IIROC OCRCVM
Investment Industry Regulatory Organization of Canada
Organisme canadien de réglementation du commerce des valeurs mobilières

# IIROC NOTICE

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# Proposed amendments to Dealer Member Rules 100 and 1200 and to Form 1 relating to the client free credit cash usage limit, client free credit segregation requirements, and securities concentration test

## Summary of nature and purpose of proposed Rule

On November 26, 2014, the Board of Directors (the Board) of the Investment Industry Regulatory Organization of Canada (IIROC) approved the publication for comment of proposed amendments to the Dealer Member Rules 100 and 1200 and to Form 1relating to the client free credit cash usage limit, client free credit segregation requirements, and securities concentration test (collectively, "the Proposed Amendments").

The main purpose of the Proposed Amendments is to strengthen the prudential framework for IIROC Dealer Members for ensuring the safeguarding of and timely client access to client assets. The Proposed Amendments seek to appropriately restrict a Dealer Member's ability to use client free credit cash balances in the conduct of its business, by reducing the allowable usage ratio to a more appropriate ratio of client free credits to liquid capital (i.e. early warning reserve (EWR)). The

Proposed Amendments also serve to prevent any undue concentration of the investment of client free credit cash balances and Dealer Member capital in securities of a single issuer by expanding the types of securities that will be subject to the securities concentration test.

### *Statement D (Statement of Free Credit Segregation Amount) of Form 1*

#### *Current rules*

The prudential framework that IIROC Dealer Members must adhere to, relating to the safeguarding of client assets, is primarily comprised of the capital formula, internal controls, books and records requirements, regulatory reporting, segregation of client securities, and insurance requirements.

An additional safeguard enacted by the self-regulators in 1993 is the client free credit cash usage limit (also referred to as "free credit usage limit"). The purpose of this requirement is to address the risk that firms may excessively leverage their business activities through the use of unencumbered client cash on hand ("client free credits" or "free credits"). Borrowing unencumbered cash from client accounts without restriction, at some point, may expose a Dealer Member to undue leverage risk; which, in turn, can threaten the Dealer Member's own solvency; which, in turn, can threaten the Dealer Member's ability to repay the money it has borrowed from clients. The client free credit cash usage limit is meant to restrict undue leverage by limiting free credit use in relation to the firm's regulatory capital position. The fundamental elements of this current requirement are as follows[1]:

(i) *Client free credit cash usage limit*

The free credit limit for a Dealer Member[2] is calculated as follows:

Free credit limit = 8 x net allowable assets (NAA) + 4 x early warning reserve (EWR)

NAA of a firm is the total regulatory capital employed in the business. EWR is the liquid capital available within the firm to meet near-term business obligations. The factors of 8 and 4 are consistent with the leverage ratios established for financial institutions under the Basle Accord.

(ii) *Client free credit segregation requirement*

Pursuant to Statement D (Statement of Free Credit Segregation Amount) of Form 1, client free credit cash balances in excess of the free credit limit must be segregated in the form of

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[1] The third element of the free credit requirement relates to disclosure. Pursuant to Dealer Member Rule section 1200.2, firms must inform their clients that not all free credits are required to be held in trust by including the following disclosure on all client account statements: *"Any free credit balances represent funds payable on demand which, although properly recorded in our books, are not segregated and may be used in the conduct of our business".*

[2] Since 2011, IIROC Dealer Members have been voluntarily complying with a client free credit cash usage limit of 12 x early warning reserve (EWR), which is more conservative than the limit under the current rules.

government securities with a term of one year or less, or in the form of cash deposited in a trust account held by an Acceptable Institution. The balance of the client free credit cash balances may be used by the firm within its operations.

The primary concern that has been identified with the current treatment of client free credit cash balances is that the client free credit usage limit does not exclusively rely on a Dealer Member's liquid capital level (i.e. EWR level), which is considered the best measure of the short-term solvency of a firm. More specifically, a Dealer Member's NAA level is a measure of the total regulatory capital employed by the firm and is not, therefore, a good indicator of liquid capital. Since a Dealer Member's NAA level is used in the current approach, the current limit does not effectively restrict Dealer Members' free credit usage based on liquid capital levels.

Table 1 indicates that the ratio of NAA/EWR has declined during the review period. However, it is during periods where the NAA/EWR ratio is high, which is indicative of potential liquidity concerns, that the current client free credit limit is the least effective at imposing segregation requirements.

**Table 1 –**
**Ratio of NAA to EWR for all dealers with free credits**

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|---|
| Net allowable assets (NAA) (amounts in billions) | $13.884 | $15.070 | $17.579 | $18.894 | $20.044 | $19.548 | $21.678 |
| Early warning reserve (EWR) (amounts in billions) | $5.554 | $7.282 | $10.312 | $10.707 | $11.181 | $11.219 | $12.058 |
| Ratio (NAA/EWR) | 2.50 | 2.07 | 1.71 | 1.77 | 1.79 | 1.74 | 1.80 |

Tables 2 and 3 show that although the actual industry average ratio of client free credit cash balances to Dealer Member EWR levels is not high and has been declining since 2007, the current client free credit cash usage limit is not constraining Dealer Members' use of client free credit balances in any significant way. The ineffectiveness of this formula was most apparent in 2007, when the ratio of NAA/EWR was at its highest level for the review period.

**Table 2 –**
**Ratio of client free credits to EWR for all dealers with free credits**

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|---|
| Client free credits (amounts in billions) | $29.214 | $34.420 | $37.137 | $38.275 | $39.792 | $39.183 | $42.442 |
| Early warning reserve (EWR) (amounts in billions) | $5.554 | $7.282 | $10.312 | $10.707 | $11.181 | $11.219 | $12.058 |
| Ratio (Client free credits/EWR) | 5.26 | 4.73 | 3.60 | 3.57 | 3.56 | 3.49 | 3.52 |

**Table 3 –**
**Statistics illustrating the limited effectiveness of the current client free credit cash usage limit**

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|---|
| Ratio (Client free credits/EWR) before free credit limit is considered | 5.26 | 4.73 | 3.60 | 3.57 | 3.56 | 3.49 | 3.52 |
| Ratio (Client free credits/EWR) net of amount segregated under current approach | 5.25 | 4.70 | 3.58 | 3.54 | 3.50 | 3.42 | 3.47 |
| Impact of current segregation requirement on ratio (Client free credits/EWR) | 0.01 | 0.03 | 0.02 | 0.03 | 0.06 | 0.07 | 0.05 |
| Dollar amount required to be segregated under current segregation requirement (amounts in billions) | $0.046 | $0.161 | $0.265 | $0.330 | $0.694 | $0.763 | $0.616 |
| Number of dealers with a client free credit segregation requirement under current approach | 4 | 8 | 9 | 7 | 11 | 12 | 12 |

### *Proposed rules*

*Amend Statement D (Statement of Free Credit Segregation Amount) of Form 1 by changing the client free credit cash usage limit to the following "two-test" approach:*

- *Test #1 General limit = 12 x early warning reserve (EWR), or*
- *Test #2 Margin lending adjusted limit = Free credit limit for margin lending purposes = 20 x EWR; and Free credit limit for all other purposes = 12 x (EWR – 1/20th x margin debit total).*

*Amend the eligible investments for the purposes of client free credit segregation by adding Canadian bank paper with a term to maturity of 1 year or less and requiring that debt securities of or guaranteed by national foreign governments other than Canada, the U.K. and U.S., must be a member of the Basle Accord and have a current rating of Aaa or AAA by Moody's Investors Services or Standard & Poor's Corporation, respectively.*

*Amend the client free credit cash usage monitoring requirements so that the frequency of estimating the client free credit cash usage limit and segregation amounts must be at least weekly, but more frequently if required, consistent with the frequency requirement for early warning tests under Dealer Member Rule 2600 (Internal Control Policy Statements). Also, require Dealer Members to correct a client free credit segregation deficiency within five (5) business days.*

## Client free credit cash usage limit

IIROC staff performed industry impact analysis work for the period from 2007-2013 to assess the effectiveness of:

- the current client free credit cash usage limit set out in Statement D of Form 1;
- an interim measure to restrict client free credit cash usage to a maximum of 12 times the Dealer Member's EWR level; and
- alternatives based on other multiples of EWR.

The main analysis finding was that the 12 times EWR limit was very effective in eliminating situations where a Dealer Member was using client free credit cash on a highly leveraged basis (in relation to the Dealer Member's liquid capital levels). As a result, IIROC staff concluded that there was no need at this time to consider further constraints over a Dealer Member client free credit cash usage and specifically, no need to propose that the revised client free credit usage limit be set at a lower multiple of a Dealer Member's early warning reserve than 12.

As part of the development of formal rules to codify a more restrictive client free credit usage limit, we kept in mind the following considerations:

- the over-riding need to ensure that client cash deposits are properly protected for and easily accessible to clients
- the likelihood that more restrictive leverage constraints will result in a reduction in the interest paid to clients for free credit cash amounts deposited at the Dealer Member
- the lending of client free credit cash to another client creates the potential situation where rules designed to protect clients with free credit cash balances could potentially negatively impact the clients that are borrowing this cash under a margin loan arrangement
- there are significant regulatory requirements to be met when margin lending to clients that may justify allowing a higher leverage multiple where client free credit cash balances are used to fund these margin loans.

While the development of one general free credit usage limit to codify the "12 times EWR" limit was seen as the simplest solution, after looking further into the risks and issues associated with using client free credit cash to finance margin loans, we decided to pursue an approach of giving Dealer Members the option of complying with a "two-tiered" limit on client free credit cash usage whereby:

- the Dealer Member use of client free credit cash to finance margin loans would be limited to 20 times the Dealer Member's early warning reserve; and
- the Dealer Member use of client free credit cash for all other purposes would be limited to 12 times the remaining portion of the Dealer Member's early warning reserve that is not used to support its margin lending activities.

The 20 times factor was selected for the margin lending activity because:

- the 20 times leverage factor has been commonly used as a benchmark limit by deposit-taking institutions and dealers[3] over the years; and
- the strict and extensive IIROC requirements that govern the margin lending activity support an argument that the use of client free credit cash to finance margin loans is a lower risk use than other uses (such as use of the client free credit cash within the firm's operations).

As a result, IIROC staff developed and recommends a "two-test" approach to free credit segregation, which gives Dealer Members the flexibility to apply a larger free credit usage allowance (20 x EWR) to support client margin lending, and restricts the free credit usage allowance for all other purposes to a maximum of 12 x EWR, subject to a deduction to account for any margin lending allocations.

Under this "two-test" approach, Dealer Members would first calculate their free credit limit under the "general segregation test" (i.e. 12 x EWR level). Because the majority of Dealer Members are well within the general 12 x EWR limit, those Dealer Members would not need to consider the different available leverage factors for customer margin lending and principal business purposes. As such, if this first test confirmed that the Dealer Member was within the limit, no further testing would be required. If, however, the first test indicated that a client free credit segregation requirement had been triggered, the Dealer Member would apply the second test, utilizing the "margin lending adjusted segregation test", to determine if they are eligible for any increased free credit usage allowances for its margin lending business.

