Chapter 13

SROs, Marketplaces and Clearing Agencies

13.1 SROs

13.1.1 IIROC Rules Notice – Request for Comment – Amendments to Schedule 12 of Form 1 and the Notes and Instructions to Schedule 12 of Form 1

12-0021
January 20, 2012

IIROC RULES NOTICE – REQUEST FOR COMMENT – AMENDMENTS TO SCHEDULE 12 OF FORM 1 AND THE NOTES AND INSTRUCTIONS TO SCHEDULE 12 OF FORM 1

Summary of nature and purpose of proposed amendments

On November 23, 2011, the Board of Directors (the Board) of the Investment Industry Regulatory Organization of Canada (IIROC) approved the publication for comment of the proposed amendments to Schedule 12 of Form 1(the Schedule) and the Notes and Instructions to Schedule 12 of Form 1 relating to the concentration margin calculation for futures and deposits (collectively, the Proposed Amendments).

The primary objective of the Proposed Amendments is to re-organize and re-write the Schedule and its Notes and Instructions into a simpler and more logical format, making it easier to read and interpret.

The recent insolvency of an IIROC Dealer Member (MF Global Canada Co.) has raised the issue of whether dealing with a broker that maintains a certain capital level is alone sufficient when dealing with foreign correspondent brokers. However, as the proposal to amend Schedule 12 and its Notes and Instructions is largely a technical rule amendment proposal, the broader regulatory policy issue of foreign correspondent broker minimum capital levels will be reviewed separately to determine if further rule amendments are necessary.

Issues and specific Proposed Amendments

Schedule 12 of Form 1 currently requires Dealer Members to provide margin on commodity and commodity futures positions and related deposits with correspondent brokers to cover possible commodity concentration risk and related counterparty risk. The Schedule contains four separate margin calculations on Lines 1 through 4: a general margin calculation, a concentration margin in individual accounts calculation, a concentration margin in individual commodities calculation and a "deposits with correspondent brokers" margin calculation. The Notes and Instructions to the Schedule detail those calculations.

The Schedule and its accompanying Notes and Instructions require updating in order to:

- address changes in the futures markets over the past several years, including:
  - futures contracts on other asset classes (e.g. financial futures contracts) beyond commodities;
  - the fact that there are more risk reduction offset strategies that are recognized by the futures exchanges;
  - more timely publication of futures contracts margin requirements by the futures exchanges; and
- make the regulatory requirements easier to understand.

The Proposed Amendments would therefore: i) clarify that the Schedule covers both commodities and financial futures; ii) stipulate the additional risk reduction offset strategies that can be excluded from the margin calculations; and iii) clarify that futures contracts, whose maintenance margin requirements are published daily by the futures exchange, may be excluded from the general margin calculation.

The Proposed Amendments are applied to the International Financial Reporting Standards-based Form 1 (IFRS-based Form 1) because it is anticipated that Dealer Members will no longer be reporting under the Canadian Generally Accepted Accounting Principles-based Form 1 (CGAAP-based Form 1) when these Proposed Amendments are expected to be implemented.

The benefits of the Proposed Amendments are:

- a more comprehensive set of margin requirements that will cover futures contracts on other asset classes;
- a more logically organized set of margin requirements that would be easier to read and interpret; and
- a set of margin requirements that are more reflective of current industry practices.

The following are the Proposed Amendments to the Schedule and its Notes and Instructions, and reasons for them:

Changes to Schedule 12 of Form 1

1. *Renaming Lines 1 through 4:*

   The proposed amendments will rename Lines 1 through 4. The purpose of renaming these Lines is to make them more concise and/or precise. Line 1 will be renamed as "Total futures contract and futures contract option positions" from "Margin on total positions". Line 2 will be renamed as "Concentration in individual accounts" from "Margin regarding concentration in individual accounts". Line 3 will be renamed as "Concentration in individual futures contracts" from "Margin regarding concentration in individual futures contracts". Line 4 will be renamed as "Deposits with correspondent brokers" from "Margin on futures contract deposits - correspondent brokers".

