13.1.6 IDA Regulations 100.9 and 100.10 – CDCC issued currency options

INVESTMENT DEALERS ASSOCIATION OF CANADA –

REGULATIONS 100.9 AND 100.10 – CDCC ISSUED CURRENCY OPTIONS

I OVERVIEW

A Current Rules

IDA Regulations 100.9 and 100.10 set out the capital and margin requirements for currency options cleared by the Options Clearing Corporation (OCC) in the United States. There are no current capital and margin requirements set out in the rules for currency options cleared by the Canadian Derivatives Clearing Corporation (CDCC).

B The Issue

The Bourse de Montréal intends to introduce currency options to be cleared by the Canadian Derivatives Clearing Corporation (CDCC). There is therefore a need to amend the existing rules to address CDCC issued currency options.

C Objectives

The main objective of this proposal is to amend Regulations 100.9 and 100.10 to extend the current margin treatment given to OCC issued currency options to CDCC issued currency options.

D Effect of Proposed Rules

The proposals seek to:

- amend Regulations 100.9 and 100.10 to incorporate CDCC currency options;
- set the margin rates for the underlying interest of the currency options to be the IDA's published spot risk margin rate for the underlying currency; and
- make the capital and margin requirements for CDCC currency options consistent with the capital and margin requirements for OCC currency options in IDA Regulations 100.9 and 100.10.

The net effect of these proposals is that CDCC issued currency options will be margined in the same manner as OCC issued currency options. The impact of these proposed amendments is not expected to be significant in terms of impact on market structure, competition, and costs of compliance and other rules,

II DETAILED ANALYSIS

A Present Rules, Relevant History and Proposed Policy

A detailed analysis was considered unnecessary

B Issues and Alternatives Considered

No other alternatives were considered

C Comparison with Similar Provisions

A comparison with similar regulations in the United Kingdom and the United States was not considered necessary.

D Systems Impact of Rule

It is believed that the proposed amendments, set out in Attachment #1, will have no impact in terms of capital market structure, member versus non-member level playing field, competition generally, costs of compliance and conformity with other rules. The Bourse de Montréal is also in the process of passing this amendment. Implementation of this amendment will therefore take place once both the IDA and the Bourse de Montréal have received approval to do so from their respective recognizing regulators.

E Best Interests of the Capital Markets

The Board has determined that the rule is not detrimental to the best interests of the capital markets.

F Public Interest Objective

According to subparagraph 14(c) of the IDA's Order of Recognition as a self regulatory organization, the IDA shall, where requested, provide in respect of a proposed rule change "a concise statement of its nature, purposes (having regard to paragraph 13 above) and effects, including possible effects on market structure and competition". Statements have been made elsewhere as to the nature and effects of this proposal. The purposes of the proposal are to:

- Facilitate an efficient capital-raising process and to facilitate transparent, efficient and fair secondary market trading and the availability to members and investors of information with respect to offers and quotations for and transactions in securities, and efficient clearance and settlement procedures;

- Standardize industry practices where necessary or desirable for investor protection;

The proposal does not permit unfair discrimination among customers, issuers, brokers, dealers, members or others. It does not impose any burden on competition that is not necessary or appropriate in furtherance of the above purposes.

The proposal is believed to be public interest as it is intended to establish the capital and margin requirements that apply to CDCC issued foreign currency option positions held in Member firm and customer accounts.

III COMMENTARY

A Filing in Other Jurisdictions

This proposed amendments will be filed for approval in Alberta, British Columbia, Ontario and Quebec and will be filed for information in Manitoba, Nova Scotia and Saskatchewan.

B Effectiveness

As indicated in the previous sections, the objective of the proposal is to incorporate CDCC currency options in IDA Regulations 100.9 and 100.10 and make the capital and margin requirements for CDCC currency options consistent with the capital and margin requirements for OCC currency options. It is believed that the proposal will be effective for this purpose.

C Process

These proposed amendments have been developed and recommended for approval by the FAS Capital Formula Subcommittee and have been recommended for approval by the FAS Executive Committee and the Financial Administrators Section.

IV SOURCES

References:

- Regulation 100.9 and 100.10

V OSC REQUIREMENT TO PUBLISH FOR COMMENT

The IDA is required to publish for comment the accompanying amendments.

