



Now New Self-Regulatory Organization of Canada, a consolidation of IIROC and the MFDA

New SRO Notice

Rules Notice

Notice of Approval/Implementation

Investment Dealer and Partially Consolidated Rules

Rule Connection:

[IDPC Rule](#)

23-0072

May 18, 2023

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Amendments to the IDPC Rules and to IDPC Form 1 regarding the floating index margin rate methodology

Executive Summary

The Canadian Securities Administrators (**CSA**) have approved amendments to the Investment Dealer and Partially Consolidated (**IDPC**) Rules and Form 1 (**Amendments**) that set floor margin rates for qualifying Canadian and U.S. index products. The Amendments also codify the qualification criteria for a qualifying index and New SRO's discretionary authority to modify the underlying floating index margin rate calculation formula.

The purpose of the Amendments is to reduce procyclicality in New SRO's floating index margin rate methodology (the **Methodology**).

The Amendments were originally published as proposed amendments to the IIROC Rules and Form 1 in Notice 22-0063. On January 1, 2023, the Board of Directors of New SRO approved the adoption of the Amendments as proposed amendments to IDPC Rules 5100 and 5300 and IDPC Form 1, General notes and definitions.

1. Background

Procyclical requirements or practices are those that are positively correlated with business or credit cycle fluctuations and that may cause or exacerbate financial instability. The current Methodology is procyclical. It calculates lower than optimal margin rate requirements during long periods of low market volatility, but results in sharp increases in margin rates during intermittent periods of high market volatility. The Amendments reduce procyclicality in the Methodology.

2. Comments received

We did not receive any comment letters in response to Notice 22-0063.

3. The Amendments

The Amendments:

- set floor margin rates for qualifying Canadian and U.S. index products included on the List of floating and tracking error margin rates for qualifying Canadian and U.S. index products,
- revise the floating index margin rate calculation for individual and offset (tracking error) positions to a “greater of” the floor margin rate and the floating margin rate percentage methodology,
- define “qualifying index” for the purposes of determining floating margin rates, which includes categorizing qualifying index types as either a broad based index or a sector index, and
- codify New SRO’s discretionary authority to modify the regulatory margin interval calculation.

The text of the Amendments to the IDPC Rules is set out in [Appendix A](#) and a blackline of the changes is set out in [Appendix B](#). The text of the Amendments to IDPC Form 1 is set out in [Appendix C](#) and a blackline of the changes is set out in [Appendix D](#).

4. Implementation

The Amendments will be effective on August 8, 2023. Upon implementation we plan to:

- update the floating margin rate list [web-page](#) to reflect the Amendments,
- discontinue regular margin rate-setting for unhedged U.S. index futures contracts,
- discontinue regular monthly floating margin rate list publications, and
- publish updated floating margin rate lists when a floating or tracking error margin rate change occurs above a floor margin rate.

5. Appendices

[Appendix A](#) – Clean copy of the Amendments to IDPC Rules

[Appendix B](#) – Blackline copy of the Amendments to IDPC Rules

[Appendix C](#) – Clean copy of the Amendments to IDPC Form 1

[Appendix D](#) – Blackline copy of the Amendments to IDPC Form 1

New Self-Regulatory Organization of Canada

Amendments to the IDPC Rules and to IDPC Form 1 regarding the floating index margin rate methodology

Clean copy of the Amendments to IDPC Rules

Amendment #1 – IDPC Rule subsection 5130(4) is amended to replace the term “major broadly based index” with “major widely quoted market index” as follow:

“foreign listed equity securities eligible for margin”	Securities (other than bonds, debentures, rights and warrants) listed on an <i>acceptable exchange</i> outside of Canada and the United States that are constituent securities for the exchange’s major widely quoted market <i>index</i> , and the <i>index</i> is on the <i>Corporation’s</i> list of foreign market indices whose constituent securities are eligible for margin.
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Amendment #2 – IDPC Rule subsection 5130(9) is amended by:

- adding and amending the definition “broad based index”, currently found in the General notes and definitions of Form 1, and
- amending the following other definitions,

in alphabetical sequence:

“broad based index”	An equity index in which: <ol style="list-style-type: none"> (i) the basket of <i>equity securities</i> underlying the index consists of thirty or more securities, (ii) the single largest basket security position by weighting comprises not more than 20% of the overall <i>market value</i> of the basket, (iii) the average market capitalization associated with each security in the basket of <i>equity securities</i> underlying the index is at least \$100 million, (iv) the basket securities shall be from a broad range of industries and market sectors as determined by the <i>Corporation</i> to represent index diversification, and (v) the index constituent securities are listed and traded on an <i>acceptable exchange</i>.
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...

