

**13.1.2 IIROC Rules Notice – Request for Comments – Amendments to Dealer Member Rules to permit partial offsets for offset strategies involving interest rate swaps and total performance swaps**

**AMENDMENTS TO DEALER MEMBER RULES TO PERMIT PARTIAL OFFSETS  
FOR OFFSET STRATEGIES INVOLVING INTEREST RATE SWAPS  
AND TOTAL PERFORMANCE SWAPS**

**Summary of nature and purpose of Proposed Amendments**

On January 28, 2009, the Board of Directors (the Board) of the Investment Industry Regulatory Organization of Canada (IIROC) approved the publication for comment of the proposed amendments (Proposed Amendments) to the Dealer Member Rule section 100.4F (the Rule) that would allow for partial offsets on interest rate swaps and total performance swaps.

The primary objective of the Proposed Amendments is to extend the current margin treatment on swap offsets to partial offsets on interest rate and total performance swaps. This would permit partial notional amounts to be netted before applying the required margin to the swap position.

Specifically, the Proposed Amendments to IIROC Dealer Member Rule subsections 100.4F(a) and 100.4F(d) set out in Attachment A would:

- add the term “or agreements” to cover the situation where multiple swap contracts are entered into; and
- specifically permit the provision of reduced margin for partial swap agreement offsets.

**Issues and specific Proposed Amendments**

Subsections 100.4F(a) and (d) stipulate that swap positions (for each pair of interest rate swap or total performance swap offsets) may be netted where the notional amount of the offsetting swap or underlying security position is the same. The subsections, however, are silent on permitting partial offsets between two positions with different notional amounts. Consequently, under current rules, even partially offset positions would be required to be margined separately, which results in a higher overall margin requirement than necessary to cover the position risk.

The following two examples are used to illustrate the rationale for allowing partial swap offsets:

1. A Dealer Member is long two interest rate swaps with underlying notional amounts of \$50 million and \$25 million, respectively, and short an interest rate swap with an underlying notional amount of \$50 million. Assuming all positions are either fixed or variable, current subsection 100.4F(a) would allow for the netting of the long and short swaps of \$50 million and margin would be required on the remaining \$25 million long swap position.
2. Another Dealer Member is long one interest rate swap of \$75 million and short one interest rate swap of \$50 million. Assuming all positions are either fixed or variable, there would be no offset allowed by current subsection 100.4F(a), because the notional amounts are not the same. Margin would be required on both the \$75 million and the \$50 million swap positions, although the risk exposure is economically the same as a \$25 million long swap position.

Based on the two examples above, IIROC is of the opinion that partial offsets should be allowed as the economic risk exposures that are inherent in the position are the same. Regarding subsection 100.4F(d), similar examples using total performance swap offsets instead of the above interest rate swaps would arrive at similar outcomes. As a result, it is proposed that partial offsets also be allowed for total performance swaps.

The proposed rule amendments and a black-line copy of the Dealer Member Rule affected by these amendments are set out in Attachments A and B.

**Proposed Rule Classification**

In deciding to propose these amendments, IIROC identified that there was a need to permit the provision of reduced margin for partial offsets involving either interest rate swaps or total performance swaps as Dealer Members should be motivated through the capital requirements to at least partially reduce/hedge position risk.

The Proposed Amendments were assessed as being in the public interest and not detrimental to the best interests of the capital markets. As a result, the Board has determined that the Proposed Amendments are a Public Comment Rule proposal.

**Effects of the proposed Rule on market structure, Dealer Members, non-Dealer Members, competition, and costs of compliance**

Statements have been made elsewhere as to the nature and purpose of the Proposed Amendments.

The Proposed Amendments are intended to promote the efficient use of capital and to align the capital and margin requirements with the offset risk. Hence, they do not impose any burden or constraint on competition or innovation that is not necessary or appropriate in furtherance of IIROC's regulatory objectives. They do not impose costs or restrictions on the activities of market participants (including Dealer Members and non-Dealer Members) that are disproportionate to the goals of the regulatory objectives sought to be realized. The Proposed Amendments are also consistent with other IIROC rules and regulations.