Table 4 shows the leverage of client free credits permitted under the "two-test" approach compared to a general "12 x EWR" approach. The leverage ratio for the "two-test" approach indicates an improved constraint over free credit usage compared to the current approach (Table 3), and a slightly higher leverage ratio than the general 12xEWR approach. The differences in leverage constraints are more apparent in Table 5, which narrows the focus to just those Dealer Members that would have client free credit segregation requirements using each of the calculation methods.

[3] As an example, FINRA currently monitors the balance sheet leverage of its member dealers in comparison to a 20 to 1 benchmark level.

**Table 4 –**
**Leverage of client free credits for all dealers with free credits under "two-test" approach compared to general 12 x EWR approach**

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|---|
| Ratio (Client free credits/EWR) before free credit limit is considered | 5.26 | 4.73 | 3.60 | 3.57 | 3.56 | 3.49 | 3.52 |
| Ratio (Client free credits/EWR) net of amount segregated under "12 x EWR" general approach | 4.79 | 4.34 | 3.50 | 3.42 | 3.44 | 3.40 | 3.45 |
| Number of dealers with a client free credit segregation requirement under "12 x EWR" general approach | 13 | 15 | 14 | 19 | 17 | 14 | 13 |
| Ratio (Client free credits/EWR) net of amount segregated under proposed "two test" approach (20x margin lending with 12x net free credits) | 4.91 | 4.42 | 3.52 | 3.49 | 3.48 | 3.42 | 3.47 |
| Number of dealers with a client free credit segregation requirement under proposed "two-test" approach (20x margin lending with 12x net free credits) | 10 | 15 | 11 | 15 | 15 | 14 | 12 |

**Table 5 –**
**Leverage of client free credits and amounts required to be segregated for dealers with free credit segregation requirements under current approach, general 12 x EWR approach, and proposed "two-test" approach**

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|---|
| **Current approach** | | | | | | | |
| Ratio (Client free credits/EWR) net of amount segregated | 24.44 | 15.65 | 16.54 | 16.54 | 15.02 | 15.32 | 15.16 |
| Dollar amount required to be segregated (amounts in billions) | $0.046 | $0.161 | $0.265 | $0.330 | $0.694 | $0.763 | $0.616 |
| **"12 x EWR" general approach** | | | | | | | |
| Ratio (Client free credits/EWR) net of amount segregated | 12.00 | 12.00 | 12.00 | 12.00 | 12.00 | 12.00 | 12.00 |
| Dollar amount required to be segregated (amounts in billions) | $2.627 | $2.809 | $1.043 | $1.669 | $1.278 | $1.055 | $0.804 |
| **Proposed "two-test" approach (20x margin lending with 12x net free credits)** | | | | | | | |
| Ratio (Client free credits/EWR) net of amount segregated | 15.09 | 13.58 | 14.78 | 14.44 | 14.11 | 15.17 | 14.54 |
| Dollar amount required to be segregated (amounts in billions) | $1.968 | $2.215 | $0.804 | $0.938 | $0.883 | $0.759 | $0.648 |

Under the "two-test" approach, an individual Dealer Member reaching the 20x maximum leverage ratio would do so as a result of its margin lending activities. As a result, the Dealer Member would be required to segregate any remaining net client free credit cash balances, and would therefore not be able to use client free credits in its operations for any other purposes.

### Eligible investments for free credit segregation purposes

The Proposed Amendments make two changes to the eligible investments for client free credit segregation purposes. First, sovereign debt issued by Basle Accord Countries, other than Canada, the United States (U.S.) and the United Kingdom (U.K.), must have a current credit rating of Aaa or AAA by Moody's Investors Service Inc. or Standard & Poor's Corporation, respectively, in order to be eligible investments for free credit segregation purposes. The intention of this recommendation is to ensure that client free credits that must be segregated are invested in debt securities that are transparently identified and categorized as lower risk debt securities in the IIROC margin rules.

Second, Canadian bank paper maturing within 1 year, which is covered by Dealer Member Rule 100.2(b), is made an eligible investment for the purposes of meeting client free credit segregation obligations. IIROC margin rules accord Canadian bank paper maturing within 1 year, the same margin rate treatment as provincial short-term debt[4], which is an eligible investment for client free credit segregation. Further, many Dealer Members currently invest client free credits in debt securities that are categorized as Canadian bank paper, which include Canadian chartered bank acceptances.

### Free credit monitoring

The current IIROC Dealer Member Rules lack clear, client free credit cash usage monitoring requirements and timelines. The Proposed Amendments recommend the following monitoring requirements:

- The client free credit limit and segregation requirements must be calculated at least weekly, but more frequently if required, consistent with the monitoring requirements for the early warning tests under Dealer Member Rule 2600 (Internal Control Policy Statements); and
- Dealer Members must correct any client free credit segregation deficiency within five (5) business days.

The intention of these recommendations is to align the client free credit cash usage monitoring requirements and timelines with established IIROC internal control requirements regarding capital adequacy monitoring and the treatment of segregation deficiencies.

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[4] Both have a margin rate of "2% of market value multiplied by the fraction determined by dividing the number of days to maturity by 365".

Dealer Member Rule 2600, *Internal Control Policy Statement 2 – Capital Adequacy*, Item 5 requires that "at least weekly, but more frequently if required[5]" the Dealer Member's chief financial officer (or his or her designate) must estimate "the application to the Dealer Member of the liquidity and capital tests under the early warning calculations..." set out in Dealer Member Rule 30 (Early Warning System). Preparing such estimates requires the weekly calculation of EWR.

The recommendation that Dealer Members be given five (5) business days to correct a client free credit segregation deficiency is consistent with the time given within Dealer Member Rule 2000.9 to correct a number of common security segregation deficiencies.

### *Schedule 9 (Concentration of Securities) of Form 1*

#### *Current rules*

Schedule 9 of Form 1 addresses securities concentration risk by assessing a Dealer Member's aggregate capital exposure to any single security or group of related securities of the same issuer in relation to defined thresholds of its regulatory capital. The aggregate capital exposure is referred to as the "amount loaned" in Schedule 9 and may be composed of an issuer position(s) carried by the Dealer Member in inventory, client margin accounts, or delinquent cash or cash on delivery (COD) accounts.

When the amount loaned exceeds the defined thresholds in Schedule 9, capital charges are applied in order to provide sufficient coverage against the increased risk associated with exposing a large portion of the Dealer Member's capital to a concentrated security position.

A limitation under the current Dealer Member Rules is imposed by virtue of the fact that debt securities with a normal margin rate of 10% or less are excluded from Schedule 9, and are not included in the aggregate amount loaned. Given that debt securities are subject to interest rate risk and credit risk, a gap exists in the regulation of securities concentration risk. In general, the range of risk in the global debt securities market is vast; however, risk is more pronounced where exposures are concentrated in one or a few longer term corporate debt issuances or higher yield, non-commercial debt issuances.

#### *Proposed rules*

*Amend Schedule 9 (Concentration of Securities) of Form 1 to include in the concentration test corporate debt securities with a normal margin rate of 10% or less and other non-commercial debt securities with a normal margin rate of 10%. For the purposes of Schedule 9, the amount loaned for corporate debt with a normal margin rate of 10% or less and other non-commercial debt with a normal margin rate of*

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[5] Dealer Member Rule 2600 lists situations where the firm is operating close to early warning levels or where volatile market conditions exist as situations where the early warning tests must be performed more frequently.

*10% maturing within 3 years would be calculated by applying an adjustment factor of 50%. Exclude issuer positions that are financed by limited recourse loans that include the industry standard wording set out in the Limited Recourse Call Loan Agreement.*

### Extend coverage of Schedule 9 to more debt securities

The Proposed Amendments seek to address the regulatory gap that exists because Schedule 9 applies to securities with a margin rate greater than 10% but does not apply to debt securities with a margin rate of 10% or less. The challenge faced in extending the application of Schedule 9 was to ensure that the revised securities concentration test applies to the more volatile, relatively riskier debt securities that are margined at 10% or less, and not to the relatively less risky non-commercial debt securities and highly liquid, short-term cash like corporate debt securities that Dealer Members' business operations rely on.

The Proposed Amendments extend Schedule 9 to apply to "corporate debt securities with a normal margin of 10% or less", with the exception of Canadian bank paper maturing within 1 year. The Proposed Amendments also extend Schedule 9 to apply to "other non-commercial debt securities"[6] with a normal margin rate of 10%. These changes are needed in order to address concentration risk exposures of any Dealer Member whose client free credit investment policy may seek to maximize the spread on income yield without the consideration of concentration risk.

### Adjustment factor for certain debt securities

In comparison to equity securities, which are already covered by Schedule 9, debt securities generally exhibit lower volatility and therefore, have lower initial margin requirements and higher regulatory loan values. However, higher loan value securities are given higher weightings in calculating the aggregate amount loaned in Schedule 9. In order to ensure a proper risk measurement scale for introducing lower margin rate debt securities into Schedule 9, which has historically monitored concentration risk associated with higher margin rate securities, IIROC staff proposes the use of an adjustment factor for certain debt securities. The adjustment factor, which takes into consideration that shorter-term debt securities generally exhibit lower volatility than longer-term debt securities, would be applied to debt securities that mature within 3 years in recognition of their lower risk.

For "corporate debt securities with a normal margin rate of 10% or less" and "other non-commercial debt securities" with a normal margin rate of 10% maturing within 3 years, the "amount loaned" will be reduced by an adjustment factor of 50% of the amount loaned, calculated using the following formula:

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[6] "Other non-commercial debt securities" are primarily made up of lower credit-rated debt issued by governments other than Canada, the United Kingdom or the United States.

*"Adjusted amount loaned = loan value x adjustment factor", where the adjustment factor is (50%)".*

Corporate debt securities that are not senior to outstanding equity securities from the same issuer in the case of insolvency would not be eligible for the 50% adjustment factor.

As part of the review of Schedule 9, IIROC staff conducted a debt concentration survey in late 2012, using a sample of Dealer Members[7], to assess the potential impact that the proposed changes to the securities concentration test may have on Dealer Members' regulatory capital. The survey indicated that Dealer Members' corporate and non-commercial debt portfolios were generally well diversified and predominantly invested in shorter maturity securities (i.e. less than 3 years). IIROC staff concluded, based on these survey results, that the Proposed Amendments would effectively restrain Dealer Members from taking on undue concentrations in longer maturity, lower quality debt securities, because these securities would be more likely to be subject to concentration capital charges. In addition, the application of the more robust proposed securities concentration test would not have caused a regulatory capital deficiency at any of the Dealer Members surveyed[8].

To sum up the foregoing discussion, the use of an adjustment factor is considered appropriate to account for the following factors:

- generally lower volatility of shorter maturity debt compared to equity and longer maturity debt;
- generally lower interest rate risk for shorter maturity debt;
- seniority of corporate debt securities over equity securities; and
- availability of government resources regarding "other non-commercial debt securities".

For reference, Table 6 provides more detail on the proposed treatment of different debt issuer categories**.**

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[7] The survey was distributed to 99 Dealer Members representing Types 3 and 4 introducers, self-clearing firms and Capital Formula Subcommittee Members. IIROC received responses from 55 Dealer Members, including 30 that reported positions in corporate debt securities and/or "other non-commercial debt securities".

[8] From the 30 Dealer Members that reported positions in corporate debt securities and/or "other non-commercial" debt securities, 3 Dealer Members would have had potential capital charges, and none of the capital charges would have resulted in a capital deficiency. All three potential charges were triggered due to the Dealer Member holding material positions (relative to their risk adjusted capital (RAC)) in corporate debt securities with maturities greater than 3 years, which would not be eligible for the 50% adjustment factor under the proposal.

