☒	**Trading – Interest Rate Derivatives**	☒	**Back-office - Options**
☒	**Trading – Equity and Index Derivatives**	☒	**Technology**
☒	**Back-office – Futures**	☒	**Regulation**

CIRCULAR
January 24, 2006

REQUEST FOR COMMENTS

PROPOSED NEW METHODOLOGY FOR MARGINING EQUITY SECURITIES

AMENDMENTS TO ARTICLES 7202, 7203, 7204, 7213 AND 7224 AND TO SCHEDULE 2 OF THE JOINT REGULATORY FINANCIAL QUESTIONNAIRE AND REPORT (POLICY C-3)

Summary

The Rules and Policies Committee of Bourse de Montréal Inc. (the Bourse) has approved amendments to articles 7202, 7203, 7204, 7213 and 7224 of the Rules, and to Schedule 2 of Policy C-3 of the Bourse. The purpose of these amendments is to put in place a methodology that will permit to determine an overall margin rate for each equity security that will more accurately address its market risk. These amendments also aim to eliminate the current methodology according to which the margin on equity securities is determined only on the basis of the market value of these securities.

Process for Changes to the Rules

Bourse de Montréal Inc. is recognized as a self-regulatory organization (SRO) by the Autorité des marchés financiers (the Autorité). In accordance with this recognition, the Bourse carries on activities as an exchange and as a SRO in Québec. In its SRO capacity, the Bourse assumes market regulation and supervision responsibilities of its approved participants. The responsibility for regulating the market and the approved participants of the Bourse comes under the Regulatory Division of the Bourse (the Division). The Division carries on its activities as a distinct business unit separate from the other activities of the Bourse.

Circular no.: 018-2006

Tour de la Bourse
P.O. Box 61, 800 Victoria Square, Montréal, Quebec H4Z 1A9
Telephone: (514) 871-2424
Toll-free within Canada and the U.S.A.: 1 800 361-5353
Website: www.m-x.ca

The Division is under the authority of a Special Committee appointed by the Board of Directors of the Bourse. The Special Committee is empowered to recommend to the Board of Directors the approval or amendment of some aspects of the Rules and Policies of the Bourse governing approved participants, among which, the Rules and Policies relating to margin and capital requirements. The Board of Directors has delegated to the Rules and Policies Committee of the Bourse its powers to approve or amend these Rules and Policies with recommendation from the Special Committee. These changes are submitted to the Autorité for approval.

Comments on the proposed amendments to articles 7202, 7203, 7204, 7213 and 7224 of the Rules, and to Schedule 2 of Policy C-3 of the Bourse must be submitted within 30 days following the date of publication of the present notice in the bulletin of the Autorité. Please submit your comments to:

Ms. Joëlle Saint-Arnault
Vice-President, Legal Affairs and Secretary
Bourse de Montréal Inc.
Tour de la Bourse
P.O. Box 61, 800 Victoria Square
Montréal, Quebec H4Z 1A9
E-mail: legal@m-x.ca

A copy of these comments shall also be forwarded to the Autorité to:

Ms. Anne-Marie Beaudoin
Director – Secretariat of L'Autorité
Autorité des marchés financiers
800 Victoria Square, 22nd Floor
P.O. Box 246, Tour de la Bourse
Montréal (Quebec) H4Z 1G3
E-mail: consultation-en-cours@lautorite.qc.ca

Appendices

For your information, you will find in appendices an analysis document of the proposed rule amendments as well as the proposed regulatory text. The implementation date of the proposed amendments will be determined, if applicable, with the other Canadian self-regulatory organizations following approval by the "Autorité des marchés financiers”.

APPENDIX A

PROPOSED NEW METHODOLOGY FOR MARGINING EQUITY SECURITIES

AMENDMENTS TO ARTICLES 7202, 7203, 7204, 7213 AND 7224 AND TO SCHEDULE 2 OF THE JOINT REGULATORY FINANCIAL QUESTIONNAIRE AND REPORT (POLICY C-3)

I OVERVIEW

When a margin rate for a security is established, it is intended that such rate be sufficient to cover the risk associated with the security, specifically market risk. The existing methodology for determining a listed equity security's margin rate is based on its market price.

A CURRENT RULES

The existing capital and margin requirements for equity securities and related securities (other than options contracts and futures contracts) are set out in Rule Seven of Bourse de Montréal Inc. (the Bourse). More specifically, this Rule specifies that:

- for listed and unlisted equity securities, the margin rates must be based on the individual security's market price per share; and
- for related securities, the margin rates for the related equity security must be used in determining the capital and margin requirement.

The existing rules also set out a series of "strategy-based" rules that are available for offset positions held in both approved participants and customer accounts. These strategy-based offset rules allow for a lowering of the margin requirement associated with two or more positions related to the same underlying security where the positions in combination result in lower market risk.

B THE ISSUE

Studies undertaken by Investment Dealers Association of Canada (IDA) have indicated that market price per share is not an accurate indicator of a listed equity security's market risk. While determining margin rates on this basis may be operationally easy to apply, its use results in margin deposits and "strategy-based" margin rules that do not reflect the true economic risk of positions in and offsets involving equity securities. To address these issues, the Financial Administrators Section (FAS) Capital Formula Subcommittee of the IDA reviewed various methodologies with the requirements that the methodology selected would have to track as accurately as possible an individual security's market risk by measuring both price risk and liquidity risk and be reasonably simple to implement both from an operational and investor information standpoint.

C OBJECTIVE(S)

The new margin rate approach selected, referred to as the "basic margin rate" methodology, is essentially a methodology for determining a customized margin rate for each listed equity security. The objective of this methodology is to determine an overall margin rate for each equity security that will more accurately address its market risk. The proposed methodology will replace the existing market price per share based rates as the standard margin rate methodology to be used by all approved participants and their customers for all Canadian and U.S. listed equity securities. The proposed methodology will also determine the appropriate margin rate based on the two components of an individual security's market risk: (i) price risk and (ii) liquidity risk.

The objective of the proposed amendments to Rule Seven is to accommodate the elimination of both the market price per share margining methodology and the list of securities eligible for reduced margin. Changes are also proposed to the margin requirements applicable to convertible debentures and to convertible preferred shares to make these requirements more consistent with those that are applicable to related debt and equity securities of the same issuer.

D EFFECT OF PROPOSED AMENDMENTS TO THE RULES

The effect of these proposals could be significant both in terms of approved participant versus non-approved participant competition and operations and/or compliance costs. The effect of these proposals on the listed equity markets generally is expected to be neutral to positive based on the previous experience with implementing the "List of Securities Eligible for Reduced Margin" (LSERM) in August 2000 and the results of six years of market impact test work performed.

Approved participants versus non-approved participants competition

The existing market price per share based margin rates have been around for several decades. During this period more sophisticated and less conservative risk measurement methodologies have been developed and adopted by other financial institutions regulators and derivatives clearing corporations. The use of these new risk measurement methodologies has made it less attractive, from a capital usage standpoint, for Canadian securities dealers to maintain their equity securities trading positions in their inventory. Many have opted to move these positions to a related bank or to a related foreign securities dealer[1] where the capital requirements are less onerous. The following is a summary of the current requirements of the Bourse and some of the risk measurement alternatives that are available with respect to the margining of positions in and offsets involving listed equity securities, some of which the Bourse has already adopted:

[1] Canadian banks are permitted to use Value at Risk (VaR) modeling to determine the capital requirements on their equity securities trading book. For their part, United Kingdom securities dealers are permitted to use the Position Risk Requirement (PRR) approach to margin their equity securities trading book, which is a portfolio risk approach.

	Basic requirements of the Bourse	Alternative requirements (current, proposed and under consideration)
Margin requirements that apply to **unhedged** positions	▪ Market price per share based margin rates	▪ Proposed “basic margin rate” methodology based on measured market risk *(this proposal)* ▪ Value at Risk (VaR) modeling *(see VaR modeling proposal submitted simultaneously with this proposal)* ▪ TIMS or SPAN for positions in and offsets involving exchange-traded derivative instruments (implemented on a facultative basis on January 1, 2005, see article 9002 of the Rules of the Bourse) ▪ Position Risk Requirement or similar portfolio margining approach
Margin requirements that apply to **hedged offset** positions	▪ “Strategy-based” requirements	▪ Enhanced “strategy-based” rules of more general application (implemented on January 1, 2005 following an in-depth revision and a consolidation of the relevant requirements in new Rule Nine of the Bourse) ▪ VaR modeling *(see separate VaR modeling proposal)* ▪ TIMS or SPAN for positions in and offsets involving exchange-traded derivative instruments (implemented on a facultative basis on January 1, 2005, see article 9002 of the Rules of the Bourse). ▪ Position Risk Requirement or similar portfolio margining approach

The purpose of the proposed transition to the “basic margin rate” methodology is to adopt a more sophisticated risk measurement approach without introducing undue complexity to approved participants and their clients. As a result, the “basic margin rate” methodology, as its name suggests, will be a relatively simple margining approach that will be used:

- by approved participants with relatively small proprietary trading books or books that utilize straightforward hedging strategies; and
- to margin retail customer account positions.

A by-product of adopting this approach will be to remove some of the existing conservatism in the margin rates that apply to listed equity securities, which will in turn positively impact approved participant versus firms that do not have an approved participant status competition in the area of proprietary trading.

Operations costs and impacts on operations

During the development of this proposal, efforts were made to address operations cost concerns with respect to implementing this methodology. To help address these concerns, the IDA staff will calculate margin rates under this new methodology and once calculated, these rates will be made available electronically to all approved participants in a downloadable form such that where “table driven” software is utilized, little or no modifications will be required to be made to margining systems to use this new methodology.
It is likely that this proposal will have operational impacts upon implementation. Studies performed over a six year period (see Attachment #4) indicate that more than 90% of the securities listed on the Toronto Stock Exchange will experience a margin rate change on the date this proposal is implemented.
Once the proposal is implemented, its operational impacts will be less significant. Studies performed over a six year period (see Attachment #4) indicate that an average of approximately 70% of the securities

listed on the Toronto Stock Exchange will not experience a period to period margin rate change at any given time.

Effect on the listed equity markets generally

In terms of the specific capital market effects of using the proposed “basic margin rate” methodology, it is considered that the overall effects will be either neutral or positive. The quarterly “List of Securities Eligible for Reduced Margin” (LSERM) published by the IDA has been prepared using this methodology for approximately five years and the methodology has been performing well with this select group of securities. The only concerns received to date from users of those lists is that they should be prepared on a more timely basis after each quarter end[2] and that users be notified in advance of any securities with margin rate increases[3]. The IDA has also indicated that they have received few complaints from the investing public. Finally, no significant market effects resulting from the introduction of the LSERM have been noticed.

It is believed that the specific effects of moving to the “basic margin rate” approach for all Canada and United States listed equity securities will:

- likely be positive in terms of reduced proprietary inventory requirements (estimated capital savings were between $200 to $300 million for the industry based on equity levels held in approved participant proprietary accounts as at December 31, 2004); and
- likely be neutral or positive in terms of increased customer margin account loan values (estimated at $500 million for the industry based margin loan levels as at December 31, 2004), depending upon whether approved participants will adjust their house rates to pass along the reduced margin requirements to their retail customers.

II DETAILED ANALYSIS

A CURRENT RULES, BACKGROUND AND PROPOSED AMENDMENTS

CURRENT RULES

The existing margin requirements for equity securities are set out in articles 7201 and following of Rule Seven of the Bourse. These requirements specify that the margin rates for equity securities be based on the market price per share of the security being margined. Furthermore, in the case of related equity derivative instruments, the margin requirements applicable to these instruments are determined on the basis of the margin requirements applicable to the underlying equity security. In the case of offsets involving equity securities, the current rules also set out a series of “strategy-based” offset rules that are available to both an approved participant and its customers. These offset rules allow for a reduction of the margin requirement associated with two or more positions related to the same underlying security where the positions in combination represent a lower market risk.

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2 Currently it takes IDA staff about five weeks to prepare the LSERM as the current process for preparing it is largely manual. This time period will be shortened considerably once the IDA in-house Equity Margin Program, a software designed to calculate margin rates on an automated basis, is put into production.

3 This concern has already been addressed to some extent by the IDA as it is current practice to inform approved participants ten business days in advance of any margin rate increases resulting from the publication of the quarterly LSERM.

PROPOSED AMENDMENTS – DETAILS OF "BASIC MARGIN RATE" METHODOLOGY

To measure both price risk and liquidity risk and arrive at a customized margin rate for each security, the IDA FAS Capital Formula Subcommittee has developed a methodology whereby:

i) the price risk component of market risk is determined for each individual security based on historic price volatility measures;

ii) the liquidity risk component of market risk is determined for each individual security based on average traded volumes and public float values; and

iii) a custom margin rate is determined for each individual security by adding together the price risk and liquidity risk components calculated in (i) and (ii) above.

Price risk calculation

It is proposed that price risk be estimated using historical price volatility measures and that this risk be calculated using the simplifying assumption that prices are normally distributed. The security's price volatility will be calculated for 20, 90 and 260 trading day periods and the greatest of these three calculations will be used as an estimate of the current price volatility. A margin interval will be calculated for the security based on the calculated price volatility and the required number of days of price risk coverage. The number of days coverage will be dependent upon the relative liquidity of the security. Rather than publishing the exact calculated margin interval as the margin rate to be used for each security, margin rate categories will be used. There will be eight categories (15%, 20%, 25%, 30%, 40%, 60%, 75% and 100%) for approved participant long positions and six[4] categories (25%, 30%, 40%, 60%, 75% and 100%) for customer long positions. An additional 150% margin rate category is also proposed for approved participant and customer short positions.

