CIRCULAR
January 12, 2004

MARGIN AND CAPITAL REQUIREMENTS FOR SPECIAL WARRANTS, SUBSCRIPTION RECEIPTS AND RESTRICTED SECURITIES

INTRODUCTION

With the promulgation of Multilateral Instrument 45-102 in November 2001 and since the *Quebec Securities Act* provides for a final exemption system in Quebec, there has been a decrease in the use of special warrants as issuers meeting the definition of "qualifying issuer"[1] ("reporting issuer" in Quebec) are rather opting for the use of restricted securities that are subject to a four months trading restriction and which do not require the clearance of a prospectus. Bourse de Montréal Inc. (the "Bourse") current rules do not deal specifically with this new type of security. As restricted securities have features similar to special warrants and subscription receipts, they must be margined in a similar way.

The purpose of this circular is to clarify the margin and capital requirements applicable to special warrants, subscription receipts and restricted securities, as defined herein. Requirements for any differing products, not covered by existing rules or circulars, must be determined on a case-by-case basis by the audit jurisdiction self-regulatory organization. In the absence of such a determination, a 100 percent margin rate must be applied.

DEFINITIONS

For the purposes of this circular:

"special warrants" means limited term securities issued via prospectus exemptions under the securities acts or regulations of the jurisdictions where they are sold and which are convertible, at no additional cost to the subscriber and at a preset conversion rate, into another security class of the issuer (usually common shares) upon clearance of a final prospectus.

Circular no.: 008-2004

[1] A "qualifying issuer" is generally defined as a reporting issuer having either a class of equity securities listed or quoted on certain specified exchanges or markets or outstanding securities that have received an approved rating.

“subscription receipts” means limited term securities issued via a prospectus and which are convertible, at a preset conversion rate, into another security class of the issuer (usually common shares) upon the successful completion of a planned reorganization or transaction. Where completion of such reorganization or transaction is not successful, subscription receipts proceeds are either returned to the subscribers or a more generous conversion rate is made available to them.

“restricted securities” means securities with resale restrictions and that are initially distributed pursuant to the Multilateral Instrument 45-102 regime or pursuant to the Commission des valeurs mobilières du Québec (the “CVMQ”) prospectus exemption regime[2]. The resale restriction period is four months for qualifying/reporting issuers and twelve months for non-qualifying issuers. At the end of the trading restriction period, the restriction legend is removed and the securities then trade as common shares. Usually, investors receive restricted securities through private placement offers.

SPECIAL WARRANTS

Special warrants may differ in the treatment of the issue proceeds from the purchase date to the date of expiry or receipt for a final prospectus and in the events occurring upon expiry. Currently existing variations are as follows:

1. The proceeds of the issue are required to be held in trust until the expiry or conversion of the special warrants. If, on that date, no receipt for a final prospectus has been obtained from the selling jurisdiction securities commission, the cash proceeds plus interest are returned to the subscribers.

2. The proceeds of the issue are not restricted and are available to the issuer immediately. Upon expiry of the special warrants, if no receipt for a final prospectus has been obtained from the selling jurisdiction securities commission, the subscribers receive common shares based on a preset conversion rate subject to the requirements of the selling jurisdiction securities act for the exemption used.

SUBSCRIPTION RECEIPTS

As with special warrants, subscription receipts may differ in the treatment of the issue proceeds from the purchase date to the date of expiry of the original conversion rate terms and in the events occurring upon expiry of such terms. Currently existing variations are as follows:

1. The proceeds of the issue are required to be held in trust until the expiry of original conversion rate terms or conversion of the subscription receipts. If the planned reorganization or transaction is not successful, there are then three possibilities:

   i) the cash proceeds plus interest rate are returned to the subscribers; or

[2] CVMQ Decision No 2001-C-0507 sets out circumstances under which resale restrictions on privately placed securities in that province are reduced from 12 months to 4 months.

ii) the common shares are made available to the subscribers at a more generous conversion rate; or

iii) both of the options under i) and ii) are made available to the subscribers.

2. The proceeds of the issue are not restricted and are available to the issuer immediately. Upon expiry of the original conversion rate terms, if the planned reorganization or transaction is not successful, the subscribers receive common shares at a more generous conversion rate.

RESTRICTED SECURITIES

The proceeds of restricted securities are usually available to the issuer immediately but there may be instances where the proceeds are held in trust in an escrow account with an acceptable institution and returnable to subscribers under certain conditions.

MARKET VALUE DETERMINATION

The market value of special warrants, subscription receipts and restricted securities may be difficult to determine. If indeterminable directly, the market value of these securities may be determined based on the market value of the underlying common shares.

In the case of underwriting commitments for special warrants, subscription receipts and restricted securities, the market value to be reported for the underwriting commitment position must be the lesser of:

i) The market value determined for the security position; and

ii) The value of the security position determined on the basis of its issue price.

MARGIN AND CAPITAL REQUIREMENTS

- *In the case where the underwriting proceeds are held in trust in an escrow account at an acceptable institution and may be returned to the subscriber:*

  The margin and capital requirements must be the margin and capital ordinarily required for the underlying security plus any conversion loss (when the special warrant or the subscription receipt has a market value greater than the value of the equivalent underlying security position). However, the loan value (market value of the special warrants, subscription receipts or restricted securities less applicable margin) determined for the position cannot exceed the underwriting cash proceeds being held in trust.

- *In the case where the underwriting proceeds are available to the issuer:*

  During the underwriting period

  The capital requirement must be 100 percent of the market value reported for the underwriting commitment position subject to the capital requirement reductions permitted pursuant to article 7224 of the Rules of the Bourse.

  Post underwriting period

  - For special warrants, where the underwriting commitment position is held on or after the settlement date of the underwriting, the capital requirement must be 100 percent of the market value of the underwriting commitment position.

  - For subscription receipts that trade on a recognized exchange, the capital requirement must be the capital ordinarily required for the underlying security plus any conversion loss (when the market value of the subscription receipts is greater than the value of the equivalent underlying security position).

  - For restricted securities, after the underwriting period and as long as the trading restrictions are not removed, the capital requirement must be 100 percent of the market value of the position, as the restricted securities are not readily marketable. Once the trading restrictions are removed, the capital requirement must be the capital ordinarily required for an unrestricted listed security.

For further information, please contact Eric Bernard, Financial Analyst, at (514) 871-4949, extension 373 or by e-mail at ebernard@m-x.ca.

Jacques Tanguay
Vice-President, Regulatory Division