**Table 6 –**
**Proposed treatment of debt securities for the purposes of Schedule 9 (Concentration of Securities)**

| Debt Issuer Category | Included on Schedule 9 (Yes or No) | "Adjustment Factor" |
|---|---|---|
| 1. Corporate debt with a normal margin rate of 10% or less (not including Canadian bank paper) | Yes | 50% if maturing within 3 years and senior to outstanding equity from same issuer |
| 2. Canadian bank paper (Dealer Member Rule 100.2(b)) maturing within 1 year | No<br>[no change] | N/A<br>[no change] |
| 3. Corporate debt with a normal margin greater than10% | Yes<br>[no change] | N/A<br>[no change] |
| 4. Other non-commercial debt with a normal margin rate of 10% (Dealer Member Rule 100.2(a)(iv)) | Yes | 50% if maturing within 3 years |
| 5. Non-commercial debt with a normal margin rate of less than 10% (including federal and provincial stripped coupons and residual debt instruments as per Note 5 to Schedule 9) | No<br>[no change] | N/A<br>[no change] |
| 6. Non-commercial debt with a normal margin rate greater than 10% | Yes<br>[no change] | N/A<br>[no change] |

## Limited recourse call loan agreement exclusion

The limited recourse call loan agreement exclusion applies to securities issued by, and financed by, a "provider of capital". In simple terms, a "provider of capital" is any individual or entity and its affiliates that provide capital to a Dealer Member. Schedule 14 (Provider of Capital Concentration Charge) of Form 1 applies capital charges if a Dealer Member's exposure to a provider of capital exceeds defined thresholds. When Schedule 14 was drafted, an allowance was made in order to allow the continuation of certain established Dealer Member business activities, such as underwriting the issuance of provider of capital securities. As a result, Schedule 14 allows a Dealer Member to exclude its exposure to investments in securities issued by a provider of capital, if the securities are financed by a qualifying limited recourse call loan agreement. The industry standard limited recourse loan agreement limits the repayment of the loan to the market value of the financed securities, thereby offsetting the asset and the liability.

Although the debt concentration survey results did not indicate material capital charges for any respondents' positions in provider of capital securities, the proposal does provide a more robust security concentration test, especially if applied at the lower test threshold for non-arm's length securities. In consultations with Dealer Members, a concern was raised that the proposal may at some point restrict the ability of affected Dealer Members to provide an active, liquid secondary market in securities issued by the provider of capital. In consideration of this concern, and as a

result of the risk mitigation offered by limited recourse loans in general, the Proposed Amendments exclude from Schedule 9 issuer positions that are financed by limited recourse loans, executed according to the industry standard wording set out in the Limited Recourse Call Loan Agreement.

### *Issues and alternatives considered*

IIROC staff considered a wide range of alternatives in this policy area, including maintaining the status quo, various alternative free credit segregation regimes and securities concentration models. IIROC staff believes that the "two-test" free credit limit approach offers the most appropriate means to strengthen the safeguarding of client free credit balances, by striking a balance between margin lending usage and other usages, while basing the overall leverage ratio on a liquid capital measure, EWR. IIROC staff also believes that the safeguarding of client free credits requires stronger regulatory oversight of potential concentration risks, which is most effectively addressed by the proposed changes to the securities concentration test.

### *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, which are two IIROC policy advisory committees. The proposed amendments have also been reviewed and supported by Canadian Investor Protection Fund (CIPF) staff.

### *Comparison with similar provisions*

Other jurisdictions such as the U.K. and the U.S. have established regulatory regimes in place that address the usage/segregation of client cash and securities concentration risk. The IIROC rules differ from these jurisdictions in certain areas. Tables 7 and 8 provide an overview of the relevant rules and requirements in the three jurisdictions for the segregation of client cash and the treatment of securities concentrations, respectively.

**Table 7 –**
**Investment firm client cash regimes in three jurisdictions**

| Jurisdiction | Segregation of client cash | Terms of use for client cash | Disclosure |
|---|---|---|---|
| 1. U.K. - Financial Conduct Authority (FCA) | Client cash must be held in an account, or accounts, identified separately from any accounts used to hold cash for the firm. Firm holds client cash on a statutory trust basis. (FCA Client Assets Sourcebook – CASS 7) | Firm may not use client cash unless it has either received a title transfer or a professional client "opt-out" of the pure custody client money rules. (CASS 7) | Firm must send an annual statement disclosing to clients details of client money held by the firm for the client, including the extent to which any client money has been the subject of securities financing transactions. |

| Jurisdiction | Segregation of client cash | Terms of use for client cash | Disclosure |
|---|---|---|---|
| | | | (FCA Conduct of Business Sourcebook – COBS 16) |
| 2. U.S. - Securities and Exchange Commission (SEC) | Firms must maintain a "Special Reserve Bank Account for the Exclusive Benefit of Customers". On a weekly basis, the Reserve Formula computation determines the amount of customer cash (or qualified securities such as U.S. treasuries) to be segregated in the Special Reserve Bank Account. A deposit must be made to the extent that customer related payables (credits) exceed customer related receivables (debits). (SEC Rule 15c3-3) | Customer cash (credit balances) may only be used to support other customer transactions, such as margin loans (debit balances). A basic premise of the SEC Reserve Requirement is to prevent firms from using customer cash in the conduct of their principal business operations, other than supporting other customer transactions. This objective is met by segregating the excess of credits over debits as required by the Reserve Formula computation. (SEC Rule 15c3-3) | Firm must send customer account statement at least quarterly. If there are free credit balances in a customer account, a statement must be sent to the customer stating the following:<br>• Free credit balances are not segregated by the member firm;<br>• Free credit balances may be used by the member in the conduct of its business; and<br>• Free credit balances are available to the customer on demand.<br>In practice, client free credit balances are rare in the U.S., because most firms automatically "sweep" these balances into money market funds.<br>(FINRA Rule 2340, and SEC Rule 15c3-2) |
| 3. Canada - IIROC current | Unencumbered client cash, or free credits, in excess of the current free credit limit must be segregated in the form of qualifying government securities with a term of one year or less, or in the form of cash in a trust account with an Acceptable Institution. (IIROC Form 1, Statement D) | Client free credit cash balances that are within the current free credit limit do not require segregation and may be used by firms in the conduct of their business operations. (IIROC Form 1, Statement D) | Firm must inform their clients that not all free credits are required to be held in trust by including the following disclosure on all client account statements: *"Any free credit balances represent funds payable on demand which, although properly recorded in our books, are not segregated and may be used in the conduct of our business".* (IIROC Dealer Member Rule 1200.2) |
| 4. Canada - IIROC proposed | Unencumbered client cash, or free credits, in excess of the ***proposed*** free credit limit must be segregated in the form of | Client free credit cash balances that are within the ***proposed*** free credit limit do not require segregation and may be | Same as current. |

| Jurisdiction | Segregation of client cash | Terms of use for client cash | Disclosure |
|---|---|---|---|
| | qualifying government securities with a term of one year or less, or in the form of cash in a trust account with an Acceptable Institution. (IIROC Form 1, Statement D) | used by firms in the conduct of their business operations. (IIROC Form 1, Statement D) | |

**Table 8 –**
**Investment firm securities concentration rules in three jurisdictions**

| Jurisdiction | Securities concentration rules | Notable Exemptions | Relationship of securities concentration rules to treatment of client cash under Table 7 |
|---|---|---|---|
| 1. U.K. - Financial Conduct Authority (FCA); EU Legislation – Capital Requirements Directive IV (CRD IV) and Capital Requirements Regulation (CRR) | Article 392 of the CRR defines a large exposure as an institution's exposure to a client or group of connected clients, which in aggregate equals or exceeds 10% of the firm's eligible capital. In general, in the firm's trading book, capital charges will apply if the total amount of an identified exposure exceeds 25% of the firm's eligible capital.(See Articles 392 and 395-397 CRR) | There are a number of eligible exemptions, including: asset items constituting claims on central governments; central banks or public sector entities; international organizations, and multilateral development banks. The CRR also allows some discretionary authority to the relevant "competent authorities" to determine other possible exemptions.(Article 400 CRR and See FCA IFPRU 8.2) | No direct relationship |
| 2. U.S. - Securities and Exchange Commission (SEC) | SEC Rules identify an undue concentration, subject to capital charges, if the value of a security exceeds 10% of tentative net capital. (SEC Rule 15c3-1) | "Exempted securities" such as U.S. Treasury securities. (SEC Rule 15c3-1) | No direct relationship |
| 3. Canada - IIROC current | IIROC Rules identify securities concentrations, subject to capital charges, in issuer positions and precious metals positions that exceed the defined | Securities required to be in segregation or safekeeping and debt securities with a margin rate of 10% or less. (IIROC Form 1, Schedule 9) | Capital charges will affect the firm's Early Warning Reserve (EWR), which is used to calculate the free credit limit. However, EWR is only one weighting |

| Jurisdiction | Securities concentration rules | Notable Exemptions | Relationship of securities concentration rules to treatment of client cash under Table 7 |
|---|---|---|---|
| | percentage of Risk Adjusted Capital (RAC) in Schedule 9. (IIROC Form 1, Schedule 9) | | component in the current calculation. |
| 4. Canada - IIROC proposed | IIROC Rules identify securities concentrations, subject to capital charges, in issuer positions and precious metals positions that exceed the defined percentage of Risk Adjusted Capital (RAC) in Schedule 9. (IIROC Firm 1, Schedule 9) | Securities required to be in segregation or safekeeping, non-commercial debt securities with a margin rate of less than 10%, and Canadian bank paper maturing within 1 year. (proposed IIROC Form 1, Schedule 9) | Capital charges will affect the firm's Early Warning Reserve (EWR), which is used to calculate the free credit limit. |

The proposed IIROC rule amendments are unique in structuring the terms of use for client free credits on a Dealer Member's liquid capital measure, EWR. As a result, the strengthening of the securities concentration test has a more direct impact on the protection of client cash than in the other jurisdictions. Capital charges resulting from securities concentrations will reduce a Dealer Member's EWR, which will, in turn, reduce the Dealer Member's client free credit leverage limit.

### *Proposed Rule classification*

The purposes of the proposed rule amendments are to:

- *establish and maintain rules that are necessary or appropriate to govern and regulate all aspects of IIROC's functions and responsibilities as a self-regulatory entity, and*
- *promote the protection of investors.*

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 a Public Comment Rule proposal.

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

The Proposed Amendments strengthen the prudential framework for investment dealer registrants for the safeguarding of client assets, and 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 that are disproportionate to the goals of the regulatory objectives sought to be realized.

IIROC staff's analysis indicates that the proposed changes to the client free credit limit will affect a relatively small group of Dealer Members, including the major carrying brokers and smaller Dealer Members that are self-clearing firms that operate with low levels of EWR, relative to their retail client free credit cash balances. The primary impact upon these Dealer Members would be the requirement to segregate a higher percentage of client free credit cash balances in high quality assets, which may negatively impact the investment returns for the Dealer Members, in order to strengthen the safeguarding of client assets. IIROC staff believes that the recommended "two-test" approach to free credit segregation effectively meets the objective of reducing the leveraging of client free credits industry wide. Moreover, it is anticipated that the flexibility provided by allowing a larger leverage factor for margin lending purposes will be most applicable to smaller Dealer Members that operate with lower levels of EWR relative to their client free credit balances.