Changes to the Notes and Instructions

2. *Setting out definitions for the purposes of the Schedule:*

   The proposed amendments will define the terms "correspondent broker", "futures contracts", "long futures contract positions", "short futures contract positions", and "maintenance margin requirements" at the beginning of the Notes and Instructions. Defining these terms will ensure consistency in their meaning and use throughout the Schedule. *[Beginning of the Notes and Instructions]*

3. *Setting out the exclusion to the 15% general margin provision:*

   Maintenance margin rates were published by the futures exchanges typically on a monthly basis. As a result, Line 1 was intended to act as a cushion over and above the published maintenance margin rates to reduce the likelihood that margin rates may be insufficient at some point within the next month. However, many of the futures exchanges (e.g. NYMEX, CBOT, COMEX, Eurex, and Montréal Exchange) have already or are in the process of publishing maintenance margin rates on a daily basis instead of on a monthly basis, which results in more accurate market risk coverage on an ongoing basis. Consequently, the proposed amendments will exclude the 15% margin provision on futures contract positions traded on futures exchanges that publish maintenance margin rates on a daily basis. *[Line 1 Notes and Instructions]*

4. *Allowing the exclusion of futures contract spread positions with different delivery months:*

   Under the current Notes and Instructions, there is a divergence of practices among Dealer Members in calculating this provision for Line 1. Some Dealer Members are calculating this provision on a net product/commodity basis. That is, they are calculating the net value of the futures contracts irrespective of their contract months. Other Dealer Members are viewing each futures contract month as a separate product/commodity and are taking the greater of the long or short position on each contract month. The proposed amendment will allow the netting of futures contracts irrespective of their contract months given that the underlying commodity is the same and the futures contracts are traded on the same futures exchange. This proposed amendment is consistent with IIROC staff's previous interpretation on this Line 1 calculation. *[Line 1 Notes and Instructions]*

5. *Clarifying the exclusion of paired short option positions on futures contracts:*

   Current Note 1 (1.3) in the Schedule needs to be more specific when describing the short option positions that should be excluded from the concentration calculations of Lines 2 and 3. The purpose of the exclusions is to exclude all positions that will not result in concentration risk to the firm. For example, current Note 1 (1.3)(iv) states that a short option paired with a futures contract can be excluded from the calculation. This may result in various combinations which may result in a loss. The proposed amendments will clarify the type of short option pairings to be excluded. Using the example above, the provision will now state that a short *call (put)* should be paired with a *long (short)* futures contract if the pairing is to be excluded from the respective calculations. *[Lines 2 and 3 Notes and Instructions]*

6. *Clarifying the treatment of maintenance margin deposits with correspondent brokers:*

   In the current Notes and Instructions to Line 4 (margin on commodity deposits with correspondent brokers) it is unclear if maintenance margin deposits should, when calculating the excess amount, be included or excluded from the assets owed to a Dealer Member from a correspondent broker. The proposed amendment would require maintenance margin deposits with a correspondent broker to be included as assets owing to a Dealer Member for the excess amount calculation. This proposed amendment is consistent with IIROC staff's previous interpretation on this Line 4 calculation. *[Line 4 Notes and Instructions]*

7. *Covering the situation when the net worth of a correspondent broker is exactly $50 million:*

   The current wording does not cover the margin required when the net worth of a correspondent broker is exactly $50 million. The proposed amendment adds the phrase "or equal to" to the provision where margin is required when the net worth of the correspondent broker is less than $50 million. *[Line 4 Notes and Instructions]*

8. *Deleting the letter of credit provision:*

   This proposed amendment removes the letter of credit provision, which allowed a Dealer Member to rely on a Commodity Futures Correspondent Broker's unconditional and irrevocable letter of credit issued by a U.S. bank, if the Commodity Futures Correspondent Broker's net worth was less than $50 million. Letters of credit are rarely used in this circumstance; furthermore, the ability to cash in letters of credit, given the observed liquidity risks in the recent financial crisis, is highly uncertain. Removing the letter of credit would result in a more stringent provision. *[Line 4 Notes and Instructions]*

Rule making process

The Proposed Amendments were developed by IIROC staff and recommended for approval by the FAS Capital Formula Subcommittee and the Financial Administrators Section, two policy advisory committees of IIROC.

Issues and alternatives considered

The Proposed Amendments do not create any onerous new obligations for Dealer Members and have been drafted to clarify the existing requirements with respect to margin calculations on futures concentrations and deposits. Furthermore, no alternatives have been considered.

Comparison with similar provisions

Both the United Kingdom and the United States have concentration rules for commodities futures and options on futures. Since the Proposed Amendments are technical in nature, a detailed comparison to these rules was considered unnecessary.

Proposed Rule classification

In deciding to propose these amendments, IIROC identified that there was a need to enhance clarity in the Schedule and its Notes and instructions.