Liquidity risk calculation

It is proposed that an individual security's liquidity risk be determined by its average daily traded volume and dollar value of its public float. As the measurement of liquidity risk is not an exact science, other liquidity risk measures, such as the daily turnover percentage[5], could have been used as risk parameters. Average daily traded volume and dollar value of public float were selected as liquidity risk parameters as, based on studies made by the IDA, they provided the best means to delineate highly liquid from less liquid issues[6].

The assessment of liquidity risk is important because any margin rate set must be sufficient to cover price risk over the period of time it might take to liquidate a security position. The proposal sets out four liquidity levels that will be used to determine liquidity risk: "higher than typical", "typical", "lower than typical" and "low" as follows:

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4 A seventh category, a 20% margin rate category, will be available for client security positions where measured price volatility is sufficiently low and an exchange traded equity option or single stock futures contract trades on the security.

5 "Daily turnover" percentage is daily traded volume of an issue divided by outstanding share amount of this issue.

6 In comparison, when "daily turnover" was studied as a possible parameter for determining liquidity risk, the turnover percentages were so similar for all listings that it became very difficult to delineate highly liquid from less liquid issues.

- a security whose liquidity is determined to be “higher than typical” will require fewer days coverage than normal and, as a result, a price risk margin interval will be calculated to yield either two or three business days price risk coverage;
- a security whose liquidity is determined to be “typical” will require four business days price risk coverage;
- a security whose liquidity is determined to be “lower than typical” will result in either a specific liquidity premium being added in the determination of the overall margin rate or in the overall margin rate being set at 75% for that security; and
- a security whose liquidity is determined to be “low” will attract either a 75% or 100% margin rate depending upon whether or not the issuer’s dollar value of public float level is in excess or $5 million.

“Basic margin rate” proposal general assumptions

The proposal also includes some general assumptions that will be used in the determination of a security’s margin rate under the “basic margin rate” methodology as follows:

- the minimum margin rate for long positions has been set at 15% for approved participant positions and 20% for customer positions where an individual equity options or futures contract is listed on a Canadian or U.S. derivatives exchange, otherwise 25%;
- the maximum margin rate has been set at 150% for short positions;
- daily price change percentages to be used in the determination of price risk are assumed to be normally distributed;
- the Canadian equity markets are assumed to be sufficiently liquid to accurately measure price risk;
- preferred and senior shares are to be margined at a rate no higher than the rate calculated for related junior issues of the same issuer on the assumption that they do not represent, in a worst case scenario, a higher market risk; and
- the existing “strategy-based” offset rules for equities and equity related derivatives will be retained.

“Basic margin rate” proposal back-testing

The proposed “basic margin rate” methodology uses a market risk assessment approach that is similar to the approach embedded in TIMS and SPAN risk assessment methodologies that are in widespread use by derivatives clearing houses[7] around the world. As a result, the proposal back-testing focused on ensuring that actual price movements over the period of margin rate coverage were less than the margin rate set using the proposed “basic margin rate” methodology rather than justifying the predictive use of historical pricing information.

[7] In Canada, the Canadian Derivatives Clearing Corporation (CDCC) uses TIMS and SPAN in determining its clearing fund requirements with respect to the clearing and settlement of derivative instruments listed on Bourse de Montréal.

The back testing results were in line with expectations as they indicated that:

- days where coverage period price changes are in excess of a security's margin rate (i.e., violation days) are not uncommon under the current market price per share based methodology;
- the average violation day percentages are higher under the proposed "basic margin rate" methodology than under the current market price per share based methodology – this was expected because calculated margin rates are generally lower under the proposed "basic margin rate" methodology; and
- the average violation day percentages under the proposed "basic margin rate" methodology indicate that the required level of confidence with respect to margin rate adequacy (99% confidence) is being achieved by the methodology.
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"Basic margin rate" proposal impact testing

The proposed "basic margin rate" methodology was tested over a six year period by the IDA to determine its impact on affected capital markets, approved participants and their customers. The testing was comprised of:

- a comparison between current margin rates and proposed margin rates;
- a comparison between proposed margin rates for the previous quarter end and proposed margin rates for the current quarter end;
- an analysis of the impact of the proposed margin rates on short positions, focusing mainly on those issues with measured price volatility in excess of 100%; and
- a firm by firm impact assessment (for a sample of IDA member firms that are all approved participants of the Bourse) of the proposed margin rates on proprietary inventory and customer account positions.

Debentures, warrants and foreign-based equities were excluded from the analysis in order to prevent any skewing of the results.

Comparison of current margin rates with proposed margin rates - TSX listed securities

For the six years studied, the average margin requirement[8] weighted by traded value declined, under the proposed methodology, by 7.77% for approved participant positions (from 26.93% to 19.16%) and by 4.86% for customer positions (from 31.60% to 26.73%). This translates to an average estimated proprietary inventory capital requirement reduction of $356 million and an average increase in customer account security loan value of $516 million for the periods studied. Estimates are even higher as at December 31, 2004 at $501 million and $655 million, respectively.

It is worth noting that a significant number of securities experienced a margin rate change when applying the proposed methodology in each of the quarters tested. On average:

- 3.52%[9] of the value held in approved participant accounts (also 3.52% in the case of customer accounts) experienced a margin rate reduction of at least 20%;

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[8] For each quarter the individual security margin rates were weighted by traded value and then to arrive at an overall average, a straight average of the weighted rates calculated for the quarters tested was taken.

[9] The traded value weighted average for the past six years was used to determine this percentage.

- 81.20% of the value held in approved participant accounts (89.56% in the case of customer accounts) experienced a margin rate reduction of less than 20%;
- 8.40% of the value held in approved participant accounts (2.68% in the case of customer accounts) experienced no change in margin rates; and
- 6.89% of the value held in approved participant accounts (4.24% in the case of customer accounts) experienced an increase in margin rates.
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In terms of the number of issues affected with significant rate changes, if the proposed methodology had been adopted as at December 31, 2004, 336[10] securities with prices over $2.00 (currently margined at either 50% or 30% (25% for positions held for their own account by approved participants)) would have had margin rates of 75% or greater. On the other hand, 296[11] securities with prices less than $2.00 (currently margined at 60% or higher) would have had margin rates of 40% or less.

Comparison of current margin rates with proposed margin rates - TSX Venture listed securities

For the period studied, the average margin requirement decreased by 1.85% for approved participant positions (from 69.18% to 67.33%) and decreased by 1.75% for customer positions (from 69.19% to 67.44%) under the proposed methodology.

It is worth noting that there were a relatively lesser (when compared with the TSX securities) number of securities that are anticipated to incur major rate changes. This is mainly because under both the current and proposed methodologies, the majority of securities that are listed on the TSX Venture Exchange will be margined at 100%.

Comparison of current quarter proposed margin rates to previous quarter proposed margin rates - TSX listed Securities

On average, the number of margin rate changes from quarter to quarter under the proposed methodology was greater than under the current methodology[12]. More specifically:

- 2.99%[10] of the value held in approved participant accounts (2.66% in the case of customer accounts) experienced a margin rate reduction of at least 20%;
- 10.43% of the value held in approved participant accounts (4.07% in the case of customer accounts) experienced a margin rate reduction of less than 20%;
- 69.21% of the value held in approved participant accounts (85.43% in the case of customer accounts) experienced no change in margin rates; and
- 14.69% of the value held in approved participant accounts (5.17% in the case of customer accounts) experienced a margin rate increase.

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[10] These securities represent less than 1% of the value traded by approved participants for the quarter ended December 31, 2004.

[11] These securities represent less than 1% of the value traded by approved participants for the quarter ended December 31, 2004.

[12] This conclusion ignores the regular rate changes that currently take place for listed equity securities with a market value of less than $2.00.

In terms of numbers of issues affected, a quarter-to-quarter trend analysis performed for both approved participant and customer account positions showed the following:

- the average number of issues whose margin rates declined by at least 20% were 112 and 107, respectively,
- the average number of issues whose margin rates increased by at least 20% were 82 and 77, respectively, and
- the average number of issues whose margin rates did not change were 1,162 and 1,250, respectively.

These results confirmed the expectation that on an ongoing basis the number of securities experiencing margin rate changes would be relatively low (i.e., around 20%) but this would still create an operational issue to be addressed on a quarterly basis as all margin rate changes would take place at the same time.

Comparison of current quarter proposed margin rates with previous quarter proposed margin rates - TSX Venture Exchange listed securities

A quarter-to-quarter comparison was not prepared for securities trading on the TSX Venture Exchange because, as stated previously, the majority of securities listed on the TSX Venture Exchange will continue to be margined at 100% under the proposed methodology.

Impact of proposed margin rates on the margining of short positions

Tests were conducted to determine the adequacy of the proposed margin treatment for short positions. As it is proposed that the current methodology be retained for short positions in securities with prices of less than $2.00 per share, the primary focus of the testing was on securities priced at $2.00 or more per share. There were very few such securities (i.e., on average less than three issues per quarter) that had calculated margin intervals greater than 100%. As a result, it was felt necessary to add only one additional margin rate category for short positions in listed securities, a 150% category. The following table summarizes the proposed revisions for short positions:

Price per Share	Listed Securities	Unlisted Securities
$2.00 and more	basic margin rate methodology with additional 150% margin rate category for volatile issues	200% or margin rate for related junior security if issuer has listed classes of securities

Approved participant by approved participant impact assessment

To determine the likely impact of the proposed basic margin rate methodology on approved participants and their customers, an impact assessment survey was performed by the IDA involving eight approved participants that are members of the FAS Capital Formula Subcommittee. As part of the survey, each participant calculated both its proprietary inventory capital requirements and its client accounts margin requirements using the proposed basic margin rate methodology.

(a) Approved participant proprietary inventory capital requirements

On average, the study indicated that as at June 30, 2003, the eight approved participants surveyed would have had a 16% lower capital requirement under the proposed basic margin rate methodology as compared to the current requirements. This compares to a 9% lower requirement for the TSX as a whole as at June 30, 2003. The larger than market average reduction is reasonable given the tendency at most approved participants to hold only the most liquid equity positions (the positions that benefit the most from the proposed basic margin rate methodology) in their proprietary inventory.

Approved participants proprietary inventories				
Approved participant	**Current capital requirement** (000's)	**Proposed capital requirement** (000's)	**Increase/ (Decrease)** (000's)	**Increase/ (Decrease)** (%)
1	$ 37,119	$ 32,423	-$ 4,696	-12.65%
2	$ 127,444	$ 103,987	-$ 23,457	-18.41%
3	$ 193,164	$ 160,121	-$ 33,043	-17.11%
4	$ 1,846	$ 1,755	-$ 91	-4.93%
5	$ 42,223	$ 37,775	-$ 4,448	-10.53%
6	$ 2,977	$ 1,977	-$ 1,000	-33.57%
7	$ 650	$ 509	-$ 141	-21.69%
8	$ 414	$ 414	Nil	0.00%
Weighted average				-16.48%

(b) Client account margin requirements

During the development of its survey, the IDA determined that it would be difficult to precisely assess the impact of the proposed basic margin rate methodology on the levels of customer account margin. The reason for this is that most customer accounts have significant excess margin in their accounts and therefore a change in margin rates is unlikely to significantly affect the under-margined account levels. The IDA therefore focused its survey on measuring changes in loan values and credit requirements for customer account long positions and short positions, respectively.

On average, the study indicated that as at June 30, 2003, loan values for long positions in customer accounts at the eight approved participants surveyed increased 5% under the proposed basic margin rate methodology as compared to the current requirements. This lower increase for customer account long position loan value was expected since the loan value amounts reported include amounts for acceptable institutions and acceptable counterparties for which neither margin nor market value deficiency margin is applied in determining long positions loan value. The results for approved participants #6 and #8 were more reflective of the impact the proposed basic margin rate methodology will have on retail customers as both of these approved participants cater almost exclusively to retail clients. These two approved participants averaged an 11% increase in customer account long position loan value.

Loan values of customer account long positions				
Approved participant	**Current loan value** (000's)	**Proposed loan value** (000's)	**Increase/ (Decrease)** (000's)	**Increase/ (Decrease)** (%)
1	N/A	N/A	N/A	N/A
2	$ 474,328	$ 506,116	$ 31,788	6.70%
3	$ 1,057,862	$ 1,077,548	$ 19,686	1.86%
4	$ 363,025	$ 373,485	$ 10,460	2.88%
5	N/A	N/A	N/A	N/A
6	$ 501,298	$ 556,043	$ 54,744	10.92%
7	$ 6,029	$ 6,404	$ 376	6.22%
8	$ 128,445	$ 143,072	$ 14,627	11.39%
Weighted average				5.20%

On average, the IDA study indicated that as at June 30, 2003, credit requirements for short positions in customer accounts at the eight approved participants surveyed remained unchanged under the proposed basic margin rate methodology as compared to the current requirements. This was to be expected as most shorting activity occurs in highly active and price volatile securities, which in general will not experience significant rate reductions under the proposed basic margin rate methodology.