The Association has determined that the entry into force of the proposed amendments would be in the public interest. Comments are sought on the proposed. Comments should be made in writing. One copy of each comment letter should be delivered within 30 days of the publication of this notice, addressed to the attention of Arif Mian, Investment Dealers Association of Canada, Suite 1600, 121 King Street West, Toronto, Ontario, M5H 3T9 and one copy addressed to the attention of the Manager of Market Regulation, Ontario Securities Commission, 20 Queen Street West, 19th Floor, Box 55, Toronto, Ontario, M5H 3S8.

Questions may be referred to:

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INVESTMENT DEALERS ASSOCIATION OF CANADA

REGULATIONS 100.9 AND 100.10 – CDCC ISSUED CURRENCY OPTIONS

BOARD RESOLUTION

THE BOARD OF DIRECTORS of the Investment Dealers Association of Canada hereby makes the following amendments to the By-laws, Regulations, Forms and Policies of the Association:

1. Regulation 100.9(a)(iii) is amended by adding the following paragraph after paragraph (C):

   "(D) for CDCC currency options, which gives the holder the right to buy and the writer the obligation to sell the underlying interest at a stated exercise price either on or before the expiration date of the CDCC option.";

2. Regulation 100.9(a)(viii)(A) is amended by adding the text "a currency" after the text "a participation unit,";

3. Regulation 100.9(a)(xiv)(A) is amended by adding the text "a currency" after the text "a participation unit,";

4. Regulation 100.9(a)(xix)(A) is amended by adding the text "a currency" after the text "a participation unit,";

5. Regulation 100.9(a)(xxiii)(A) is amended by adding the text "a currency" after the text "a participation unit,";

6. Regulation 100.9(a)(xxvii) is amended by adding the following paragraph after paragraph (F):

   "(G) in the case of a CDCC currency option, the currency or an asset denominated in the same currency;";

7. Regulation 100.9(b)(ii)(A) is amended by adding the text "currency" after the text "in the case of equity,";

8. Regulation 100.9(b) is amended by adding the following paragraph after paragraph (iii):

   "(iv) For CDCC currency options``, the normal margin required for the underlying interest shall be a percentage of the market value of the underlying interest determined using IDA's published spot risk margin rate for the currency."

   and by renumbering paragraph (iv) as paragraph (v);

9. Regulation 100.9(c)(i)(I) is amended by replacing the word "securities" with the word "interest";

10. Regulation 100.9(d)(i)(B) is amended by adding the following paragraph after paragraph (II):

    "(III) For CDCC currency options, the IDA's published spot risk margin rate for the currency;";

11. Regulation 100.9(d)(ii)(B) is amended by replacing the period at the end of paragraph (IV) with the text "; or" and by adding the following paragraph after paragraph (IV):

    "(V) For CDCC currency options, 0.75%.";

12. Regulation 100.9(g)(i) is amended by adding in the first line the text ", currency" after the text "in the case of equity";

13. Regulation 100.9(g)(ii) is amended by adding in the first line the text ", currency" after the text "in the case of equity";

14. Regulation 100.9(g)(iii) is amended by adding in the first line the text ", currency" after the text "in the case of equity";

15. Regulation 100.9(g)(iv) is amended by adding in the first line the text ", currency" after the text "in the case of equity";

16. Regulation 100.10(b) is amended by adding the following paragraph after paragraph (iii):

    "(iv) For CDCC currency options, the normal margin required for the underlying interest shall be a percentage of the market value of the underlying interest determined using IDA's published spot risk margin rate for the currency"

    and by renumbering paragraph (iv) as paragraph (v);

17. Regulation 100.10(c)(i)(B)(I) is amended by replacing the word “securities” with the word “interest”;

18. Regulation 100.10(d)(i) is amended by adding the following paragraph after paragraph (C):

    “(D) In case of CDCC currency options, the IDA’s published spot risk margin rate for the currency;”;

19. Regulation 100.10(g)(i) is amended by adding in the first line the text “, currency” after the text “in the case of equity”;

20. Regulation 100.10(g)(ii) is amended by adding in the first line the text “, currency” after the text “in the case of equity”;

21. Regulation 100.10(g)(iii) is amended by adding in the first line the text “, currency” after the text “in the case of equity”; and

22. Regulation 100.10(g)(iv) is amended by adding in the first line the text “, currency” after the text “in the case of equity”.

PASSED AND ENACTED BY THE Board of Directors this 26th day of June 2005, to be effective on a date to be determined by Association staff.

