

**FULLY-PAID SECURITIES LENDING (FPL)  
 TEMPLATE FOR REVIEW OF CIRO FPL MINIMUM REQUIREMENTS**

<b>Name of the Dealer Member:</b>	
<b>Date of review:</b>	
<b>Type of Program:</b>	
<b>Brief description of program:</b>	

<b>Type</b>	<b>Minimum requirement</b>	<b>Comments on how requirement has been met, including reference to any firm documentation</b>
<b>3.1 PROGRAM RESTRICTIONS</b>	<p><b>3.1.1 Account set-up</b></p> <p>The Dealer must record the client’s fully-paid securities lending transactions and the cash collateral in <b>the same account as, or a sub-account(s)</b> of, the securities trading account (<b>FPL combined account</b>).</p>	

### **3.1.2 Securities eligible for the FPL program**

The Dealer must ensure that the FPL program is **restricted to equity securities** that are:

- listed on an Exchange, and
- held by clients in their non-registered accounts only. For purposes of the FPL program, Tax-Free Savings Accounts are not considered registered accounts however, the Dealer must ensure compliance with all applicable tax laws.

The Dealer must also ensure that for **equity securities listed on an exchange in Canada**, the FPL program includes only those securities that meet at least one of the following criteria:

- 6-month average volume weighted average price (VWAP)  $\geq$  \$2.00, or
- 6 month average daily trading volume  $\geq$  100,000 shares, or
- 6-month average free float market capitalization  $\geq$  \$200 million.

The Dealer is required to maintain a list of securities eligible under the FPL program based on the above criteria. They must review their FPL program transactions against this criteria at least monthly and terminate loans that don't meet the criteria as soon as possible.

	<p><b>3.1.3 Restriction on use of fully-paid securities</b></p> <p>The Dealer <b>cannot borrow fully-paid securities from their clients under the FPL program to settle or cover their own inventory trading</b> strategies unless the Dealer can demonstrate, to the satisfaction of CIRO, that they can effectively manage the conflicts of interest</p>	
	<p><b>3.1.4 Collateral provided to clients</b></p> <p>The Dealer must provide <b>cash collateral</b> to the client and keep it in a separate bank account held in trust for clients.</p> <p>The <b>total amount of cash collateral</b> to be set aside and calculated daily is the sum of:</p> <ul style="list-style-type: none"> <li>i) 100% of the market value of the fully-paid securities borrowed by the Dealer and adjusted daily for any mark-to-market deficiency, and</li> <li>ii) 100% of the overcollateralization collected from street borrowers for the fully-paid securities loaned by the Dealer</li> </ul>	
	<p><b>3.1.5 Client-stipulated restrictions</b></p> <p>The Dealer must <b>obtain instructions from the client</b> on:</p> <ul style="list-style-type: none"> <li>i) securities that they would like to exclude from the fully-paid lending program, and</li> <li>ii) their maximum risk tolerance limit on the total dollar value of securities they are willing to lend under the FPL program. The Dealer is required to review FPL program transactions against this criteria daily and terminate loans</li> </ul>	

	<p>that exceed the client's risk tolerance limit as soon as possible.</p>	
	<p><b>3.1.6 Borrowing from clients of introducing brokers and portfolio managers</b></p> <p>The Dealer Member must ensure that <b>each Introducing Broker has received a non-objection</b> letter from CIRO before fully-paid securities of clients of Introducing Brokers are borrowed.</p> <p>The Dealer must also ensure that <b>each Portfolio Manager has notified the applicable Canadian Securities Administrators</b> regulator before fully-paid securities of clients of Portfolio Managers are borrowed by the Dealer.</p>	
<p><b>3.2 CLIENT DOCUMENTATION</b></p>	<p><b>3.2.1 Agreements</b></p> <p>The Dealer must sign a <b>securities loan agreement</b> directly with the client. Clients of an Introducing Broker or Portfolio Manager must enter into a tri-party securities loan agreement with the Dealer where:</p> <ul style="list-style-type: none"> <li>• the client is the lender,</li> <li>• the Introducing Broker or Portfolio Manager is responsible for client eligibility, appropriateness and suitability, and</li> <li>• the Dealer, in its capacity as Carrying Broker (for the Introducing Broker) or Custodian (for the Portfolio Manager), is the borrower.</li> </ul> <p>The securities loan agreement must be in a form acceptable to CIRO and must clearly identify the:</p> <ul style="list-style-type: none"> <li>• roles and responsibilities of each party,</li> </ul>	

