

Chapter 13

SRO Notices and Disciplinary Proceedings

13.1.1 IDA Swap Arrangements Involving Regulated Entities – IDA Regulations 100.2(j) and 100.2(k)

INVESTMENT DEALERS ASSOCIATION OF CANADA

SWAP ARRANGEMENTS INVOLVING REGULATED ENTITIES - IDA REGULATIONS 100.2(J) AND 100.2(K)

I OVERVIEW

A Current Rules

The margin requirements for swap agreements where the counterparty is a regulated entity are not explicitly stated in current IDA Regulations 100.2(j) and 100.2(k). Instead, these margin requirements are implied based on the margin requirements in Schedules 1 and 7 to Form 1, where the market value deficiency calculated relating to the position(s) applies.

B The Issue(s)

As a result, where a Member enters into a swap agreement where the counterparty is a regulated entity there is room for different interpretations as to the required margin treatment.

Further, the reference to By-law 17 in the first paragraph of Regulation 100.2 is circular and therefore not necessary. Specifically, By-law 17.11 currently stipulates that a Member "shall obtain from clients and maintain in respect of its own account such minimum margin in such amount and in accordance with such requirements as the Board of Directors may from time to time by Regulation prescribe". It is therefore circular to reference the requirements in By-law 17 within Regulation 100.2.

C Objectives

The main objective of the proposed rule changes set out in Attachment #1 is to clarify the margin requirements for swap agreements where the counterparty is a regulated entity.

D Effect of Proposed Rules

The effect is positive as it will eliminate confusion in calculating margin requirements for regulated entities relating to positions in interest rate swaps or total performance swaps.

II DETAILED ANALYSIS

A Present Rules, Relevant History and Proposed Policy

This section is considered unnecessary due to the housekeeping nature of these proposals.

B Issues and Alternatives Considered

No alternative proposals were considered as the proposed change is housekeeping in nature and intended to clarify the existing rule.

C Comparison with Similar Provisions

The proposed changes are housekeeping in nature and therefore, it is not necessary to compare with that in the other jurisdictions such as the U.S. or U.K.

D Systems Impact of Rule

We believe that the proposed amendments will have no impact in terms of capital market structure, competition, cost of compliance and be in conformity with other rules.

E Best Interests of the Capital Markets

The Board has determined that the proposed rule is not detrimental to the best interests of the capital markets.

F Public Interest Objective

The proposed amendments are housekeeping in nature. The proposal will clarify the existing margin requirements for swap agreements where the counterparty is a regulated entity. It does not impose any burden on competition that is unnecessary or inappropriate in furtherance of the above purposes.

III COMMENTARY

A Filing in Other Jurisdictions

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

B Effectiveness

An assessment of the effectiveness of the proposed rules in addressing the issues has been discussed above.

C Process

These proposed amendments have been developed and recommended for approval by the FAS (Financial Administrators Section) Capital Formula Subcommittee and have been recommended for approval by the FAS Executive Committee and the FAS.

IV SOURCES

References:

- IDA Regulations 100.2(j) and 100.2(k)
<http://ida.knotia.ca/Knowledge/View/Document.cfm?Ktype=445&linkType=toc&dbID=210711341&tocID=483>
- Schedules 1 and 7 to Form 1 (Joint Regulatory Financial Questionnaire and Report)
<http://ida.knotia.ca/Knowledge/View/Document.cfm?Ktype=445&linkType=toc&dbID=210711341&tocID=830>
<http://ida.knotia.ca/Knowledge/View/Document.cfm?Ktype=445&linkType=toc&dbID=210711341&tocID=847>

V REQUIREMENT TO PUBLISH FOR COMMENT

The Association has determined that the entry into force of the proposed amendments would be housekeeping in nature. Comments are not sought on the proposed amendments.

Questions may be referred to:

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INVESTMENT DEALERS ASSOCIATION OF CANADA

SWAP ARRANGEMENTS INVOLVING REGULATED ENTITIES - IDA REGULATIONS 100.2(J) AND 100.2(K)

BOARD RESOLUTION

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. Regulation 100.2 is amended by deleting the following words immediately following the words "this Regulation 100":
"and By-law 17.13".
2. Regulation 100.2(j) is amended by adding the following words immediately following the words "acceptable counterparties":
"or regulated entities".
3. Regulation 100.2(k) is amended by adding the following words immediately following the words "acceptable counterparties":
"or regulated entities".

BE IT RESOLVED THAT the Board of Directors adopts, on this 12th day of December 2007, the English and French versions of these amendments. The Board of Directors also authorizes the Association 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 the Association Staff.

INVESTMENT DEALERS ASSOCIATION OF CANADA

SWAP ARRANGEMENTS INVOLVING REGULATED ENTITIES - IDA REGULATIONS 100.2(J) AND 100.2(K)

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"100.2 For the purpose of this Regulation 100 and ~~By-law 17.13~~ the following margin requirements are hereby prescribed:

(j) **Interest Rate Swaps**

For the purposes of this regulation, a "fixed interest rate" is an interest rate, which is not reset at least every 90 days and a "floating interest rate" is an interest rate, which is not a fixed interest rate. On interest rate swap agreements where payments are calculated with reference to a notional amount, the obligation to pay and the entitlement to receive shall each be margined as separate components as follows:

- (i) Where a component is a payment calculated according to a fixed interest rate, the margin required shall be the margin rate specified in Regulation 100.2(a)(i) for a security with the same term to maturity as the outstanding term of the swap, multiplied by 125% and in turn multiplied by the notional amount of the swap;
- (ii) Where a component is a payment calculated according to a floating interest rate, the margin required shall be the margin rate specified in Regulation 100.2(a)(i) for a security with the same term to maturity as the remaining term to the swap reset date, multiplied by the notional amount of the swap.

The counterparty to the interest rate swap agreement shall be considered the Member's customer. No margin is required for an interest rate swap entered into with a customer, which is an acceptable institution. The margin requirement for customers, which are acceptable counterparties or regulated entities, shall be any market value deficiency calculated relating to the interest rate swap agreement. The margin requirement for customers which are other counterparties shall be any loan value deficiency calculated relating to the interest rate swap agreement, determined by using the same margin requirements for each swap component as calculated in clauses (i) and (ii) above.

(k) **Total Performance Swaps**

On total performance swap agreements, the obligation to pay and the entitlement to receive shall each be margined as separate components as follows:

- (i) Where a component is a payment calculated based on the performance of a stipulated underlying security or basket of securities, with reference to a notional amount, the margin requirement shall be the normal margin required for the underlying security or basket of securities relating to this component, based on the market value of the underlying security or basket of securities;
- (ii) Where a component is a payment calculated according to a floating interest rate, the margin required shall be the margin rate specified in Regulation 100.2(a)(i) for a security with the same term to maturity as the remaining term to the swap reset date, multiplied by the notional amount of the swap.

The counterparty to the total performance swap agreement shall be considered the Member's customer. No margin is required for a total performance swap entered into with a customer, which is an acceptable institution. The margin requirement for customers, which are acceptable counterparties or regulated entities, shall be any market value deficiency calculated relating to the total performance swap agreement. The margin requirement for customers which are other counterparties shall be any loan value deficiency calculated relating to total performance rate swap agreement, determined by using the same margin requirements for each swap component as calculated in clauses (i) and (ii) above.