



**CIRCULAR**  
February 12, 2004

## **REQUEST FOR COMMENTS**

### **ACCEPTABLE COUNTERPARTIES AND ACCEPTABLE INSTITUTIONS**

### **AMENDMENTS TO THE GENERAL NOTES AND DEFINITIONS OF THE “JOINT REGULATORY FINANCIAL QUESTIONNAIRE AND REPORT”**

#### **Summary**

The Rules and Policies Committee of Bourse de Montréal Inc. (the "Bourse") has approved amendments to the General Notes and Definitions of the “Joint Regulatory Financial Questionnaire and Report” – Policy C-3 of the Bourse, which deal with acceptable counterparties and acceptable institutions. The objective of the proposed amendments is to allow foreign pension funds subject to a regulatory regime that is enforced in one of the countries that are members of the Basle Accord to be classified as acceptable counterparties (for foreign pension funds with total net assets in excess of \$15 million) or as acceptable institutions (for foreign pension funds with total net assets in excess of \$300 million). These amendments will facilitate access to foreign pension funds as clients for approved participants by reducing the regulatory capital requirement (foreign pension funds being currently classified only as acceptable counterparties).

#### **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 broker-dealers regulation responsibilities. The broker-dealers regulated by the Bourse are 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.: 019-2004

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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 the General Notes and Definitions 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  
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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, 22<sup>nd</sup> Floor  
P.O. Box 246, Tour de la Bourse  
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## **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".



### ACCEPTABLE COUNTERPARTIES AND ACCEPTABLE INSTITUTIONS

#### – AMENDMENTS TO THE GENERAL NOTES AND DEFINITIONS OF THE “JOINT REGULATORY FINANCIAL QUESTIONNAIRE AND REPORT” – POLICY C-3 OF THE BOURSE

#### I OVERVIEW

##### A) Introduction

Policy C-3 (Joint Regulatory Financial Questionnaire and Report) of Bourse de Montréal Inc. (the “Bourse”) makes a distinction between various types of institutional clients in the calculation of an approved participant’s risk adjusted capital. Institutional clients are categorized in accordance with, among other things, their financial resources and the kind of financial services they provide. Another major criteria that is considered is the level of regulatory supervision to which the institutions are subjected.

The categorization of each client is important because the calculation of the regulatory capital is different for each type of clients. For example, an “acceptable counterparty” is an entity with which the approved participant may deal on a value for value basis, with the obligation to mark to market the outstanding transactions while an “acceptable institution” is an entity with which the approved participant is permitted to deal on an unsecured basis without capital penalty. Attachment 1 lists the entities

that are currently classified as acceptable counterparties and as acceptable institutions<sup>1</sup>.

##### B) The Issue

As shown in attachment 1, foreign entities may be classified as acceptable counterparties and acceptable institutions if they are subject to a satisfactory regulatory regime<sup>2</sup>. Foreign banks, trust companies and insurance companies may be classified as acceptable counterparties or acceptable institutions based on more stringent criteria than those used to classify similar Canadian entities. Generally, the financial criteria are 1.5 times higher for foreign entities than for Canadian entities. However, the foreign equivalent to a Canadian pension fund cannot be considered as an acceptable institution (currently, a foreign pension fund may only be classified as an acceptable counterparty, regardless of its net assets balance). The purpose of the proposed amendments to the General Notes and Definitions of Policy C-3 of the Bourse is to allow foreign pension funds that are subject to a satisfactory regulatory regime to be classified as acceptable counterparties or acceptable institutions.

##### ▪ Satisfactory regulatory regime for foreign pension funds

Whatever the type of pension plans under which a pension fund operates (defined contribution plan, defined benefit plan or others), countries that are members of the Basle Accord have regulations regarding the governance of pension funds. Policies and laws, like the “*Employee Retirement Income Security Act* (ERISA)” in the

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<sup>1</sup> Attachment 1 presents a summary of the criteria used to determine an acceptable institution and an acceptable counterparty. For further information, see paragraphs b) and c) of the General Notes and Definitions of Policy C-3 of the Bourse.

