

13.1.3 IDA Regulation 100.5 - Capital Requirements for Certain Private Placements of Restricted Securities during the Distribution Period

**INVESTMENT DEALERS ASSOCIATION OF CANADA –
REGULATION 100.5 - CAPITAL REQUIREMENTS FOR CERTAIN PRIVATE PLACEMENTS
OF RESTRICTED SECURITIES DURING THE DISTRIBUTION PERIOD**

I OVERVIEW

A Current Rules

The current capital and margin rules effectively require 100% margin for restricted securities at all times by virtue of the fact that the security trading restriction renders the security “not readily marketable” and therefore not eligible for regulatory loan value.

B The Issue(s)

In the case of four-month restricted security issuances that are privately placed (pursuant to Multilateral Instrument 45-102 or a similar provincial securities legislation exemption), the underwriting risk borne by the Member firm during the underwriting distribution period is less than 100%. This is because the firm may sell the underwriting to any interested accredited investor during the underwriting period without additional ownership transfer conditions.

C Objective(s)

The objective of the proposed rule change is to amend the existing capital requirements for underwriting requirements to properly reflect the lower risk associated with private placements of four-month restricted securities during the underwriting distribution period.

D Effect of Proposed Rules

The proposed rule change is not expected to have any negative impact on market structure, member versus non-member competition or costs of compliance. It is anticipated that the proposed rule change will have a positive impact on the ability of the smaller Member firms to compete for underwriting opportunities by reducing the existing conservative capital requirements that apply during the underwriting distribution period.

II DETAILED ANALYSIS

A Present Rules, Relevant History and Proposed Policy

Present Rules and Relevant History

As previously stated, the current capital and margin rules effectively require 100% margin for restricted securities at all times. The current requirements that apply to four-month restricted security issuances that are privately placed (pursuant to Multilateral Instrument 45-102 or a similar provincial securities legislation exemption) are set out in IDA Member Regulation Notice MR0244, issued on October 6, 2003. The requirements state that for restricted securities:

- where the underwriting proceeds are held in trust in an escrow account at an acceptable institution, the underwriting position capital requirement during the underwriting distribution period shall be that ordinarily required for the underlying security plus any conversion loss (subject offering meeting certain other conditions); and
- where the underwriting proceeds are available to the issuer, the underwriting position capital requirement during the underwriting distribution period shall be 100% of the market value reported for the underwriting position

Since, the underwriting proceeds related to private placements of four-month restricted security offerings are almost always made available to the issuer company at the underwriting close date (and not at the end of the four-month restricted period), these offerings are not generally currently eligible for regulatory loan value.

Proposed Rule Amendment

The proposed rule amendment seeks to permit that a margin rate of less than 100% may be used in determining the capital requirement for a private placement of a four-month restricted security offering. The amendment will determine the appropriate rate to be used taking into consideration the margin rate that would be used for the same issuer security if unrestricted. To accomplish this it proposed that IDA Regulation 100.5 be amended to incorporate the following wording:

“Margining of private placements of restricted equity securities

For a private placement of a equity security subject to a four-month trading restriction (issued pursuant to Multilateral 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 Regulation 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%.”

The effect of this amendment for the existing underlying security margin rate categories (and assuming a disaster out clause is in effect until offering settlement date) would be as follows:

Primary distribution period		Restricted period (generally four-months)	Unrestricted and trading in secondary market (reference underlying security margin rate)
Five business days or less subsequent to the offering commitment date	Greater than five business days subsequent to the offering commitment date		
25.00%	50.00%	100.00%	25.00%
25.00%	50.00%	100.00%	50.00%
30.00%	50.00%	100.00%	60.00%
40.00%	50.00%	100.00%	80.00%
50.00%	50.00%	100.00%	100.00%

B Issues and Alternatives Considered

The only other alternative considered was to leave the current capital requirements unchanged. This alternative was dismissed as the current capital requirements that apply to certain restricted security offerings during the underwriting distribution period are considered to be overly conservative.

C Comparison with Similar Provisions

The use of the “not readily marketable” concept in determining whether or not a security position (including a restricted security position) should receive regulatory loan value is also the standard used in both the United Kingdom and the United States.

The practice of dealers entering into committed offerings is relatively unique to Canada and therefore a comparison to specific underwriting capital requirements in the United Kingdom and the United States was considered of little relevance.

D Systems Impact of Rule

Implementation of this proposed rule amendment will result in little or no systems impacts as the calculation of underwriting position capital requirements is already a largely manual process. The Bourse de Montreal is also in the process of passing this amendment. Implementation of this amendment will therefore take place once both the IDA and the Bourse de Montreal have received approval to do so from their respective recognizing regulators.

E Best Interests of the Capital Markets

The Board has determined that this public interest amendment is not detrimental to the best interests of the capital markets

F Public Interest Objective

According to the IDA’s Order of Recognition as a self regulatory organization, the IDA shall, where requested, provide in respect of a proposed rule change “a concise statement of its nature, purposes (having regard to paragraph 13 above) and effects, including possible effects on market structure and competition”. Statements have been made elsewhere as to the nature and effects of the proposals with respect to capital requirements for certain private placements of restricted securities during the distribution period. The purposes of the proposal are to: “facilitate an efficient capital-raising process and to facilitate transparent, efficient and fair secondary market trading and the availability to members and investors of information with respect

to offers and quotations for and transactions in securities, and efficient clearance and settlement procedures” and to “standardize industry practices where necessary or desirable for investor protection”.

The proposal does not permit unfair discrimination among customers, issuers, brokers, dealers, members or others. It does not impose any burden on competition that is not necessary or appropriate in furtherance of the above purposes.

Because of the potential impact of this amendment on the reported regulatory capital of IDA Member firms, it has been determined to be in the public interest.

III COMMENTARY

A Filing in Other Jurisdictions

These proposed amendments will be filed for approval in Alberta, British Columbia, Quebec and Ontario and will be filed for information in Manitoba, Nova Scotia and Saskatchewan.

B Effectiveness

It is believed that adoption of these amendments will be effective in reducing the existing conservative capital requirements that apply to private placements of four-month restricted security offerings during the underwriting distribution period without permitting Member firms to unduly leverage their regulatory capital.

C Process

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

IV SOURCES

References:

- IDA Regulation 100.5
- IDA Form 1, General Notes and Definitions - definition of “market value of securities”
- Member Regulation Notice MR0244, “Capital and Margin Requirements for Special Warrants, Subscription Receipts and Restricted Securities”

V OSC REQUIREMENT TO PUBLISH FOR COMMENT

The IDA is required to publish for comment the accompanying proposed rule amendment.

The Association has determined that the entry into force of the proposed amendment would be in the public interest. Comments are sought on the proposed amendment. 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 J. Corner, Vice President, Regulatory Policy, Investment Dealers Association 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.

Questions may be referred to:

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REGULATION 100.5 - CAPITAL REQUIREMENTS FOR CERTAIN PRIVATE PLACEMENTS OF
RESTRICTED SECURITIES DURING THE DISTRIBUTION PERIOD**

THE BOARD OF DIRECTORS of the Investment Dealers Association of Canada hereby makes the following amendments to the By-laws, Regulations, Forms and Policies of the Association:

1. By-law 100.5 is amended by adding the following new section 100.5(g):

“(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 Multilateral 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 Regulation 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%.”

PASSED AND ENACTED BY THE Board of Directors this 18th day of January 2006, to be effective on a date to be determined by Association staff.