Regarding the proposed changes to the securities concentration test, it is not anticipated that the proposed changes will have an immediate impact on Dealer Member regulatory capital reporting levels. IIROC staff conducted a Dealer Member survey in late 2012, which indicated that Dealer Members' corporate and non-commercial debt portfolios were generally well diversified and predominantly invested in shorter maturity securities (less than 3 years). As a result, in the current low-yield market environment, the proposed changes to the securities concentration test can be seen as a deterrent to Dealer Members seeking to increase the yield of their debt security portfolios by purchasing material positions in higher risk corporate and non-commercial debt securities.

### *Technological implications and implementation plan*

There should not be significant technological implications for Dealer Members as a result of the Proposed Amendments. It is anticipated that the changes to the free credit limit will be effected through changes to the electronic version of Form 1 housed on the Securities Industry Regulatory Financial Filing System (SIRFF), which will limit the compliance expense for any individual Dealer Member. However, some Dealer Member and/or service provider expense may be required in order to ensure that existing compliance systems capture the additional debt security exposures that will be covered under the Proposed Amendments.

The Proposed Amendments will be implemented upon approval by the recognizing regulators within a reasonable period.

### *Request for public comment*

Comments are sought on the proposed amendments. While we are seeking comments on the scope and direction of all elements of the Proposed Amendments to the client free credit cash usage

limit, client free credit segregation requirements, and securities concentration test, we are also asking stakeholders to specifically consider the following questions:

1. The current client free credit segregation requirements were adopted in 1993 in response to concerns over the undue leveraged use of client free credit cash balances. IIROC believes that now is the appropriate time to again re-assess the treatment of client free credit cash balances by Dealer Members. Do you agree with the fundamental concept of the rule amendment that the client free credit cash usage limit should be based solely upon a liquid capital measure, and that the best liquid capital measure is early warning reserve (EWR)? Further, do you agree that the proposed change to the client free credit usage limit strikes a proper balance between margin lending usage and other usages?
2. Do the proposed changes to the eligibility criteria for securities that may be invested in for client free credit segregation purposes adequately meet the objective of raising the eligibility standards?
3. The proposed amendments include changes to the client free credit cash usage monitoring requirements (e.g. minimum weekly calculation of client free credit limit and segregation requirements, and 5 business days for correcting any client free credit segregation deficiencies) that are intended to align these requirements with established IIROC internal control requirements regarding capital adequacy monitoring and the treatment of segregation deficiencies. Do you have any specific issue or concern with the proposed client free credit cash usage monitoring requirements?
4. Should the proposed amendments to the client free credit segregation requirements be accompanied by the proposed amendments to the securities concentration test? If so, do the proposed amendments adequately address concentration risk for debt securities with a normal margin rate of 10% or less, by focusing on corporate debt securities (excluding Canadian bank paper maturing within 1 year) and higher yield non-commercial debt securities?

Comments should be made in writing. Two copies of each comment letter should be delivered by April 17, 2015 (120 days from the publication date of this notice). One copy should be addressed to the attention of:

Bruce Grossman
Senior Information Analyst, Member Regulation Policy
Investment Industry Regulatory Organization of Canada
Suite 2000, 121 King Street West
Toronto, ON M5H 3T9
bgrossman@iiroc.ca

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, ON  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 "Rulebook - IIROC Dealer Member Rules - Proposed Policy").

Questions may be referred to:

Bruce Grossman
Senior Information Analyst, Member Regulation Policy
Investment Industry Regulatory Organization of Canada
416-943-5782
bgrossman@iiroc.ca

**Attachments**

Attachment A - Proposed amendments to Dealer Member Rules 100.20 and 1200, and to Statement D and Schedule 9 of Form 1

Attachment B - Black-line of proposed amendments to Dealer Member Rules 100.20 and 1200, and to Statement D and Schedule 9 of Form 1

**Attachment A**

## INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA
## AMENDMENTS TO DEALER MEMBER RULES 100 AND 1200 AND TO FORM 1 RELATING TO THE CLIENT FREE CREDIT CASH USAGE LIMIT, CLIENT FREE CREDIT SEGREGATION REQUIREMENTS, AND SECURITIES CONCENTRATION TEST

### PROPOSED AMENDMENTS

1. Dealer Member Rule 100.20(a)(ii)(B) is repealed and replaced by the following:

   "(B) all long and short positions in debt or other securities, other than non-commercial debt securities with a normal margin requirement of less than 10% and Canadian bank paper maturing within 1 year."

2. Dealer Member Rule 100.20(b) is amended by adding the following, with the numbering altered thereafter in sequence:

   "(v) In calculating the amount loaned for debt securities subject to the concentration charge calculation, the amount loaned for:

   (A) commercial debt securities with a normal margin rate of 10% or less; and

   (B) non-commercial debt securities with a normal margin rate of 10%;

   may be reduced by applying an adjustment factor of 50% if the debt securities mature within 3 years.

   In order to qualify for the 50% adjustment factor, commercial debt securities must also be ranked senior to any outstanding equity securities from the same issuer in case of insolvency;

   (vi) Security positions that are financed by limited recourse loans that meet the industry standard wording set out in the Limited Recourse Call Loan Agreement may be excluded from the calculation below;"

3. Dealer Member Rule 1200.3 is repealed and replaced by the following:

   "1200.3. No Dealer Member shall use in the conduct of its business clients' free credit balances in excess of the greater of the following amounts:

   (a) General free credit limit:

   Twelve times the early warning reserve amount of the Dealer Member; or

   (b) Margin lending adjusted free credit limit:

Twenty times the early warning reserve amount of the Dealer Member for margin lending purposes plus twelve times the remaining early warning reserve amount for all other purposes, where the remaining early warning reserve amount equals the early warning amount minus 1/20th of the total settlement date client margin debit amount.

Each Dealer Member shall hold an amount at least equal to the amount of clients' free credit balances in excess of the foregoing either:

(c) in cash segregated in trust for clients in a separate account or accounts with an acceptable institution; or

(d) segregated and separate and apart from the Dealer Member's property in Canadian bank paper with a maturity of one year or less and bonds, debentures, treasury bills and other securities with a maturity of one year or less of or guaranteed by the Government of Canada, a province of Canada, the United Kingdom, the United States of America and any other national foreign government (provided such other foreign government is a member of the Basle Accord and that the securities are currently rated Aaa or AAA by Moody's Investors Service, Inc. or Standard & Poor's Corporation, respectively)."

4. Dealer Member Rule 1200.4 is amended by adding the following words immediately following the words "at least weekly":

", but more frequently if required,".

5. Dealer Member Rule 1200.6 is amended by repealing and replacing the text "shall expeditiously take the most appropriate action to rectify the deficiency." with the text "must correct the segregation deficiency within 5 business days following the determination of the deficiency.".

6. Statement D and Schedule 9 of Form 1 are repealed and replaced by the attached.

**Attachment A**

## FORM 1, PART I – STATEMENT D

_____

(Dealer Member Name)

## STATEMENT OF FREE CREDIT SEGREGATION AMOUNT

at _____

| REFERENCE | | | NOTES | (CURRENT YEAR) C$'000 |
|---|---|---|---|---|
| **A. AMOUNT REQUIRED TO SEGREGATE BASED ON GENERAL FREE CREDIT LIMIT** | | | | |
| | | **General client free credit limit** | | |
| 1. | C-13 | Early warning reserve of $_____ multiplied by 12<br>[Report NIL if amount is negative] | | |
| | | **Less client free credit balances:** | | |
| 2. | Sch.4 | Dealer Member's own [see note] | | |
| 3. | | Carried For Type 3 Introducers | | |
| 4. | | **Total client free credit balances** [Section A, Line 2 plus Section A, Line 3] | | |
| 5. | | **AMOUNT REQUIRED TO SEGREGATE BASED ON GENERAL CLIENT FREE CREDIT LIMIT**<br>[Section A, Line 4 minus Section A, Line 1; report NIL if result is negative; see note] | | |
| **B. AMOUNT REQUIRED TO SEGREGATE BASED ON MARGIN LENDING ADJUSTED CLIENT FREE CREDIT LIMIT** | | | | |
| | | **Client free credit limit for margin lending purposes** | | |
| 1. | C-13 | Early warning reserve of $_____ multiplied by 20<br>[Report NIL if amount is negative] | | |
| | | **Less client free credit balances used to finance client margin loans:** | | |
| 2. | | Total settlement date client margin debit balances | | |
| 3. | | Total client free credit balances [Include amount from Section A, Line 4 above] | | |
| 4. | | **Subtotal - Client free credit balances used to finance client margin loans**<br>[Lesser of Section B, Line 2 and Section B, Line 3] | | |
| 5. | | **Amount required to segregate relating to margin lending**<br>[Section B, Line 4 minus Section B, Line 1; report NIL if result is negative] | | |
| | | **Free credit limit for all other purposes** | | |
| 6. | C-13 | Early warning reserve<br>[Report NIL if amount is negative] | | |
| 7. | | Total settlement date client margin debit balances divided by 20 | | |
| 8. | | **Portion of early warning reserve available to support all other uses of client free credits**<br>[Section B, Line 6 minus Section B, Line 7; report NIL if result is negative] | | |
| 9. | | **Client free credit limit for all other purposes**<br>[Section B, Line 8 multiplied by 12] | | |
| 10. | | **Client free credits not used to finance margin loans**<br>[Section A, Line 4 minus Section B, Line 4] | | |
| 11. | | **Amount required to segregate relating to all other purposes**<br>[Section B, Line 10 minus Section B, Line 9; report NIL if result is negative] | | |
| 12. | | **AMOUNT REQUIRED TO SEGREGATE BASED ON MARGIN LENDING ADJUSTED CLIENT FREE CREDIT LIMIT** [Section B, Line 5 plus Section B, Line 11] | | |
| **C. AMOUNT REQUIRED TO SEGREGATE** | | | | |
| 1. | | Amount required to segregate based on general client free credit limit<br>[Section A, Line 5] | | |

## FORM 1, PART I – STATEMENT D

| | | | |
|---|---|---|---|
| 2. | | Amount required to segregate based on margin lending adjusted client free credit limit<br>[Section B, Line 12] | |
| 3. | | **AMOUNT REQUIRED TO SEGREGATE BASED ON MARGIN LENDING ADJUSTED CLIENT FREE CREDIT LIMIT**<br>[Lesser of Section C, Line 1 and Section C, Line 2 if Section B completed; otherwise Section C, Line 1] | |
| **D.** | | **AMOUNT IN SEGREGATION:** | |
| 1. | A-3 | Client funds held in trust in an account with an *acceptable institution* [see note] | |
| 2. | Sch.2 | Market value of securities owned and in segregation [see note] | |
| 3. | | **AMOUNT IN SEGREGATION** [Section D, Line 1 plus Section D, Line 2] | |
| 4. | | **NET SEGREGATION EXCESS (DEFICIENCY)** [Section D, Line 3 minus Section C, Line 3, see note] | |

**NOTES:**

**General –** The client free credit limit and segregation requirements must be calculated at least weekly, but more frequently if required, consistent with the monitoring requirements for the early warning tests.