This need was assessed as being in the public interest and not detrimental to the best interests of the capital markets. As a result, the Board has classified the Proposed Amendments as a Public Comment Rule proposal and is not contrary to the public interest.

Effects of the Proposed Amendments on market structure, Dealer Members, non-Dealer Members, competition and costs of compliance

With the Proposed Amendments, Dealer Members will benefit from enhanced clarity and certainty in the Schedule and the required concentration calculations.

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

There should not be any significant technological implications for Dealer Members as a result of the Proposed Amendments.

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 (60 days from the publication date of this notice). One copy should be addressed to the attention of:

Mindy Kwok
Information Analyst, Member Regulation Policy
Investment Industry Regulatory Organization of Canada
Suite 2000, 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:

Mindy Kwok
Information Analyst, Member Regulation Policy
Investment Industry Regulatory Organization of Canada
416-943-6979
mkwok@iiroc.ca

Attachments

Attachment A – Board Resolution

Attachment B – Proposed Amendments to Schedule 12 of Form 1 and the Notes and Instructions to Schedule 12 of Form 1

Attachment C – Black-line of Proposed Amendments

Attachment D – Clean copy of proposed Schedule 12 of Form 1 and the Notes and Instructions to Schedule 12 of Form 1

Attachment A

INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA

AMENDMENTS TO SCHEDULE 12 OF FORM 1 AND THE NOTES AND INSTRUCTIONS TO SCHEDULE 12 OF FORM 1

BOARD RESOLUTION

BE IT RESOLVED ON THE 23RD DAY OF NOVEMBER, 2011, THAT:

1. The English and French IFRS-based versions of the proposed amendments to Schedule 12 of Form 1 and the Notes and Instructions to Schedule 12 of Form 1 regarding margin on futures concentrations and deposits, in the form presented to the Board of Directors:

    (a) be approved for publication for public comment for 60 days;

    (b) be approved for submission to the Recognizing Regulators for review and approval;

    (c) be determined to be in the public interest; and

    (d) be approved for implementation if there are no material comments from the public or the Recognizing Regulators.

2. The President be authorized to approve such non-material changes to the proposed amendments prior to publication and/or implementation as the President considers necessary and appropriate.

Attachment B

INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA

AMENDMENTS TO SCHEDULE 12 OF FORM 1 AND THE NOTES AND INSTRUCTIONS TO SCHEDULE 12 OF FORM 1

PROPOSED AMENDMENTS

1. IFRS-based Schedule 12 of Form 1 is amended by:

    (a) Adding "'s" after the words "Dealer Member";

    (b) Adding the words "*notes and*" after the words "*refer to*";

    (c) Adding the words "Margin required" above the column "C$'000";

    (d) Replacing the words "Margin on total" with the words "Total futures contract and futures contract option" on Line 1;

    (e) Replacing the words "Margin regarding concentration" with the word "Concentration" on Line 2;

    (f) Replacing the words "Margin regarding concentration" with the word "Concentration" on Line 3;

    (g) Replacing the words "Margin on futures contract deposits -" with the words "Deposits with" on Line 4; and

    (h) Adding the words "*[lines 1 through 4]*" after the word "TOTAL" on Line 5.

2. The IFRS-based Notes and Instructions to Schedule 12 of Form 1 is amended by repealing and replacing it with the attached.

Attachment C

INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA

AMENDMENTS TO SCHEDULE 12 OF FORM 1
AND THE NOTES AND INSTRUCTIONS TO SCHEDULE 12 OF FORM 1(BASED ON IFRS)

BLACK-LINE COPY

DATE: ______________________

____
(Dealer Member's Name)

MARGIN ON FUTURES CONCENTRATIONS AND DEPOSITS
(*refer to notes and instructions*)

		Margin required C$'000
1.	~~Margin on total~~Total futures contract and futures contract option positions	
2.	~~Margin regarding concentration~~Concentration in individual accounts	
3.	~~Margin regarding concentration~~Concentration in individual futures contracts	
4.	~~Margin on futures contract deposits -~~Deposits with correspondent brokers	
5.	TOTAL *[lines 1 through 4]*	
		B-18

Attachment C

FORM 1, PART II – SCHEDULE 12
NOTES AND INSTRUCTIONS

1. The purpose of Schedule 12 is to ensure that there is adequate capital available at a Dealer Member to cover concentration risks regarding commodity and financial futures positions and counterparty risk related to deposits with correspondent brokers.