	<ul style="list-style-type: none"> <li>• events of default,</li> <li>• rights of the client to the collateral in the event of insolvency of the Dealer and if the Dealer is unable to recall lent securities within stipulated timeframes, and</li> <li>• the fee schedule and the basis for the fee calculation</li> </ul>	
	<p><b>3.2.2 Disclosure to clients</b></p> <p>The Dealer must provide a <b>clear description to clients of the FPL program</b> including the type of accounts or sub-accounts to be opened and the purpose of borrowing the fully-paid securities.</p> <p>The Dealer must also <b>obtain signed risk disclosure acknowledgements</b> from, and provide documentation in plain language<sup>1</sup> to, the client that explains all applicable risks including:</p> <ul style="list-style-type: none"> <li>• market risks that could result from the lent securities being used to facilitate short selling which could put downward pressure on the price of the lent securities,</li> <li>• restrictions on access to lent securities on demand if the Dealer is unable to recall the securities within the timeframes stipulated by the Dealer,</li> <li>• potential tax implications of receiving manufactured payments from the Dealer (in lieu of dividends and distributions directly from the issuer),</li> </ul>	

<sup>1</sup> The language used must be such that the client, as a reasonably knowledgeable person, would clearly understand the risks of lending their fully-paid securities.

	<ul style="list-style-type: none"> <li>• potential tax implications if the client exercises their rights to the cash collateral,</li> <li>• loss of voting rights on securities that are out on loan, including that the Dealer may not be able to recall the lent securities in time to vote (i.e. before the record date) and that the lent securities could be voted on contrary to how the client might have wanted to vote,</li> <li>• lending out securities may trigger insider or early warning reporting requirements under applicable securities laws,</li> <li>• restrictions on access to collateral, and</li> <li>• in the event of insolvency of the Dealer, limitations on recourse to collateral with increased risk if all of a client’s fully-paid securities have been lent to the Dealer, and lack of CIPF coverage for lent securities</li> </ul>	
	<p><b>3.2.3 Confirmations</b></p> <p>The Dealer must provide a <b>confirmation to the client</b> with all required details related to the securities loan transaction when the following has occurred:</p> <ul style="list-style-type: none"> <li>• securities have been lent</li> <li>• the loan is terminated</li> <li>• there is a change in fees and/or rates</li> </ul>	

### 3.2.4 Account statements

The Dealer must send the client a **monthly statement of the FPL combined account** which:

- distinguishes client securities that are on loan and cash collateral received under the FPL program from securities that are segregated and fully-paid
- includes the market value of security positions on loan in the total market value of the security positions in the FPL combined account
- excludes cash collateral from the total cash balance in the FPL combined account
- provides the following specific disclosure on CIPF coverage:

*Fully paid securities lent under [Dealer Member's] fully paid lending program are not eligible for Canadian Investor Protection Fund (CIPF) coverage. Fully paid securities not lent under [Dealer Member's] fully paid lending program and held at [Dealer Member], as at the date of insolvency of [Dealer Member], are eligible for CIPF coverage.*

### **3.2.5 Performance report and fee/charge report**

The Dealer must incorporate fully-paid lending in the **performance report and fee/charge report provided to retail clients for the FPL combined account** in the following manner:

- Where the Dealer pays the client a spread or split of the total borrow fee received from street borrowers:
  - the annual performance report must include that portion of fully-paid lending revenue earned by the client.
  - the annual fee/charge report must include, at a minimum, text disclosure describing all compensation earned by the Dealer, and the Introducing Broker or Portfolio Manager as applicable, from lending the fully-paid securities.
- Where the Dealer pays the client a fixed or gross borrow fee and/or deducts an amount for fees and charges:
  - the annual performance report must include the gross fee amount received by the client before any deductions.
  - the annual fee/charge report must include:
    - i) the dollar amount of all fees and charges paid by the client to the Dealer, and to the Introducing Broker or Portfolio Manager as applicable, and
    - ii) text disclosure that describes all compensation earned by the Dealer,