INVESTMENT DEALERS ASSOCIATION OF CANADA

REGULATIONS 100.9 AND 100.10 – CDCC ISSUED CURRENCY OPTIONS

BLACKLINE COPY OF AMENDED PARAGRAPHS

Paragraph 100.9(a)(iii) – Amendment #1

(iii) the term "call option" means an option:

(A) for equity, participation unit, and bond options, which gives the holder the right to buy and the writer the obligation to sell the underlying interest at a stated exercise price either on or before the expiration date of the option;

(B) for index options, which gives the holder the right to receive and the writer the obligation to pay, if the current value of the index rises above the exercise price, the difference between the aggregate exercise price and the aggregate current value of the underlying interest either on or before the expiration date of the option; or

(C) for OCC options, which gives the holder the right to buy and the writer the obligation to sell the underlying interest at a stated exercise price either on or before the expiration date of the OCC option.

<u>(D) for CDCC currency options, which gives the holder the right to buy and the writer the obligation to sell the underlying interest at a stated exercise price either on or before the expiration date of the CDCC option.</u>

Paragraph 100.9(a)(viii)(A) – Amendment #2

(viii) the term "exercise price" in respect of an option means:

(A) in the case of an equity, a participation unit<u>, a currency </u>or a bond option, the specified price per unit at which the underlying interest may be received in the case of a call option, or delivered, in the case of a put option;

(B) in the case of index options, the specified price per unit, which may be received by the holder and paid by the writer in the case of a call option or a put option; or

(C) in the case of an OCC option, the specified price per unit at which the underlying interest may be received in the case of a call option, or delivered, in the case of a put option;

upon exercise of the option.

Paragraph 100.9(a)(xiv)(A) – Amendment #3

(xiv) the term "in-the-money" means:

(A) in the case of an equity, a participation unit<u>, a currency </u>or a bond option, that the market price;

(B) in the case of an index option, that the current value; or

(C) in the case of an OCC option, that the market price or the current value;
of the underlying interest is above the exercise price in the case of a call option, and below the exercise price in the case of a put option.

Paragraph 100.9(a)(xix)(A) – Amendment #4

(xix) the term "out-of-the-money" means:

(A) in the case of an equity, a participation unit<u>, a currency </u>or a bond option, that the market price;

(B) in the case of an index option, that the current value; or

(C) in the case of an OCC option, that the market price or the current value;

of the underlying interest is below the exercise price in the case of a call option, and above the exercise price in the case of a put option.

Paragraph 100.9(a)(xxiii)(A) – Amendment #5

(xxiii) the term "put option" means, an option:

(A) for an equity, a participation unit, a currency or a bond option, which gives the holder the right to sell and the writer the obligation to buy the underlying interest at a stated exercise price either on or before the expiration date of the option;

(B) for index options, which gives the holder the right to receive and the writer the obligation to pay, if the current value of the index falls below the exercise price, the difference between the aggregate exercise price and the aggregate current value of the underlying interest either on or before the expiration date of the option; or

(C) for OCC options, which gives the holder the right to sell and the writer the obligation to buy the underlying interest at a stated exercise price either on or before the expiration date of the OCC option.

Paragraph 100.9(a)(xxvii) – Amendment #6

(xxvii) the term "underlying interest" means,

(A) in the case of an equity, a participation unit or a bond option, the security;

(B) in the case of an index option, the index;

(C) in the case of an OCC option in a currency, the currency;

(D) in the case of an OCC option in debt, the debt;

(E) in the case of an OCC option in an index, the index;

(F) in the case of any other OCC option, the security;

(G) in the case of a CDCC currency option, the currency or an asset denominated in the same currency;

which is the subject of the option.

Paragraph 100.9(b) – Amendments #7 and #8

(b) **Exchange traded options – general margin requirements**

The minimum amount of margin which must be obtained in margin accounts of customers having positions in options shall be as follows:

(i) All opening writing transactions and resulting short positions must be carried in a margin account.

(ii) Each option shall be margined separately and:

(A) in the case of equity, currency or participation unit options, any difference between the market price of the underlying interest; or

(B) in the case of index options, any difference between the current value of the index,

and the exercise price of the option shall be considered to be of value only in providing the amount of margin required on that particular option.

(iii) Where a customer account holds both options and OCC options that have the same underlying interest, the OCC options may be considered to be options for the purposes of the calculation of the margin requirements for the account under this Regulation 100.9.

(iv) For CDCC currency options, the normal margin required for the underlying interest shall be a percentage of the market value of the underlying interest determined using the IDA's published spot risk margin rate for the currency.

~~(iv)~~(v) From time to time the Association may impose special margin requirements with respect to particular options or particular positions in options.