2. For the purposes of this schedule the term:

   (i) **"correspondent broker"** means a broker who is registered to engage in soliciting or accepting and handling orders for the purchase or sale of futures contracts or futures contract options on the behalf of the Dealer Member in a country other than Canada;

   (ii) **"futures contracts"** includes commodity futures and financial futures contracts;

   (iii) **"long futures contract positions"** includes futures contracts underlying short put options on futures contracts;

   (iv) **"maintenance margin requirements"** means the requirements prescribed by the futures exchange on which the futures contracts were entered into; and

   (v) **"short futures contract positions"** includes futures contracts underlying short call options on futures contracts.

3. **Line 1 - General margin provision**~~. The margin requirement for futures contracts and options on futures contracts shall be 15% of the maintenance margin requirements, as required by the Commodity Futures Exchange on which such futures contracts were entered into, for the greater of the total long or total short futures contracts per commodity or financial futures carried for all client and Dealer Member accounts. For the purpose of this general margin provision, short futures contracts positions include futures contracts underlying the short call options on futures contracts and long futures contracts positions include futures contracts underlying the short put options on futures contracts.~~ **(Notes 3 and 4)**
   Line 1 is used to establish a base level of capital that a Dealer Member is to provide when the maintenance margin requirements (calculated and published by the futures exchange in which the futures contracts and futures contract options are entered) are not calculated on a daily basis. The base level of capital is dependent on the number and type of contracts currently held by the Dealer Member and its clients.

   The general margin provision calculation is on the Dealer Member and client account open positions in futures contracts and futures contract options, except for the specified excluded positions in the related Note below.

   The margin required is 15% of the greater of:

   (i) the maintenance margin requirements of the total long futures contract positions for each type of futures contract carried for all Dealer Member and client accounts; or

   (ii) the maintenance margin requirements of the total short futures contract positions for each type of futures contract carried for all Dealer Member and client accounts.

   Where a futures exmchange calculates and publishes maintenance margin requirements on a daily basis, no margin is required under Line 1.

   ~~The following~~4. **Excluded positions** ~~are excluded~~ **from** ~~this~~**the calculation**~~:~~ **of Line 1**

   (~~a~~) ~~positions in~~i) Positions held in accounts of acceptable institutions, acceptable counterpart~~y~~ies and regulated entit~~y~~ies ~~accounts;~~.

   (~~b~~ii) ~~hedge~~Hedge positions (as opposed to speculative positions), ~~, provided that~~ where the underlying interest is held in the client's account at the Dealer Member or that the Dealer Member has a document giving the Dealer Member an irrevocable right to take possession of the underlying interest and deliver it at the location designated by the appropriate clearing corporation.

   All other hedge positions are treated as speculative positions for the purpose of this calculation~~;~~.

(~~c~~) ~~client and Dealer Member spreads in the same futures contract~~iii) Dealer Member or individual client spread positions in futures contracts in the same product (including futures contracts in the same product with different delivery months) entered into on the same futures exchange.

All other spread positions are treated as speculative positions for the purpose of this calculation~~;~~.

(~~d~~) ~~The following options on futures contracts positions:(i) short options~~iv) Dealer Member or individual client short option positions on futures contracts which are out-of-the-money by more than two maintenance margin requirements~~; and~~.

(~~ii~~) ~~spreads~~v) Dealer Member or individual client spread positions in the same ~~options on~~ futures ~~contracts~~contract options.

5. **Line 2 - Concentration in individual accounts.** ~~The Dealer Member must provide for the amount by which;~~ **(Notes 5, 6 and 9)**

Line 2 requires capital to be provided to cover concentration risk in individual accounts (client or the Dealer Member) when the aggregate of the maintenance margin requirements for each type of futures contract position or underlying interest on futures contract option position held both long and short for individual clients (including groups of clients or related clients) or in the Dealer Member's inventory is greater than 15% of the Dealer Member's net allowable assets. The concentration risk is the excess amount of the aggregate of those maintenance margin requirements over 15% of the Dealer Member's net allowable assets.

The capital to be provided is dependent on the excess amount calculation below (which allows for specified deductions and excluded positions in the related Notes below) and how quickly the Dealer Member eliminates this concentration risk.