Credit requirements for customer account short positions				
Approved participant	**Current credit requirement** (000's)	**Proposed credit requirement** (000's)	**Increase/ (Decrease)** (000's)	**Increase/ (Decrease)** (%)
1	N/A	N/A	N/A	N/A
2	$ 182,917	$ 190,806	$ 7,889	4.31%
3	$ 448,107	$ 449,585	$ 1,478	0.33%
4	$ 411,168	$ 407,397	-$ 3,770	-0.92%
5	N/A	N/A	N/A	N/A
6	$ 3,727	$ 3,709	-$ 18	-0.48%
7	$ 2,503	$ 2,413	-$ 90,700	-3.60%
8	$ 71,066	$ 70,947	-$ 119,125	-0.17%
Weighted average				0.48%

(c) Summary of impact of proposed margin rates on approved participants and their customers

While the survey work performed was at a specific point in time and involved relatively few approved participants, the results obtained were in line with the market impact testing. In general, the survey indicated that the implementation of the proposed basic margin rate methodology will have no significant capital impacts on approved participants (both in terms of requirements for proprietary inventory and under-margined customer accounts). Rather, it is believed that the main impacts of changing margin rate methodologies will be operational in terms of systems changes and credit risk assessment changes.

APPENDIX A

Impact of periodic changes to margin rates under proposed "basic margin rate" methodology

As previously stated, it is likely that this proposal will have operational impacts upon implementation. However, it has also been stated that it is not likely that this proposal will have any significant ongoing operational impacts. This statement has been made based on six-years of studies of the ongoing rate changes that will take place under the proposed "basic margin rate" methodology and based on the fact that the current market price per share based methodology also requires the making of a number of ongoing margin rate changes.

More specifically, under the current market price per share based methodology, listings whose traded price per share is in the range from pennies per share to slightly above $2.00 per share may experience significant margin rate changes as the current approach for determining these rates for long positions is as follows:

Traded price per share	*Current margin rate*
Greater than or equal to $2.00 per share and on LSERM	25.00%
Greater than or equal to $2.00 per share	50.00%
Greater than or equal to $1.75 per share and less than $2.00 per share	60.00%
Greater than or equal to $1.50 per share and less than $1.75 per share	80.00%
Less than $1.50 per share	100.00%

Under the current margin rate approach, the number of rate changes that take place during any quarter is difficult to determine. To get an idea of the number of issues that may be subject to frequent margin rate changes under the current margin rate approach, the following table summarizes the margin rates applicable to securities trading at less than or equal to $2.50 per share as at December 31, 2004:

Margin rate	**Number of TSX issues**	**Three month TSX traded value** (in millions)
30.00%	17	$ 1,997
50.00%	45	$ 730
60.00%	34	$ 468
80.00%	29	$ 294
100.00%	312	$ 1,884
Subtotal of listings trading at less than or equal to $2.50 per share	437	$ 5,373
Totals for listings on TSX	1,749	$ 428,536
Percentage of totals	**24.99%**	**1.25%**

Depending upon price movements these issues may experience either no or multiple margin rate changes during a quarter.

Under the proposed basic margin rate methodology, it is not likely that margin rate changes will occur during the quarter. Instead, issue margin rates will all change at the same time. For example, as at December 31, 2004, 365 TSX listings (representing 20.87% of the number of TSX issues and 2.01% of the TSX traded value) would have had margin rate changes.

Margin rate changes	**Number of TSX issues**	**Three month TSX traded value** (in millions)
Margin rate decrease >= 20%	125	$ 3,844
Margin rate decrease < 20%	127	$ 2,714
Margin rate increase < 20%	48	$ 1,449
Margin rate increase >= 20%	65	$ 603
Subtotal of listings with a margin rate change	365	$ 8,610
Totals for listings on TSX	1,749	$ 428,536
Percentage of totals	**20.87%**	**2.01%**

While the numbers / percentages are not significantly different from the current margin rate approach, the rate changes will all occur at the same time which may necessitate changes to each approved participant's credit assessment process. Of course, to lessen the severity and frequency of customer account margin calls (caused by changes in margin rates), approved participants may continue to establish their own house margin rates.

PROPOSED AMENDMENTS TO IMPLEMENT THE "BASIC MARGIN RATE" METHODOLOGY

The following is a detailed description of each of the amendments that are required to implement the proposed "basic margin rate" methodology:

Addition of a new paragraph 1 in article 7202 – Securities listed on a recognized exchange in Canada or in the United States

The proposed addition seeks to reflect the replacement of the market price per share based margining methodology by the "basic margin rate" margining methodology. The added wording includes a definition of what is meant by the term "basic margin rate" and a general definition of how this rate is calculated. It is worth mentioning that the basic margin rate calculation is similar to the calculation of the "floating margin rate" that already exists in article 9002 of the Rules of the Bourse. The "basic margin rate" methodology calculation allows to determine:

i) the price risk component of market risk for each individual security based on historic price volatility measures;

ii) the liquidity risk component of market risk for each individual security based on average traded volumes and public float values; and

iii) a custom margin rate for each individual security obtained by adding together the price risk and liquidity risk components calculated in (i) and (ii) above.

In addition, in connection with the addition of new paragraph 1 to article 7202, the following text has been inserted:

> *"From time to time, the Bourse can determine that positions in securities listed on markets or that are in a group on a market and for which the financial requirements for an initial or a permanent listing do not include adequate requirements regarding net earnings before taxes, tangible assets and minimum working capital may not be carried on margin."*

This wording replaces by a general rule the list of markets and securities groups on a market not eligible to margin that were previously mentioned in former paragraphs 3) v) and 5 of article 7202.

It is also to be noted that paragraph 1 of article 7202 is to be preceded by a reference to article 9001 of the Rules of the Bourse relatively to the definition of some terms that are used in article 7202 such as “floating margin rate”. “margin interval”, etc. This reference was previously in paragraph 2 (renumbered 3) of article 7202.

Amendment to paragraph 2 (formerly paragraph 1) of article 7202 – Securities listed on some other exchanges and that are components of an index

This new wording seeks to extend 50% loan value to listed securities that are constituent securities of a major index on a recognized exchange other than in Canada and the United States. Currently, loan value is only extended outside of Canada and the United States to securities traded on the London and Tokyo stock exchanges. The new wording would extend loan value to broad based index constituent securities that are listed on exchanges that qualify as “recognized exchanges and associations” for the purposes of determining “regulated entities” pursuant to the “Joint Regulatory Financial Questionnaire and Report” of Policy C-3 of the Bourse.

Amendment to paragraph 3 (formerly paragraph 2) of article 7202 – Index products

Amendments were made to subparagraphs 3 A) and 3 B) to include reference to the new basic margin rate calculation.

Abrogation of paragraph 3 of article 7202 – Securities eligible to a reduced margin rate

Since the list of securities eligible to a reduced margin published quarterly will no longer be required with the introduction of the new margin rate methodology, the reference to this list in subparagraph i) is no longer necessary. Furthermore, since the convertible and non convertible securities of an issuer will be subjected to the same margin basic rate as the one established for listed securities of that same issuer, the provisions of subparagraphs iii) and iv) are also no longer required.

Also, the reduced margin rate that was applicable to securities underlying options issued by the Options Clearing Corporation will no longer be necessary since such securities will be margined according to the new basic margin rate methodology.

Finally, subparagraph v) is deleted since the type of securities referred to in this subparagraph are now included in the wording of new paragraph 1 of article 7202.

Amendments to paragraph 4 of article 7202 – Warrants issued by a Canadian chartered bank

The purpose of the new wording is to separate the requirements applicable to bank issued warrants from the capital and margin requirements applicable to other listed securities

Abrogation of former paragraph 5 of article 7202

This paragraph is abrogated since the type of securities referred to are now included in the wording of new paragraph 1 of article 7202.

Amendments to article 7203 – Unlisted securities

This article, as amended, incorporates both the proposed "basic margin rate" method and the current method based on the share price. Basically, when there exists a published rate determined according to the "basic margin rate" method, this rate must be used; where no published rate is available, the margin rate will be determined according to the current method based on the market value of the share.

Amendments to Group V of article 7204 – Corporations and trust and mortgage loan companies

Currently, Group V of article 7204 sets out specific margin requirements for convertible debentures. These requirements refer to the list of securities eligible for reduced margin. These requirements have also been found to be excessive in the case of convertible debentures trading below par value and insufficient in the case of convertible debentures trading above par value.

More specifically, under the current wording, convertible debentures trading at less than par value are subject to a minimum additional margin requirement of 10% of par value over and above the regular requirement that would apply to a debenture. This additional margin requirement is not justified from a risk perspective because "out-of-the money" convertible debentures have the same risk characteristics as a debenture. In addition, under the current regulation, convertible debentures trading at price higher than par value are never subject to the same margin requirement as the underlying security. This is also not supported from a risk perspective because a "deep-in-the-money" convertible debenture will have the same downside price risk as the underlying security.

The proposed amendments seek to remove the reference to the list of securities eligible for reduced margin and correct identified problems with the margin requirement calculation for convertible securities.

Amendments to paragraph 1 b) of Group XI of article 7204 – Stripped coupons and residual debt securities

The current wording sets out the margin requirements for stripped coupons and residual debt instruments. The proposed amendments seek to clarify (not amend) the current margin requirements for these securities

Abrogation of paragraph 3 of article 7213 – Exceptions to margin rules

Since the list of securities eligible to a reduced margin published quarterly will no longer be required with the introduction of the new margin rate methodology, the reference to this list in subparagraph i) is no longer necessary. Furthermore, since the convertible and non convertible securities of an issuer will be subjected to the same margin basic rate as the one established for listed securities of that same issuer, the provisions of subparagraphs iii) and iv) are also no longer required. Finally, the reduced margin rate that was applicable to securities underlying options issued by the Options Clearing Corporation will be no longer necessary since such securities will be margined according to the new basic margin rate methodology.

Abrogation of paragraph 4 of article 7213

The reason for this abrogation is that this paragraph refers to the current paragraph 3 of this article. Since paragraph 3 is being abrogated, paragraph 4 is therefore no longer required.

Amendments to paragraph 5 of article 7213 (formerly paragraph 7)

This paragraph deals with convertible floating rate preferred share. It will be amended in accordance with the modifications made to the prescribed margin requirements applicable to convertible debentures, as outlined in the proposed amendments to Group V of article 7204.

Amendments to paragraph 7 of article 7213 (formerly paragraph 10)

The reference to market maker or approved participant accounts was removed to reflect the fact that there is no longer any need to refer to a specific type of account. The applicable margin rate on bank warrants for government securities is 100% of the margin rate applicable to the underlying security of the warrant regardless of the type of account in which such warrants are held.

Abrogation of subparagraph a) viii) of article 7224 – Margin requirements for underwriting commitments

Reduced "normal new issue margin" rates were introduced when changes were implemented to the capital requirements for underwriting commitments on March 1, 2005. These reduced rates were not intended to be permanent, but rather were intended to be an interim measure designed to permit the use of lower new issue margin rates until such time as the lower "basic margin rate" methodology rates were available for all listed equity securities. As a result, the removal of the definition of and references to the term "normal new issue margin" is being proposed.

Deletion of Line 7 in Schedule 2 of the Joint Regulatory Financial Questionnaire and Report (Policy C-3 of the Bourse) - Securities held in a registered trader's account

It is proposed to abrogate the existing Line 7 of Schedule 2 of the Joint Regulatory Financial Questionnaire and Report (JRFQR) (Policy C-3 of the Bourse) at the same time as the implementation of the proposed "basic margin rate" methodology.

Existing Schedule 2 of the JRFQR sets out the margin reductions available for security positions held in a registered trader's account and the minimum margin requirements for registered traders, respectively.

In recent years, both the Toronto Stock Exchange and the Bourse have introduced market-making reforms whereby responsibilities have been assigned to approved participants rather than individual registered traders, specialists and market makers. Market-making risks have also been transferred from individuals to approved participants and therefore certain requirements in Schedule 2 of the JRFQR are no longer necessary.

The proposed amendments to Schedule 2 of the JRFQR seek to:

- eliminate the 25% reduced margin granted to registered traders for certain security positions for which they had trading privileges; and
- eliminate the minimum capital requirement for Toronto Stock Exchange registered traders ($50,000 per trader) and for Bourse de Montréal registered specialists ($50,000 per specialist) [see Schedule 2, Line 7 of the JRFQR]. It is to be noted that in the case of the Bourse, this one ceased to use of market specialists when it transferred its equity trading activity to the Toronto Stock Exchange at the end of 1999.

B ISSUES AND ALTERNATIVES CONSIDERED

The main concern with the current "market price per share" approach to margining equity securities is that there is no evidence that market price per share is an accurate indicator of a security's market risk. It is believed that the relative inaccuracy of the current approach was also recognized when the current requirements were originally implemented. This is because the current margin requirement methodology generally results in the use of conservative margin rates, even in today's volatile markets, in relation to the market risk associated with the equity securities.

Another relatively minor concern with the current rules is the related "strategy-based" rules for offsets involving equity securities. These rules need to be updated to more closely track the market risk associated with the offsets as well as address some of the other inaccuracies in the rules. To a large extent, the proposed "basic margin rate" methodology will address these needs.

The main objective of the "basic margin rate" methodology is to replace the existing margin rate methodology with a methodology that more accurately tracks market risk. In order to develop a replacement methodology, the FAS Capital Formula Subcommittee of the IDA reviewed various methodologies with the requirements that: (i) the methodology selected should allow too track as accurately as possible an individual security's market risk by measuring both price risk and liquidity risk[13]; and (ii) the methodology selected should be reasonably simple to implement both from an operational and investor education standpoint. The methodology selected and referred to, as the "basic margin rate" methodology is essentially a methodology for determining a customized margin rate for each equity security.