“cumulative relative weight percentage”	An overall relative weight percentage determined by calculating, in accordance with subsection 5360(7), the actual basket weighting for each security in a <i>qualifying basket of index securities</i> in relation to its latest published relative weighting in the <i>index</i> .
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...

“floating margin rate”	The floating margin rate set by the <i>Corporation</i> in accordance with subsection 5360(5), subject to the minimum floor margin rate in subsection 5360(2).
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“incremental basket margin rate”	The incremental basket rate for a <i>qualifying basket of index securities</i> calculated in accordance with subsection 5360(8).
...	
“index”	Either a <i>broad based index</i> or a <i>sector index</i> .
...	
“qualifying basket of index securities”	A basket of <i>equity securities</i> with the characteristics in subsection 5360(6).
...	
“regulatory margin interval”	The <i>Corporation’s</i> regulatory margin calculation determined in accordance with subsection 5360(4).
“sector index”	An equity index in which: <ul style="list-style-type: none"> (i) the basket of <i>equity securities</i> underlying the index consists of eight or more securities, (ii) the single largest basket security position by weighting comprises not more than 35% of the overall <i>market value</i> of the basket, (iii) the average market capitalization associated with each security in the basket of <i>equity securities</i> underlying the index is at least \$100 million, and (iv) the index constituent securities are listed and traded on an <i>acceptable exchange</i>.
...	
“tracking error margin rate”	The last calculated <i>regulatory margin interval</i> for the tracking error resulting from a particular offset strategy, subject to the minimum floor margin rate in subsection 5360(2).

Amendment #3 – IDPC Rule subsection 5360(1) is amended by adding references to both the “greater of” and minimum floor margin rates in the margin calculations, as follows:

5360. Index participation units and qualifying baskets of index securities

- (1) The minimum *Dealer Member inventory margin* and *client account margin* requirements for *index participation units* and *qualifying baskets of index securities* are as follows:

Minimum margin required	
Category (i) Index participation units	Category (ii) Qualifying basket of index securities
(a) The greater of: <ul style="list-style-type: none"> (l) the <i>floating margin rate</i> percentage (calculated for <i>index participation unit</i> based on its <i>regulatory margin interval</i>), and 	(a) The sum of: <ul style="list-style-type: none"> (l) the greater of: <ul style="list-style-type: none"> (A) the <i>floating margin rate</i> percentage (calculated for a perfect basket of

Minimum margin required	
Category (i) Index participation units	Category (ii) Qualifying basket of index securities
(II) the minimum floor margin rate required under subsection 5360(2), multiplied by (b) The <i>market value of index participation units</i> .	index securities based on its <i>regulatory margin interval</i>), and (B) the minimum floor margin rate required under subsection 5360(2), and (II) The calculated <i>incremental basket margin rate</i> for the <i>qualifying basket of index securities</i> , multiplied by (b) The <i>market value of qualifying basket of index securities</i> .

Amendment #4 – IDPC Rule section 5360 is amended by adding new subsection 5360(2) as follows:

- (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) Broad based index as defined in subsection 5130(9)	Category (ii) Sector index as defined in subsection 5130(9)
Floor rate percentage to be used in determining margin rate for unhedged positions in <i>index participation units</i> and <i>qualifying basket of index securities</i>	10.00%	15.00%
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%

Amendment #5 – IDPC Rule section 5360 is amended by adding new subsection 5360(3) as follows:

- (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(9), and
- (ii) is included on the list of floating and tracking error margin rates for qualifying Canadian and U.S. index products.

Amendment #6 – IDPC Rule subsection 5360(2) is amended by renumbering to subsection 5360(4) and adding clause 5360(4)(ii) as follows:

- (4) The *Corporation* calculates a *regulatory margin interval* according to the following formula:
 - (i) Maximum standard deviation of percentage changes in daily closing prices over the most recent 20, 90, 260 trading days \times 3 (for a 99% confidence interval) \times Square root of 2 (for 2 days price risk coverage)
 - rounded up to the next $\frac{1}{4}$ %.
 - (ii) In limited circumstances, to ensure appropriate margin requirements, the *Corporation* may use discretion in calculating a *regulatory margin interval*. *Dealer Members* will be notified by the *Corporation* if any adjustments to the *regulatory margin interval* calculation are made.