**Section A, Lines 2 and 3 -** Free credit balances in RRSP and other similar accounts should not be included. Refer to Schedule 4 - Notes and Instructions for discussion of trade versus settlement date reporting of free credit balances. For purposes of this statement, a free credit is:

(a) For cash and margin accounts - the credit balance less an amount equal to the aggregate of the *market value* of short positions and regulatory margin on those shorts.

(b) For futures accounts - any credit balance less an amount equal to the aggregate of margin required to carry open futures contracts and/or futures contracts option positions less equity in those contracts plus deficits in those contracts, provided that such aggregate amount may not exceed the dollar amount of the credit balance.

**Section A, Line 5 -** If Nil, no further calculation on this Statement need be done.

**Section B, Line 2 -** Client margin debit balances reported on this line must be determined on a settlement date basis in order to exclude margin debit amounts relating to pending trades that have not yet settled.

**Section D, Line 1 -** The trust must be an obligation binding the Dealer Member (the trustee) to deal with the free credits over which it has control (the trust property), for the benefit of the client (the beneficiary). The trust property must be clearly identified as such even if residing with an *acceptable institution*.

FUNDS HELD IN TRUST FOR RRSP AND OTHER SIMILAR ACCOUNTS ARE NOT TO BE INCLUDED IN THIS CALCULATION.

**Section D, Line 2 -** The securities to be included are Canadian bank paper with a term of 1 year or less and bonds, debentures, treasury bills and other securities with a term of 1 year or less, of or guaranteed by the Government of Canada or a Province of Canada, the United Kingdom, the United States of America and any other national foreign government (provided such other foreign government is a member of the Basle Accord and that the securities are currently rated Aaa or AAA by Moody's Investors Service, Inc. or Standard & Poor's Corporation, respectively) which are segregated and held separate and apart from the Dealer Member's property.

**Section D, Line 4 -** If negative, then a segregation deficiency exists, and the Dealer Member must correct the segregation deficiency within 5 business days following the determination of the deficiency. The Dealer Member must provide an explanation of how the deficiency was corrected as well as the date of correction.

## FORM 1, PART II – SCHEDULE 9

DATE: _____

_____

(Dealer Member Name)

## CONCENTRATION OF SECURITIES

[excluding securities required to be in segregation or safekeeping, non-commercial debt securities with a normal margin rate of less than 10% and Canadian bank paper maturing within 1 year (see note 6)]

| Description of Security [note 3] | Client position long/(short) C$'000 [note 8] | Dealer Member's own long/(short) C$'000 [note 9] | Unit Price | Market value C$'000 | Effective margin rate | Loan value of securities C$'000 [note 4] | Adjustments in arriving at amount loaned C$'000 | "Amount loaned" C$'000 [note 10] | Amount cleared within five business days C$'000 | Adjusted amount loaned C$'000 | Concen-tration charge C$'000 [note 11] |
|---|---|---|---|---|---|---|---|---|---|---|---|
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## FORM 1, PART II – SCHEDULE 9
## NOTES AND INSTRUCTIONS

### General

1. The purpose of this schedule is to disclose the largest ten issuer positions and precious metal positions that are being relied upon for loan value whether or not a concentration charge applies. If there are more than ten issuer positions and precious metal positions where a concentration exposure exists, then all such positions must be listed on the schedule.
2. Non-commercial debt securities with a normal margin rate of less than 10% and Canadian bank paper maturing within 1 year are excluded from this schedule.
3. For the purpose of this schedule, an issuer position must include all classes of securities for an issuer (i.e. all long and short positions in equity, convertibles, debt or other securities of an issuer other than debt securities cited in note 2), and a precious metal position must include all certificates and bullion of the particular precious metal (gold, platinum or silver) where:
   - loan value is being extended in a margin account, cash account, delivery against payment account, receipt against payment account; or
   - an inventory position is being held.
4. Securities and precious metals that are required to be in segregation or safekeeping should not be included in the issuer position or precious metal position. Securities and precious metals that have been segregated, but are not required to be, can still be relied on by the Dealer Member for loan value, and must be included in the issuer position and precious metal position.
5. For the purpose of this schedule, an amount loaned exposure to *broad based index* positions may be treated as an amount loaned exposure to each of the individual securities comprising the index basket. These amount loaned exposures may be reported by breaking down the *broad based index* position into its constituent security positions and adding these constituent security positions to other amount loaned exposures for the same issuer to arrive at the combined amount loaned exposure.

   To calculate the combined amount loaned exposure for each index constituent security position held, sum

   a) the individual security positions held, and

   b) the constituent security position held.

   [For example, if ABC security has a 7.3% weighting in a *broad based index*, the number of securities that represents 7.3% of the value of the *broad based index* position shall be reported as the constituent security position.]
6. For the purpose of this schedule only, stripped coupons and residuals, [if they are held on a book based system, and are in respect of federal and provincial debt instruments], should be margined at the same rate as the underlying security.
7. For short positions, the loan value is the *market value* of the short position.

### Client position

8. (a) Client positions are to be reported on a settlement date basis for client accounts including positions in margin accounts, regular cash accounts [when any transaction in the account is outstanding after settlement date] and delivery against payment and receipt against payment accounts [when any transaction in the account is outstanding after settlement date]. Within each client account, security positions and precious metal positions that qualify for a margin offset may be eliminated.

   (b) Positions in delivery against payment and receipt against payment accounts with *acceptable institutions*, *acceptable counterparties*, or *regulated entities* resulting from transactions that are outstanding less than ten business days past settlement date are not to be included in the positions reported. If the transaction has

been outstanding ten business days or more past settlement and is not confirmed for clearing through an *acceptable clearing corporation* or not confirmed by the *acceptable institution*, *acceptable counterparty* or *regulated entity*, then the position must be included in the position reported.

**Dealer Member's own position**

9. (a) Dealer Member's own inventory positions are to be reported on a trade date basis, including new issue positions carried in inventory twenty business days after new issue settlement date. All security positions that qualify for a margin offset may be eliminated.

   (b) The amount reported must include uncovered stock positions in market-maker accounts.

**Amount Loaned**

10. The client and Dealer Member's own positions reported are to be determined based on the combined client/Dealer Member's own long or short position that results in the largest amount loaned exposure.

   (a) To calculate the combined amount loaned on the long position exposure, combine:

   - the loan value of the gross long client position (if any) contained within client margin accounts;
   - the weighted *market value* (calculated pursuant to the weighted *market value* calculation set out in Schedule 4, Note 9, Cash Accounts Instruction (a)) and/or loan value (calculated pursuant to the loan value calculation set out in Schedule 4, Note 9, Cash Accounts Instruction (b)) of the gross long client position (if any) contained within client cash accounts;
   - the *market value* (calculated pursuant to the *market value* calculation set out in Schedule 4, Note 9, DAP and RAP Accounts Instruction (a)) and/or loan value (calculated pursuant to the loan value calculation set out in Schedule 4, Note 9, DAP and RAP Accounts Instruction (b)) of the gross long client position (if any) contained within client delivery against payment accounts; and
   - the loan value (calculated pursuant to the Notes and Instructions to Schedule 2) of the net long Dealer Member's own position (if any).

   (b) To calculate the combined amount loaned on the short position exposure, combine

   - the *market value* of the gross short client position (if any) contained within client margin, cash and receipt against payment accounts; and
   - the *market value* of the net short Dealer Member's own position (if any).

   (c) If the loan value of an issuer position or a precious metal position (net of issuer securities or precious metal position required to be in segregation/safekeeping) does not exceed one-half (one-third in the case of an issuer position or precious metal position which qualifies under either note 11(a) or 11(b) below) of the sum of the Dealer Member's Risk Adjusted Capital before securities concentration charge and minimum capital (Stmt. B, Line 7) as most recently calculated, the completion of the column titled "Adjustments in arriving at Amount Loaned" is optional. However, nil should be reflected for the concentration charge.

   (d) In determining the amount loaned on either a long, or short position exposure, the following adjustments may be made:

      (i) Security positions and precious metal positions that qualify for a margin offset may be excluded, as previously discussed in notes 8(a) and 9(a);

      (ii) Security positions and precious metal positions that represent excess margin in the client's account may be excluded. (Note if the starting point of the calculations is securities or precious metal positions not required to be in segregation/safekeeping, this deduction has already been included in the loan value calculation of Column 6.);

      (iii) Security positions that are financed by limited recourse loans that meet the industry standard wording set out in the Limited Recourse Call Loan Agreement may be excluded;

(iv) In the case of margin accounts, 25% of the *market value* of long positions in any: (a) non-marginable securities or, (b) securities with a margin rate of 100%, in the account may be deducted from the amount loaned calculation, provided that such securities are carried in readily saleable quantities only;

(v) In the case of cash accounts, 25% of the *market value* of long positions in any securities whose *market value* weighting is 0.000 (pursuant to Schedule 4, Note 9, Cash Accounts Instruction (a)) in the account may be deducted from the amount loaned calculation, provided that such securities are carried in readily saleable quantities only;

(vi) The amount loaned for commercial debt securities with a normal margin rate of 10% or less and non-commercial debt securities with a normal margin rate of 10% may be reduced by applying an adjustment factor of 50% if the debt securities mature within 3 years. In order to qualify for the 50% adjustment factor, commercial debt securities must also be ranked senior to any outstanding equity securities from the same issuer in the case of insolvency;

(vii) The amount loaned values of trades made with financial institutions that are not *acceptable institutions*, *acceptable counterparties* or *regulated entities*, if the trades are outstanding less than 10 business days past settlement date, and the trades were confirmed on or before settlement date with a settlement agent that is an *acceptable institution* may be deducted from the amount loaned calculation; and

(viii) Any security positions or precious metal positions in the client's (the "Guarantor") account, which are used to reduce the margin required in another account pursuant to the terms of a guarantee agreement, shall be included in calculating the amount loaned on each security for the purposes of the Guarantor's account.

(e) Amount Loaned is the position exposure (either long or short) with the largest calculated amount loaned.

**Concentration Charge**

11. (a) Where the Amount Loaned reported relates to securities issued by

(i) the Dealer Member, or

(ii) a company, where the accounts of a Dealer Member are included in the consolidated financial statements and where the assets and revenue of the Dealer Member constitute more than 50% of the consolidated assets and 50% of the consolidated revenue, respectively, of the company, based on the amounts shown in the audited consolidated financial statements of the company and the Dealer Member for the preceding fiscal year and the total Amount Loaned by a Dealer Member on such issuer securities exceeds one-third of the sum of the Dealer Member's Risk Adjusted Capital before securities concentration charge and minimum capital (Stmt. B, Line 7), as most recently calculated, a concentration charge of an amount equal to 150% of the excess of the Amount Loaned over one-third of the sum of the Dealer Member's Risk Adjusted Capital before securities concentration charge and minimum capital (Stmt. B, Line 7) is required unless the excess is cleared within five business days of the date it first occurs. For long positions, the concentration charge as calculated herein shall not exceed the loan value of the issuer security(ies) for which such charge is incurred.