<sup>2</sup> The expression “subject to a satisfactory regulatory regime” is defined in the General Notes and Definitions of Policy C-3 of the Bourse and means “subject to a regulatory regime that is enforced in one of the countries that are members of the Basle Accord”.

United States and the “*Pension Act 1995*” in the United Kingdom, establish guidelines for the governance of a pension fund. Two of the main objectives of these guidelines are: to 1) define the fiduciary duties of the pension fund’s administrators and 2) establish a minimum funding threshold for the pension fund.

Moreover, these policies regarding the governance of a pension fund provide “insurance” mechanisms in the case where a pension fund would run into a deficit. For example, ERISA established the “*Pension Benefit Guaranty Corporation (PBGC)*” which has the mandate to take over and manage underfunded pension plans (particularly pension funds of companies going out of business)<sup>3</sup>. In Switzerland, the regulations provide for a guarantee of a fund against the insolvency of the pension provider while in Australia the guarantee of a fund is against fraud.

### ▪ **Fixing the total net assets threshold**

As mentioned previously, in the past, the financial criteria’s thresholds for foreign entities have always been fixed at a level 1.5 times higher than the financial criteria for Canadian entities. Thus, under the present proposal, to qualify as acceptable institutions, foreign pension funds would be required to have total net assets in excess of \$300 million (instead of \$200 million in the case of Canadian pension funds).

Regarding the definition of an acceptable counterparty, there is currently no distinction between Canadian and foreign pension funds. To keep uniformity throughout the Rules (i.e. establish the threshold of total net assets at a level 1.5 times higher for foreign entities than for Canadian entities), it is proposed to modify paragraph b), line 8, of the General Notes and

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<sup>3</sup> However, some of the largest pension plans, based on assets under management, are public pension plans and thus are not governed by ERISA. However, if these pension plans would run into a deficit, the employer, i.e. the taxpayers, would have to make up the shortfall.

Definitions of Policy C-3 of the Bourse so that it applies only to Canadian pension funds with total net assets in excess of \$10 million and to add a new line 11 to paragraph b) introducing a new entity category for foreign pension funds for which the threshold of total net assets is fixed at \$15 million.

### **C) Objective**

The objective of the proposed amendments is to allow foreign pension funds subject to a satisfactory regulatory regime to be classified as acceptable counterparties (for foreign pension funds with total net assets in excess of \$15 million) or as acceptable institutions (for foreign pension funds with total net assets in excess of \$300 million). These amendments will facilitate access to foreign pension funds as clients for approved participants by reducing the regulatory capital requirement (foreign pension funds being currently classified only as acceptable counterparties).

### **D) Effect of Proposed Rules**

The adoption of the proposed amendments to Policy C-3 of the Bourse will allow a reduction in the regulatory capital requirement for approved participants who want to do business with foreign pension funds. It is assumed that the proposed amendments will promote fair competition and thus promote capital market efficiency.

However, the proposed amendments do not relieve approved participant from reasonable due diligence duty of assessing the on-going credit risk of the pension funds with which they do business.

### **E) Public Interest Objective**

The purpose of this proposal is to allow some foreign pension funds to be classified as acceptable counterparties or as acceptable institutions instead of being considered only as acceptable counterparties. This new classification

will allow a reduction in the regulatory capital of approved participants doing business with this type of entities. Consequently, the proposed amendments are considered to be in the public interest.

- *Solvency Protection for Private Pension Systems – Background Note on United Kingdom Perspective*, George Russel; and
- *Pension Fund Management: Governance and Regulatory Issues*, Philip Davis.

## II COMMENTS

### A) Effectiveness

As stated above, the purpose of the proposal is to allow some foreign pension funds to be classified as acceptable counterparties (foreign pension funds subject to a satisfactory regulatory regime with total net assets in excess of \$15 million) or as acceptable institutions (foreign pension funds subject to a satisfactory regulatory regime with total net assets in excess of \$300 million). For approved participants who want to do business with American and other foreign pension funds, these new entities categories will eliminate a hindrance caused by the higher regulatory capital requirement for these institutions currently classified as acceptable counterparties.

