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DELIVERED VIA EMAIL

Answerd Ramcharan
Specialist, Member Regulation Policy
Investment Industry Regulatory Organization of Canada
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Dear Mr. Ramcharan:

Re: IIROC Concept Paper on the Feasibility of Portfolio Margining

The Investment Industry Association of Canada (IIAC or Association) appreciates the opportunity to provide comment to the Investment Industry Regulatory Organization (IIROC) on its concept paper on the feasibility of portfolio margining (the Concept Paper). A working group of IIAC Member firms assisted in our evaluation of the portfolio margining framework as proposed in the Concept Paper. Generally, we support the introduction of portfolio margining as a way to better align margin requirements with how dealers manage risk today. The optional use of portfolio margining will also provide dealers added flexibility in managing collateral and put Canada on equal footing with other jurisdictions that have already adopted similar frameworks. However, sufficient safeguards should be put in place to ensure no unintended consequences from the initiative, namely; protects against excessive leverage in the financial system and does not foster competitive dislocations in the industry.

Dealer Member Inventory Positions

We support IIROC's view that the current margin requirements for proprietary inventory account positions do not significantly reflect the risk reduction achieved through portfolio diversification or hedging activity. Providing Dealer Members the option of using a portfolio-based methodology for the purposes of margining proprietary inventory account positions could, therefore, result in a more efficient use of collateral while still ensuring appropriate risk coverage.

For dealer inventory accounts, setting an arbitrary minimum capital level for using portfolio-based margining could be somewhat problematic and may create an unfair competitive disadvantage for some Dealer Members. Any prescribed minimum capital threshold should be accompanied by some justification as to the appropriateness of such a threshold. Specifically, the amount of residual risk to a dealer from the use of portfolio margining for inventory positions should somehow relate back to the determination of minimum capital requirements.

Further, meeting capital thresholds should not be the sole determining factor for using portfolio margining. Dealers that elect to utilize portfolio margining for inventory positions should be expected to satisfy additional requirements, for example, qualitative factors such as system controls and governance are also important. Dealers capable of supporting back testing, stress testing and intraday margining would generally be in a better position to implement portfolio margining. IIROC should satisfy itself that the dealers opting to introduce portfolio margining have the necessary understanding and infrastructure to support and monitor their portfolio margining activities and protect against excessive levels of leverage.

Additionally, the composition of dealer inventory portfolios also needs to be taken into account, for example, additional safeguards might be warranted for highly illiquid or concentrated portfolios. Such safeguards might include a margin gross-up factor on those portfolios.

"Qualifying non-individual client" accounts – AI, AC and RE client positions

For qualifying non-individual client accounts, IIROC proposes the optional use of portfolio –based margining methodology; **otherwise** a position-based methodology at 50% of the normal margin rate must be used. The position-based methodology at 50% of the normal margin rate is a net new requirement for Dealer Members and represents a significant departure from current practices.

In the Concept Paper, IIROC has correctly identified a real risk that, under the proposed framework above for qualifying non-individual clients, Dealer Members may feel compelled to adopt the use of portfolio-based margining for these client accounts in order to remain competitive. Dealer Members that otherwise would not, or should not, implement portfolio margining would, therefore, have to seriously consider it as an option. To address this, IIROC may want to consider a third option for dealers permitting a custom treatment of client margining requirements.

Similar to the use of portfolio margining for inventory accounts, considerations in addition to minimum capital thresholds should be taken into account by IIROC in determining which dealers could be best suited for portfolio margining qualifying non-individual accounts. Dealers that choose to offer portfolio margining to these clients should be expected to have controls in place to monitor client portfolios and protect against excessive leverage. As such we would not object to the introduction of leverage limits on these client accounts but the exact nature of the leverage parameters would require further study.

The optional use of portfolio margining for qualifying non-individual client accounts should also include some assessment of the client in order to determine that portfolio margining is suitable for the client. The assessment could take into consideration:

- Who the client is and what level of sophistication the client has with margining methodologies
- A counterparty credit review performed by the dealer
- Additional risk disclosure documents provided to the client
- Possibly a correlation between minimum account size and inherent risk of the account

Other Client Positions

For well diversified or hedged portfolios, portfolio margining is expected to result in lower margin requirements, providing opportunities for new or additional investment strategies. As such, the optional use of portfolio margining for acceptable retail clients should not be specifically prohibited by IIROC. For these accounts, however, a minimum set account asset level should be established. FINRA's approach to setting minimum account asset levels, as referenced in the Feasibility Study Summary Report that accompanied IIROC's Concept Paper, is based on the strength of the firm's risk management systems and procedures, and its ability to capture intraday trading and market activity. Specifically, firms lacking such systems and procedures would require higher levels of minimum equity in client accounts. Also similar to FINRA, additional considerations for prime brokerage and introduced accounts where trades are executed away from the clearing firm may be warranted.

Retail clients utilizing portfolio margining should also meet additional requirements such as;

- Meeting the dealer's client suitability requirements, taking into account client experience and knowledge with respect to margin trading
- Sign a portfolio margin risk disclosure
- Meet any other credit or qualification requirement set by the dealer such as minimum account equity requirements in excess of those set by IIROC.

Investment Products and Markets

Dealer members can achieve greater capital efficiency if the list of investment products eligible for portfolio margining in inventory accounts was broadened to include instruments such as swaps, futures, and fixed income products. However, given the added complexities associated with the inclusion of these products, there should be some additional consideration given by IIROC on dealer requirements in order apply portfolio margining to these products. One suggested approach was for interested dealers to come forth and demonstrate to IIROC their capabilities, risk controls and experience in handling portfolio margining for these products.

Other Considerations

The introduction of a portfolio margining framework in Canada would have a significant technology implication for most dealers and will require some firms to undertake the necessary development in order to effectively manage their risk on a more real-time basis. Staffing at the dealers, as well as IIROC, would also have to be supported by bringing individuals with the necessary skill set to administer and oversee the initiative. These should be factored into IIROC's determination on a suitable implementation timeline for portfolio margining. Also, the IIAC would be supportive of a staged implementation approach for the portfolio margining framework. A multiple phase approach where portfolio margining is first introduced for use in dealer inventory accounts before it is broadened in later phases to client accounts might contribute greatly in the rollout of the initiative.

Sincerely,

"Jack Rando"

Jack Rando
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Investment Industry Association of Canada