The excess amount is:

(~~a~~i) the aggregate of the maintenance margin requirements for each type of ~~the commodity or financial~~ futures contract position or underlying interest ~~of option~~ on futures ~~contracts~~contract option position held both long and short for ~~any client~~individual clients (including ~~without limitation~~ groups of clients or related clients) or in the Dealer Member's inventory, except for positions mentioned in Note ~~1 below, less any excess margin provided~~9; minus

~~exceeds~~

(~~b~~ii) 15% of the Dealer Member's net allowable assets.
~~The excess margin must be based on the maintenance margin. However, spread positions in the same product or different product on the same exchange and an inter-exchange or inter-commodity spread could be included using the maintenance margin as set by the exchange, provided that the spread is acceptable for margin purposes by a recognized exchange.~~

~~If the excess is not eliminated within three (3) trading days after it first occurs, the Dealer Member's capital shall be charged the lesser of:~~

Margin is required on the close of the third trading day after the concentration first occurred and is the lesser of:

(~~a~~i) the excess amount calculated when the concentration first occurred; and

(~~b~~ii) the excess amount, if any, that exists on the close of the third trading day.

~~For the purpose of the concentration calculation, short futures contracts positions include futures contracts underlying the short call options on futures contracts and long futures contracts positions include futures contracts underlying the short put options on futures contracts.~~

6. **Deductions from Part (i) of the excess amount calculation of Line 2**

(i) Any excess margin in the Dealer Member account or client's account is to be deducted from Part (i) of the excess calculation. The excess margin is to be based on the maintenance margin. Spread positions in the same product or different product on the same exchange and an inter-exchange or inter-commodity spread could be included using the maintenance margin as set by the exchange, provided that the spread is acceptable for margin purposes by the applicable exchange.

7. **Line 3 - Concentration in individual open futures contracts and short options on futures contract positions~~.~~ ~~The Dealer Member must provide for the amount by which;~~ (Notes 7 to 9)**

Line 3 requires capital to be provided to cover concentration risk in individual open futures contracts and short options on futures contract positions when the aggregate of two maintenance margin requirements on the greater of the long or the short futures contracts positions for each type of futures contract position or underlying interest of futures contract option position, held in both the Dealer Member's inventory and for all clients, is greater than 40% of the Dealer Member's net allowable assets. The concentration risk is the excess amount of those aggregate of two maintenance margin requirements over 40% of the Dealer Member's net allowable assets.

The capital to be provided is dependent on the excess amount calculation below (which allows for specified deductions and excluded positions in the related Notes below) and how quickly the Dealer Member eliminates this concentration risk.

The excess amount is:

(~~a~~i) the aggregate of two maintenance margin requirements on the greater of the long or the short ~~commodity or financial futures contracts position held for clients and in~~futures contracts positions for each type of futures contract position or underlying interest of futures contract option position, held in both the Dealer Member's inventory and for all clients, except for positions mentioned in Note ~~1 below,~~9; minus

~~exceeds~~

(~~b~~ii) 40% of the Dealer Member's net allowable assets.

~~There may be deducted from this difference, on a per client basis, the excess margin available in all accounts of the client up to two maintenance margin requirements of the client's positions in the futures contracts.~~

~~The excess margin must be based on the maintenance margin. However, spread positions in the same product or different product on the same exchange and an inter-exchange or inter-commodity spread could be included in both the long and short side using the maintenance margin as set by the exchange, provided that the spread is acceptable for margin purposes by a recognized exchange.~~

~~If the excess is not eliminated within three (3)~~Margin is required on the close of the third trading ~~days after it first occurs, the Dealer Member's capital shall be charged~~day after the concentration first occurred and is the lesser of:

(~~a~~i) the excess amount calculated when the concentration first occurred; and

(~~b~~ii) the excess amount, if any, that exists on the close of the third trading day.

~~For the purpose of the concentration calculation, short futures contracts positions include futures contracts underlying the short call options on futures contracts and long futures contracts positions include futures contracts underlying the short put options on futures contracts.~~

8. **Deductions from Part (i) of the excess amount calculation of Line 3**

(i) Any excess margin may be deducted from Part (i) of the excess amount calculation, up to two maintenance margin requirements in the Dealer Member account or client's account (on a per client basis). The excess margin is to be based on the maintenance margin. Spread positions in the same product or different product on the same exchange and an inter-exchange or inter-commodity spread could be included using the maintenance margin as set by the exchange, provided that the spread is acceptable for margin purposes by the applicable exchange.

9. **Excluded positions from Part (i) of the excess amount calculation of Lines 2 and 3**

(i) Positions held in accounts of acceptable institutions, acceptable counterparties and regulated entities.