### B) 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 amendments are then submitted to 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 Commission des valeurs mobilières du Québec for approval.

## III REFERENCE

- Policy C-3 of Bourse de Montréal Inc.;
- *Standards of Practice Handbook*, AIMR;

# APPENDIX A

## ATTACHMENT 1

ACCEPTABLE COUNTERPARTIES	
Entities	Criteria
Canadian banks, Quebec savings banks, trust companies licensed to do business in Canada	Paid up capital and surplus between \$10 million and \$100 million
Credit and central credit unions and caisses populaires	Paid up capital and surplus or net worth between \$10 million and \$100 million
Insurance companies licensed to do business in Canada	Paid up capital and surplus or net worth between \$10 million and \$100 million
Canadian provincial capital cities and other Canadian municipalities	Populations of 50,000 and over
Mutual Funds subject to a satisfactory regulatory regime	Total net assets in excess of \$10 million
Corporations (other than Regulated Entities)	Minimum net worth of \$75 million
Trusts and Limited Partnerships	Total net assets in excess of \$100 million
Pension Funds subject to a satisfactory regulatory regime	Total net assets in excess of \$10 million
Foreign banks and trust companies subject to a satisfactory regulatory regime	Paid up capital and surplus between \$15 million and \$150 million
Foreign insurance companies subject to a satisfactory regulatory regime	Paid up capital and surplus or net worth in excess of \$15 million
Federal governments of foreign countries which do not qualify as a Basle Accord country	-
<i>A satisfactory regulatory regime will be one within Basle Accord countries.</i>	

ACCEPTABLE INSTITUTIONS	
Entities	Criteria
Government of Canada, Bank of Canada and Provincial Governments	-
Crown corporations, agencies of the Canadian federal or provincial governments	-
Canadian banks, Quebec savings banks, trust companies licensed to do business in Canada	Paid up capital and surplus in excess of \$100 million
Credit and central credit unions and caisses populaires	Paid up capital and surplus in excess of \$100 million
Federal governments of Basle Accord countries	-
Foreign banks and trust companies subject to a satisfactory regulatory regime	Paid up capital and surplus in excess of \$150 million
Insurance companies licensed to do business in Canada	Paid up capital and surplus or net worth in excess of \$100 million
Canadian pension funds	Total net assets in excess of \$200 million
<i>A satisfactory regulatory regime will be one within Basle Accord countries.</i>	

JOINT REGULATORY FINANCIAL QUESTIONNAIRE AND REPORT  
GENERAL NOTES AND DEFINITIONS

DEFINITIONS:

(b) “**acceptable counterparties**” means those entities with whom a Member may deal on a value for value basis, with mark to market imposed on outstanding transactions. The entities are as follows:

1. Canadian banks, Quebec savings banks, trust companies and loan companies licensed to do business in Canada or a province thereof. Each of the aforementioned entities must have paid up capital and surplus on the last audited balance sheet (plus such other forms of capital recognized as such in their regulatory regime as well as in this capital formula, e.g. subordinated debt) in excess of \$10 million and less than or equal to \$100 million to qualify, provided acceptable financial information with respect to such entities is available for inspection.
2. Credit and central credit unions and regional caisses populaires with paid up capital and surplus or net worth (excluding appraisal credits but including general reserves) on the last audited balance sheet in excess of \$10 million and less than or equal to \$100 million, provided acceptable financial information with respect to such entities is available for inspection.
3. Insurance companies licensed to do business in Canada or a province thereof with paid up capital and surplus or net worth on the last audited balance sheet in excess of \$10 million and less than or equal to \$100 million, provided acceptable financial information with respect to such companies is available for inspection.
4. Canadian provincial capital cities and all other Canadian cities and municipalities, or their equivalents, with populations of 50,000 and over.
5. Mutual Funds subject to a satisfactory regulatory regime with total net assets in the fund in excess of \$10 million.
6. Corporations (other than Regulated Entities) with a minimum net worth of \$75 million on the last audited balance sheet, provided acceptable financial information with respect to such corporation is available for inspection.
7. Trusts and Limited Partnerships with minimum total net assets on the last audited balance sheet in excess of \$100 million, provided acceptable financial information with respect to such trust or limited partnership is available for inspection.
8. Canadian Pension Funds subject to a satisfactory regulatory regime which are regulated either by the Office of Superintendent of Financial Institutions or a provincial pension commission, and with total net assets on the last audited balance sheet in excess of \$10 million, provided that in determining net assets the liability of a fund for future pension payments shall not be included.
9. Foreign banks and trust companies subject to a satisfactory regulatory regime with paid up capital and surplus on the last audited balance sheet in excess of \$15 million and less than or equal to \$150 million, provided acceptable financial information with respect to such entities is available for inspection.
10. Foreign insurance companies subject to a satisfactory regulatory regime with paid up capital and surplus or net worth on the last audited balance sheet in excess of \$15 million, provided acceptable financial information with respect to such companies is available for inspection.