As previously stated, there are other alternatives to the "basic margin rate" methodology that could have been selected as a replacement to the current market price per share based methodology. Some of these alternatives are as follows:

- value at risk (VaR) modeling;
- TIMS or SPAN for positions in and offsets involving exchange-traded derivatives;
- position risk requirement (PRR) or similar portfolio margining methodology.

These approaches were not retained as an appropriate replacement for the current market price per share based methodology not because they are inaccurate, but rather because they would be less straightforward to implement both from an operational and investor education standpoint.

It is to be noted that the Bourse has already amended its Rules to grant approved participants the option of using TIMS or SPAN to margin their proprietary inventory positions in and offsets involving exchange-traded derivative instruments. A separate proposal will be forthcoming to grant approved participants the option of using VaR modeling to margin their proprietary inventory. It is also likely that the optional use of a portfolio margining methodology will be studied at a future date. However, none of these methodologies are easily applicable to margin retail customer accounts.

C COMPARISON WITH SIMILAR PROVISIONS

RULES IN OTHER JURISDICTIONS - UNITED STATES AND UNITED KINGDOM

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13 Since the main components of market risk are price risk and liquidity risk and since margin requirements should be designed to cover market risk, no other approaches were seriously considered.

Neither the United States nor the United Kingdom have “basic margin rate” rules similar to those being proposed for use in margining both dealer proprietary inventory and retail customer account positions. Both jurisdictions employ a version of a market price per share based margin requirement as their basic margining methodology to be used for retail customer account positions.

In the United Kingdom, a more sophisticated methodology, referred to as the Position Risk Requirement (“PRR”), may be used by a dealer in margining its own proprietary inventory. This PRR methodology allows for the reduction in the margin that would otherwise be required for a basket of securities if a sufficient level of diversification across industries can be demonstrated.

In the United States, since August 2004, certain securities dealers have been granted an option to use VaR modeling (as part of an alternative financial filing approach known as the Alternative Net Capital Requirement) as a basis for margining their own proprietary inventory. Dealers electing to use this method are subject to enhanced net capital, early warning, recordkeeping, reporting, and certain other requirements, and must implement and document an internal risk management system. Furthermore, as a condition to the use of a VaR method, a broker-dealer's ultimate holding company and affiliates must consent to group-wide SEC supervision. This supervision would impose reporting (including reporting of a capital adequacy measurement consistent with the standards adopted by the Basel Committee on Banking Supervision), recordkeeping, and notification requirements on the ultimate holding company.

Methodologies similar to that being proposed are in widespread use by derivatives clearing houses around the world. In fact, the two major methodologies in use by clearinghouses, TIMS and SPAN, employ a similar margin interval approach to determine a market risk margin requirement. The following is a summary of the assumptions used by some well known derivatives clearing houses along with those included in the Bourse’s proposed “basic margin rate” methodology:

Organization	Required Statistical Confidence Level[14]	Required Number of Days Price Risk Coverage
CDCC	3	2
OCC	5	1
LCH	3	1 or 2
CME	2 to 3	1
BOURSE & IDA	3	2, 3, 4 or more
Note: These parameters are adjusted from time to time by each of the clearinghouses.		

What distinguishes the assumptions in the Bourse’s proposed methodology from those of the clearinghouses is the assumption relating to the number of days of price risk coverage. There are two reasons for this difference:

1. clearinghouses ask for clearing fund deposits to cover the risk they assume by guaranteeing the settlement of all transactions they clear. Although similar, this is not the same risk that regulatory margin rates are designed to cover. Regulatory margin rates are designed to cover price risk over the period of time it would take to close out a security position.
2. the clearinghouses referred to in the above table are derivative instruments clearing houses. Exchange traded derivatives are generally only listed on the most liquid securities. As a result, the number of days price risk coverage required is lower.

[14] Expressed as number of standard deviations.

The Canadian Depository for Securities Limited (CDS) implemented in October 2004 a similar market risk assessment tool, which they refer to as the "VaR method" and which is very similar to the proposed "basic margin rate" methodology. CDS uses this "VaR method" tool to determine its exposure to market risk with respect to the outstanding failed trade positions of its participants. CDS refers to the "basic margin rate" proposal in their "CDS Settlement Services Risk Model" discussion paper as follows:

> "The VaR method of estimating market risk is an industry-standard methodology. CDS currently uses this approach to calculate the DetNet Participant Fund contributions. The VaR methodology employed is also used by the IDA to calculate the margin rates for securities in their "Equity Margin Project" proposal. CDS will adopt a VaR methodology similar to the one that underlies the proposed IDA Margin Guidelines. Since the IDA Margin Guidelines were developed for use by broker/dealers for their individual margin accounts, there will be some differences in CDS' implementation. The major differences are:
>
> - the IDA Guidelines "band" the margin rates for ease of use. For example, if the IDA's calculations result in a 5% haircut for a given security, the guidelines use 15% (i.e. any calculated haircut between 0% and 15% are scaled up to 15%). CDS will use the calculated amount instead of the assigned "banded" amount.
> - the IDA proposal assigns different holding periods and a "liquidity factor" to security margin rates based on the liquidity of the security. The guidelines assume that it might take 2 days to liquidate a position in a "higher-than-typical" security and up to 4 days in a "less-than-typical" security. CDS will apply a minimum standard 3-day holding period to all securities. Securities with less than average liquidity will be applied a 5-day or 10-day holding period. The details of the treatment of liquidity are under review. CDS will be conducting daily surveillance of Participants' CNS and ACCESS outstanding positions to identify any situations that fall outside these parameters (e.g. CNS outstanding positions that represent an unusually large proportion of the daily trading volume of a security). CDS may use its discretionary authority to request more collateral from a Participant if the surveillance identifies cases that are not addressed by the standard calculations.
> - the IDA Margin Guideline are intended to cover three standard deviations of price risk, meaning that the margin rates that are calculated in the model expect to cover the portfolio value changes in excess of 99% of the time. CDS will use a 99% confidence interval in its calculations (which is approximately 2.3 standard deviations).
>
> CDS will conduct on-going reviews of the VaR models using back-testing of the risks from the CNS Outstandings and the adequacy of the collateral in the Participant funds. The backtesting of collateral requirements will be conducted for each Participant in each CCP service. These backtesting results will be made available to Participants. To the extent that the backtesting indicates that the collateral would have been insufficient, CDS may request additional collateral in order to maintain the required 99% confidence factor."

It should be noted that of the three areas of difference between the CDS "VaR method" and the proposed Bourse's "basic margin rate" methodology, the only difference that might suggest that the Bourse's parameters are less stringent than those at CDS is in the way that CDS determines the required number of days price risk coverage. This was necessary for CDS as its risk model was designed to cover market risk associated with both listed and unlisted equity securities, while the Bourse's proposal focuses on addressing the market risk associated with listed equity securities only.

D SYSTEMS IMPACT OF RULE

A previous section has described the likely impacts of this proposal on approved participants both in terms of operational impacts and credit risk assessment impacts.

There will also be impacts at third party service bureaus. Most approved participants use one of three third party service bureaus (ADP, ADP Dataphile and IBM) to assist them in the preparation of books and records relating to customer account cash and security positions. When the rule changes will be implemented, these service bureaus will need to change their approach for determining margin rates from a formula driven approach (where margin rates are determined based on market price per share) to a table driven approach (where margin rates are published on a regular basis by the IDA). While the table driven margin rate approach is currently being used by all service bureaus on a limited basis[15], it is likely that some of the services bureaus will have to undertake significant programming changes to accommodate the proposed margin rate approach. Since programming changes will only take place once these proposals have been approved by the regulatory authorities, it is estimated that a one year implementation period will be required before the proposed "basic margin rate" methodology becomes effective.

E. POSITION OF BOURSE DE MONTRÉAL REGARDING THE PROPOSED METHODOLOGY

This proposal for a new methodology based on a "basic margin rate" has been initiated and developed by the IDA and its Board of Directors approved it on October 26, 2005. The Bourse had the opportunity to participate into the discussions on this subject matter since the project started and wishes to amend its Rules in the same manner for the main reason that the implementation of the methodology proposed by the IDA will have a direct impact on the margin and capital requirements applicable to equity options listed on the Bourse. Effectively, for a significant number of strategies involving equity options, the margin or the capital required are based on the margin and capital required on the underlying security.

As was explained previously (see section entitled "**Effect on the listed equity markets generally"** on page 4 of this analysis), the "basic margin rate" methodology will result in a \$200 to \$300 million reduction in the capital required on positions held by the approved participants of the Bourse for their own account and in a \$500 million increase in the loan value of the positions held in equity securities by their clients. These positive effects on positions held in equity securities by approved participants and their clients will certainly affect the margin and capital requirements applicable to positions held in options contracts or in strategies involving such contracts, the more so that equity options that are traded on an exchange generally have as underlying interest securities that demonstrate a very high liquidity and a lower volatility. These underlying equities will therefore likely qualify for the lowest margin rates and, as a consequence, margins required on options, and more particularly on strategies involving options, will likely be reduced.

F BEST INTERESTS OF THE CAPITAL MARKETS

The Bourse has determined that the proposed amendments to its Rules and Policies are of public interest and that they are not detrimental to the best interests of the capital markets.

G PUBLIC INTEREST OBJECTIVE

The purposes of the proposed regulatory amendments are to facilitate:

- an efficient capital-raising process;

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15 When the List of Securities Eligible for Reduced Margin (LSERM) was introduced for the quarter ended June 30, 2000 each of the service bureaus had to make system changes to accommodate rates provided in a table. While the changes made may have been workable for the 400-500 listings that appear on the quarterly LSERM they may no longer be workable for the approximately 30,000 listings that will have custom margin rates set under the proposal.

- transparent, efficient and fair secondary market trading;
- the availability to approved participants and investors of information with respect to offers and quotations for and transactions in securities;
- efficient clearance and settlement procedures; and
- fair and open competition in securities transactions generally.

The proposal does not permit unfair discrimination among customers, issuers, brokers, dealers, approved participants or others. It does not impose any burden on competition that is not necessary or appropriate in furtherance of the above purposes. Based on the significance of these proposed amendments they have been determined to be of public interest.

III COMMENTARY

A EFFECTIVENESS

As stated above, the objective of the proposed "basic margin rate" methodology is to determine an overall margin rate for each equity security that will more accurately address a security's market risk than the existing market price per share based methodology. The proposed methodology seeks to measure market risk on a security specific basis by separately measuring price and liquidity risk and then combining these measured risks into a custom margin rate for each security. It is believed this approach, setting margin rates based on a security's market risk, will be effective.

B APPROVAL PROCESS

The first step of the approval process for the regulatory amendments proposed in the present document consists in having the proposed amendments approved by the Special Committee – Regulatory Division of the Bourse. The proposed amendments are then submitted to the approval of the Rules and Policies Committee of the Bourse. Once the approval of the Rules and Policies Committee obtained, the project is simultaneously published by the Bourse for a 30-day comment period and submitted to the Autorité des marchés financiers du Québec for approval and to the Ontario Securities Commission for information.

IV SOURCES

- Rule Seven of Bourse de Montréal Inc.
- "Joint Regulatory Financial Questionnaire and Report – Policy C-3 of Bourse de Montréal Inc.
- IDA Equity Margin Project Discussion Paper, Draft #14, dated May 11, 2005
- New York Stock Exchange and Securities Exchange Commission, Uniform Net Capital Rule, 15c3-1
- U.S. Securities Exchange Act of 1934, Alternative Net Capital Computation for Broker Dealers that Elect to be Supervised on a Consolidated Basis, Section 204.15c3-1(a)(7)
- United Kingdom Securities and Futures Authority, Rules 10-70 through 10-90, Financial Resources Requirement, Position Risk Requirement and Equity Method
- Canadian Depository for Securities Limited, "Settlement Services Risk Model" discussion paper dated June 25, 2003

ANALYSIS OF IMPACT UPON IMPLEMENTATION

Impact based on number of listings affected *(six year average)*

	Approved Participant rates		Customer account rates	
	Amount	**Percent**	**Amount**	**Percent**
Rate decrease >= 20%	472	29.01%	472	29.01%
Rate decrease < 20%	591	36.31%	631	38.79%
Rate unchanged	166	10.19%	131	8.07%
Rate increase < 20%	58	3.54%	52	3.19%
Rate increase >= 20%	341	20.94%	341	20.94%
Total number of listings	1,628	100.00%	1,628	100.00%

Impact based on traded value *(six year average – dollar amounts in millions)*

	Approved Participant rates		Customer account rates	
	Amount	**Percent**	**Amount**	**Percent**
Rate decrease >= 20%	$ 10,228	3.52%	$ 10,228	3.52%
Rate decrease < 20%	$ 236,068	81.20%	$ 260,393	89.56%
Rate unchanged	$ 24,414	8.40%	$ 7,793	2.68%
Rate increase < 20%	$ 15,871	5.46%	$ 8,167	2.81%
Rate increase >= 20%	$ 4,151	1.43%	$ 4,151	1.43%
Total traded value	$ 290,732	100.00%	$ 290,732	100.00%

ANALYSIS OF ONGOING IMPACT

Impact based on number of listings affected *(six year average)*

	Approved Participant rates		Customer account rates	
	Amount	**Percent**	**Amount**	**Percent**
Rate decrease >= 20%	114	7.03%	106	6.51%
Rate decrease < 20%	154	9.43%	105	6.42%
Rate unchanged	1,088	66.86%	1,187	72.93%
Rate increase < 20%	115	7.07%	83	5.11%
Rate increase >= 20%	102	6.27%	93	5.69%
New listings	54	3.34%	54	3.34%
Total number of listings	1,627	100.00%	1,627	100.00%

Impact based on traded value *(six year average – dollar amounts in millions)*

	Approved Participant rates		Customer account rates	
	Amount	**Percent**	**Amount**	**Percent**
Rate decrease >= 20%	$8,450	2.99%	$7,520	2.66%
Rate decrease < 20%	$29,528	10.43%	$11,530	4.07%
Rate unchanged	$195,858	69.21%	$241,749	85.43%
Rate increase < 20%	$36,406	12.86%	$10,978	3.88%
Rate increase >= 20%	$5,191	1.83%	$3,654	1.29%
New listings	$7,558	2.67%	$7,558	2.67%
Total number of listings	$282,991	100.00%	$282,991	100.00%

SUMMARY OF "BASIC MARGIN RATE" PROPOSAL BACK-TESTING

The following table summarizes the back-testing performed to determining the adequacy of margin rates set using the proposed methodology as at December 31, 2004:

Liquidity risk category	Current margin rate approach			Proposed margin rate approach		
	Average sample[1] margin rate	Average number of sample violation days[2]	Average violation day percentage	Average sample[1] margin rate	Average number of sample violation days[3]	Average violation day percentage
"Higher than typical" (2 day coverage)	32.26%	0.00	0.00%	15.33%	0.07	0.11%
"Higher than typical" (3 day coverage)	47.99%	0.10	0.16%	19.17%	0.17	0.27%
"Typical" (4 day coverage)	59.54%	0.07	0.11%	32.08%	0.38	0.62%
"Lower than typical" (4 day coverage plus liquidity premium)	65.95%	0.17	0.27%	65.67%	0.23	0.38%
"Low" (either 75% or 100% margin rate)	Back testing work was not performed because liquidity of these issues is at such a low level that the accuracy of the actual pricing data in predicting actual realization value is suspect.					