Amendment #7 – IDPC Rule subsection 5360(3) is amended by:

- renumbering to subsection 5360(5),
- clarifying language in clause 5360(5)(iii) and
- updating the reference in clause 5360(5)(iv),

as follows:

- (5) To calculate the *floating margin rate* for an *index participation unit* or a perfect basket of index securities:
 - (i) the *Corporation* uses the last calculated *regulatory margin interval*, which is effective for the *regular reset period* unless a *violation* occurs,
 - (ii) in normal circumstances, the *floating margin rate* is reset on the *regular reset date* to the *regulatory margin interval* calculated as at the *regular reset date*,
 - (iii) if a *violation* occurs, the *Corporation* may reset the *floating margin rate* on the date the *violation* occurs to the *regulatory margin interval* determined as at the date of the *violation*, and
 - (iv) the *regulatory margin interval* determined in clause 5360(5)(iii) will be effective for a minimum of 20 trading days and reset at the close of the 20th trading day to the *regulatory margin interval* determined as at that date if a reset results in a lower margin rate.

Amendment #8 – IDPC Rule subsections 5360(4) through 5360(6) are amended by renumbering sequentially and updating the references in clause 5360(7)(ii), as follows:

- (6) A basket of *equity securities* is a *qualifying basket of index securities* if:
 - (i) all of the securities in the basket are included in the composition of the same *index*,

- (ii) the basket comprises a portfolio with a *market value* equal to the *market value* of the *underlying securities* in the *index*,
- (iii) the *market value* of each *equity security* comprising the portfolio proportionally equals or exceeds the *market value* of its relative weight in the *index*, based on the latest published relative weights of securities comprising the *index*, and
- (iv) the required *cumulative relative weight percentage* of all *equity securities* comprising the portfolio:
- (a) equals 100% of the cumulative weighting of the corresponding *index*, if the basket of *equity securities* underlying the *index* is comprised of less than 20 securities,
- (b) equals or exceeds 90% of the cumulative weighting of the corresponding *index*, if the basket of *equity securities* underlying the *index* is comprised of 20 or more securities but less than 100 securities, and
- (c) equals or exceeds 80% of the cumulative weighting of the corresponding *index*, if the basket of *equity securities* underlying the *index* is comprised of 100 or more securities,
- based on the latest published relative weightings of the *equity securities* comprising the *index*.
- (v) If the cumulative relative weighting of all *equity securities* in the basket equals or exceeds the required *cumulative relative weight percentage* and is less than 100% of the cumulative weighting of the corresponding *index*, the deficiency in the basket must be filled by other *equity securities* included in the composition of the *index*.
- (7) The *cumulative relative weight percentage* is determined:
- (i) by calculating for each security in a *qualifying basket of index securities*:
- (a) its actual basket weighting, and
- (b) its latest published relative weighting in the *index*,
- and then,
- (ii) by summing the lesser of the two weighting percentages calculated for each security in sub-clauses 5360(7)(i)(a) and 5360(7)(i)(b) for all of the securities in the *qualifying basket of index securities*.
- (8) The *incremental basket margin rate* for a *qualifying basket of index securities* is calculated as the sum:

<i>Market value</i> of each underweighted security in basket	x	Margin rate for that security	x	The % by which the security is underweighted (calculated according to the formula: published relative weighting of the security - actual basket weighting of the security)
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for each underweighted security in the basket.

New Self-Regulatory Organization of Canada

Amendments to the IDPC Rules and to IDPC Form 1 regarding the floating index margin rate methodology

Clean copy of the Amendments to IDPC Form 1

Amendment #1 – IDPC Form 1 (General notes and definitions) is amended by updating the term “broad based index” to mirror the proposed amendments to the term in subsection 5130(9), as follows:

“broad based index”	<p>An equity index in which:</p> <ul style="list-style-type: none"> (i) the basket of <i>equity securities</i> underlying the index consists of thirty or more securities, (ii) the single largest basket security position by weighting comprises not more than 20% of the overall <i>market value</i> of the basket, (iii) the average market capitalization associated with each security in the basket of <i>equity securities</i> underlying the index is at least \$100 million, (iv) the basket securities shall be from a broad range of industries and market sectors as determined by the <i>Corporation</i> to represent index diversification, and (v) the index constituent securities are listed and traded on an <i>acceptable exchange</i>.
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