**Technological implications and implementation plan**

The Proposed Amendments will not have an impact on Dealer Members' systems. The Bourse de Montréal is also in the process of passing these amendments. As such, it is intended that these amendments will be implemented once both IIROC and Bourse de Montréal receive approval from their recognizing regulators.

**Request for public comment**

Comments are sought on the Proposed Amendments. Comments should be made in writing. Two copies of each comment letter should be delivered by March 16, 2009 (30 days from the publication date of this notice). One copy should be addressed to the attention of:

Mindy Kwok  
Investment Analyst, Member Regulation Policy  
Investment Industry Regulatory Organization of Canada  
Suite 1600, 121 King Street West,  
Toronto, Ontario,  
M5H 3T9

The second copy should be addressed to the attention of:

Manager of Market Regulation  
Ontario Securities Commission,  
19<sup>th</sup> floor, Box 55,  
20 Queen Street West,  
Toronto, Ontario,  
M5H 3S8

Those submitting comment letters should be aware that a copy of their comment letter will be made publicly available on the IIROC website ([www.iiroc.ca](http://www.iiroc.ca) under the heading "IIROC Rulebook – Dealer Member Rules – Policy Proposals and Comment Letters Received").

Questions may be referred to:

Mindy Kwok  
Investment Analyst, Member Regulation Policy  
Investment Industry Regulatory Organization of Canada  
(416) 943-6979  
[mkwok@iiroc.ca](mailto:mkwok@iiroc.ca)

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**Attachments**

Attachment A – Proposed Amendments

Attachment B – Black-line copy of IIROC Dealer Member Rule 100.4F reflecting the amendments

**INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA  
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**PROPOSED AMENDMENTS**

1. Dealer Member Rule sections 100.4F(a) and (d) are amended to allow for partial offsets by:
  - (a) adding the words “or agreements” after the words “swap agreement”; and
  - (b) adding the words “notional amount or same partial” after the words “reference to the same”.

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**Dealer Member Rule Sections 100.4F(a) and (d)**

**100.4F. Swap Positions Offset**

For the purposes of this regulation, a “**fixed interest rate**” is an interest rate, which is not reset at least every 90 days, a “**floating interest rate**” is an interest rate, which is not a fixed interest rate and “**realization clause**” is an optional clause within a total performance swap agreement which allows the Dealer Member to close out the swap agreement at the realization price (either the buy-in or sell-out price) of the security position involved in the offset.

**(a) Interest Rate Swap versus Interest Rate Swap Offset**

Where a Dealer Member

- (i) is a party to an interest rate swap agreement or agreements requiring it to pay (or entitling it to receive) Canadian dollar or United States dollar fixed (or floating) interest rate amounts calculated with reference to a notional amount;

and

- (ii) is a party to another offsetting interest rate swap agreement or agreements entitling it to receive (or requiring it to pay) a fixed (or floating) interest rate amount calculated with reference to the same notional amount or same partial notional amount, denominated in the same currency and is within the same maturity band for margin purposes as the interest rate swap referred to in (i);

the margin required in respect of the positions in (i) and (ii) may be netted, provided that margin on fixed interest rate component payment (or receipt) positions may only be offset against margin on fixed interest rate component receipt (or payment) positions, and margin on floating interest rate component payment (or receipt) positions may only be offset against margin on other floating interest rate component receipt (or payment) positions.

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**(d) Total Performance Swap versus Total Performance Swap Offset**

Where a Dealer Member:

- (i) is a party to a total performance swap agreement or agreements requiring it to pay (or entitling it to receive) Canadian dollar or United States dollar amounts calculated based on the performance of a stipulated underlying security or basket of securities, with reference to a notional amount;

and

- (ii) is a party to another total performance swap agreement or agreements entitling it to receive (or requiring it to pay) amounts calculated based on the performance of the same underlying security or basket of securities, with reference to the same notional amount or same partial notional amount and denominated in the same currency;

the margin required in respect of the positions in (i) and (ii) may be netted, provided that margin on performance component payment (or receipt) positions may only be offset against margin on performance component receipt (or payment) positions, and margin on floating interest rate component payment (or receipt) positions may only be offset against margin on other floating interest rate component receipt (or payment) positions.