INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

11 King Street West, Suite 1600, Toronto ON M5H 4C7
T 416.364.2754 | F 416.364.4861

www.iiac.ca

November 8, 2018

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

Manager of Market Regulation
Ontario Securities Commission
19th floor, Box 55
20 Queen Street West
Toronto, ON
M5H 3S8

Via: email

RE: IIROC Notice 18-0153, Proposed Amendments to Dealer Member Rules and Form 1

The Investment Industry Association of Canada (IIAC) welcomes the opportunity to comment on IIROC Notice 18-0153 proposing amendments to its Dealer Member Rules (DMRs) and Form 1 (collectively, the "Proposed Amendments") designed to bring debt securities with a normal margin rate of 10% or less into the existing securities concentration test. A working group of IIAC Members active in fixed-income markets assisted in the preparation of this submission.

General Comments

The IIAC understands the policy rationale behind the Proposed Amendments, namely to limit the ability of Dealer Members to take on material positions in lower-rated debt securities that could potentially expose the Dealer Member to high risk. While we concur that the Proposed Amendments will likely not detract from most Dealer Members' core debt market business and that the potential regulatory capital impacts would likely be limited to a small number of Dealer Members, they will pose other challenges across the industry as outlined herein. The general view of IIAC Members is that the Proposed Amendments will represent a substantial work effort on the part of industry to ensure compliance. This should be considered by IIROC when determining a suitable implementation time frame.

Recommendations:

The IIAC submits the following recommendations:

1. IIROC Dealer Members be provided at least twelve to eighteen months to be able to complete the work necessary to meet the Proposed Amendments.

2. IIROC consider adding netting allowances for fully-hedged client positions.

3. The credit rating risk-weighting adjustments be calibrated to better reflect the default probability of an issuer.

4. Following implementation, IIROC and the Canadian Securities Administrtors monitor the effects of the Proposed Amendments on the functioning of debt markets and be prepared to recalibrate the Proposed Amendments, if necessary, to achieve balance between sound member regulation and efficient market functioning.

We elaborate on each of the above recommendations below.

Operational Impacts

The Proposed Amendments introduce complex new calculations and reporting requirements for Dealer Members. We believe that most Dealer Members will, where possible, develop automated solutions which will entail systems development as well as changes to internal processes.

Specifically, our Members have identified the following as necessary steps needed as part of this implementation:

- Certain debt securities must be captured and aggregated by issuer for the purposes of the new Schedule 9. Unlike equities, a corporation may issue dozens of different tranches of debt securities. Aggregating debt securities by issuer may, therefore, be a challenge to firms as their current systems may not collect the level of information required to carry out this activity.

- The issuer aggregation of debt security positions is further complicated by the fact that some Dealer Member positions will need to be "filtered out" for the purposes of determining the issuer concentration.

- The Proposed Amendment centers on the use of credit ratings from designated rating organizations (DROs) to calculate the appropriate risk weighting adjustments. As DRO ratings are not incorporated in current IIROC regulatory reporting, Dealer Members will have to revise their modules accordingly to source the information.

- Since Dealer Members calculate risk-adjusted capital (RAC) on a weekly and monthly basis, the debt security aggregation and DRO rating would have to be available weekly which may present additional complexities for IIAC members to ensure their systems can provide the satisfactory credit rating agency monitoring.

Reliance on External Vendors

Several IIAC members have indicated they will be coordinating with external service providers to implement the changes required to meet the Proposed Amendments. Discussions are currently underway to properly size the development effort including the related cost. Initial feedback indicates the work entailed will be significant given the complexity of the new requirements.

Preliminary feedback from IIAC members also indicates that they, or their service providers, will require at least twelve to eighteen months to complete the work necessary to meet the Proposed Amendments. Cost estimates for the development effort could easily reach six figures for some dealers and must be budgeted accordingly. Better forecast of resources required will be available as technology teams and vendors are engaged.

Netting Allowances

Members appreciate that the Proposed Amendments include netting allowances for certain debt security inventory positions of the IIAC member. To further reduce the operational impact of the Proposed Amendments IIAC members request that IIROC consider additional netting allowances. Specifically, we request that IIROC consider netting allowances for fully-hedged client positions.

Members also believe there may be a need to revisit the credit rating risk-weighting adjustments shown in the table on page 15 of the Notice. Members noted that they can be better calibrated to reflect the default probability of an issuer. For example, the 80% adjustment factor for BBB bonds may be excessive given their historical probability of default.

Impact on Market Functioning

The proposal could potentially limit the ability of dealers with less regulatory capital to take on material positions in lower rated debt securities. While this may be a policy objective of IIROC, it may have the unintended consequence of negatively effecting the efficiency of market functioning. Specifically, if some dealers are prevented from taking positions or making markets in these securities it could impair the trading or liquidity in these bonds. Following implementation of the Proposed Amendment, IIROC or the CSA, should monitor its effects on the functioning of debt markets and be prepared to recalibrate the Proposed Amendments, if necessary, to achieve balance between sound member regulation and efficient market functioning.

Sincerely,

"Jack Rando"

Jack Rando
Managing Director