

Discussion of four types of counterparties defined within IIROC's capital and margin rules

In order to more accurately assess the credit risk associated with dealing with individual and corporate clients, the IIROC capital and margin rules categorize each counterparty client with which a Dealer Member may transact as one of the following:

1. Acceptable institutions
2. Acceptable counterparties
3. Regulated entities
4. Other

Acceptable institutions

Acceptable institutions are considered the lowest credit risk clients. Dealer Members may transact with acceptable institutions on an unsecured basis provided that each transaction is confirmed within a reasonable period of time. The following clients qualify as acceptable institutions:

- Government of Canada, Bank of Canada and provincial governments and any related crown corporations and agencies;
- Foreign federal governments of signatory nations of the Basel Accord on banking and supervision;
- Canadian banks, Quebec savings banks, credit unions, caisses populaires, insurance companies, trust companies and loan companies licensed to do business in Canada or a province thereof with paid up capital and surplus in excess of \$100 million;
- Foreign banks and trust companies subject to a satisfactory regulatory regime¹ with paid up capital and surplus in excess of \$150 million;
- Canadian pension funds which are regulated either by the Office of Superintendent of Financial Institutions or a provincial pension commission, with total net assets in excess of \$200 million; and
- Foreign pension funds subject to a satisfactory regulatory regime with total net assets on the in excess of \$300 million.

¹ For the purposes of this definition, a satisfactory regulatory regime will be one within Basel Accord countries.

Acceptable counterparties

Acceptable counterparties are considered to be clients of moderate credit risk. Dealer Members must, with some exceptions, transact with acceptable counterparties on a “value for value”² basis provided that each transaction is confirmed within a reasonable period of time. An exception is made for cash and security borrowing and lending transactions, as a modest amount of over-collateralization (i.e. 2% to 5%) is permitted in order to avoid requiring the dealer to post additional collateral during the term of the arrangement in response to minor market price fluctuations. The following clients qualify as acceptable counterparties:

- Canadian provincial capital cities and all other Canadian cities and municipalities, or their equivalents, with populations of 50,000 and over;
- Foreign federal governments which do not qualify as an “acceptable institution”;
- Canadian banks, Quebec savings banks, credit unions, caisses populaires, insurance companies, trust companies and loan companies licensed to do business in Canada or a province thereof with paid up capital and surplus in excess of \$10 million and less than or equal to \$100 million;
- Foreign banks and trust companies subject to a satisfactory regulatory regime³ with paid up capital and surplus in excess of \$15 million and less than or equal to \$150 million;
- Foreign insurance companies subject to a satisfactory regulatory regime with paid up capital and surplus in excess of \$15 million;
- Canadian pension funds which are regulated either by the Office of Superintendent of Financial Institutions or a provincial pension commission, with total net assets in excess of \$10 million and less than or equal to \$200 million;
- Foreign pension funds subject to a satisfactory regulatory regime with total net assets on the in excess of \$15 million and less than or equal to \$300 million;
- Mutual funds subject to a satisfactory regulatory regime with total net assets in the fund in excess of \$10 million;
- Corporations other than “regulated entities” with a minimum net worth of \$75 million; and
- Trusts and limited partnerships with minimum total net assets in excess of \$100 million.

² Transactions performed on a “value for value” basis are those where the market value of the cash or securities received in by the investment dealer is equal to the market value of the cash or securities delivered out by the investment dealer.

³ For the purposes of this definition, a satisfactory regulatory regime will be one within Basel Accord countries.

Regulated entities

As is the case with acceptable counterparties, regulated entities are considered to be clients of moderate credit risk. Dealer Members must, with some exceptions, transact with regulated entities on a “value for value” basis provided that each transaction is confirmed within a reasonable period of time. To qualify as a regulated entity, the client must be a dealer and must be a member of the Canadian Investor Protection Fund or a member of a recognized exchange or association that:

- maintains or is a member of an investor protection regime equivalent to the Canadian Investor Protection Fund;
- requires the segregation by its members of customers’ fully paid for securities;
- that has rules that set out specific methodologies for the segregation of, or reserve for, customer credit balances;
- that has established rules regarding Dealer Member and customer account margining;
- that is subject to the regulatory oversight of a government agency or a self-regulatory organization under a government agency which conducts regular examinations of its members and monitors member’s regulatory capital on an ongoing basis; and
- that requires regular regulatory financial reporting by its members.

Examples of dealers that qualify as regulated entities include FINRA members, “full scope BIPR” investment firms regulated by the United Kingdom Financial Conduct Authority, firms with an Australian financial services licence regulated by the Australian Securities Exchange Limited and investment firms regulated by the Tokyo Stock Exchange, Inc.

Other

An “Other” counterparty is a client or dealer that does not qualify under any of the other counterparty categories. “Other” counterparties are considered to be clients of high credit risk. For this reason, no reliance is placed on the credit worthiness of the client/dealer and credit risk exposures may only be incurred with these clients in situations where the client has account security positions with regulatory “loan value”⁴.

⁴ The loan value of a security position is its market value less any margin required on the position to cover the risk of future loss.