

Canadian Investment Regulatory Organization

Amendments regarding margin requirements for structured products

Blackline copy of Amendments to IDPC Rules and Form 1

Amendment #1 - IDPC Rule section 5130 is amended as follows:

5130. Definitions

- (1) In Rules 5100 through 5900, unless stated otherwise, any term used that is not defined here or in the Rule where it is used, but is defined or used in Form 1, has the meaning defined or used in Form 1.
- (2) For all positions subject to margin, the term:

<p>“underlying interest” or “underlying security” or “underlying basket of securities”</p>	<p>In the case of:</p> <ul style="list-style-type: none"> <li>(i) a <i>convertible security</i>, the security to be received upon invoking the conversion or exchange feature,</li> <li>(ii) an <i>exercisable security</i>, the security to be received upon invoking the exercise feature,</li> <li>(iii) an <i>index participation unit</i>, the basket of securities to be received upon invoking the conversion or exchange feature,</li> <li>(iv) an <i>installment receipt</i>, the security that has been purchased on an installment basis by the holder of the <i>installment receipt</i>,</li> <li>(v) residual debt securities and strip debt securities, the <i>debt security</i> used to create the residual debt securities and strip debt securities,</li> <li>(vi) <i>currency options</i>, the currency referenced by the <i>option</i>,</li> <li>(vii) equity, <i>index participation unit</i> and <i>debt options</i>, the security referenced by the <i>option</i>,</li> <li>(viii) <i>index options</i>, the <i>index</i> referenced by the <i>option</i>, <del>and</del></li> <li>(ix) a <i>total performance swap</i>, the security or basket of securities on which the swap is based, <u>and</u></li> <li><u>(x) a <i>structured product</i>, the security or basket of securities on which the performance of the <i>structured product</i> is based.</u></li> </ul>
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- (8) For structured product positions, the term:

<p><u>“structured product”</u></p>	<p><u>A financial instrument where the return is linked to the performance of a specified <i>underlying security</i> or <i>underlying basket of securities</i>. Structured products include:</u></p> <ul style="list-style-type: none"> <li><u>(i) <i>principal at risk notes</i>, and</u></li> </ul>
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	<u>(ii) principal protected notes.</u>
<u>“principal at risk note”</u>	<u>A financial instrument where the return is linked to the performance of a specified underlying security or underlying basket of securities and the investor carries a risk of losing part or all of the initial amount invested.</u>
<u>“principal protected note”</u>	<u>A financial instrument where the return is linked to the performance of a specified underlying security or underlying basket of securities and at maturity the investor receives as a minimum, the initial amount invested.</u>

(89) For positions in and offsets involving foreign exchange exposures, the term:

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(910) For positions in and offsets involving derivative products, the term:

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**Amendment #2** - IDPC Rule subsections 5360(2), 5360(3) and 5775(1) are amended as follows:

**INDEX PRODUCTS**

**5360. Index participation units and qualifying baskets of index securities**

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(2) The minimum floor *Dealer Member inventory margin* and *client account margin* rates for the purposes of subsection 5360(1) and offset strategies recognized in Rule 5700 are as follows:

Qualifying index, individual and offset strategies	Category (i)	Category (ii)
	Broad based index as defined in subsection 5130(910)	Sector index as defined in subsection 5130(910)
Floor rate percentage to be used in determining margin	10.00%	15.00%

rate for unhedged positions in <i>index participation units</i> and <i>qualifying basket of index securities</i>		
Floor rate percentage to be used in determining <i>tracking error margin rate</i> for qualifying offset strategies involving index products	2.00%	3.00%

- (3) The *Corporation* calculates a *regulatory margin interval* for *index* products on qualifying indices. A qualifying *index* for the purposes of subsections 5360(1) and 5360(2) must be a widely quoted market *index*, as determined by the *Corporation*, that:
- (i) meets the minimum requirements for an *index* in subsection 5130(910), and
  - (ii) is included on the list of floating and tracking error margin rates for qualifying Canadian and U.S. index products.