(ii) Hedge positions (as opposed to speculative positions), where the underlying interest is held in the client's account at the Dealer Member or that the Dealer Member has a document giving the Dealer Member an irrevocable right to take possession of the underlying interest and deliver it at the location designated by the appropriate clearing corporation.

All other hedge positions are treated as speculative positions and are thereby not excluded.

(iii) The following short option positions on futures contracts in a Dealer Member or client account, and provided that the pairings are acceptable for margin purposes by the applicable exchange:

(a) short calls or puts which are out-of-the-money by more than two maintenance margin requirements;

(b) a short call and a short put pairing on the same futures contract with the same exercise price and same expiration month;

(c) a futures contract paired with an in-the-money option;

(d) a short call (put) paired with a long in-the-money call (put);

(e) a short call (put) paired with a long (short) futures contract;

(f) an out-of-the-money short call paired with an out-of-the-money long call, where the strike price of the short call exceeds the strike price of the long call; and

(g) an out-of-the-money short put paired with an out-of-the-money long put.

10. **Line 4 - Margin on deposits with correspondent brokers**

(i) Where a correspondent broker owes assets~~,~~ (including cash, open trade equity and securities~~, owing~~) to a Dealer Member ~~from a Commodity Futures Correspondent Broker exceed~~exceeding 50% of the Dealer Member's net allowable assets, ~~any~~the excess ~~over this~~ amount ~~shall~~must be provided as a charge in computing the Dealer Member's margin required.

The assets owing to the Dealer Member are the amount of deposits without reducing this amount by the maintenance margin requirements for all open positions.

(ii) Where the net worth of the ~~Commodity Futures Correspondent Broker,~~ correspondent broker (as determined from its latest published audited financial statements~~, exceeds~~) is:

(a) greater than $50,000,000, no margin is required under this rule~~.~~;

(b) less than or equal to $50,000,000, the Dealer Member must provide the amount calculated in Note 10(i).

~~Where the net worth of the Commodity Futures Correspondent Broker, as determined from its latest published financial statements, is less than $50,000,000, the Dealer Member may use a confirmed unconditional and irrevocable letter of credit issued by a US bank qualifying as an *acceptable institution* on behalf of the Commodity Futures Correspondent Broker to offset any margin requirement calculated above. The amount of the offset is limited to the amount of the letter of credit~~

~~No exemption from this requirement is permitted for~~(iii) Where a Dealer ~~Members~~Member who ~~operate their commodity~~operates its futures contracts and ~~commodity option on~~ futures ~~contracts~~contract options business on a fully disclosed basis with a correspondent broker, no exemption from this requirement is permitted.

~~**Note 1:** For the purpose of the calculation of the concentration margin on individual client accounts (Line 2) and for open futures contracts and short options on futures contracts positions (Line 3), the following positions are excluded:~~

~~1.1 positions held in *acceptable institution*, *acceptable counterparty* and *regulated entity* accounts;~~

~~1.2 hedge positions (as opposed to speculative positions) provided that the underlying interest is held in the client's account at the Dealer Member or that the Dealer Member has a document giving the Dealer Member an irrevocable right to take possession of the underlying interest and deliver it at the location designated by the appropriate clearing corporation. All other hedge positions are treated as speculative positions and are thereby not excluded;~~

~~1.3 the following short Options on Futures Contracts Positions:~~

~~(i) either the short call or the short put where a client or Dealer Member account is short a call and short a put on the same futures contract with the same exercise price and same expiration month;~~

~~(ii) a futures contract paired with an in-the-money option provided that this pairing is acceptable for margin purposes by a recognized exchange;~~

~~(iii) a short option paired with a long in-the-money option provided that this pairing is acceptable for margin purposes by a recognized exchange;~~

~~(iv) a short option paired with a futures contract provided that this pairing is acceptable for margin purposes by a recognized exchange;~~

~~(v) an out-of-the-money short call option paired with an out-of-the-money long call option, where the strike price of the short call exceeds the strike price of the long call, provided that this pairing is acceptable for margin purposes by a recognized exchange;~~

~~(vi) an out-of-the-money short put option paired with an out-of-the-money long put option provided that this pairing is acceptable for margin purposes by a recognized exchange; and~~

