InteractiveBrokers

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Market Regulation
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and

Capital Markets Regulation
B.C. Securities Commission
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Re: Commentaries of Interactive Brokers Canada Inc. on the proposed rule amendments — Fully paid securities lending and financing arrangements

Interactive Brokers Canada Inc. ("IBC") appreciates the opportunity to submit its comments on the proposed rule amendments applicable to Fully Paid Lending Securities Programs ("FPLPs") offered by Canadian Investment Regulatory Organization ("CIRO") Dealer Members ("DMs"), in particular section 4625 – Asset Reuse Prohibition.

Section 4625 - Asset Reuse Prohibition

IBC is concerned that subsection 4625(1)[1] would have undue negative consequences for clients such as

[1] 4625. Asset reuse prohibition
(1) The lending client cannot use the securities loaned under this Part B.2 of Rule 4600 in any hedging strategy while such securities are on loan.

1. An increase in margin requirements
2. Reduction of buying power
3. Placing the clients into a margin deficit and
4. Subjecting positions to liquidation

These consequences would normally (and should only) be the result of an adverse market movement against a client's economic exposure. Indeed, a client's "hedged" economic exposure does not become "unhedged" due to a component being loaned through FPLPs just like margined stocks which are rehypothecated as collateral for a margin loan and subsequently lent by the DM. Considering subsection 4626(1) which requires the DM to record the client's securities loan transaction under the FPLP in the same account as, or a sub-account(s) of, the client's securities trading account (**FPL combined account**), **the DM's lending of those loaned securities should not affect risk margin offset calculations**[2].

Furthermore, according to section 4316, a DM may remove from segregation, rehypothecate and lend a different stock to finance a margin loan as a result of its client buying a marginable stock. Therefore, for consistency, IBC submits that subsection 4625(1) refrain from making the assumption that the DM will remove from segregation only stocks for which it is providing a margin offset.

Therefore, instead of saying that the DM cannot borrow a security from a client if the security is used to reduce margin as part of a margin offset in the client account, IBC suggests that subsection 4625(1) says that the DM cannot rehypothecate loaned securities when these are and remain on loan under a FPLP.

We respectfully suggest that the language of subsection 4625(1) be changed to read as follows:

1) *The borrowing Dealer Member cannot allow a client to lend rehypothecated securities under this Part B.2 of Rule 4600.*

IBC understands and agrees with the stated purpose of this subsection 4625 (1) to mitigate risks that result from asset reuse (due to the duplicative use of collateral which is rehypothecated to support a margin loan and also lent through FPLPs), including competing claims to the same asset, which can span from DM default risk to more systemic contagion risks, but we find these risks highly unlikely, considering

[2] Subsection 4626(1) is distinct from the general rule requirement, under clause 4603(3)(ii), whereby a DM must keep client financing arrangement accounts separate from the client's securities trading accounts.

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existing segregation rules. **In the below example of a fully-hedged portfolio, after the market value of the stocks comprising the index doubles, the portion of the basket of stocks which is "loaned out" (and unsegregated due to rehypothecation) would not be considered excess-margin securities. Only the excess-margin portion of the basket of stocks (that is not "loaned out" because segregated and not rehypothecated) would be eligible to be lent through FPLPs. Therefore, no asset would be used twice.**

Please see the below example which illustrates our concern.

According to clauses 5750(i)(ii) and 5750(i)(iii), a margin offset is provided for a position of a long qualifying basket of index securities and short the index.

Consider a client account with the following characteristics:

1. Holds a long position of a basket of stocks of an index with a value of $10,000
2. Holds a short position in the same index with a value of -$10,000
3. Carries a margin loan of $10,000
4. The entire basket of stocks is being rehypothecated and lent by the DM
5. Is enrolled in a CIRO approved DMFPLP

The client currently receives a margin risk offset because this portfolio is fully-hedged. Assume that the market value of the basket of stocks and the index increase to $20,000 each. The DM is allowed to rehypothecate a portion of the margin loan, and for the purpose of this example, that portion is $11,000.

A market value of $9,000 would then be re-classified from margin collateral to excess-margin stock and become eligible to be lent through the FPLP. According to proposed subsection 4625(1) as currently written, if the client lends out those stocks (versus collateral), a market value of $9,000 out of $20,000 of the basket held by the client would no longer be considered "hedged" even though the economic exposure of the client is unaltered as the offset risk margin of the short index remains intact. **The negative consequences itemized above (such as increased margin requirements) would normally be the result of adverse market movement against the client's economic exposure. However, the client's economic exposure has not changed because the client's positions continue to be fully hedged[3].**

[3] Respectfully, the highly theoretical risks of (i) a client not receiving back the securities on loan and (ii) a shortfall in the assets available in the customer pool for a firm as solidly capitalized as IBC should not suffice to trump the fact that an economic exposure is either fully-hedged or it is not. We use the adjective "theoretical" also due to the fact that clients'

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To conclude, IBC reads the proposed rule, in particular its subsection 4625(1), to mean that if a DM makes a stock marginable, it cannot lend the same stock via a FPLP. This contravenes the rule which allows DMs to remove from segregation any stock in the portfolio as collateral for a margin loan, regardless of its marginability.

Our arguments are:

(1) That subsection 4625(1) should be consistent with the existing rehypothecation rule, where marginability of a stock has no bearing the DM's ability to loan it.

(2) Enacting subsection 4625(1) as written would also have negative consequences for clients, such as increased margin requirements.

Sincerely,

INTERACTIVE BROKERS CANADA INC.

Jean-François Bernier
Managing Director

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specific recourse rights as they would apply to loaned securities under FPLPs in the highly unlikely event of the bankruptcy of the FPLP sponsoring DM are still judicially untested and may very well remain so for a very long time as DM bankruptcies, in general, are to say the least, few and far between.