December 14, 2012

Mr. Answerd Ramcharan
Specialist, Member Regulation Policy
Investment Industry Regulatory Organization of Canada
121 King Street West, Suite 2000
Toronto, Ontario M5H 3T9

Dear Sirs/Mesdames:

Re: IIROC Staff Consultation – Concept Paper on the Feasibility of Portfolio Margining

The Canadian Advocacy Council[1] for Canadian CFA Institute[2] Societies (the CAC) appreciates the opportunity to comment on IIROC's Concept Paper on the Feasibility of Portfolio Margining as set out in IIROC Notice #12-0275.

As a general comment, we note that to the extent a new margining methodology could result in excessive leverage, the negative consequences of a severe market downturn on retail clients cannot be overstated. The CAC wishes to respond to the questions in Appendix 1 to the Concept Paper that relate to the use of portfolio margining for determining margin lending limits for certain sophisticated clients as set out below.

<u>*Scope of Users*</u>

(i) Should Dealer Members be given the choice of using the portfolio-based methodology for their accredited investor client positions? If the use of a portfolio-based margining methodology for the margining of these client accounts was made optional for all qualifying Dealer Members, would Dealer Members really have a choice or would they feel compelled to allow the use a portfolio-based margining methodology for these clients in order to remain competitive?

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[1] The CAC represents the 13,000 Canadian members of CFA Institute and its 12 Member Societies across Canada. The CAC membership includes portfolio managers, analysts and other investment professionals in Canada who review regulatory, legislative, and standard setting developments affecting investors, investment professionals, and the capital markets in Canada. See the CAC's website at http://www.cfasociety.org/cac. Our Code of Ethics and Standards of Professional Conduct can be found at http://www.cfainstitute.org/ethics/codes/ethics/Pages/index.aspx.

[2] CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion for ethical behavior in investment markets and a respected source of knowledge in the global financial community. The end goal: to create an environment where investors' interests come first, markets function at their best, and economies grow. CFA Institute has more than 113,000 members in 140 countries and territories, including 102,000 CFA charterholders, and 137 member societies. For more information, visit http://www.cfainstitute.org/.

Dealer Members should be given the choice of using the portfolio-based methodology for accredited investors, subject to the caveats set out in the responses below. We believe that Dealer Members would feel compelled for competitive reasons to utilize such methodology, and thus it is important that the safeguards described below be employed, particularly those described in response (iv) below relating to a Dealer Member's exposure to any one particular security or sector.

(ii) Should Dealer Members have to meet a minimum capital requirement before they may use the portfolio-based methodology for their accredited investor client positions? If yes, what should the minimum capital be? Would a set minimum capital amount for a Dealer Member, such as $10 million, create an unfair competitive advantage for some Dealer Members?

We do not believe that Dealer Members should be required to meet a minimum capital requirement before they may use the portfolio-based methodology for their accredited investor client positions, subject to the caveats set out in the responses below. We believe that Dealer Members are already subject to some of the most stringent and thorough regulation in the industry by IIROC. To the extent Dealer Members are already subject to extensive regulation regarding capital, systems and operational capabilities, each such Dealer Member should be able to appropriately monitor margin positions for client accounts and take corrective action as needed. To the extent IIROC were to impose a minimum capital requirement, we do not believe that such a requirement is different from any other requirement that is easier to meet by larger members or that any resulting advantage to larger dealers is necessarily inappropriate or significant.

(iii) Should there be an overall leverage limit compared to a Dealer Member's capital on the amount loaned to these clients under this methodology? If so, what should the leverage limit be?

Yes, there should be an overall leverage limit on the amount loaned to clients as one tool to help preserve the solvency of a Dealer Member in the event of a significant market downturn, but we do not have a position with respect to the specific leverage limit.

(iv) Should Dealer Members have to satisfy other conditions than a minimal capital requirement? If yes, what should those other conditions be?

The Concept Paper states that there is a need to assess the feasibility of portfolio-based margining for accredited investor clients because the risk reduction achieved by portfolio diversification are not consistently reflected in the current margin requirements. However, it is important to note that not every Dealer Member maintains a diversified portfolio for individual and other non-individual clients. Some Dealer Members, for a variety of reasons, may hold more concentrated positions, both by issuer and by sector.

In determining whether a Dealer Member may be permitted to use portfolio-based margining, it would be useful to examine the member's percentage exposure to any one particular investment product, as well as their exposure to any one particular market sector. If a client portfolio is heavily concentrated in common shares of a junior mining company, for example, the appropriate margin level could be quite different for that portfolio in comparison to a portfolio more diversified across issuers and sectors.

(v) Should the Dealer Member be required to assess whether the portfolio-based methodology is suitable for the accredited investor client?

We believe it is very important that, prior to its use, a Dealer Member must first determine that the portfolio-based methodology is suitable for all its clients, including accredited investors. The portfolio-based methodology would be but one aspect of a client account for which suitability determinations must be made.

(vi) Should the accredited investor client be required to maintain a set account asset value to be eligible for the portfolio-based methodology? If yes, what should that account asset value be?

If it is determined that the portfolio-based methodology should be made available to these clients, we believe it should only be made available to clients with a significant minimum account size. The suggested minimum account size of $5 million in account assets may be sufficient, but should be coupled with additional safeguards to ensure that the client truly understands the implication of using a margin account and of the portfolio-based methodology for determining margin requirements. The minimum account size alone does not necessarily imply any level of sophistication on the part of an investor, or any suitability as the appropriateness of the margin account. We would recommend that clients to whom the portfolio-based methodology would apply must also be educated, experienced investors.

(vii) Should the accredited investor client account have to satisfy other conditions to be eligible to use the portfolio-based methodology? If yes, what should they be?

Yes. Please refer to our response in (vi) above.

<u>*Scope of products*</u>

(viii) Should the portfolio-based methodology be limited to certain investment products on certain markets? If yes, what investment products and markets should be excluded and should they be excluded because of liquidity risk concerns?

It will be important that the portfolio-based methodology not result in investment products which are not currently marginable becoming marginable. Illiquid investment products should be excluded, as well as any investment product that already contains embedded leverage, such as certain hedge funds and inverse exchange traded funds.

(ix) Should compensating risk controls be considered as an alternative to excluding certain investment products that have liquidity risk concerns and if so, what should those compensating risk controls be and what products should they apply to?

The CAC believes that the strongest safeguard would be to ensure that certain investment products with liquidity risk concerns are excluded. It is also important to consider counterparty risk for those investment products which rely on the counterparty's credit for investment returns.

(x) For investment products in an accredited investor account that are ineligible for portfolio margining due to liquidity concerns, should these positions be subject to position-based margining and specific offset-based margining or should another margining methodology apply to them. If so, what should that margining methodology be?

For investment products that are ineligible for portfolio margining, margin should continue to be required on a position-by-position basis, calculated as a set percentage of the market value of each account position or underlying security. The same methodology should be used for retail clients who do not qualify as accredited investors with the requisite minimum account level and demonstrated investment sophistication.

Concluding Remarks

We thank you for the opportunity to provide these comments. We would be happy to address any questions you may have and appreciate the time you are taking to consider our points of view. Please feel free to contact us at chair@cfaadvocacy.ca on this or any other issue in future.

(Signed) *Ada Litvinov*

Ada Litvinov, CFA
Chair, Canadian Advocacy Council