~~(vii) short option, which is out-of-the-money by more than two~~

Attachment D

INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA

PROPOSED SCHEDULE 12 OF FORM 1 AND THE NOTES AND INSTRUCTIONS TO SCHEDULE 12 OF FORM 1(BASED ON IFRS)

CLEAN COPY

DATE: ______________________

____
(Dealer Member's Name)

MARGIN ON Futures CONCENTRATIONS AND DEPOSITS
(*refer to notes and instructions*)

		Margin required C$'000
1.	Total futures contract and futures contract option positions	----------------
2.	Concentration in individual accounts	----------------
3.	Concentration in individual futures contracts	----------------
4.	Deposits with correspondent brokers	----------------
5.	TOTAL *[lines 1 through 4]*	B-18

Attachment D

FORM 1, PART II – SCHEDULE 12
NOTES AND INSTRUCTIONS

1. The purpose of Schedule 12 is to ensure that there is adequate capital available at a Dealer Member to cover concentration risks regarding commodity and financial futures positions and counterparty risk related to deposits with correspondent brokers.

2. For the purposes of this schedule the term:

   (i) **"correspondent broker"** means a broker who is registered to engage in soliciting or accepting and handling orders for the purchase or sale of futures contracts or futures contract options on the behalf of the Dealer Member in a country other than Canada;

   (ii) **"futures contracts"** includes commodity futures and financial futures contracts;

   (iii) **"long futures contract positions"** includes futures contracts underlying short put options on futures contracts;

   (iv) **"maintenance margin requirements"** means the requirements prescribed by the futures exchange on which the futures contracts were entered into; and

   (v) **"short futures contract positions"** includes futures contracts underlying short call options on futures contracts.

3. **Line 1 - General margin provision (Notes 3 and 4)**

   Line 1 is used to establish a base level of capital that a Dealer Member is to provide when the maintenance margin requirements (calculated and published by the futures exchange in which the futures contracts and futures contract options are entered) are not calculated on a daily basis. The base level of capital is dependent on the number and type of contracts currently held by the Dealer Member and its clients.

   The general margin provision calculation is on the Dealer Member and client account open positions in futures contracts and futures contract options, except for the specified excluded positions in the related Note below.

   The margin required is 15% of the greater of:

   (i) the maintenance margin requirements of the total long futures contract positions for each type of futures contract carried for all Dealer Member and client accounts; or

   (ii) the maintenance margin requirements of the total short futures contract positions for each type of futures contract carried for all Dealer Member and client accounts.

   Where a futures exchange calculates and publishes maintenance margin requirements on a daily basis, no margin is required under Line 1.

4. **Excluded positions from the calculation of Line 1**

   (i) Positions held in accounts of acceptable institutions, acceptable counterparties and regulated entities.

   (ii) Hedge positions (as opposed to speculative positions) where the underlying interest is held in the client's account at the Dealer Member or that the Dealer Member has a document giving the Dealer Member an irrevocable right to take possession of the underlying interest and deliver it at the location designated by the appropriate clearing corporation.

   All other hedge positions are treated as speculative positions for the purpose of this calculation.

   (iii) Dealer Member or individual client spread positions in futures contracts in the same product (including futures contracts in the same product with different delivery months) entered into on the same futures exchange.

   All other spread positions are treated as speculative positions for the purpose of this calculation.

(iv) Dealer Member or individual client short option positions on futures contracts which are out-of-the-money by more than two maintenance margin requirements.

(v) Dealer Member or individual client spread positions in the same futures contract options.

5. **Line 2 - Concentration in individual accounts (Notes 5, 6 and 9)**

Line 2 requires capital to be provided to cover concentration risk in individual accounts (client or the Dealer Member) when the aggregate of the maintenance margin requirements for each type of futures contract position or underlying interest on futures contract option position held both long and short for individual clients (including groups of clients or related clients) or in the Dealer Member's inventory is greater than 15% of the Dealer Member's net allowable assets. The concentration risk is the excess amount of the aggregate of those maintenance margin requirements over 15% of the Dealer Member's net allowable assets.

The capital to be provided is dependent on the excess amount calculation below (which allows for specified deductions and excluded positions in the related Notes below) and how quickly the Dealer Member eliminates this concentration risk.

The excess amount is:

(i) the aggregate of the maintenance margin requirements for each type of futures contract position or underlying interest on futures contract option position held both long and short for individual clients (including groups of clients or related clients) or in the Dealer Member's inventory, except for positions mentioned in Note 9; minus

(ii) 15% of the Dealer Member's net allowable assets.