(b) Where the Amount Loaned reported relates to non-marginable securities of an issuer held in a cash account(s), where loan value has been extended pursuant to the weighted *market value* calculation set out in Schedule 4, Note 9, and the total Amount Loaned by a Dealer Member on such issuer securities exceeds one-third of the sum of the Dealer Member's Risk Adjusted Capital before securities concentration charge and minimum capital (Stmt. B, Line 7), as most recently calculated, a concentration charge of an amount equal to 150% of the excess of the Amount Loaned over one-third of the sum of the Dealer Member's Risk Adjusted Capital before securities concentration charge and minimum capital (Stmt. B, Line 7) is required unless the excess is cleared within five business days of the date it first occurs. For long positions, the

concentration charge as calculated herein shall not exceed the loan value of the issuer security(ies) for which such charge is incurred.

(c) Where the Amount Loaned reported relates to arm's length marginable securities of an issuer (i.e., securities other than those described in note 11(a), or 11(b)) or a precious metal position, and the total Amount Loaned by a Dealer Member on such issuer securities or precious metal position exceeds two-thirds of the sum of the Dealer Member's Risk Adjusted Capital before securities concentration charge and minimum capital (Stmt. B, Line 7), as most recently calculated, a concentration charge of an amount equal to 150% of the excess of the Amount Loaned over two-thirds of the sum of the Dealer Member's Risk Adjusted Capital before securities concentration charge and minimum capital (Stmt. B, Line 7) is required unless the excess is cleared within five business days of the date it first occurs. For long positions, the concentration charge as calculated herein shall not exceed the loan value of the issuer security(ies) or precious metal position for which such charge is incurred.

(d) Where:

(i) The Dealer Member has incurred a concentration charge for an issuer position under either note 11(a) or 11(b) or 11(c); or

(ii) The Amount Loaned by a Dealer Member on any one issuer (other than issuers whose securities may be subject to a concentration charge under either note 11(a) or 11(b) above) or a precious metal position exceeds one-half of the sum of the Dealer Member's Risk Adjusted Capital before securities concentration charge and minimum capital (Stmt. B, Line 7), as most recently calculated; and

(iii) The Amount Loaned on any other issuer or precious metal position exceeds one-half (one-third in the case of issuers whose securities may be subject to a concentration charge under either note 11(a) or 11(b) above) of the sum of Risk Adjusted Capital before securities concentration charge and minimum capital (Stmt. B, Line 7); then

(iv) A concentration charge on such other issuer position or precious metal position of an amount equal to 150% of the excess of the Amount Loaned on the other issuer or precious metal position over one-half (one-third in the case of issuers whose securities may be subject to a concentration charge under either note 11(a) or 11(b) above) of the sum of the Dealer Member's Risk Adjusted Capital before securities concentration charge and minimum capital (Stmt. B, Line 7) is required unless the excess is cleared within five business days of the date it first occurs. For long positions, the concentration charge as calculated herein shall not exceed the loan value of the security(ies) or precious metal position for which such charge is incurred.

(e) For the purpose of calculating the concentration charges as required by notes 11(a), 11(b), 11(c) and 11(d) above, such calculations shall be performed for the largest five issuer positions and precious metal positions by Amount Loaned in which there is a concentration exposure.

**Other**

12. (a) Where there is an over exposure in a security or a precious metal position and the concentration charge as referred to above would produce either a capital deficiency or a violation of the Early Warning Rule, the Dealer Member must report the over exposure situation to the Corporation on the date the over exposure first occurs.

(b) A measure of discretion is left with the Corporation in dealing with the resolution of concentration situations, particularly as regards to time requirements for correcting any over exposure, as well as whether securities or precious metal positions are carried in "readily saleable quantities".

**INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA**

**AMENDMENTS TO DEALER MEMBER RULES 100 AND 1200 AND TO FORM 1 RELATING TO THE CLIENT FREE CREDIT CASH USAGE LIMIT, CLIENT FREE CREDIT SEGREGATION REQUIREMENTS, AND SECURITIES CONCENTRATION TEST**

**BLACK-LINE OF PROPOSED AMENDMENTS**

## 100.20. Concentration of Securities

(a) For the purposes of this paragraph:

(i) "Amount Loaned" includes:

(A) In respect of long positions:

1. The loan value of long securities and precious metals in margin accounts on settlement date;
2. The loan value of long securities and precious metals in a regular settlement cash account when any portion of the account is outstanding after settlement date;
3. The loan value of long securities and precious metals in a delivery against payment cash account when such securities and precious metals are outstanding after settlement date;
4. The loan value of long inventory positions on trade date; and
5. The loan value of new issues carried in inventory 20 business days after new issue settlement date.

(B) In respect of short positions:

1. The market value of short positions in margin accounts on settlement date;
2. The market value of short positions in a regular settlement cash account when any portion of the account is outstanding after settlement date;
3. The market value of short positions in a delivery against payment cash account when such securities are outstanding after settlement date; and
4. The market value of short inventory securities on trade date.

(ii) "Security" includes:

(A) all long and short positions in equity and convertible securities of an issuer; and

(B) all long and short positions in debt or other securities, other than non-commercial debt securities with a normal margin requirement of ~~10% or~~ less than 10% and Canadian bank paper maturing within 1 year.

(iii) "Precious metal" includes:

(A) long positions in certificates evidencing an interest in gold, platinum or silver that are acceptable for margin purposes as defined in Dealer Member Rule 100.2(i)(i); and

(B) long positions in London Bullion Market Association (LBMA) gold or silver good delivery bars that are acceptable for margin purposes as defined in Dealer Member Rule 100.2(i)(ii).

(iv) "Risk Adjusted Capital" means a Dealer Member's risk adjusted capital as calculated before the securities concentration charge (Statement B, Line 25 on Form 1) plus minimum capital (Statement B, Line 6 of Form 1).

(b) For the purposes of calculating the amount loaned:

(i) Security positions that qualify for margin offsets pursuant to Rule 100, as applicable, may be netted;

(ii) Separate calculations must be made for long security positions and short security positions. The greater of the long or short position must be used in the calculations below;

(iii) In calculating the total amount loaned for each customer on long (or short) positions on any one security, there may be deducted from the loan value (market value) of the long (or short) position:

(A) Any excess margin in the customer's account; and

(B) 25% of the market value of long positions in any non-marginable securities in the account provided such securities are carried in readily saleable quantities only.

(iv) In calculating the amount loaned on long positions for a customer, where such customer (the "guarantor" has guaranteed another customer account (the "guaranteed account"), any securities and precious metal in the guarantor's account which are used to reduce margin required in the guaranteed account in accordance with Rule 100.14, shall be included in calculating the amount loaned on each security and precious metal for the purposes of the guarantor's account;

(v) In calculating the amount loaned for debt securities subject to the concentration charge calculation, the amount loaned for:

(A) commercial debt securities with a normal margin rate of 10% or less; and

(B) non-commercial debt securities with a normal margin rate of 10%;

may be reduced by applying an adjustment factor of 50% if the debt securities mature within 3 years.

In order to qualify for the 50% adjustment factor, commercial debt securities must also be ranked senior to any outstanding equity securities from the same issuer in the case of insolvency;

(vi) Security positions that are financed by limited recourse loans that meet the industry standard wording set out in the Limited Recourse Call Loan Agreement may be excluded from the calculation below;

(vii) The values of trades made with acceptable institutions, acceptable counterparties and regulated entities that are outstanding 10 business days past settlement date and are:

(A) Not confirmed for clearing through a recognized clearing corporation; or

(B) Not confirmed by the acceptable institution, acceptable counterparty or a regulated entity,

Must be included in the calculation below in the same manner as delivery against payment cash accounts; and

(~~vi~~viii) The value of trades made with a financial institution that is not an acceptable institution, acceptable counterparty or regulated entity, outstanding less than 10 business days past settlement date, may be excluded from the calculation below if each such trade was confirmed on or before settlement date with a settlement agent that is an acceptable institution or acceptable counterparty.

(c)

(i) Subject to subclause (ii) below, where the total amount loaned by a Dealer Member on any one security or precious metal for all customers and/or inventory accounts, as calculated hereunder, exceeds an amount equal to two-thirds of the sum of the Dealer Member's risk adjusted capital, before securities concentration charge and minimum capital, as most recently calculated for more than five business days, an amount equal to 150% of the excess of the amount loaned over two-thirds of the sum of the Dealer Member's risk adjusted capital, before securities concentration charge and minimum capital (Statement B, Line 6 of Form 1), shall be deducted from the risk adjusted capital of the Dealer Member. For long positions, the concentration charge as calculated herein shall not exceed the loan value of the security or precious metal for which the charge is incurred.

(ii) Notwithstanding subclause (i) above, where the loaned security issued by

(A) The Dealer Member, or

(B) A company, where the accounts of a Dealer Member are included in the consolidated financial statements and where the assets and revenues of the Dealer Member constitute more than 50% of the consolidated assets and 50% of the consolidated revenue, respectively, the company, based on the amounts shown in the audited consolidated financial statements of the company and the Dealer Member for the preceding fiscal year,

And the total amount loaned by the Dealer Member on any one such security, as calculated hereunder, exceeds an amount equal to one third of the Dealer Member's risk adjusted capital before securities concentration charge plus minimum capital as most recently calculated for more than five business days, an amount equal to 150% of the excess of the amount loaned over one-third of the sum of the Dealer Member's risk adjusted capital before securities concentration charge and minimum capital shall be deducted from the risk adjusted capital of the Dealer Member.

(d) Where the total amount loaned by a Dealer Member on any one security or precious metal for all customers and/or inventory accounts as calculated hereunder exceeds an amount equal to one half of the sum of the Dealer Member's risk adjusted capital before securities concentration charge and minimum capital as most recently calculated, and the amount loaned on any other security or precious metal which is being carried by a Dealer Member for all customers and/or inventory accounts as calculated hereunder, exceeds an amount equal to one-half of the sum of the Dealer Member's risk adjusted capital before securities concentration charge and minimum capital as most recently calculated for more than five business days, an amount equal to 150% of the excess of the amount loaned on the other security or precious metal over one-half of the Dealer Member's risk adjusted capital shall be deducted from the risk adjusted capital of the Dealer Member. For long positions, the concentration charge as calculated herein shall not exceed the loan value of the security or precious metal for which the charge is incurred.

(e) For the purposes of calculating the concentration charges as required by paragraphs (c) and (d) above, such calculations shall be performed for the first five securities and precious metals in which there is a concentration.

(f) Where the capital charges described in subsections (c) and (d) would result in a capital deficiency or a violation of the rule permitting designation in early warning pursuant to Rule 30, the Dealer Member must report the over-concentration situation to the appropriate Joint Regulatory Bodies on the date the over-concentration first occurs.

## RULE 1200
## CLIENTS' FREE CREDIT BALANCES

1200.1. For the purposes of this Rule 1200, "free credit balances" shall mean:

(a) For cash and margin accounts - the credit balance less an amount equal to the aggregate of (i) the market value of short positions, and (ii) margin as required pursuant to the Rules on those short positions; and

(b) For commodity accounts - the credit balance less an amount equal to the aggregate of (i) margin required to carry open futures contracts and/or futures contract option positions, (ii) less any equity in such contracts, (iii) plus any deficits in such contracts, provided that such aggregate amount may not exceed the dollar amount of the credit balance.

