MEMBER REGULATION

INVESTMENT DEALERS ASSOCIATION OF CANADA

notice

ASSOCIATION CANADIENNE DES COURTIERS EN VALEURS MOBILIÈRES

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MR0351

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Regulation 100.2(d)(iv) – Margin treatment of unhedged foreign exchange positions held in customer accounts

This Notice has been prepared to provide further guidance on the margin treatment of foreign exchange positions held in customer accounts. It replaces the customer account margin guidance set out in section 9 of IDA Member Regulation Notice MR0181.

Overview

Pursuant to the methodology implemented for foreign exchange positions on September 1, 1996, the margin treatment of unhedged foreign exchange positions depends on:

- The currency group classification of the foreign currency(ies) involved; and
- The calculated spot and term risks for the unhedged foreign exchange position.

Foreign currencies are categorized into one of four currency groups. Both quantitative and qualitative market risk factors are considered in determining the currency group for a particular currency [refer to Reg. 100.2(d)(v) for specifics].

For each currency group, the margin requirements dictate minimum margin requirements for spot risk [Reg. 100.2(d)(i)(A)] and annualized term risk [Reg. 100.2(d)(i)(A)] and for maximum term risk [Reg. 100.2(d)(iii)(b)] as follows:

	Group 1	Group 2	Group 3	Group 4
Spot risk	1.00%	3.00%	10.00%	25.00%
Annualized term risk	1.00%	3.00%	5.00%	12.50%
Maximum term risk	5.00%	10.00%	20.00%	50.00%

In the case of spot risk, a margin surcharge will apply where the current exchange rate volatility is excessive [Reg. 100.2(d)(v)(C)]. The exchange rate for Cda.$ versus U.S.$ has been subject to this surcharge for the past several years.

Margin treatment of unhedged foreign exchange positions held in customer accounts

Foreign exchange positions subject to margin

All foreign exchange positions in a customer account other than cash positions[1] are subject to a margin requirement. However, not all non-Cdn.$ denominated positions are considered to be foreign exchange positions. Specifically, positions denominated in the same currency as the currency of the account are excluded [Reg. 100.2(d)(iv)(C)]. The following table summarizes which positions are considered foreign exchange positions that are subject to margin and which positions aren't:

	Foreign currency denominated cash position	Foreign currency denominated non-cash position
Position denominated in same currency as currency of the account	Not subject to margin	Not subject to margin
Position denominated in different currency from currency of the account	Not subject to margin	Subject to margin

Margin requirements - general

As with other positions, foreign exchange positions are margined differently, depending upon the credit risk classification of the customer. The following is a summary of the requirements:

Counterparty	Position	Margin treatment
Acceptable institutions	Foreign exchange futures contracts	No margin, unless a transaction or transactions has not been confirmed within 15 business days of the trade date where full margin applies. [Form 1-Schedule 4; Reg. 100.2(d)(iv)(D)]
	Foreign exchange forward contracts and other foreign exchange positions (excluding cash)	No margin, unless a transaction or transactions has not been confirmed within 15 business days of the trade date where full margin applies. [Form 1-Schedule 4; Reg. 100.2(d)(iv)(A)]
Acceptable counterparties and regulated entities	Foreign exchange futures contracts	Mark to market, unless a transaction or transactions has not been confirmed within 15 business days of the trade date where full margin applies. [Form 1-Schedule 4; Reg. 100.2(d)(iv)(D)]
	Foreign exchange forward contracts and other foreign exchange positions (excluding cash)	Mark to market, unless a transaction or transactions has not been confirmed within 15 business days of the trade date where full margin applies. [Form 1-Schedule 4; Reg. 100.2(d)(iv)(B)]

[1] Cash positions in client accounts are not subject to margin because these positions are included by the Member firm in its calculation of net foreign exchange monetary assets for the purposes of determining a foreign exchange capital requirement.