Paragraph 100.9(c) – Amendment #9

(c) **Long option positions**

(i) Subject to sub-paragraph (ii), the margin requirement for long options shall be the sum of:

(A) where the period to expiry is greater or equal to 9 months, 50% of the option's time value, 100% of the option's time value otherwise; and

(B) the lesser of:

(I) the normal margin required for the underlying ~~securities~~interest; and

(II) the option's in-the-money amount, if any.

(ii) Where in the case of equity options, the underlying interest in respect of a long call option is the subject of a legal and binding cash take-over bid for which all conditions have been met, the margin required on such call option shall be the market value of the call option less the amount by which the amount offered exceeds the exercise price of the call option. Where such a take-over bid is made for less than 100% of the issued and outstanding securities, the margin requirement shall be applied pro rata in the same proportion as the offer and paragraph (c)(i) shall apply to the balance.

Paragraph 100.9(d) – Amendments #10 and #11

(d) **Short option positions**

(i) The minimum credit requirement which must be maintained in respect of an option carried short in a customer account shall be:

(A) 100% of the current market value of the option; plus

(B) a percentage of the market value of the underlying interest determined using the following percentages:

(I) For equity options or equity participation unit options, the margin rate used for the underlying interest;

(II) For index options or index participation unit options, the published floating margin rate for the index or index participation unit;

(III) For CDCC currency options, the IDA's published spot risk margin rate for the currency;

minus

(C) any out-of-the-money amount associated with the option.

(ii) Paragraph (d)(i) notwithstanding, the minimum credit requirement which must be maintained and carried in a customer account trading in options shall be not less than:

(A) 100% of the current market value of the option; plus

(B) an additional requirement determined by multiplying:

(I) In the case of a short call option position, the market value of the underlying interest; or

(II) In the case of a short put option position, the aggregate exercise value of the option;

by one of the following percentages:

(III) For equity options or equity participation unit options, 5.00%; or

(IV) For index options or index participation unit options, 2.00%~~.~~; or

(V) For CDCC currency options, 0.75%.

Paragraph 100.9(g) – Amendments #12 through #15

(g) **Option and security combinations**

(i) **Short call – long underlying (or convertible) combination**

Where, in the case of equity, currency or equity participation unit options, a call option is carried short in a customer's account and the account is also long an equivalent position in the underlying interest or, in the case of equity options in a security readily convertible or exchangeable (without restrictions other than the payment of consideration and within a reasonable time provided such time shall be prior to the expiration of the call option) into the underlying interest, or in the case of equity participation unit options in securities readily exchangeable into the underlying interest, the minimum margin required shall be the sum of:

(A) the lesser of:

(I) the normal margin required on the underlying interest; and

(II) any excess of the aggregate exercise value of the call options over the normal loan value of the underlying interest;

and

(B) where a convertible security or exchangeable security is held, the amount of the conversion loss as defined in Regulation 100.4H.

In the case of exchangeable or convertible securities, the right to exchange or convert the long security shall not expire prior to the expiration date of the short call option. If the expiration of the right to exchange or convert is accelerated (whether by reason of redemption or otherwise), then such short call option shall be considered uncovered after the date on which such right to exchange or convert expires.

(ii) **Short put – short underlying combination**

Where, in the case of equity, currency or equity participation unit options, a put option is carried short in a customer's account and the account is also short an equivalent position in the underlying interest, the minimum margin required shall be the lesser of:

(A) the normal margin required on the underlying interest; and

(B) any excess of the normal credit required on the underlying interest over the aggregate exercise value of the put options.

(iii) **Long call – short underlying combination**

Where, in the case of equity, currency or equity participation unit options, a call option is carried long in a customer's account and the account is also short an equivalent position in the underlying interest, the minimum credit required shall be the sum of:

(A) 100% of the market value of the call option; and

(B) the lesser of:

(I) the aggregate exercise value of the call option; and

(II) the normal credit required on the underlying interest.

(iv) **Long put – long underlying combination**

Where, in the case of equity, currency or equity participation unit options, a put option is carried long in a customer's account and the account is also long an equivalent position in the underlying interest, the minimum margin required shall be the lesser of:

(A) the normal margin required on the underlying interest; and

(B) the excess of the combined market value of the underlying interest and the put option over the aggregate exercise value of the put option.