#### 5775. Cross index offset combinations involving index products

- (1) Offsets involving products based on two different indices are permitted provided:
- (i) both indices qualify as an *index* as defined in subsection 5130(910),
  - (ii) there is significant performance correlation between the indices, and
  - (iii) the *Corporation* has made available a published *tracking error margin rate* for cross *index* offsets involving the two indices.

Where offsets involving products based on two different indices are permitted the margin requirements set out in sections 5730 through 5772 may be used provided that any margin requirement calculated shall be no less than the published *tracking error margin rate* for cross *index* offsets involving the two indices.

**Amendment #3** - IDPC Rule section 5401 is amended as follows:

#### 5401. Introduction

- (1) Rule 5400 sets out specific *Dealer Member inventory margin* and *client account margin* requirements for investment products not covered in Rules 5200 or 5300. The order of subjects in Rule 5400 is:
- (i) securities subject to redemption call or offer [section 5410],
  - (ii) units [section 5420],
  - (iii) precious metal certificates and bullion [section 5430],
  - (iv) swap contracts [sections 5440 through 5442],
  - (v) mutual fund positions [section 5450],
  - (vi) structured products [section 5455 through 5456], and

(vii) foreign exchange positions [sections 5460 through 5469].

**Amendment #4** - IDPC Rule sections 5455 and 5456 are added as follows:

**5451. - 5454. Reserved.**

**STRUCTURED PRODUCTS**

**5455. Margin requirements for structured products**

- (1) A structured product is eligible to be margined provided:
  - (i) the issuer of the structured product is a Canadian financial institution as defined in securities laws, which qualifies as an acceptable institution,
  - (ii) at the time of issuance, the structured product's underlying security or underlying basket of securities are eligible for a margin rate of 50% or less under Rule 5200, 5300 or 5400, and
  - (iii) the issuer of the structured product or its affiliate is actively providing a secondary market.
- (2) Where a structured product is eligible to be margined pursuant to 5455(1), the minimum Dealer Member inventory margin and client account margin requirements are as follows:

<u>Type of structured product</u>	<u>Minimum margin required</u>
<u>principal protected note</u>	<u>30% of the market value of the principal protected note position</u>
<u>principal at risk note</u>	<u>50% of the market value of the principal at risk note position</u>

**5456. Alternative calculation approach for structured products**

- (1) For structured products with protection of all or a portion of the investment principal, where the performance component can be separated from the debt instrument component, the minimum Dealer Member inventory margin and client account margin requirements may be calculated as the sum of the separate components as follows:
  - (i) For the performance component linked to an underlying interest, 100% of the market value of the performance component; and
  - (ii) For the debt instrument component, the margin rate percentage specified in subsection 5223(1), multiplied by the market value of the debt instrument component, provided the conditions in section 5455(1) are met.

**5457. - 5459. Reserved.**

**Amendment #5** – The notes and instructions to Schedule 9A of Form 1 are amended as follows:

**Form 1, Part II – Schedule 9A**  
**Notes and instructions**

**General Security Test**

- (1) *Dealer Members* must disclose the largest ten issuer positions and precious metal positions subject to the General Security Test, 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.
- (2) An issuer position must include all classes of securities for an issuer (i.e. all long and short positions in equity, convertibles, debt, structured products or other securities of an issuer other than *debt securities* cited in note 3). Precious metal positions are also tested using the General Security Test methodology, and must include all certificates and bullion of the particular precious metal (gold, platinum or silver).
- (3) Exclude all:
  - (i) *debt securities* with a normal margin requirement of 10% or less, and
  - (ii) stripped coupons and residuals if they are held on a book based system and are in respect of federal and provincial debt instruments.
- (4) 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:

- (i) the individual security positions held, and
- (ii) 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.)