIROC website at www.iiroc.ca.



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1. Discussion of Proposed Amendments

1.1 Relevant background

Dealers may use client free credit cash balances in their business within certain limits prescribed by IIROC Rule 1200 and Statement D of Form 1. The limits are based on a Dealer's early warning reserve and client margin loans. If the free credit balances exceed the limits, the Dealer is required to segregate the excess amount in one or both of these options:

- a separate investment such as bank paper or government securities
- a separate bank account "in trust" for the clients.

The purpose of segregating free credit cash balances is to protect clients in the event of a Dealer's insolvency. If the Dealer became insolvent, the segregated cash would become the property of the trustee in bankruptcy and be included in the customer pool.

A Dealer normally holds free credit cash in a separate account at an acceptable institution when segregation is required. This account is labelled as being "in trust" for the benefit of clients, creating an implicit trust to protect the client funds from misuse by the acceptable institution and preserve the funds in the event of a Dealer's insolvency.

A formal explicit trust is not intended and would require a Dealer to have formal written trust agreements with each client.

1.2 Current Rule 1200.3 and Notes to Statement D

DMR 1200 and Notes to Statement D describe the "in trust" arrangement for segregating free credit client cash.

DMR 1200.3 currently requires the Dealer to segregate free credits in excess of the free credit limit in a separate account in trust for clients at an acceptable institution.

Notes to Statement D currently state "the trust must be an obligation binding the Dealer member (the trustee) to deal with the free credits over which it has control (the trust property), for the benefit of the client (the beneficiary). The trust property must be clearly identified as such, even if residing with an acceptable institution."



1.3 Inconsistency between Rule 1200.3 and Notes to Statement D

The description of the type of trust account required to segregate clients free credit balances is inconsistent between the Notes to Statement D and DMR 1200.3.

The main inconsistencies are:

- DMR 1200.3 does not clarify that the trust property must be *identified* as being held for the benefit the client but the Notes to Statement D have this clarification.
- The Notes to Statement D have language which could be construed as a requirement for an explicit trust but DMR 1200.3 allows an implicit trust.

1.4 Proposed Amendments

We propose amendments to both Notes to Statement D and IIROC Rule 1200.3 to clarify that an explicit trust agreement is not required for the segregation of clients free credit cash, so long as

- cash is held in trust for clients in a separate account with an acceptable institution
- the account is labelled as “trust account”.

This will align Notes to Statement D with DMR 1200.3 in the requirement of an implied trust for client free credit balances, rather than an explicit trust.

A summary of the Proposed Amendments are shown as black-lined changes in **Appendix A**.

2. Analysis

2.1 Issues and alternatives considered

We considered two alternatives, (1) to propose the Proposed Amendments and (2) to maintain the status quo. We selected the first alternative, to propose the Proposed Amendments, because it will provide consistency between DMR 1200.3 and the Notes to Statement D.

2.2 Comparison with similar provisions

We did not compare the Proposed Amendments with similar provisions from other jurisdictions because we do not believe it would be relevant given the unique nature of Statement D of Form 1.

3. Impacts of the Proposed Amendments

Dealers are expected to benefit from the consistency in the language of the rules which clarifies a formal explicit trust is not required.



IIROC staff's analysis indicates that the proposed changes will affect a relatively small group of Dealers that are required to hold client free credits in segregation. These Dealers may need to revise the name of the account holding the segregated funds and/or update the written agreement with the acceptable institution.

The Proposed Amendments are not expected to impact Dealers' systems or capital requirements.

We believe that the Proposed Amendments will have no material impact in terms of capital market structure, competition generally, cost of compliance and conformity with other rules. The Proposed Amendments do not permit unfair discrimination among customers, issuers, brokers, dealers, members or others.

4. Implementation

After we receive approval from our Recognizing Regulators, we intend to implement the Proposed Amendments within 90 days.

5. Policy development process

5.1 Regulatory purpose

The Proposed Amendments are intended to:

- establish and maintain rules that are necessary or appropriate to govern and regulate all aspects of IIROC's functions and responsibilities as a self-regulatory entity
- foster fair, equitable and ethical business standards and practices
- promote the protection of investors.

IIROC identified a need for consistency in how we expect Dealers to segregate client free credits. This need was assessed as being in the public interest and not detrimental to the best interests of the capital markets.

5.2 Rule making process

The Board of Directors of IIROC (Board) has determined the Proposed Amendments to be in the public interest and on June 25, 2019 approved them for public comment.

IIROC developed the Proposed Amendments in consultation with the IIROC's Financial and Operations Advisory Section (**FOAS**) Executive Committee, Capital Formula Subcommittee, and the full FOAS. These advisory committees supported the Proposed Amendments.



After considering the comments on the Proposed Amendments received in response to this Request for Comments together with any comments of the Recognizing Regulators, IIROC may recommend revisions to the applicable Proposed Amendments. If the revisions and comments received are not of a material nature, the Board has authorized the President to approve the revisions on behalf of IIROC and the Proposed Amendments as revised will be subject to approval by the Recognizing Regulators. If the revisions or comments are material, we will submit the Proposed Amendments including any revisions to the Board for approval for republication or implementation as applicable.

6. Appendices

- [Appendix A](#) - Blackline comparison of the Proposed Amendments
- [Appendix B](#) - Clean copy of the Proposed Amendments
- [Appendix C](#) - Plain language Rule Book version of the Proposed Amendments
- [Appendix D](#) - Proposed Guidance