1 Back testing was performed on a sample of security issues in each of the liquidity risk categories. The total sample tested was 150 as follows:
- "Higher than typical" (2 day coverage) – sample of 30
- "Higher than typical" (3 day coverage) – sample of 30
- "Typical" (4 day coverage) – sample of 60
- "Lower than typical" (2 day coverage) – sample of 30

2. To determine the number of violation days under the current method, the current margin rate for each trading day was compared to the absolute value of actual price change over the coverage period indicated by the issue's liquidity risk categorization for each of the 62 trading days from January 1, 2005 to March 31, 2005.

3. To determine the number of violation days under the proposed method, the proposed margin rate calculated as at December 31, 2004 was compared to the absolute value of actual price change over the coverage period indicated by the issue's liquidity risk categorization for each of the 62 trading days from January 1, 2005 to March 31, 2005.

7202 **Listed Securities**
(15.12.86, 30.09.87, 18.06.88, 01.04.93, 11.02.00, 29.04.02, 16.09.02, 01.05.03, 17.05.04, 01.01.05, 13.09.05, 00.00.06)

For the purpose of this article, the terms "floating margin rate", "incremental basket margin rate", "index", "margin interval", "qualifying basket of index securities" and "tracking error margin rate" are defined in article 9001.

1) Securities listed on a recognized exchange in Canada or in the United States

For positions in securities (other than bonds and debentures but including rights and warrants other than Canadian bank warrants) listed on any recognized stock exchange in Canada or in the United States:

i) Long positions – margin required

The published long position basic margin rate for the security as approved by a recognized self-regulatory organization, multiplied by the market value of the security position.

From time to time, the Bourse can determine that positions in securities listed on markets or that are in a group on a market and for which the financial requirements for an initial or a permanent listing do not include adequate requirements regarding net earnings before taxes, tangible assets and minimum working capital may not be carried on margin.

ii) Short positions – Credit required

The credit required on short securities positions is the greater of the two following amounts:

A) 100% plus the published short position basic margin rate percentage for the security as approved by a recognized self-regulatory organization, multiplied by the market value of the security position;

B) In the case of a security trading at less than $2.00 per share, the calculated minimum credit requirement, based on the price, as follows:

- Securities trading at $1.50 to $1.99, $3.00 per share
- Securities trading at $0.25 to $1.49, 200% of market value
- Securities trading at less than $0.25, market value plus $0.25 per share

For the purposes of this Rule, the term "basic margin rate" means a customized security specific margin rate calculated based on the measured price and liquidity risk for the security. As in the case of the calculation of the "floating margin rate" for index products, the measured price risk is based on the maximum standard deviation of the percentage changes in the daily closing prices over the most recent 20, 90 and 260 trading days. For its part, the measured liquidity risk is based on the security's public float value and average daily volume levels. The risk assessments are then combined into an overall market risk assessment and, on the basis of this assessment, one of the following margin rates is assigned;

- 15% (only approved participants account positions are eligible to this rate);
- 20% (positions in customer accounts or approved participants accounts are eligible to this rate only where a related option or future contract is listed on an exchange);
- 25%, 30%, 40%, 60%, 75%, and 100%
- 150% (where necessary for short security positions)

~~1~~2) **Securities listed on some other exchanges and that are components of an index**

For positions in~~The margins required on~~ securities ~~including rights and warrants~~ (other than bonds and debentures, but including rights and warrants), 50% of the market value, provided that the two following conditions are met: ~~listed on any of the recognized exchanges in Canada and in the United States, on the stock list of The London Stock Exchange and on the first section of the Tokyo Stock Exchange are as follows~~:

A) the exchange on which the security is listed is an exchange whose name appears in the list of exchanges and associations qualifying as « recognized exchanges and associations » published from time to time by the Investment Dealers Association of Canada for the purpose of determining “regulated entities”;

B) the security is a component of the main broad-based index of the exchange on which it is listed.

~~Long Positions~~	~~Margin Required~~
~~a) Securities trading at $2.00 or more~~	~~50% of market value~~
~~b) Securities trading between $1.75 and $1.99~~	~~60% of market value~~
~~c) Securities trading between $1.50 and $1.74~~	~~80% of market value~~

~~d) Securities selling under $1.50, securities of companies designated as Capital Pool Companies on the TSX Venture Exchange and securities of companies classified as Tier 3 or inactive Tier 2 issuers on the TSX Venture Exchange may not be carried on margin.~~

~~Short Positions~~	~~Credit Required~~
~~a) Securities trading at $2.00 or more~~	~~150% of market value~~
~~b) Securities trading between $1.50 and $1.99~~	~~$3.00 per share~~
~~c) Securities trading between $0.25 and $1.49~~	~~200% of market value~~
~~d) Securities trading at less than $0.25~~	~~Market value plus $0.25 per share~~

~~2~~3) Index products

A) Long qualifying basket of index securities or long index participation units

The minimum margin required, must be the sum of:

i) in the case of index participation units, the floating margin rate percentage (calculated for the index participation unit based on its regulatory margin interval) of the qualifying basket of index securities (or index participation units); and~~)~~

ii) in the case of a qualifying basket of index securities, the floating margin rate percentage (calculated for a perfect basket of index securities based on its regulatory margin interval), plus the calculated incremental basket margin rate for the qualifying basket of index securities;

multiplied by the market value of the qualifying basket of index securities (or index participation units).

B) Short qualifying basket of index securities or short index participation units

The minimum margin required must be the sum of:

i) 100%; and

ii) the floating margin rate percentage (calculated for the index participation unit or a perfect basket of index securities) of the qualifying basket of index securities (or index participation units); and

iii) in the case of a qualifying basket of index securities, the calculated incremental basket margin rate percentage;

multiplied by the market value of the qualifying basket of index securities (or index participation units).

C) Long qualifying basket of index securities offset with short index participation units

Where a position in a qualifying basket of index securities is carried long in an account and the account is also short an equivalent number of index participation units, the margin required must be the sum of the published tracking error margin rate and the calculated incremental basket margin rate for the qualifying basket of index securities, multiplied by the market value of the index participation units.

D) Short qualifying basket of index securities offset with long index participation units

Where a position in a qualifying basket of index securities is carried short in an account and the account is also long an equivalent number of index participation units, the margin required must be the sum of:

i) the tracking error margin rate, unless the short basket of index securities is of a size sufficient to comprise a basket of securities or multiple thereof required to obtain the index participation units;

and

ii) the calculated incremental basket margin rate for the qualifying basket of index securities;

multiplied by the market value of the index participation units.

E) Long qualifying basket of index securities – short index participation units – commitment to purchase index participation units

Where an approved participant has a commitment pursuant to an underwriting agreement to purchase a new issue of index participation units, and holds an equivalent long position in a qualifying basket of index securities and also holds an equivalent number of short index participation units, no capital is required, provided the long basket:

i) is of size sufficient to comprise a basket of securities or multiple thereof required to obtain the index participation units; and

ii) does not exceed the approved participant's underwriting commitment to purchase the index participation units.

~~3) Securities eligible to a reduced margin rate~~

~~The margin required is 30% of the market value on long positions and the credit required is 130% of the market value on short positions if such securities are~~:.

~~i) on the list of securities eligible to a reduced margin rate as approved by a recognized self-regulatory organization and such securities continue to be traded at $2.00 or more;~~

~~ii) securities against which options issued by the Options Clearing Corporation are traded;~~

~~iii) convertible into securities that qualify under subparagraph i) or subparagraph ii);~~

~~iv) non-convertible preferred and senior shares of an issuer any of whose securities qualify under subparagraph i); or~~

~~v) securities whose original issuance generated Tier 1 capital for a financial institution any of whose securities qualify under subparagraph i) and the financial institution is under the regulatory oversight of the Office of the Superintendent of Financial Institutions of Canada.~~

~~For the purpose of the present paragraph 3) the Bourse and the Investment Dealers Association of Canada are designated as recognized self-regulatory organizations~~.

4) For positions (other than positions of an approved participant that are subject to the provisions of paragraph 7 of article 7213)~~The margin required in respect of positions~~ in warrants issued by a Canadian chartered bank and which ~~are listed on any recognized stock exchange or other listing~~

~~organization referred to above and which~~ entitle the holder to purchase securities issued by the Government of Canada or any province thereof, the required margin must be the greater of the two following elements:

a) The margin otherwise required by paragraph 1) of ~~the present~~this article according to the ~~market value of~~published basic margin rate for the warrant; or

b) 100% of the margin required in respect of the security to which the holder of the warrant is entitled upon exercise of the warrant. However, in the case of a long position, the amount of margin need not exceed the market value of the warrant.

~~5) For the purpose of the present article, "inactive Tier 2" securities are securities of companies classified as Tier 2 issuers that are considered to be inactive by the TSX Venture Exchange. Such securities are identifiable through the use of unique trading symbols.~~

7203 Unlisted Securities Eligible to Margin
(01.04.93, 18.02.00, 13.09.05, 25.11.05, 00.00.06)

a) Provided there exists a verifiable market between dealers and securities brokers for positions in ~~T~~the following unlisted securities ~~may be carried on margin on the same basis as prescribed for listed securities~~:

- securities of Canadian banks;
- securities of insurance companies licensed to do business in Canada;
- securities of Canadian trust companies;
- Securities of mutual funds qualified for sale by prospectus in any Canadian province, except money market mutual funds securities (as defined in Regulation 81-102 regarding mutual funds) which can be margined at a rate of 5%;
- other senior securities of already listed companies;
- unlisted securities in respect of which application has been made to list on a recognized stock exchange in Canada and approval has been given subject to the filing of relevant documents and of satisfactory evidence of distribution may be carried on margin for a period not exceeding 90 days from the date of such approval;
- securities which qualify as legal for investment by Canadian life insurance companies, without recourse to the "basket clause";
- all securities listed on the Nasdaq Stock Market^sm (Nasdaq National Market® and The Nasdaq SmallCap Market^sm).

The required margin or the required credit must be determined on the basis of the published basic margin rate applicable to the most junior listed security of the issuer, as approved by a recognized self-regulatory organization, multiplied by the market value of the position in the security. Where a published rate is not available, the following rules apply**:**

i) Long positions- margin required

- Securities trading at $2.00 or more, 50% of market value
- Securities trading at $1.75 to $1.99, 60% of market value
- Securities trading at $1.50 to $1.74, 80% of market value
- Securities trading under $1.50 may not be carried on margin.

ii) Short positions – credit required

- Securities trading at $2.00 or more, 150% of market value
- Securities trading at $1.50 to $1.99, $3.00 per share
- Securities trading at $0.25 to $1.49, 200% of market value
- Securities trading at less than $0.25, market value plus $0.25 per share.