1200.2. Each Dealer Member which does not keep its clients' free credit balances segregated in trust for clients in an account with an acceptable institution separate from the other monies from time to time received by such Dealer Member shall legibly make a notation on all statements of account sent to its clients in substantially the following form:

Any free credit balances represent funds payable on demand which, although properly recorded in our books, are not segregated and may be used in the conduct of our business.

1200.3. No Dealer Member shall use in the conduct of its business clients' free credit balances in excess of the ~~aggregate~~greater of the following amounts:

(~~a) Eight~~a) General free credit limit:

Twelve times the ~~net allowable assets~~early warning reserve amount of the Dealer Member; ~~plus~~or

(b) Margin lending adjusted free credit limit:

~~(b) Four times the~~Twenty times the early warning reserve amount of the Dealer Member for margin lending purposes plus twelve times the remaining early warning reserve ~~of the Dealer Member~~amount for all other purposes, where the remaining early warning reserve amount equals the early warning amount minus 1/20th of the total settlement date client margin debit amount.

Each Dealer Member shall hold an amount at least equal to the amount of clients' free credit balances in excess of the foregoing either :

(~~a~~c) in cash segregated in trust for clients in a separate account or accounts with an acceptable institution; or

(~~b~~d) segregated and separate and apart ~~as~~from the Dealer Member's property in Canadian bank paper with a maturity of one year or less and bonds, debentures, treasury bills

and other securities with a maturity of ~~less than~~ one year or less of or guaranteed by the Government of Canada, a province of Canada, the United Kingdom, the United States of America and any other national foreign government (provided such other foreign government is a member of the Basle Accord and that the securities are currently rated Aaa or AAA by Moody's Investors Service, Inc. or Standard & Poor's Corporation, respectively).

1200.4. Dealer Members shall determine at least weekly, but more frequently if required, the amounts required to be segregated in accordance with Rule 1200.3.

1200.5. Dealer Members shall review on a daily basis compliance with Rule 1200.3 against the latest determination under this Rule 1200 of amounts to be segregated with a view to identifying and correcting any deficiency in amounts of free credit balances to be segregated.

1200.6. In the event that a deficiency exists in amounts of free credit balances required to be segregated by a Dealer Member, the Dealer Member ~~shall expeditiously take the most appropriate action to rectify~~must correct the segregation deficiency within 5 business days following the determination of the deficiency.

**Attachment B**

**FORM 1, PART I – STATEMENT D**

_____

(Dealer Member Name)

**STATEMENT OF FREE CREDIT SEGREGATION AMOUNT**

at _____

| REFERENCE | | | NOTES | (CURRENT YEAR) C$'000 |
|---|---|---|---|---|
| **A. AMOUNT REQUIRED TO SEGREGATE~~:~~ BASED ON GENERAL FREE CREDIT LIMIT** | | | | ~~C$'000~~ |
| ~~1.~~ | ~~B-6~~ | ~~Net allowable assets of $_____ multiplied by 8~~**General client free credit limit** | | |
| ~~2.~~1. | C-13 | Early warning reserve of $_____ multiplied by ~~4~~12<br>[Report NIL if amount is negative] | | |
| ~~3.~~ | | ~~**FREE CREDIT LIMIT** [Lines 1 plus 2]~~ | | |
| | | **Less client free credit balances:** | | |
| ~~4.~~2. | Sch.4 | Dealer Member's own [see note] | | |
| ~~5.~~3. | | Carried For Type 3 Introducers | | |
| 4. | | **Total client free credit balances** [Section A, Line 2 plus Section A, Line 3] | | |
| 5. | | **AMOUNT REQUIRED TO SEGREGATE BASED ON GENERAL CLIENT FREE CREDIT LIMIT**<br>[Section A, Line 4 minus Section A, Line 1; report NIL if result is negative; see note] | | |
| ~~6.~~**B. AMOUNT REQUIRED TO SEGREGATE** ~~[NIL if Line 3 exceeds Line 4 plus Line 5, see note]~~**BASED ON MARGIN LENDING ADJUSTED CLIENT FREE CREDIT LIMIT** | | | | |
| | | ~~**AMOUNT IN SEGREGATION:**~~**Client free credit limit for margin lending purposes** | | |
| 1. | C-13 | Early warning reserve of $_____ multiplied by 20<br>[Report NIL if amount is negative] | | |
| | | **Less client free credit balances used to finance client margin loans:** | | |
| 2. | | Total settlement date client margin debit balances | | |
| 3. | | Total client free credit balances [Include amount from Section A, Line 4 above] | | |
| 4. | | **Subtotal - Client free credit balances used to finance client margin loans**<br>[Lesser of Section B, Line 2 and Section B, Line 3] | | |
| 5. | | **Amount required to segregate relating to margin lending**<br>[Section B, Line 4 minus Section B, Line 1; report NIL if result is negative] | | |
| | | **Free credit limit for all other purposes** | | |
| 6. | C-13 | Early warning reserve<br>[Report NIL if amount is negative] | | |
| 7. | | Total settlement date client margin debit balances divided by 20 | | |
| 8. | | **Portion of early warning reserve available to support all other uses of client free credits**<br>[Section B, Line 6 minus Section B, Line 7; report NIL if result is negative] | | |
| 9. | | **Client free credit limit for all other purposes**<br>[Section B, Line 8 multiplied by 12] | | |
| 10. | | **Client free credits not used to finance margin loans**<br>[Section A, Line 4 minus Section B, Line 4] | | |
| 11. | | **Amount required to segregate relating to all other purposes**<br>[Section B, Line 10 minus Section B, Line 9; report NIL if result is negative] | | |

## FORM 1, PART I – STATEMENT D

| | | | |
|---|---|---|---|
| 12. | **AMOUNT REQUIRED TO SEGREGATE BASED ON MARGIN LENDING ADJUSTED CLIENT FREE CREDIT LIMIT** [Section B, Line 5 plus Section B, Line 11] | | |
| **C. AMOUNT REQUIRED TO SEGREGATE** | | | |
| 1. | Amount required to segregate based on general client free credit limit [Section A, Line 5] | | |
| 2. | Amount required to segregate based on margin lending adjusted client free credit limit [Section B, Line 12] | | |
| 3. | **AMOUNT REQUIRED TO SEGREGATE BASED ON MARGIN LENDING ADJUSTED CLIENT FREE CREDIT LIMIT** [Lesser of Section C, Line 1 and Section C, Line 2 if Section B completed; otherwise Section C, Line 1] | | |
| **D. AMOUNT IN SEGREGATION:** | | | |
| ~~7.~~1 | A-3 Client funds held in trust in an account with an *acceptable institution* [see note] | | |
| ~~8.~~2 | Sch.2 Market value of securities owned and in segregation [see note] | | |
| ~~9.~~3 | **~~TOTAL~~AMOUNT IN SEGREGATION** [~~Lines 7~~Section D, Line 1 plus ~~8~~Section D, Line 2] | | |
| ~~10.~~ 4. | **NET SEGREGATION EXCESS (DEFICIENCY)** [Section D, Line ~~6 less~~3 minus Section C, Line ~~9,~~3, see note] | | |

**NOTES:**

~~**Line 3 -** If negative, then Line 6 equals Line 4 plus Line 5, i.e. Dealer Member is required to segregate 100% of client free credits.~~**General –** The client free credit limit and segregation requirements must be calculated at least weekly, but more frequently if required, consistent with the monitoring requirements for the early warning tests.

**Section A, Lines ~~4~~2 and ~~5~~3 -** Free credit balances in RRSP and other similar accounts should not be included. Refer to Schedule 4 - Notes and Instructions for discussion of trade versus settlement date reporting of free credit balances. For purposes of this statement, a free credit is:

(a) For cash and margin accounts - the credit balance less an amount equal to the aggregate of the *market value* of short positions and regulatory margin on those shorts.

(b) For futures accounts - any credit balance less an amount equal to the aggregate of margin required to carry open futures contracts and/or futures contracts option positions less equity in those contracts plus deficits in those contracts, provided that such aggregate amount may not exceed the dollar amount of the credit balance.

**Section A, Line ~~6~~5 -** If Nil, no further calculation on this Statement need be done.

**Section B, Line 2 -** Client margin debit balances reported on this line must be determined on a settlement date basis in order to exclude margin debit amounts relating to pending trades that have not yet settled.

**Section D, Line ~~7~~1 -** The trust must be an obligation binding the Dealer Member (the trustee) to deal with the free credits over which it has control (the trust property), for the benefit of the client (the beneficiary). The trust property must be clearly identified as such even if residing with an *acceptable institution*.

FUNDS HELD IN TRUST FOR RRSP AND OTHER SIMILAR ACCOUNTS ARE NOT TO BE INCLUDED IN THIS CALCULATION.

**Section D, Line ~~8~~2 -** The securities to be included are Canadian bank paper with a term of 1 year or less and bonds, debentures, treasury bills and other securities with a term of 1 year or less, of or guaranteed by the Government of Canada or a Province of Canada, the United Kingdom, the United States of America and any other national foreign government (provided such other foreign government is a ~~party to the Basel Accord~~member of the Basle Accord and that the securities are currently rated Aaa or AAA by Moody's Investors Service, Inc. or Standard &

Poor's Corporation, respectively) which are segregated and held separate and apart ~~as~~ from the Dealer Member's property.

**Section D, Line ~~10~~4 -** If negative, then a segregation deficiency exists, and the Dealer Member must ~~expeditiously take the most appropriate action required to settle~~correct the segregation deficiency within 5 business days following the determination of the deficiency. The Dealer Member must provide an explanation of how the deficiency was corrected as well as the date of correction.

## FORM 1, PART II – SCHEDULE 9

DATE: _____

_____
(Dealer Member Name)

## CONCENTRATION OF SECURITIES

[excluding securities required to be in segregation or safekeeping ~~5~~, non-commercial debt securities with a normal margin rate of ~~10% or~~ less than 10% and Canadian bank paper maturing within 1 year (see note ~~5~~6)]

| Description of Security [note ~~6~~3] | Client position long/(short) C$'000 [note ~~7~~8] | Dealer Member's own long/(short) C$'000 [note ~~8~~9] | Unit Price | Market value C$'000 | Effective margin rate | Loan value of securities C$'000 [note ~~2~~4] | Adjustments in arriving at amount loaned C$'000 | "Amount loaned" C$'000 [note ~~9~~10] | Amount cleared within five business days C$'000 | Adjusted amount loaned C$'000 | Concen-tration charge C$'000 [note ~~10~~11] |
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**Attachment B**

## FORM 1, PART II – SCHEDULE 9
## NOTES AND INSTRUCTIONS

### General

1. The purpose of this schedule is to disclose the largest ten issuer positions and precious metal positions that are being relied upon for loan value whether or not a concentration charge applies. If there are more than ten issuer positions and precious metal positions where a concentration exposure exists, then all such positions must be listed on the schedule.

2. Non-commercial debt securities with a normal margin rate of less than 10% and Canadian bank paper maturing within 1 year are excluded from this schedule.

3. For the purpose of this schedule, an issuer position must include all classes of securities for an issuer (i.e. all long and short positions in equity, convertibles, debt or other securities of an issuer other than debt securities ~~with a normal margin requirement of 10% or less),~~cited in note 2), and a precious metal position must include all certificates and bullion of the particular precious metal (gold, platinum or silver) where:
   - loan value is being extended in a margin account, cash account, delivery against payment account, receipt against payment account; or
   - an inventory position is being held.