11. Foreign Pension Funds subject to a satisfactory regulatory regime with total net assets on the last audited balance sheet in excess of \$15 million, provided that in determining net assets the liability of a fund for futures pension payments shall not be included.

~~12.~~ Federal governments of foreign countries which do not qualify as a Basle Accord country.

For the purposes of this definition, a satisfactory regulatory regime will be one within Basle Accord countries.

Subsidiaries (excluding Regulated Entities) whose business falls in the category of any of the above enterprises and

### GENERAL NOTES AND DEFINITIONS (Cont'd)

whose parent or affiliate qualifies as an acceptable counterparty may also be considered as an acceptable counterparty if the parent or affiliate provides a written unconditional irrevocable guarantee, subject to approval by the appropriate Joint Regulatory Body.

(c) **“acceptable institutions”** means those entities with which a Member is permitted to deal on an unsecured basis without capital penalty. The entities are as follows:

1. Government of Canada, the Bank of Canada and Provincial Governments.
2. All crown corporations, instrumentalities and agencies of the Canadian federal or provincial governments which are government guaranteed as evidenced by a written unconditional irrevocable guarantee or have a call on the consolidated revenue fund of the federal or provincial governments.
3. Canadian banks, Quebec savings banks, trust companies and loan companies licensed to do business in Canada or a province thereof. Each of the aforementioned entities must have paid up capital and surplus on the last audited balance sheet (plus such other forms of capital recognized as such in their regulatory regime as well as in this capital formula, e.g. subordinated debt) in excess of \$100 million, provided acceptable financial information with respect to such entities is available for inspection.
4. Credit and central credit unions and regional caisses populaires with paid up capital and surplus (excluding appraisal credits but including general reserves) on the last audited balance sheet in excess of \$100 million, provided acceptable financial information with respect to such entities is available for inspection.
5. Federal governments of Basle Accord Countries.
6. Foreign banks and trust companies subject to a satisfactory regulatory regime with paid up capital and surplus on the last audited balance sheet in excess of \$150 million, provided acceptable financial information with respect to such entities is available for inspection.
7. Insurance companies licensed to do business in Canada or a province thereof with paid up capital and surplus or net worth on the last audited balance sheet in excess of \$100 million, provided acceptable financial information with respect to such companies is available for inspection.
8. Canadian pension funds which are regulated either by the Office of Superintendent of Financial Institutions or a provincial pension commission, and with total net assets on the last audited balance sheet in excess of \$200 million, provided that in determining net assets the liability of a fund for future pension payments shall not be included.

9. Foreign Pension Funds subject to a satisfactory regulatory regime with total net assets on the last audited balance sheet in excess of \$300 million, provided that in determining net assets the liability of a fund for futures pension payments shall not be included.

For the purposes of this definition, a satisfactory regulatory regime will be one within Basle Accord countries.

Subsidiaries (other than Regulated Entities) whose business falls in the category of any of the above enterprises and whose parent or affiliate qualifies as an acceptable institution may also be considered as an acceptable institution if the parent or affiliate provides a written unconditional irrevocable guarantee, subject to approval by the appropriate Joint Regulatory Body.