~~b) Where securities of mutual funds qualified by prospectus for sale in any province or territory of Canada are carried in a client or firm account, the margin required must be:~~

~~i) 5% of the market value of the fund, where the fund is a money market mutual fund as defined in Part 1.1 of National Instrument 81-102 regarding mutual funds; or~~

~~ii) the margin rate determined on the same basis as for listed stocks multiplied by the market value of the fund.~~

~~c~~b) The minimum margin required on all other unlisted securities not mentioned above must be as follows:

Long Positions	**Margin Required**
	100% of market value
Short Positions	**Credit Required**
Securities trading at $0.50 or more	200% of market value
Securities trading at less than $0.50	Market value plus $0.50 per share

7204 Bonds, Debentures, Treasury Bills and Notes
(01.07.86, 04.02.87, 15.09.89 30.04.91, 09.10.91, 01.03.93, 01.05.93, 05.07.93, 01.04.93, 27.05.97, 18.02.98, 29.08.01, 17.05.04, 13.09.05, 00.00.05)

APPENDIX B

GROUP I Governments of Canada, United States, United Kingdom and other foreign national governments

The margins required on bonds, debentures, Treasury bills, and other securities of or guaranteed by the Government of Canada, of the United States, of the United Kingdom and of any other national foreign government (provided such foreign government securities are currently rated Aaa or AAA by Moody's Investors Service Inc. or Standard & Poor's Corporation, respectively), and maturing (or called for redemption) in the periods indicated below, are as follows:

	Margin Required
1 year or less	1% of market value multiplied by the fraction determined by dividing the number of days to maturity by 365.
over 1 year to 3 years	1% of market value
over 3 years to 7 years	2% of market value
over 7 years to 11 years	4% of market value
over 11 years	4% of market value

GROUP II Provinces of Canada and International Bank of Reconstruction and Development

The margins required on bonds, debentures, treasury bills and other securities of or guaranteed by any Province of Canada, bonds of the International Bank of Reconstruction and Development, and bonds and debentures guaranteed by the deposit in trust of a grant payable by a province in Canada covering the principal and the interest maturing, or called for redemption in the time periods indicated below are as follows:

	Margin required
1 year or less	2% of market value multiplied by the fraction determined by dividing the number of days to maturity by 365
over 1 year to 3 years	3% of market value
over 3 years t 7 years	4% of market value
over 7 years to 11 years	5% of market value
over 11 years	5% of market value

GROUP III Municipal, school and hospital corporations and religious orders

Margins required on bonds, debentures or notes (not in default) of or guaranteed by any municipal corporation in Canada or in the United Kingdom, maturing in the time periods indicated below, are as follows:

	Margin required
1 year or less	3% of market value multiplied by the fraction determined by dividing the number of days to maturity by 365
over 1 year to 3 years	5% of market value
over 3 years to 7 years	5% of market value
over 7 years to 11 years	5% of market value
over 11 years	5% of market value

Bonds and debentures (not in default) of or guaranteed by any school corporation, religious order or hospital corporation in Canada, 5% of market value.

GROUP IV Other non-commercial bonds and debentures

The margin required on other non-commercial bonds and debentures (not in default), is equal to 10% of market value.

GROUP V Corporations and trust and mortgage loan companies – non-negotiable and non-transferable debt securities

The margins required on commercial and corporate bonds, debentures and notes (not in default) and non negotiable and non transferable trust company and mortgage loan company obligations registered in the approved participant's name, maturing in the time periods indicated below, are, subject to the provisions of paragraphs a) and b) hereafter, as follows :

	Margin Required
1 year or less	3% of market value
over 1 year to 3 years	6% of market value
over 3 years to 7 years	7% of market value
over 7 years to 11 years	10% of market value
over 11 years	10% of market value

~~a) i) if convertible and trading over par, apply the above rates on par value and add 50% (30% for clients' accounts, 25% for market-makers and approved participants of the Bourse when convertible into shares eligible for a reduced margin rate as provided for in paragraph 3 of article 7202) of the excess of market value over par when convertible into securities acceptable~~

~~for margin purposes or 100% of the excess of market value over par when convertible into securities not acceptable for margin purposes with a minimum addition to the above rates of 10% of par value, whether convertible into securities acceptable or not for margin purposes. If convertible and selling at or below par, add 10% of par value to the quoted rates;~~

~~ii) if trading at 50% of par value and under, and if rated "B" or lower by Canadian Bond Rating Service and Dominion Bond Rating Service for Canadian dollar pay securities or by Moody's and Standard and Poor's for U.S. dollar pay securities, the margin required is 50% of the market value;~~

1) if convertible and selling over par, the margin required must be the lesser of the two following amounts:

   a) the sum of the two following elements :

      i) the par value multiplied by the above rates;

      ii) the excess of market value over the par value;

   b) the maximum margin required for a convertible security calculated pursuant to paragraph 8 of article 7213;

2) if these securities are convertible and selling at or below par, the margin required must be the above rates multiplied by the market value;

3) if these securities are selling at 50% or less of the par value and if they are rated “B” or lower by either Dominion Bond Rating Service or by Canadian Bond Rating Service, the margin required must be 50% of the market value;

4) in the case of U.S. pay securities, if selling at 50% or less of the par value and if rated “B” or lower by either Moody’s or Standard & Poors, the margin required must be 50% of the market value;

5) if these securities are convertible and are residual debt instruments (zero coupon), the margin required is the lesser of the two following amounts :

   a) the greater of

      i) the margin required for a convertible debt instrument calculated pursuant to this Group V;

      ii) the margin required for a residual debt instrument (zero coupon), calculated pursuant to Group XI of this article;

   b) the maximum margin required for a convertible security calculated pursuant to paragraph 8 of article 7213;

6) where such commercial bonds, debentures and notes are debt securities of companies whose notes are acceptable notes, as defined in Group VI of the present article, then the margin requirements of this Group VI must apply.

GROUP VI Corporations and trust and mortgage loan companies – negotiable and transferable debt securities

The margins required on acceptable commercial, corporate and finance company notes, and trust company and mortgage loan company bonds, readily negotiable and transferable and maturing in the time periods indicated below are as follows:

	Margin Required
1 year or less	3% of market value multiplied by the fraction determined by dividing the number of days to maturity by 365
over 1 year	apply rates for commercial and corporate bonds, debentures and notes

Acceptable commercial, corporate and finance company notes means notes issued by a company incorporated in Canada or in any province of Canada and a) having a net worth of not less than $10,000,000 or b) guaranteed by a company having a net worth of not less than $10,000,000 or c) a binding agreement exists whereby a company having a net worth of not less than $25,000,000 is obliged, as long as the notes are outstanding, to pay to the issuing company or to a trustee for the noteholders, amounts sufficient to cover all indebtedness under the notes where the borrower, :

a) files annually under the applicable provincial legislation a prospectus relating to its notes which have a term to maturity of one year or less and provides to approved participants acting as authorized agents the following information in written form:

   i) disclosure of limitation, if any, on the maximum principal amount of notes authorized to be outstanding at any one time;

   ii) a reference to the bank lines of credit of the borrower or of its guarantor if a guarantee is required;

   or

b) provides to approved participants acting as authorized agents an information circular or memorandum which includes or is accompanied by the following:

   i) recent audited financial statements of the borrower or of its guarantor if a guarantee is required;

   ii) an extract from the borrower's general borrowing by-law dealing with the borrower's corporate authorization to borrow;

   iii) a true copy of a resolution of directors of the borrower certified by the borrower's secretary, and stating in substance:

[1] the limitation, if any, on the maximum amount authorized to be borrowed by way of issues or notes;

[2] those officers of the borrower company who may legally sign the notes by hand or by facsimile;

[3] the denomination in which notes may be issued;

iv) where notes are guaranteed, a certified copy of a resolution of directors of the guarantor company, authorizing the guarantee of such notes;

v) a certificate of incumbency and facsimile signatures of the authorized signing officers of the borrower and its guarantor, if any;

vi) specimen copies of the note or notes;

vii) a favorable opinion from the legal counsel of the borrower regarding the incorporation, the organization and the corporate status of the borrower, its corporate capacity to issue the notes and the due authorization by it of the issuance of the notes;

viii) where notes are guaranteed, a favorable opinion from the legal counsel of the guarantor regarding the incorporation, the organization and the corporate status of the guarantor, its capacity to guarantee the notes and the due authorization, validity and effectiveness of its guarantee;

ix) a summary setting forth the following:

[1] a brief historical summary of the borrowing company and of its guarantor, if any;

[2] the purpose of the issue;

[3] a reference to the bank lines of credit of the borrowing company or of its guarantor, if a guarantee is required;

[4] the denomination in which notes may be issued.

GROUP VII Bonds in default

The margin required on bonds in default must be equal to 50% of market value.

GROUP VIII Income bonds

The margins required on income bonds and debentures on which interest has been paid in full at the stated rate for the two preceding years as required by the related trust indenture which must specify that such interest be paid if earned, are as follows:

Currently paying interest at the stated rate :

Margin required

10% of market value

Not paying interest, or paying at less than the stated rate :

Margin required

50% of market value

GROUP IX British Columbia Government guaranteed parity bonds:

Long Positions : ¼ of 1 % of par value or rates prescribed under Group II above;

Short Positions: rates prescribed under Group II above.

GROUP X Floating rate debt obligations:

50% of the rates of margin otherwise required. If margin is otherwise required in respect of excess market value over par, 100 % of the margin rates otherwise required must apply to the excess market value.

For the purpose of this paragraph, the term "floating rate debt obligation" means a debt instrument described in Groups I, II, III and VI of the present article and in article 7205 for which the rate of interest is adjusted at least quarterly by reference to an interest rate for periods of 90 days or less.

This paragraph is applicable only to an account of a market-maker or to inventory accounts of an approved participant.

GROUP XI Stripped Coupons and Residual Debt Securities

1) The margin required for stripped coupons and residual debt securities, which is based on a percentage of the market value, is equal to:

   a) for securities with a term to maturity of less than 20 years, one and a half times the margin rate applicable to the debt instrument which has been stripped or to which the detached coupon or other evidence of interest relates; and

   b) for securities with a term of 20 years or more, three times the margin rate applicable to the debt instrument which has been stripped or to which the detached coupon or other evidence of interest relates.

   In determining the term to maturity of a coupon or other evidence of interest, the payment date for such interest must be considered the maturity date ~~-~~.~~date for the purposes of the present paragraph)~~ Margin in respect of residual debt instruments which are convertible into other securities must be determined in accordance with Group V of this article.

2) Where an approved participant holds a short (or long) position in bonds or debentures denominated in Canadian dollars issued or guaranteed by either the Government of Canada or a Province of Canada and also holds a long (or short) position in the stripped coupons or residual portion of such debt

securities, the margin required must be the excess of the margin required on the long (or short) position over the margin required on the short (or long) position, provided that the net margin may only be determined as aforesaid on the basis that:

a) margin required in respect of a short (or long) position in bonds or debentures may only be netted against margin required in respect of a long (or short) position in stripped coupons or residual portion to the extent that the market value of the two positions is equal. No offset is permitted in respect of the market value of a short (or long) position which is in excess of the market value of the long (or short) position;

b) margin required in respect of bonds or debentures issued or guaranteed by the Government of Canada may only be netted against the margin required for the stripped coupons or residual portion of other Government of Canada securities which mature within the same periods referred to in Group I of the present article;

c) margin required in respect of bonds or debentures issued or guaranteed by a Province of Canada may only be netted against the margin required for the stripped coupons or residual portion of another Province of Canada securities which mature within the same periods referred to in Group II of the present article.

3) Notwithstanding the foregoing provisions of this Group XI, where an approved participant holds:

a) a short (or long) position in bonds or debentures issued or guaranteed by the Government of Canada and a long (or short) position in the stripped coupons or residual portion of bonds or debentures issued or guaranteed by a province of Canada; or

b) a short (or long) position in bonds or debentures issued or guaranteed by a province of Canada and a long (or short) position in the stripped coupons or residual portion of bonds or debentures issued or guaranteed by the Government of Canada;

the margin required must be 50% of the total margin required for both positions otherwise determined under the Rules, provided that such margin may only be determined as aforesaid on the basis that:

i) margin required in respect of a short (or long) position in bonds or debentures may only be netted against margin required in respect of a long (or short) position in stripped coupons or residual portion to the extent that the market value of the two positions is equal, and no such netting is permitted in respect of the market value of a short (or long) position which is in excess of the market value of the long (or short) position;

ii) margin required in respect of bonds or debentures may only be netted against the margin required for the stripped coupons or residual portion of securities which mature within the same periods referred to in Group I and II of this article;

iii) the bonds and debentures and the stripped coupons or residual portion of such debt instrument must be denominated in Canadian dollars.

4) Where an approved participant holds a short (or long) position in bonds or debentures denominated in Canadian dollars issued by a corporation with a single A or higher rating by any of Canadian Bond

Rating Service, Dominion Bond Rating Service, Moody's Investors Service or Standard and Poor's Bond Record, and also holds a long (or short) position in the stripped coupon or residual portion of such debt instruments, the margin required must be the lesser of 20% and the greater of the margin required on the long (or short) position and the margin required on the short (or long) position, provided that the margin may only be determined as aforesaid on the basis that:

a) the offset is permitted only to the extent that the market value of the two positions is equal, and no offset is permitted in respect of the market value of a short (or long) position which is in excess of the market value of the long (or short) position; and

b) margin required in respect of bonds or debentures issued by a corporation may only be offsetted against the margin required for the stripped coupons or residual portion of debt instruments of the same issuer, which mature within the same periods referred to in Group XI in this article for the purpose of determining margin rates.

5) Where an approved participant holds a short (or long) position in bonds or debentures denominated in a foreign currency referred to in Group I of this article and also holds a long (or short) position in the stripped coupons or residual portion of such debt instruments denominated in the same currency, the margin required must be the excess of the margin required on the long (or short) position over the margin required on the short (or long) position, provided that the net margin may only be determined as aforesaid on the basis that:

a) margin required in respect of a short (or long) position in bonds or debentures may only be netted against margin required in respect of a long (or short) position in stripped coupons or residuals to the extent that the market value of the two positions is equal, and no such netting or offset is permitted in respect of the market value of a short (or long) position which is in excess of the market value of the long (or short) position; and

b) margin required in respect of bonds or debentures issued or guaranteed by a particular government may only be netted against the margin required for the stripped coupon or residual portion of debt instruments of the same government, which mature within the same periods referred to in Group I of this article for the purpose of determining margin rates.