Margin is required on the close of the third trading day after the concentration first occurred and is the lesser of:

(i) the excess amount calculated when the concentration first occurred; and

(ii) the excess amount, if any, that exists on the close of the third trading day.

6. **Deductions from Part (i) of the excess amount calculation of Line 2**

(i) Any excess margin in the Dealer Member account or client's account is to be deducted from Part (i) of the excess calculation. The excess margin is to be based on the maintenance margin. Spread positions in the same product or different product on the same exchange and an inter-exchange or inter-commodity spread could be included using the maintenance margin as set by the exchange, provided that the spread is acceptable for margin purposes by the applicable exchange.

7. **Line 3 - Concentration in individual open futures contracts and short options on futures contract positions (Notes 7 to 9)**

Line 3 requires capital to be provided to cover concentration risk in individual open futures contracts and short options on futures contract positions when the aggregate of two maintenance margin requirements on the greater of the long or the short futures contracts positions for each type of futures contract position or underlying interest of futures contract option position, held in both the Dealer Member's inventory and for all clients, is greater than 40% of the Dealer Member's net allowable assets. The concentration risk is the excess amount of those aggregate of two maintenance margin requirements over 40% of the Dealer Member's net allowable assets.

The capital to be provided is dependent on the excess amount calculation below (which allows for specified deductions and excluded positions in the related Notes below) and how quickly the Dealer Member eliminates this concentration risk.

The excess amount is:

(i) the aggregate of two maintenance margin requirements on the greater of the long or the short futures contracts positions for each type of futures contract position or underlying interest of futures contract option position, held in both the Dealer Member's inventory and for all clients, except for positions mentioned in Note 9; minus

(ii) 40% of the Dealer Member's net allowable assets.

Margin is required on the close of the third trading day after the concentration first occurred and is the lesser of:

(i) the excess amount calculated when the concentration first occurred; and

(ii) the excess amount, if any, that exists on the close of the third trading day.

8. **Deductions from Part (i) of the excess amount calculation of Line 3**

(i) Any excess margin may be deducted from Part (i) of the excess amount calculation, up to two maintenance margin requirements in the Dealer Member account or client's account (on a per client basis). The excess margin is to be based on the maintenance margin. Spread positions in the same product or different product on the same exchange and an inter-exchange or inter-commodity spread could be included using the maintenance margin as set by the exchange, provided that the spread is acceptable for margin purposes by the applicable exchange.

9. **Excluded positions from Part (i) of the excess amount calculation of Lines 2 and 3**

(i) Positions held in accounts of acceptable institutions, acceptable counterparties and regulated entities.

(ii) Hedge positions (as opposed to speculative positions), where the underlying interest is held in the client's account at the Dealer Member or that the Dealer Member has a document giving the Dealer Member an irrevocable right to take possession of the underlying interest and deliver it at the location designated by the appropriate clearing corporation.

All other hedge positions are treated as speculative positions and are thereby not excluded.

(iii) The following short option positions on futures contracts in a Dealer Member or client account, and provided that the pairings are acceptable for margin purposes by the applicable exchange:

(a) short calls or puts which are out-of-the-money by more than two maintenance margin requirements;

(b) a short call and a short put pairing on the same futures contract with the same exercise price and same expiration month;

(c) a futures contract paired with an in-the-money option;

(d) a short call (put) paired with a long in-the-money call (put);

(e) a short call (put) paired with a long (short) futures contract;

(f) an out-of-the-money short call paired with an out-of-the-money long call, where the strike price of the short call exceeds the strike price of the long call; and

(g) an out-of-the-money short put paired with an out-of-the-money long put.

10. **Line 4 - Margin on deposits with correspondent brokers**

(i) Where a correspondent broker owes assets (including cash, open trade equity and securities) to a Dealer Member exceeding 50% of the Dealer Member's net allowable assets, the excess amount must be provided as a charge in computing the Dealer Member's margin required.

The assets owing to the Dealer Member are the amount of deposits without reducing this amount by the maintenance margin requirements for all open positions.

(ii) Where the net worth of the correspondent broker (as determined from its latest published audited financial statements) is:

(a) greater than $50,000,000, no margin is required under this rule;

(b) less than or equal to $50,000,000, the Dealer Member must provide the amount calculated in Note 10(i).

(iii) Where a Dealer Member who operates its futures contracts and futures contract options business on a fully disclosed basis with a correspondent broker, no exemption from this requirement is permitted.