13.1.6 IIROC Rules Notice – Request for Comments – Proposed Amendments to Simplify the Equity Margin Project

IIROC RULES NOTICE

REQUEST FOR COMMENTS

PROPOSED AMENDMENTS TO SIMPLIFY THE EQUITY MARGIN PROJECT

Summary and purpose of proposed amendments

On March 25, 2009, the Board of Directors (the Board) of the Investment Industry Regulatory Organization of Canada (IIROC) approved the publication for comment of proposed amendments (Proposed Amendments) to Dealer Member Rule 100.2(f). The Proposed Amendments would simplify a number of processes for IIROC staff and Dealer Members regarding the implementation and ongoing support of the Equity Margin Project's new methodology for margining equity securities.

The Proposed Amendments are to the main proposed amendments on the Equity Margin Project (the Main Proposal) that have not yet been implemented and are currently being reviewed by the securities commissions. The Main Proposal was submitted by IIROC to the securities commissions on September 3, 2008 and it is IIROC's version of the IDA's main proposed amendments on the Equity Margin Project that were approved by the securities commissions on August 18, 2006 when it was an IDA proposal. The Proposed Amendments and the Main Proposal will be implemented together following their approval by the securities commissions. Specifically, the Proposed Amendments set out in Attachment A would:

- remove the 20% customer margin rate category for both long and short customer positions, which is dependent on the security's price volatility and an option or future listed against it on an exchange
- remove the 150% margin rate category for short positions
- allow the market price per share based margin rate methodology to be used where there is no published long or short margin rate for a listed security
- allow the market price per share based margin rate methodology to be used for specific unlisted securities that are eligible for margin
- harmonize the market price per share based margin rate categories with the new methodology's margin rate categories
- correct the rule references to Dealer Member Rule 100.9 within the index products section of Dealer Member Rule 100.2(f).

Issues and specific proposed amendments

The main issue is to simplify the implementation and ongoing support of the new methodology for margining equity securities for both IIROC staff and Dealer Members. By removing the 20% customer margin rate category that is dependent on both the security's price volatility and an option or future listed against it on an exchange, it would eliminate the need to track on an ongoing basis whether a security has an option or future listed against it on an exchange. Consequently, the lowest customer margin rate category would now be 25% for listed equity securities. By removing the 150% margin rate category for short positions, it would allow for the simplification of the implementation programming work that would have been needed for a very small number of securities that would be affected by this margin rate category.

In allowing the market price per share based margin rate methodology to be used where there is no published long or short margin rate for a listed equity security, it would make it possible for Dealer Members to easily determine a margin rate for a security if there were any quality controls issues with IIROC's quarterly margin rate file where the security or its margin rate is missing or if the security is issued after the release of the margin rate file.

In allowing the market price per share based margin rate methodology to be used for specific unlisted securities that are eligible for margin, it would give Dealer Members the choice to either simply use the market price per share margin rate methodology in determining the unlisted security's margin rate or develop systems to link the unlisted security to the margin rate of its related listed security whose margin rate would be published in the margin rate file. Following the implementation of the new methodology for margining equity securities, the market price per share margin rate methodology would have 4 margin rate categories (50%, 60%, 80% and 100%) for long positions, two of which (50% and 80%) are not margin rate categories in the new methodology. The closest margin rate categories to the 50% and 80% margin rate categories in the new methodology are 40% and 75%, respectively. Therefore, in amending the 50% and 80% margin rate categories to 40% and 75%, respectively, they would be harmonized. Accordingly, the corresponding margin rate category for short positions in the market price per share margin rate methodology to the 50% margin rate category would be amended from 150% to 140%.

Finally, a secondary issue is to correct the rule references to Dealer Member Rule 100.9 within the index products subparagraph of Dealer Member Rule 100.2(f).

The Proposed 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

IIROC has identified the need to simplify both the implementation and ongoing support of the new methodology for margining equity securities, which will be used to determine the minimum margin and capital requirements for margining equity securities. IIROC assessed this need as being in the public interest and not detrimental to the best interests of the capital markets.

The Board therefore has determined that the Proposed Amendments are not contrary to the public interest.

Due to the extent and substantive nature of the Proposed Amendments, they have been classified as Public Comment Rule proposals.

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

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

The specific purpose of the Proposed Amendments is to simplify the implementation and ongoing support of the Equity Margin Project's new methodology for margining equity securities.

It is believed that the proposed amendments will have no 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. It does not impose any burden on competition that is not necessary or appropriate in furtherance of the above purposes.

Technological implications and implementation plan

It is anticipated that there will be less system impacts resulting from the implementation of these rule changes than if they were not implemented, in comparison to the current implementation of the Equity Margin Project's new methodology for margining equity securities. The Bourse de Montréal (the Bourse) is also in the process of passing these amendments. Implementation of the Proposed Amendments will therefore take place once both IIROC and the Bourse have received approval to do so from their respective recognizing regulators.