GROUP XII Mortgage-backed securities

On securities which are based upon mortgages and are guaranteed as to timely payment of principal and interest by the issuer or its agent, the margin rate is the rate prescribed in articles 7204, 7205 and 7206 applicable to the securities of such guarantor according to the relevant maturity plus an additional margin of 25% of such applicable rate.

Where an approved participant holds a short (or long) position in bonds or debentures issued or guaranteed by the Government of Canada and also holds a long (or short) position in mortgage-backed securities guaranteed by the Government of Canada, the margin required must be the excess of the margin required on the long (or short) position over the margin required on the short (or long) position, provided that the net margin may only be determined as aforesaid on the basis that:

1) Margin required in respect of a short (or long) position in bonds or debentures may only be netted against margin required in respect of a long (or short) position in mortgage-backed securities to the extent that the market value of the two positions is equal. No netting or offset is permitted in respect

of the market value of a short (or long) position which is in excess of the market value of the long (or short) position;

2) Margin required in respect of bonds or debentures may only be netted against the margin required for the mortgage-backed securities which mature within the same periods referred to in the present article for the purpose of determining margin rates; and

3) Notwithstanding the foregoing, if the market value of a long (or short) position in mortgage-backed securities exceeds the remaining principal amount of such position and the mortgages underlying such mortgage-backed securities position are subject to being repaid in full at the option of the mortgagee prior to maturity, the margin required must be the greater of the individual margins for (i) the long (or short) position in mortgage-backed securities as determined under the present paragraph or (ii) the short (or long) position in bonds or debentures as determined under Group I of this article.

7213 Exceptions to Margin Rules
(30.11.86, 15.12.86, 01.06.88, 01.01.92, 15.01.93, 10.05.93, 01.04.93, 25.02.94, 12.03.97, 21.12.98, 29.08.01, 18.07.03, 01.01.04, 17.05.04, 01.01.05, 13.09.05, 00.00.06)

Exceptions to the margin rules are the following:

1) No margin is required on securities meeting the following conditions:

a) securities which have been formally called for cash redemption;

b) securities for which a legal and binding cash offer has been made provided that:

i) all conditions of the offer have been met;

ii) securities are not carried for an amount in excess of the price offered.

When the legal and binding cash offer is for less than 100% of the issued and outstanding securities and all conditions of the offer have been met, the margin required must be adjusted prorata to shares purchased by the offeror on the number of shares deposited;

c) deposit certificates issued by a Canadian chartered bank or a trust company in Canada qualifying as an acceptable institution or an acceptable counterparty, as these terms are defined in Policy C-3 of the Bourse, and having a 24-hour call feature that would not reduce the principal amount received on redemption if applicable.

2) Margin requirements for potential liability under an underwritten rights or warrants agreement.

Where an underwriter has a commitment to purchase securities in connection with a rights or warrants offering, such commitment must be margined at the following rates:

a) if the market value of the security which can be acquired pursuant to the exercise of the rights or warrants is below the subscription price, the underwriter's commitment must be valued at the current market price for the security and the margin rates applicable to the security must be applied;

b) if the market value of the security is equal to or greater than the subscription price, the commitment must be margined at rates, calculated on the subscription price, equal to the following percentage of the margin rate applicable to the security under the present section:

50%, where market value is 100% to 105% of the subscription price;

30%, where market value is more than 105% but not more than 110% of the subscription price;

10% where market value is more than 110% but not more than 125% of the subscription price;

no margin is required where market value is more than 125% of the subscription price.

~~3) Securities eligible to a reduced margin rate~~

~~The margin required is 25% of the market value if such securities held by an approved participant are:~~

~~i) on the list of securities eligible to a reduced margin rate as approved by a recognized self-regulatory organization and such securities continue to trade at $2.00 or more;~~

~~ii) securities against which options issued by the Options Clearing Corporation are traded;~~

~~iii) convertible into securities that qualify under the subparagraph i) or subparagraph ii);~~

~~iv) non-convertible preferred and senior shares of an issuer any of whose securities qualify under subparagraph i); or~~

~~v) securities whose original issuance generated Tier 1 capital for a financial institution any of whose securities qualify under subparagraph i) and the financial institution is under the regulatory oversight of the Office of the Superintendent of Financial Institutions of Canada.~~

~~For the purpose of the present paragraph 3), the Bourse and the Investment Dealers Association of Canada are designated as recognized self-regulatory organizations.~~

~~4) Whenever the Bourse decides not to open for trading any additional options of the class covering that underlying security according to article 6605, the margin rate as permitted in paragraph 3) of this article remains in force up to the expiration of the last series of options.~~

3~~5~~) Any security which is part of a control block has no loan value for margin calculation purposes, except to the extent that the control block constitutes any or all of the securities which an approved participant has an obligation or commitment to acquire, or has acquired, under a prospectus filing. In such case, the appropriate margin requirement provided for in article 7224 applies as long as the criteria in said article have been met. For the purpose of the present paragraph, a "control block" means a sufficient number of any securities of the same issuer to affect materially the control of that issuer. In the absence of evidence to the contrary, any holding by any person, company or combination of persons or companies of more than 20% of the outstanding voting securities of an issuer is deemed to affect materially the control of that issuer.

4~~6~~) Where the account of an approved participant, a market-maker or a restricted trading permit holder contains preferred shares for which the principal and dividends are unconditionally guaranteed by the Canadian government or a provincial government, the margin rate for these securities must be 25% of their market value.

5~~7~~) ~~a)~~For the purposes ~~of sub-paragraphs b) to f)~~ of this paragraph, the term "floating rate preferred share" means a special or a preferred share, for which the rate of dividend fluctuates at least quarterly, in relation with a prescribed short-term interest rate. ~~The sub-paragraphs b) to f) of this paragraph are applicable only to an account of a market-maker, a restricted trading permit holder or inventory account of an approved participant.~~

~~b) Margin on floating rate preferred shares of companies with securities which are eligible to a reduced margin rate under paragraph 3 of article 7202 must be provided at the rate of 10% of the market value of such securities.~~

~~c) The margin rate which must be applied on floating rate preferred shares which qualify for margin under this paragraph, but which are of companies which do not have securities which are eligible to a reduced margin rate under paragraph 3 of article 7202, is 25% of the market value of such securities.~~

~~d) Where the issuer is in default of payment of a dividend due on floating rate preferred shares which qualify for margin purposes under this paragraph, margin must be provided at the rate of 50% of the market value of such securities.~~

~~e) Where the floating rate preferred shares of companies with securities which are eligible to a reduced margin rate under paragraph 3 of article 7202 are convertible and are trading over par, margin must be provided at the rate of 10% of the par value of such securities plus 25% of the excess of market value of such securities over par.~~

~~f) Where the floating rate preferred shares of companies which do not have securities which are eligible to a reduced margin rate under paragraph 3 of article 7202, but are convertible and are trading over par, margin must be provided at the rate of 25% of the par value of such securities plus 50% of the excess of market value of such securities over par.~~

~~8) a) For the purposes of sub-paragraphs b) to f) of this paragraph, the term "floating rate preferred share" means a preferred share, by the terms of which the rate of dividend fluctuates at least quarterly, in tandem with a prescribed short-term interest rate. The sub-paragraphs b) to f) of this paragraph are applicable only to an account of a market-maker, specialist, a restricted trading permit holder or inventory account of an approved participant.~~

~~b) Margin on floating rate preferred shares of companies with securities which are eligible to a reduced margin rate under paragraph 3 of article 7202 of the Rules of the Bourse must be provided at the rate of 10% of the market value of such securities.~~

~~c) The margin rate which must be provided on floating rate preferred shares which qualify for margin under this paragraph but which are of companies which do not have securities which are eligible to a reduced margin rate under paragraph 3 of article 7202 of the Rules of the Bourse, is 25% of the market value of such securities.~~

~~d) Where the issuer is in default of payment of a dividend due on floating rate preferred shares which qualify for margin under this paragraph, margin must be provided at the rate of 50% of the market value of such securities.~~

~~e) Where the floating rate preferred shares of companies with securities which are eligible to a reduced margin rate under paragraph 3 of article 7202 of the Rules of the Bourse are convertible and are selling over par, margin must be provided at the rate of 10% of the par value of such securities plus 25% of the excess of market value of such securities over par.~~

~~f) Where the floating rate preferred shares of companies which do not have securities which are eligible to a reduced margin rate under paragraph 3 of article 7202 of the Rules of the Bourse, but are convertible and are selling over par, margin must be provided at the rate of 25% of the par value of such securities plus 50% of the excess of market value of such securities over par.~~

The margin rates applicable to floating rate preferred shares are the following ones:

i) 50% of the margin rate that applies to the related junior security of the issuer multiplied by the market value of the floating rate preferred shares;

ii) If the floating rate preferred shares are selling over par and are convertible into other securities of the issuer, the margin required must be the lesser of:

A) the sum of:

I) the effective rate determined in subparagraph i) above multiplied by par value; and

II) the excess of market value over par value;

and

(B) the maximum margin requirement for a convertible security calculated pursuant to paragraph 8 of this article.

(iii) 50%, if the issuer of the shares is in default of the payment of any dividend on the shares, in which case, the foregoing clauses are not applicable.

6~~9~~) Consideration other than cash to be obtained following an offer

a) For the purpose of computing the margin on shares which are the subject of an offer, and in respect of which all conditions have been met, the margin required may be computed on the consideration, other than cash, that would be obtained upon acceptance of the offer. The margin rate to be used is the one prescribed in articles 7201 and following on the consideration to be obtained.

b) Where the offer is made for less than 100% of the issued and outstanding shares, the preceding principle must be applied pro rata in the same proportion as the offer.

7~~10~~) Bank warrants for governments securities

~~Where the account of a market maker or an approved participant contains~~ The margin required on bank warrants for government securities must be~~the~~ 100% of the margin rate which is~~must be the one~~ required in respect of the securities to which the holder of the warrant is entitled upon exercise of the warrant provided that, in the case of a long position, margin need not exceed the market value of the warrant.

For the purpose of this paragraph, bank warrants for government securities means warrants issued by a Canadian chartered bank which are listed on any recognized stock exchange or on any other listing organization referred to in paragraph 1) of article 7202, and which entitle the holder to purchase securities issued by the Government of Canada or any province thereof.

8~~11~~)Maximum Margin Required for Convertible Securities

The margin required for a security that is currently convertible or exchangeable into another security (the "underlying security") need not exceed the sum of:

i) the margin required for the underlying security; and

ii) any excess of the market value of the convertible or exchangeable security over the market value of the underlying security.

7224 Margin Requirements for Underwriting Commitments
(01.06.88, 19.08.93, 01.03.05, 00.00.05)

a) In the present article, the expression:

i) “appropriate documentation” with respect to the portion of the underwriting commitment where expressions of interest have been received from exempt purchasers means, at a minimum:

A) that the lead manager has a record of the final affirmed exempt purchaser allocation indicating for each expression of interest:

I) the name of the exempt purchaser;

II) the name of the employee of the exempt purchaser accepting the amount allocated;

III) the name of the representative of the lead underwriter responsible for affirming the amount allocated to the exempt purchaser; and

IV) the date and time of the affirmation,

and

B) that the lead manager has notified in writing all the banking group participants when the entire allotment to exempt purchasers has been affirmed pursuant to paragraph A) above so that all banking group participants may take advantage of the reduction in the capital requirement.

Under no circumstances may the lead manager reduce its own capital requirement on an underwriting commitment due to such expressions of interest from exempt purchasers without providing notification to the rest of the banking group.

ii) a “commitment” pursuant to an underwriting agreement or banking group agreement to purchase a new issue of securities or a secondary issue of securities means, where all other non-pricing agreement terms have been agreed to, where two of the following three pricing terms have been agreed to:

A) issue price;

B) number of shares;

C) commitment amount [issue price x number of shares].

iii) "disaster out clause" means a provision in an underwriting agreement substantially in the following form:

“The obligations of the underwriter (or any of them) to purchase the securities under this agreement may be terminated by the underwriter (or any of them) at its option by written notice to that effect to the issuer at any time prior to the closing if there should develop, occur or come into effect or existence any event, action, state, condition or major financial occurrence of national or international consequence or any law or regulation which, in the opinion of the underwriter, seriously affects adversely, or involves, or will seriously affect adversely, or involve, the financial markets or the business, operations or affairs of the issuer and its subsidiaries taken as a whole”.

iv) “exempt purchasers” means all persons with whom the issuer could, pursuant to applicable securities laws, proceed with the sales of securities without having the obligation to produce a prospectus if such sales were made exclusively to these persons.

v) "market out clause" means a provision in an underwriting agreement which permits an underwriter to terminate its commitment to purchase in the event of unsaleability due to market conditions, substantially in the following form:

“If, after the date hereof and prior to the time of closing, the state of financial markets in Canada or elsewhere where it is planned to market the securities is such that, in the reasonable opinion of the underwriters (or any of them), the securities cannot be marketed profitably, any underwriter must be entitled, at its option, to terminate its obligations under this agreement by notice to that effect given to the issuer at or prior to the time of closing”.

vi) "new issue letter" means an underwriting loan facility in a form satisfactory to the Bourse. Where the provider of the new issue letter is other than an acceptable institution, the funds that can be drawn pursuant to the letter must either be fully collateralized by high-grade securities or held in escrow with an acceptable institution.