Paragraph 100.10(b) – Amendment #16

(b) **Exchange traded options – general capital requirements**

The capital requirements with respect to options and options-related positions in securities held in Member accounts shall be as follows:

(i) in the treatment of spreads, the long position may expire before the short position;

(ii) for any short position carried for a customer or non-customer account where the account has not provided required margin, any shortfall will be charged against the Member's capital;

(iii) where a Member account holds both options and OCC options that have the same underlying interest, the OCC options may be considered to be options for the purposes of the calculation of the capital requirements for the account under this Regulation 100.10; and

(iv) for CDCC currency options, the normal margin required for the underlying interest shall be a percentage of the market value of the underlying interest determined using the IDA's published spot risk margin rate for the currency.

(v)~~(iv)~~ from time to time the Association may impose special capital requirements with respect to particular options or particular positions in options.

Paragraph 100.10(c) – Amendment #17

(c) **Long option positions**

(i) For Member accounts, subject to sub-paragraph (ii), the capital requirement for long options shall be the sum of:

(A) where the period to expiry is greater or equal to 9 months, 50% of the option's time value, 100% of the option's time value otherwise; and

(B) the lesser of:

(I) the normal capital required for the underlying ~~securities~~interest; and

(II) the option's in-the-money amount, if any.

(ii) Where in the case of equity options, the underlying interest in respect of a long call is the subject of a legal and binding cash take-over bid for which all conditions have been met, the capital required on such call shall be the market value of the call less the amount by which the amount offered exceeds the exercise price of the call. Where such a take-over bid is made for less than 100% of the issued and outstanding securities, the capital requirement shall be applied pro rata in the same proportion as the offer and paragraph (c)(i) shall apply to the balance.

Paragraph 100.10(d) – Amendment #18

(d) **Short option positions**

The capital requirement which must be maintained in respect of an option carried short in a Member account shall be:

(i) (A) in the case of equity or equity participation unit options, the market value of the equivalent number of equity securities or participation units, multiplied by the underlying interest margin rate; or

(B) in the case of index participation unit options, the market value of the equivalent number of index participation units, multiplied by the floating margin rate; or

(C) in the case of index options, the aggregate current value of the index, multiplied by the floating margin rate;

(D) in case of CDCC currency options, a percentage of the market value of the underlying currency determined by using IDA's published spot risk margin rate for the currency;

minus

(ii) any out-of-the-money amount associated with the option.

Paragraph 100.10(g) – Amendments #19 through #22

(g) **Option and security combinations**

(i) **Short call – long underlying (or convertible) combination**

Where, in the case of equity, currency or equity participation unit options, a call option is carried short in a Member's account and the account is also long an equivalent position in the underlying interest or, in the case of equity options in a security readily convertible or exchangeable (without restrictions other than the payment of consideration and within a reasonable time provided such time shall be prior to the expiration of the call option) into the underlying interest, or in the case of equity participation unit options in securities readily exchangeable into the underlying interest, the minimum capital required shall be the sum of:

(A) the lesser of:

(I) the normal capital required on the underlying interest; and

(II) any excess of the aggregate exercise value of the call options over the normal loan value of the underlying interest;

and

(B) where a convertible security or exchangeable security is held, the amount of the conversion loss as defined in Regulation 100.4H.

The market value of any premium credit carried on the short call may be used to reduce the capital required on the long security, but cannot reduce the capital required to less than zero.

(ii) **Short put – short underlying combination**

Where, in the case of equity, currency or equity participation unit options, a put option is carried short in a Member's account and the account is also short an equivalent position in the underlying interest, the minimum capital required shall be the lesser of:

(A) the normal capital required on the underlying interest; and

(B) any excess of the normal capital required on the underlying interest over the in-the-money value, if any, of the put options.

The market value on any premium credit carried on the short put may be used to reduce the capital required on the short security, but cannot reduce the capital required to less than zero.

(iii) **Long call – short underlying combination**

Where, in the case of equity, currency or equity participation unit options, a call option is carried long in a Member's account and the account is also short an equivalent position in the underlying interest, the minimum capital required shall be the sum of:

(A) 100% of the market value of the long call option; plus

(B) the lesser of:

(I) any out-of-the-money value associated with the call option; or

(II) the normal capital required on the underlying interest.

Where the call option is in-the-money, this in-the-money value may be applied against the capital required, but cannot reduce the capital required to less than zero.

(iv) **Long put – long underlying combination**

Where, in the case of equity, currency or equity participation unit options, a put option is carried long in a Member's account and the account is also long an equivalent position in the underlying interest, the minimum capital required shall be the lesser of:

(A) the normal capital required on the underlying interest; and

(B) the excess of the combined market value of the underlying interest and the put option over the aggregate exercise value of the put option.

Where the put option is in-the-money, this in-the-money value may be applied against the capital required, but cannot reduce the capital required to less than zero."