Request for public comment

Comments are sought on the Proposed Amendments. Comments should be made in writing. Two copies of each comment should be delivered by June 30, 2009 (60 days from the publication date of this notice). One copy should be addressed to the attention of:

Answerd Ramcharan
Specialist, 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,
19th Floor, Box 55,
20 Queen Street West,
Toronto, Ontario,
M5H 3S8
marketregulation@osc.gov.on.ca

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 under the heading "IIROC Rulebook – Dealer Member Rules – Policy Proposals and Comment Letters Received").

Questions may be referred to:

Answerd Ramcharan
Specialist, Member Regulation Policy
Investment Industry Regulatory Organization of Canada
(416) 943-5850
aramcharan@iiroc.ca

Attachments

Attachment A – Proposed Amendments

Attachment B – Black-line copy of IIROC Dealer Member Rule 100 reflecting amendments

Attachment A

INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA

AMENDMENTS TO DEALER MEMBER RULE 100.2(F)

PROPOSED AMENDMENTS

1. Subparagraph (i) of Dealer Member Rule 100.2(f) is amended by:

   (a) adding the sentence "Where there is no published long position margin rate for the security, the margin required is the market price per share margin rate as detailed in subparagraph (iv)." immediately after the sentence "The published long position basic margin rate for the security as approved by a recognized self-regulatory organization, multiplied by the market value of the security position.";

   (b) adding the sentence "The Corporation will maintain a list of these markets and market tiers." immediately after the sentence "Positions in securities listed on markets or market tiers with initial or ongoing financial listing requirements that do not include adequate minimum pre-tax profit, net tangible asset and working capital requirements, as determined by the Corporation from time to time, may not be carried on margin.";

   (c) adding the sentence "Where there is no published short position margin rate for the security, the credit required is the market price per share credit required rate as detailed in subparagraph (iv)." immediately below the words "Securities selling at less than $0.25 - market value plus $0.25 per share";

   (d) adding the words "Basic margin rate" immediately above the words "For the purposes of Regulation 100";

   (e) deleting the words "customer account positions, where a related option or future is listed on an exchange, and" immediately after the words "20% (only"; and

   (f) deleting the words "150% (where necessary for short security positions)" immediately below the words "25%, 30%, 40%, 60%, 75% and 100%.".

2. Subparagraph (iv) of Dealer Member Rule 100.2(f) is amended by:

   (a) replacing the words ". Where a published rate is unavailable," with the words "or based on" immediately before the words "the following requirements";

   (b) deleting the words "will apply" immediately after the words "the following requirements";

   (c) replacing the percentage "50%" with the percentage "40%" immediately below the words "Long positions – margin required";

   (d) replacing the percentage "80%" with the percentage "75%" immediately below the words "Securities selling at $1.75 to $1.99 – 60% of market value"; and

   (e) replacing the percentage "150%" with the percentage "140%" immediately below the words "Short positions – credit required".

3. Subparagraph (vi) of Dealer Member Rule 100.2(f) is amended by:

   (a) replacing the letter "c" in the rule references to Rule 100.9 with the letter "a"; and

   (b) adding the rule reference "Rule 100.9(a)(xi)" immediately after the old rule reference "Rule 100.9(c)(x)".

Attachment B

INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA

AMENDMENTS TO DEALER MEMBER RULE 100.2(F)

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(f) **Stocks**

(i) Listed on a recognized exchange in Canada or the United States

For positions in securities listed (other than bonds and debentures but including rights and warrants other than Canadian bank warrants) on any recognized stock exchange in Canada or the United States:

Long positions – margin required

The published long position basic margin rate for the security as approved by a recognized self-regulatory organization, multiplied by the market value of the security position. <u>Where there is no published long position margin rate for the security, the margin required is the market price per share margin rate as detailed in subparagraph (iv).</u>

Positions in securities listed on markets or market tiers with initial or ongoing financial listing requirements that do not include adequate minimum pre-tax profit, net tangible asset and working capital requirements, as determined by the Corporation from time to time, may not be carried on margin. <u>The Corporation will maintain a list of these markets and market tiers.</u>

Short positions – credit required

The greater of:

(A) 100% plus the published short position basic margin rate percentage for the security as approved by a recognized self-regulatory organization, multiplied by the market value of the security position

and

(B) Where the security is trading at less than $2.00 per share, the calculated minimum price based requirement as follows:

Securities selling at $1.50 to $1.99 – $3.00 per share

Securities selling at $0.25 to $1.49 – 200% of market value

Securities selling at less than $0.25 – market value plus $0.25 per share

<u>Where there is no published short position margin rate for the security, the credit required is the market price per share credit required rate as detailed in subparagraph (iv).</u>

<u>Basic margin rate</u>

For the purposes of Regulation 100, the term “basic margin rate” means a customized security specific margin rate calculated based on the measured price and liquidity risk for the security. Similar to the calculation of the “floating margin rate” for index products, measured price risk is based on the maximum standard deviation of percentage changes in daily closing prices over the most recent 20, 90 and 260 trading days. Measured liquidity risk is based on the security’s public float value and average daily volume levels. The risk assessments are combined into an overall market risk assessment and, based on that assessment, one of the following margin rates is assigned:

[1] This black line copy has been prepared taking into account other proposals pending implementation that would also result in amendments to Dealer Member Rule 100.2(f).