~~3.~~4. Securities and precious metals that are required to be in segregation or safekeeping should not be included in the issuer position or precious metal position. Securities and precious metals that have been segregated, but are not required to be, can still be relied on by the Dealer Member for loan value, and must be included in the issuer position and precious metal position.

~~4.~~5. For the purpose of this schedule, an amount loaned exposure to *broad based index* positions may be treated as an amount loaned exposure to each of the individual securities comprising the index basket. These amount loaned exposures may be reported by breaking down the *broad based index* position into its constituent security positions and adding these constituent security positions to other amount loaned exposures for the same issuer to arrive at the combined amount loaned exposure.

   To calculate the combined amount loaned exposure for each index constituent security position held, sum

   a) the individual security positions held, and

   b) the constituent security position held.

   [For example, if ABC security has a 7.3% weighting in a *broad based index*, the number of securities that represents 7.3% of the value of the *broad based index* position shall be reported as the constituent security position.]

~~5.~~6. For the purpose of this schedule only, stripped coupons and residuals, [if they are held on a book based system, and are in respect of federal and provincial debt instruments], should be margined at the same rate as the underlying security.

~~6.~~7. For short positions, the loan value is the *market value* of the short position.

### Client position

~~7.~~8. (a) Client positions are to be reported on a settlement date basis for client accounts including positions in margin accounts, regular cash accounts [when any transaction in the account is outstanding after settlement date] and delivery against payment and receipt against payment accounts [when any transaction in the account is outstanding after settlement date]. Within each client account, security positions and precious metal positions that qualify for a margin offset may be eliminated.

   (b) Positions in delivery against payment and receipt against payment accounts with *acceptable institutions*, *acceptable counterparties*, or *regulated entities* resulting from transactions that are outstanding less than ten business days past settlement date are not to be included in the positions reported. If the transaction has

been outstanding ten business days or more past settlement and is not confirmed for clearing through an *acceptable clearing corporation* or not confirmed by the *acceptable institution*, *acceptable counterparty* or *regulated entity*, then the position must be included in the position reported.

**Dealer Member's own position**

~~8.~~9. (a) Dealer Member's own inventory positions are to be reported on a trade date basis, including new issue positions carried in inventory twenty business days after new issue settlement date. All security positions that qualify for a margin offset may be eliminated.

(b) The amount reported must include uncovered stock positions in market-maker accounts.

**Amount Loaned**

~~9.~~10. The client and Dealer Member's own positions reported are to be determined based on the combined client/Dealer Member's own long or short position that results in the largest amount loaned exposure.

(a) To calculate the combined amount loaned on the long position exposure, combine:

- the loan value of the gross long client position (if any) contained within client margin accounts;
- the weighted *market value* (calculated pursuant to the weighted *market value* calculation set out in Schedule 4, Note 9, Cash Accounts Instruction (a)) and/or loan value (calculated pursuant to the loan value calculation set out in Schedule 4, Note 9, Cash Accounts Instruction (b)) of the gross long client position (if any) contained within client cash accounts;
- the *market value* (calculated pursuant to the *market value* calculation set out in Schedule 4, Note 9, DAP and RAP Accounts Instruction (a)) and/or loan value (calculated pursuant to the loan value calculation set out in Schedule 4, Note 9, DAP and RAP Accounts Instruction (b)) of the gross long client position (if any) contained within client delivery against payment accounts; and
- the loan value (calculated pursuant to the Notes and Instructions to Schedule 2) of the net long Dealer Member's own position (if any).

(b) To calculate the combined amount loaned on the short position exposure, combine

- the *market value* of the gross short client position (if any) contained within client margin, cash and receipt against payment accounts; and
- the *market value* of the net short Dealer Member's own position (if any).

(c) If the loan value of an issuer position or a precious metal position (net of issuer securities or precious metal position required to be in segregation/safekeeping) does not exceed one-half (one-third in the case of an issuer position or precious metal position which qualifies under either ~~Note 10~~note 11(a) or ~~10~~11(b) below) of the sum of the Dealer Member's Risk Adjusted Capital before securities concentration charge and minimum capital (Stmt. B, Line 7) as most recently calculated, the completion of the column titled "Adjustments in arriving at Amount Loaned" is optional. However, nil should be reflected for the concentration charge.

(d) In determining the amount loaned on either a long, or short position exposure, the following adjustments may be made:

(i) Security positions and precious metal positions that qualify for a margin offset may be excluded, as previously discussed in notes ~~7~~8(a) and ~~8~~9(a);

(ii) Security positions and precious metal positions that represent excess margin in the client's account may be excluded. (Note if the starting point of the calculations is securities or precious metal positions not required to be in segregation/safekeeping, this deduction has already been included in the loan value calculation of Column 6.);

(iii) Security positions that are financed by limited recourse loans that meet the industry standard wording set out in the Limited Recourse Call Loan Agreement may be excluded;

(iv) In the case of margin accounts, 25% of the *market value* of long positions in any: (a) non-marginable securities or, (b) securities with a margin rate of 100%, in the account may be deducted from the amount loaned calculation, provided that such securities are carried in readily saleable quantities only;

(~~iv~~v) In the case of cash accounts, 25% of the *market value* of long positions in any securities whose *market value* weighting is 0.000 (pursuant to Schedule 4, Note 9, Cash Accounts Instruction (a)) in the account may be deducted from the amount loaned calculation, provided that such securities are carried in readily saleable quantities only;

(~~v~~vi) The amount loaned for commercial debt securities with a normal margin rate of 10% or less and non-commercial debt securities with a normal margin rate of 10% may be reduced by applying an adjustment factor of 50% if the debt securities mature within 3 years. In order to qualify for the 50% adjustment factor, commercial debt securities must also be ranked senior to any outstanding equity securities from the same issuer in the case of insolvency;

(vii) The amount loaned values of trades made with financial institutions that are not *acceptable institutions*, *acceptable counterparties* or *regulated entities*, if the trades are outstanding less than 10 business days past settlement date, and the trades were confirmed on or before settlement date with a settlement agent that is an *acceptable institution* may be deducted from the amount loaned calculation; and

(~~vi~~viii) Any security positions or precious metal positions in the client's (the "Guarantor") account, which are used to reduce the margin required in another account pursuant to the terms of a guarantee agreement, shall be included in calculating the amount loaned on each security for the purposes of the Guarantor's account.

(e) Amount Loaned is the position exposure (either long or short) with the largest calculated amount loaned.

**Concentration Charge**

~~10.~~11. (a) Where the Amount Loaned reported relates to securities issued by

(i) the Dealer Member, or

(ii) a company, where the accounts of a Dealer Member are included in the consolidated financial statements and where the assets and revenue of the Dealer Member constitute more than 50% of the consolidated assets and 50% of the consolidated revenue, respectively, of the company, based on the amounts shown in the audited consolidated financial statements of the company and the Dealer Member for the preceding fiscal year and the total Amount Loaned by a Dealer Member on such issuer securities exceeds one-third of the sum of the Dealer Member's Risk Adjusted Capital before securities concentration charge and minimum capital (Stmt. B, Line 7), as most recently calculated, a concentration charge of an amount equal to 150% of the excess of the Amount Loaned over one-third of the sum of the Dealer Member's Risk Adjusted Capital before securities concentration charge and minimum capital (Stmt. B, Line 7) is required unless the excess is cleared within five business days of the date it first occurs. For long positions, the concentration charge as calculated herein shall not exceed the loan value of the issuer security(ies) for which such charge is incurred.

(b) Where the Amount Loaned reported relates to non-marginable securities of an issuer held in a cash account(s), where loan value has been extended pursuant to the weighted *market value* calculation set out in Schedule 4, Note 9, and the total Amount Loaned by a Dealer Member on such issuer securities exceeds one-third of the sum of the Dealer Member's Risk Adjusted Capital before securities concentration charge and minimum capital (Stmt. B, Line 7), as most recently calculated, a concentration charge of an amount equal to 150% of the excess of the Amount Loaned over one-third of the sum of the Dealer Member's Risk Adjusted Capital before securities concentration charge and minimum capital (Stmt. B, Line 7) is required

unless the excess is cleared within five business days of the date it first occurs. For long positions, the concentration charge as calculated herein shall not exceed the loan value of the issuer security(ies) for which such charge is incurred.

(c) Where the Amount Loaned reported relates to arm's length marginable securities of an issuer (i.e., securities other than those described in note ~~10~~11(a), or ~~10~~11(b)) or a precious metal position, and the total Amount Loaned by a Dealer Member on such issuer securities or precious metal position exceeds two-thirds of the sum of the Dealer Member's Risk Adjusted Capital before securities concentration charge and minimum capital (Stmt. B, Line 7), as most recently calculated, a concentration charge of an amount equal to 150% of the excess of the Amount Loaned over two-thirds of the sum of the Dealer Member's Risk Adjusted Capital before securities concentration charge and minimum capital (Stmt. B, Line 7) is required unless the excess is cleared within five business days of the date it first occurs. For long positions, the concentration charge as calculated herein shall not exceed the loan value of the issuer security(ies) or precious metal position for which such charge is incurred.

(d) Where:

(i) The Dealer Member has incurred a concentration charge for an issuer position under either note ~~10~~11(a) or ~~10~~11(b) or ~~10~~11(c); or

(ii) The Amount Loaned by a Dealer Member on any one issuer (other than issuers whose securities may be subject to a concentration charge under either ~~Note 10~~note 11(a) or ~~10~~11(b) above) or a precious metal position exceeds one-half of the sum of the Dealer Member's Risk Adjusted Capital before securities concentration charge and minimum capital (Stmt. B, Line 7), as most recently calculated; and

(iii) The Amount Loaned on any other issuer or precious metal position exceeds one-half (one-third in the case of issuers whose securities may be subject to a concentration charge under either ~~Note 10~~note 11(a) or ~~10~~11(b) above) of the sum of Risk Adjusted Capital before securities concentration charge and minimum capital (Stmt. B, Line 7); then

(iv) A concentration charge on such other issuer position or precious metal position of an amount equal to 150% of the excess of the Amount Loaned on the other issuer or precious metal position over one-half (one-third in the case of issuers whose securities may be subject to a concentration charge under either ~~Note 10~~note 11(a) or ~~10~~11(b) above) of the sum of the Dealer Member's Risk Adjusted Capital before securities concentration charge and minimum capital (Stmt. B, Line 7) is required unless the excess is cleared within five business days of the date it first occurs. For long positions, the concentration charge as calculated herein shall not exceed the loan value of the security(ies) or precious metal position for which such charge is incurred.

(e) For the purpose of calculating the concentration charges as required by notes ~~10~~11(a), ~~10~~11(b), ~~10~~11(c) and ~~10~~11(d) above, such calculations shall be performed for the largest five issuer positions and precious metal positions by Amount Loaned in which there is a concentration exposure.

**Other**

~~11.~~12. (a) Where there is an over exposure in a security or a precious metal position and the concentration charge as referred to above would produce either a capital deficiency or a violation of the Early Warning Rule, the Dealer Member must report the over exposure situation to the Corporation on the date the over exposure first occurs.

(b) A measure of discretion is left with the Corporation in dealing with the resolution of concentration situations, particularly as regards to time requirements for correcting any over exposure, as well as whether securities or precious metal positions are carried in "readily saleable quantities".