Under the terms of the new issue letter, the letter issuer must:

A) provide an irrevocable commitment to advance funds based only on the strength of the new issue and the approved participant;

B) advance funds to the approved participant for any portion of the commitment not sold:

I) for an amount based on a stated loan value rate;

II) at a stated interest rate; and

III) for a stated period of time,

and

C) under no circumstances, in the event that the approved participant is unable to repay the loan at the termination date, resulting in a loss or potential loss to the letter issuer, have or seek any right of set-off against:

I) collateral held by the letter issuer for any other obligations of the approved participant or the approved participant's clients;

II) cash on deposit with the letter issuer for any purpose whatsoever; or

III) securities or other assets held in a custodial capacity by the letter issuer for the approved participant either for its own account or for the approved participant's clients,

in order to recover the loss or potential loss.

vii) "normal margin" means margin otherwise required by the Rules.

~~viii) "normal new issue margin" means:~~

~~A) where the market value of the security is $2.00 per share or more and the security qualifies for a reduced margin rate pursuant to paragraph 3 of article 7213, 60% of normal margin for the period from the date of commitment to the business day prior to settlement date and 100% of normal margin from settlement date on; or~~

~~B) where the market value of the security is $2.00 per share or more and the security does not qualify for a reduced margin rate pursuant to paragraph 3 or article 7213, 80% of normal margin for the period from the date of commitment to the business day prior to settlement date and 100% of normal margin from settlement date on; or~~

~~C) where the market value of the security is less than $2.00 per share, 100% of normal margin.~~

b) Where an approved participant has a commitment pursuant to an underwriting agreement or banking group agreement to purchase a new issue of securities or a secondary issue of securities, the following margin rates are prescribed:

i) without new issue letter:

A) in the case where the underwriting agreement includes neither a disaster out clause nor a market out clause:

normal ~~new issue~~ margin from the date of commitment;

B) in the case where the underwriting agreement includes a disaster out clause:

50% of normal ~~new issue~~ margin from the date of the commitment until settlement date or the expiry of the disaster out clause, whichever is earlier. Thereafter margin as required in A) above applies;

C) in the case where the underwriting agreement includes a market out clause:

10% of normal ~~new issue~~ margin from the date of commitment until settlement date or the expiry of the market out clause, whichever is earlier. Thereafter margin as required in A) above applies;

D) in the case where the underwriting agreement includes a disaster out clause and a market out clause:

10% of normal ~~new issue~~ margin from the date of commitment until settlement date or the expiry of the market out clause, whichever is earlier. Thereafter margin as required in A), B) and C) above applies.

ii) with new issue letter:

A) in the case where the underwriting agreement includes neither a disaster out clause nor a market out clause:

10% of normal ~~new issue~~ margin from the date of the letter to the business day prior to settlement date or when the new issue letter expires, whichever is earlier;

10% of normal ~~new issue~~ margin from settlement date to 5 business days after settlement date or when the new issue letter expires, whichever is earlier, where the new issue letter has been drawn;

25% of normal ~~new issue~~ margin for the next succeeding 5 business days or when the new issue letter expires, whichever is earlier, where the new issue letter has been drawn;

50% of normal ~~new issue~~ margin for the next succeeding 5 business days or when the new issue letter expires, whichever is earlier, where the new issue letter has been drawn;

75% of normal ~~new issue~~ margin for the next succeeding 5 business days or when the new issue letter expires, whichever is earlier, where the new issue letter has been drawn;

otherwise, the normal ~~new issue~~ margin is required;

B) in the case where the underwriting agreement includes a disaster out clause:

10% of normal ~~new issue~~ margin from the date of the commitment until the settlement date or the expiry of the disaster out clause, whichever is earlier. Thereafter margin as required in A) above applies;

C) in the case where the underwriting agreement includes a market out clause:

5% of normal ~~new issue~~ margin from the date of commitment until the settlement date or the expiry of the market out clause, whichever is earlier. Thereafter margin as required in A) above applies;

D) in the case where the underwriting agreement includes a disaster out clause and a market out clause:

5% of normal ~~new issue~~ margin from the date of commitment until the settlement date or the expiry of the market out clause, whichever is earlier. Thereafter margin as required in A), B) and C) above applies.

If the margin rates prescribed above in respect of commitments for which a new issue letter is available are less than the margin rates required by the issuer of such letter, the higher rates required by the issuer must be applied.

c) Where an approved participant has a commitment pursuant to an underwriting agreement or banking group agreement to purchase a new issue of securities or a secondary issue of securities and the approved participant has determined through obtaining appropriate documentation:

I) that the allocation between retail and exempt purchasers has been finalized;

II) that expressions of interest received from the entire allotment to exempt purchasers have been verbally affirmed but not yet ticketed;

III) that there is unlikely to be a significant renege rate on the expressions of interest received from exempt purchasers; and

IV) that the approved participant is not significantly leveraging its underwriting activities through the use of the capital requirement reduction provided on that portion of the underwriting commitment where expressions of interest have been received from exempt purchasers.

The following margin rates must be applied for the portion of the commitment allocated to exempt purchasers:

i) without new issue letter:

A) in the case where the underwriting agreement includes neither a market out clause nor a disaster out clause:

From the date that the expressions of interest received from the entire allotment to exempt purchasers have been verbally affirmed but not yet ticketed until the date the sales are contracted:

20% of normal ~~new issue~~ margin is required, provided the current market value of the commitment is at or above 90% of new issue value (90% x issue price x number of shares);

40% of normal ~~new issue~~ margin is required, provided the current market value of the commitment is at or above 80% of new issue value (80% x issue price x number of shares) but less than 90% of new issue value;

otherwise, normal ~~new issue~~ margin is required;

B) in the case where the underwriting agreement includes a disaster out clause:

from the date that the expressions of interest received from the entire allotment to exempt purchasers have been verbally affirmed but not yet ticketed until the date the sales are contracted:

20% of normal ~~new issue~~ margin is required, provided the current market value of the commitment is at or above 90% of new issue value (90% x issue price x number of shares);

40% of normal ~~new issue~~ margin is required, provided the current market value of the commitment is at or above 80% of new issue value (80% x issue price x number of shares) but less than 90% of new issue value;

otherwise normal ~~new issue~~ margin is required;

C) in the case where the underwriting agreement includes a market out clause:

margin required is the one prescribed in paragraph b) i) C) above;

D) in the case where the underwriting agreement includes a disaster out clause and a market out clause:

margin required is the one prescribed in paragraph b) i) D) above.

ii) with new issue letter:

A) in the case where the underwriting agreement includes neither a disaster out clause nor a market out clause:

margin required is the one prescribed in paragraph b) ii) A) above;

B) in the case where the underwriting agreement includes a disaster out clause:

margin required is the one prescribed in paragraph b) ii) B) above;

C) in the case where the underwriting agreement includes a market out clause:

margin required is the one prescribed in paragraph b) ii) C) above;

D) in the case where the underwriting agreement includes a disaster out clause and a market out clause:

margin required is the one prescribed in paragraph b) ii) D) above.

d) Concentration

Where the normal ~~new issue~~ margin required is reduced by a new issue letter or by a qualifying expressions of interest received from exempt purchasers that have been verbally affirmed but not yet contracted, the approved participant must determine if there is any concentration by doing the calculations prescribed in the Joint Regulatory Financial Questionnaire and Report.

e) In determining the amount of an approved participant's commitment pursuant to an underwriting agreement or banking group agreement for the purposes of paragraphs b), c) and d) above, receivables from members of the banking or selling groups in respect of their obligations to take down a portion of a new issue of securities may be deducted from the liability of the approved participant to the issuer.

APPENDIX B

DATE: ________________________

SCHEDULE 2

PART II
JOINT REGULATORY FINANCIAL QUESTIONNAIRE AND REPORT

____
(Firm Name)

ANALYSIS OF SECURITIES OWNED AND SOLD SHORT AT MARKET VALUE

Category	----------**Market Value**--------- **Long**	**Short**	**Margin required**
1. Money market	$________	$________	$________
Accrued interest	________	________	NIL
TOTAL MONEY MARKET	________	________	
2. Bonds	________	________	________
Accrued interest	________	________	NIL
TOTAL BONDS	________	________	
3. Equities	________	________	________
Accrued interest on convertible debentures	________	________	NIL
TOTAL EQUITIES	________	________	
4. Options	________	________	________
5. Futures	NIL	NIL	________
6. Other	________	________	________
Accrued interest	________	________	NIL
TOTAL OTHER	________	________	
~~7. Registered traders, specialists and market makers *[see instructions]*~~	~~NIL~~	~~NIL~~	~~________~~
~~8~~7. TOTAL	________	$============ A-52	$============ B-7
~~9~~8. **LESS**: Securities, including accrued interest, segregated for client free credit ratio calculation *[see instructions]*	________ A-8 & D-7		
~~10~~9. NET TOTAL	$============ A-7		

SUPPLEMENTARY INFORMATION

~~11~~10. Market value of securities included above but held on deposit with Acceptable Clearing Corporations or Regulated Entities as variable base deposits or margin deposits $============

~~12~~11. Margin reduction from offsets against Trader reserves, PDO guarantees or General allowances $============

APPENDIX B

SCHEDULE 2
NOTES AND INSTRUCTIONS

1. All securities are to be valued at market (see General Notes and Definitions) as of the reporting date. The margin rates to be used are those outlined in the bylaws, rules and regulations of the Joint Regulatory Bodies and the Canadian Investor Protection Fund.

2. Schedule 2 summarizes **all** securities owned and sold short by the categories indicated. Details that must be included for each category are total long market value, total short market value and total margin required as indicated.

3. Where the firm utilizes the computerized options margining program of a recognized Exchange operating in Canada, the margin requirement produced by such program may be used provided the positions in the firm's records agree with the positions in the Exchange computer. No details of such positions are to be reported if the programs are employed. Details of any adjustments made to the margin calculated by an Exchange computer-margining program must be provided. For the purposes of this paragraph, recognized Exchange means The Montreal Exchange.

4. The Examiners and/or Auditors of the Joint Regulatory Bodies may request additional details of securities owned or sold short as they, in their discretion, believe necessary.

5. Where there are margin offsets between categories, the residual should be shown in the category with the larger initial margin required before offsets.

Line 1 - Money market shall include Canadian & US Treasury Bills, Bankers Acceptances, Bank paper (Domestic & Foreign), Municipal and Commercial Paper or other similar instruments.

Supplementary instructions for reporting money market commitments:

"Market Price" for money market commitments [fixed-term repurchases, calls, etc.] shall be calculated as follows:

(a) Fixed date repurchases [no borrower call feature] - the <u>market price</u> is the price determined by applying the <u>current yield</u> for the security to the term of maturity from the repurchase date. This will permit calculation of any <u>profit or loss</u> based on the market conditions at the reporting date. Exposure due to future changes in market conditions is covered by the margin rate.

(b) Open repurchases [no borrower call feature] - prices are to be determined as of the reporting date or the date the commitment first becomes open, whichever is the later. <u>Market price</u> is to be determined as in (a) and <u>commitment price</u> is to be determined in the same manner using the yield stated in the repurchase commitment.

(c) Repurchase with borrower call features - the <u>market price</u> is the borrower call price. No margin is required where the total consideration for which the holder can put the security back to the dealer is less than the total consideration for which the dealer may put the security back to the issuer. However, where a holder consideration exceeds dealer consideration [the dealer has a loss], the margin required is the lesser of:

(1) the prescribed rate appropriate to the term of the security, and

(2) the spread between holder consideration and dealer consideration [the loss] based on the call features subject to a minimum of 1/4 of 1% margin.

~~**Line 7 -** (i) The minimum margin requirement for each TSE registered trader is $50,000.~~

~~(ii) The minimum margin requirement for each ME registered specialist is the lesser of $50,000 or an amount sufficient to assume a position of twenty board lots of each security in which such specialist is registered, subject to a maximum of $25,000 per issuer.~~

~~(iii) The market maker minimum margin requirement is for the TSE $50,000 for each specialist appointed and for the ME $10,000 for each security and/or class of options appointed (not to exceed $25,000 for each market maker in each preceding case). No minimum margin is required where the market maker does not have an appointment.~~

~~The above-noted minimum margin for each registered trader, specialist, or market maker may be applied as an offset to reduce any margin on positions held long or short in the registered trading account of such registered trader, specialist or market maker. It cannot be used to offset margin required for any other registered trader, specialist or market maker or for any other security positions of the member.~~

~~The market values related to positions in registered traders, specialists and market maker accounts should be included in the appropriate categories in the preceding lines of the Schedule. Related margin in excess of the minimum margin reported on this line should also be included in the preceding lines.~~

Line ~~9~~<u>8</u> - The securities to be included are bonds, debentures, treasury bills and other securities with a term of 1 year or less, or guaranteed by the Government of Canada or a Province of Canada, the United Kingdom, the United States of America and any other national foreign government (provided such other foreign government is a party to the Basle Accord), which are segregated and held separate and apart as the Member firm's property.

Line ~~12~~<u>11</u> - Include margin reductions from offsets against IA reserves only to the extent there is a written agreement between the firm and the trader permitting the firm to recover realized or unrealized losses from the IA reserve account. Include margin reductions arising from guarantees relating to inventory accounts by Partners, Directors, and Officers of the firm (PDO Guarantees). Include margin reductions arising from offsets against non-specific allowances of the firm.