- 15% (only Member firm account positions are eligible);
- 20% (only ~~customer account positions, where a related option or future is listed on an exchange, and~~ Member firm account positions are eligible);
- 25%, 30%, 40%, 60%, 75% and 100%
- ~~150% (where necessary for short security positions)~~

(ii) Index constituent securities listed on certain other exchanges

For positions in securities (other than bonds and debentures but including warrants and rights), 50% of market value provided:

(A) the exchange on which the security is listed is included on the list of exchanges and associations that qualify as “recognized exchanges and associations” for the purposes of determining “regulated entities”; and

(B) the security is a constituent security on the exchange’s major broadly based index.

(iii) Warrants issued by a Canadian chartered bank

For positions in warrants issued by a Canadian chartered bank which entitle the holder to purchase securities issued by the Government of Canada or any province (other than firm positions to which Rule 100.12(d) applies) the margin shall be the greater of:

(A) the margin otherwise required by this Rule according to the published basic margin rate for the warrant; or

(B) 100% of the margin required in respect of the security to which the holder of the warrant is entitled upon exercise of the warrant; provided that in the case of a long position the amount of margin need not exceed the market value of the warrant.

(iv) Unlisted securities eligible for margin

Subject to the existence of an ascertainable market among brokers or dealers, for positions in the following unlisted securities:

(A) Securities of insurance companies licensed to do business in Canada;

(B) Securities of Canadian banks;

(C) Securities of Canadian trust companies;

(D) Securities of mutual funds qualified by prospectus for sale in any province of Canada, with the exception of money market mutual funds (as defined in National Instrument 81-102) which may be margined using a rate of 5%;

(E) Other senior securities of listed companies;

(F) Securities which qualify as legal for investment by Canadian life insurance companies, without recourse to the basket clause;

(G) Unlisted securities in respect of which application has been made to list on a recognized stock exchange in Canada and approval has been given subject to the filing of documents and production of evidence of satisfactory distribution may be carried on margin for a period not exceeding 90 days from the date of such approval;

the margin or credit required shall be determined based on the published basic margin rate for the most junior listed security of the same issuer company as approved by a recognized self-regulatory organization, multiplied by the market value of the security position~~. Where a published rate is unavailable,~~ or based on the following requirements~~ will apply~~:

Long positions – margin required

Securities selling at $2.00 or more – ~~50~~40% of market value

Securities selling at $1.75 to $1.99 – 60% of market value

Securities selling at $1.50 to $1.74 – ~~80~~75% of market value

Securities selling under $1.50 may not be carried on margin.

Short positions – credit required

Securities selling at $2.00 or more – ~~150~~140% of market value

Securities selling at $1.50 to $1.99 – $3.00 per share

Securities selling at $0.25 to $1.49 – 200% of market value

Securities selling at less than $0.25 – market value plus $0.25 per share

(v) Other unlisted stocks

For positions in all other unlisted stocks not mentioned above:

Long positions – margin required

100% of market value

Short positions – credit required

Securities selling at $0.50 or more – 200% of market value

Securities selling at less than $0.50 – market value plus $0.50 per share

(vi) Index participation units and qualifying baskets of index securities

(A) For index participation units:

(I) In the case of a long position, the floating margin rate percentage (calculated for the index participation unit based on its regulatory margin interval) multiplied by the market value of the index participation units;

(II) In the case of a short position, 100% plus the floating margin rate percentage (calculated for the index participation unit based on its regulatory margin interval) multiplied by the market value of the index participation units;

(B) For a qualifying basket of index securities:

(I) In the case of a long position, the floating margin rate percentage (calculated for a perfect basket of index securities based on its regulatory margin interval), plus the calculated incremental basket margin rate for the qualifying basket of index securities, multiplied by the market value of the qualifying basket of index securities;

(II) In the case of a short position, 100% plus the floating margin rate percentage (calculated for a perfect basket of index securities based on its regulatory margin interval), plus the calculated incremental basket margin rate for the qualifying basket of index securities, multiplied by the market value of the qualifying basket of index securities;

For the purposes of this subparagraph, the definitions in Rule 100.9(~~c~~a)(x), Rule 100.9(a)(xi), Rule 100.9(~~c~~a)(xii), Rule 100.9(~~c~~a)(xx) and Rule 100.9(~~c~~a)(xxiv) apply.