	<p>and the Introducing Broker or Portfolio Manager as applicable, from lending the fully-paid securities.</p>	
<p><b>3.3 REGULATORY REPORTING AND BOOKS AND RECORDS</b></p>	<p><b>3.3.1 Policies and procedures</b></p> <p>The Dealer’s <b>policies and procedures</b> for the FPL program should, at a minimum, address the following:</p> <ul style="list-style-type: none"> <li>• minimum eligibility criteria for clients to participate in the FPL program</li> <li>• appropriateness and suitability of the FPL program for clients with advisory and managed accounts<sup>2</sup></li> <li>• identification of conflicts of interest with clients<sup>3</sup></li> <li>• operational processes including: <ul style="list-style-type: none"> <li>○ how loan transactions will be initiated, terminated, and changed and the timeframes for each transaction</li> <li>○ how lending opportunities and recall requests will be allocated to clients</li> <li>○ how fees to the client will be calculated and when they will be deposited to the client account</li> </ul> </li> <li>• process for handling and resolving client questions and requests.</li> </ul>	

<sup>2</sup> DMR 1300 *Supervision of Accounts* sets out the Dealer’s suitability obligation. The suitability requirement extends to FPL programs; CIRO has issued various guidance notes clarifying the scope.

<sup>3</sup> DMR 42 *Conflicts of Interest* requires Dealers to identify, address, and avoid conflicts that cannot be managed.

### 3.3.2 Regulatory reporting

The Dealer will need to ensure accurate **reporting of fully-paid securities lending balances in the Monthly Financial Report (MFR)** and Form 1, and calculation of the segregation, concentration and margin requirements as follows:

- Cash collateral provided to clients must be reported on Statement A of the MFR and Form 1 on:
  - Line 6 *Loans receivable, securities borrowed and resold*
  - Line 53 *Client accounts*
- Cash collateral provided to clients must be excluded from the following balances reported in the MFR and Form 1:
  - Client net equity reported on Schedule 10 24
  - Free credits reported on Statement D, Line 2
- The cash collateral must be excluded from the calculation of client margin in the FPL combined account.
- The lent securities must be excluded from the assessment of securities concentration in the MFR and Form 1.

The lent securities and the corresponding collateral must be excluded from the determination of segregation requirements in the FPL combined account.

### 3.3.3 Annual audit report

The Dealer must also obtain **an annual special purpose audit report** to certify that the policies and procedures, systems and supervisory controls implemented for the FPL program comply with the following:

- the client's fully-paid securities on loan meet criteria and thresholds set by the client, CIRO and the Dealer
- the client's fully-paid securities on loan are separately identified from all other eligible fully-paid securities that are not being lent to the Dealer
- securities loan transactions are separately disclosed in the client's monthly account statement but within the securities trading account, or a sub-account thereof
- the fees paid to the client for borrowing fully-paid securities are accurately calculated according to the securities loan agreement and confirmation
- the Dealer's systems must be able to accurately calculate and generate reporting for the following:
  - a) client net equity for each client account and in aggregate under the FPL program
    - i) excluding securities on loan and corresponding collateral
    - ii) including securities on loan and corresponding collateral

	<ul style="list-style-type: none"><li>b) free credits available for use by the Dealer that excludes cash collateral provided to clients under the FPL program</li><li>c) margin and segregation requirements for other client assets which excludes fully-paid securities on loan and corresponding collateral received</li><li>d) securities record information that separately identifies:<ul style="list-style-type: none"><li>i) fully-paid securities on loan for each client</li><li>ii) location of all fully-paid securities on loan</li><li>iii) securities not on loan for each client and the locations of the securities.</li></ul></li><li>e) the daily mark-to-market requirements on the cash collateral to be set aside for the client including:<ul style="list-style-type: none"><li>o accurate pricing of the fully-paid securities on loan</li><li>o tracking whether sufficient overcollateralization has been set aside where the client's fully-paid securities borrowed by the Dealer are lent on to street borrowers</li></ul></li></ul>	
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