Counterparty	Position	Margin treatment
Other counterparties	Foreign exchange futures contracts	Foreign exchange margin applies (in addition to normal mark to market adjustment) based on the greatest of the margin required by futures exchange, the clearing corporation and the Member's clearing broker [Reg. 100.2(d)(iv)(D)]
	Foreign exchange forward contracts	Foreign exchange margin applies (in addition to normal mark to market adjustment) [Reg. 100.2(d)(iv)(C)]
	Other foreign exchange positions (excluding cash)	Margin applies (in addition to normal mark to market adjustment). Margin is: ▪ Where the position margin requirement is greater than the foreign exchange margin requirement, **the position margin requirement** [Reg. 100.2(d)(iv)(C)] ▪ Where the position margin requirement is less than or equal to the foreign exchange margin requirement, **the sum of position margin requirement and the foreign exchange margin requirement** [Reg. 100.2(d)(iv)(C)]

As a result, in the case of foreign exchange positions held in other counterparty customer accounts, where there is no established position margin requirement[2], the effective margin requirement is the calculated foreign exchange margin requirement. Since many of the positions that are affected are U.S.$ cross currency spreads, the attached revised foreign exchange ***Margin Violation Summary Report*** now includes margin rates for cross currency risk where either the Cdn.$ is the base account currency or the U.S.$ is the base account currency. The rates listed for Cdn.$ cross currency spreads are unchanged from the previous report included with Member Regulation Notice MR0331 issued on January 13, 2005.

[2] The positions created as a result of entering into spot foreign exchange contracts are an example of foreign exchange positions that do not have a margin requirement.

Security Volatility Program
Margin Violation Summary

Security (FX / Bond / Equity / Index)	Margin Rate	Start Date	End Date	Trading Days	Offside Days	%	Violation Threshold	Threshold Exceeded
BASE ACCOUNT CURRENCY – CANADA - DOLLAR								
AUSTRALIA - DOLLAR	3.00	2/1/2005	5/2/2005	64	1	1.56	5.00	**No**
ARGENTINA – PESO	25.00	2/1/2005	5/2/2005	64	0	0.00	5.00	**No**
CZECK - KORUNA	10.00	2/1/2005	5/2/2005	64	0	0.00	5.00	**No**
DENMARK - KRONE	10.00	2/1/2005	5/2/2005	64	0	0.00	5.00	**No**
EURO	3.00	2/1/2005	5/2/2005	64	0	0.00	5.00	**No**
HONG KONG - DOLLAR	10.00	2/1/2005	5/2/2005	64	0	0.00	5.00	**No**
HUNGARY - FORINT	10.00	2/1/2005	5/2/2005	64	0	0.00	5.00	**No**
JAPAN - YEN	3.00	2/1/2005	5/2/2005	64	0	0.00	5.00	**No**
MALAYSIA - RINGGIT	10.00	2/1/2005	5/2/2005	64	0	0.00	5.00	**No**
MEXICO - NEW PESO	3.00	2/1/2005	5/2/2005	64	0	0.00	5.00	**No**
NEW ZEALAND - DOLLAR	10.00	2/1/2005	5/2/2005	64	0	0.00	5.00	**No**
NORWAY - KRONE	10.00	2/1/2005	5/2/2005	64	0	0.00	5.00	**No**
POLAND - ZLOTY	10.00	2/1/2005	5/2/2005	64	0	0.00	5.00	**No**
SAUDI ARABIA - RIYAL	10.00	2/1/2005	5/2/2005	64	0	0.00	5.00	**No**
SINGAPORE - DOLLAR	10.00	2/1/2005	5/2/2005	64	0	0.00	5.00	**No**
SWEDEN - KRONA	10.00	2/1/2005	5/2/2005	64	0	0.00	5.00	**No**
SWITZERLAND - FRANC	3.00	2/1/2005	5/2/2005	64	1	1.56	5.00	**No**
UNITED KINGDOM - POUND	3.00	2/1/2005	5/2/2005	64	0	0.00	5.00	**No**
UNITED STATES - DOLLAR	3.10	2/1/2005	5/2/2005	64	1	1.56	5.00	**No**
BASE ACCOUNT CURRENCY – UNITED STATES - DOLLAR								
AUSTRALIA - DOLLAR	3.00	2/1/2005	5/2/2005	64	1	1.56	5.00	**No**
CANADA - DOLLAR	3.10	2/1/2005	5/2/2005	64	1	1.56	5.00	**No**
EURO	3.00	2/1/2005	5/2/2005	64	0	0.00	5.00	**No**
JAPAN - YEN	3.00	2/1/2005	5/2/2005	64	0	0.00	5.00	**No**
NEW ZEALAND - DOLLAR	10.00	2/1/2005	5/2/2005	64	0	0.00	5.00	**No**
SWITZERLAND - FRANC	3.00	2/1/2005	5/2/2005	64	2	3.13	5.00	**No**
UNITED KINGDOM - POUND	3.00	2/1/2005	5/2/2005	64	2	3.13	5.00	**No**