



**CIRCULAR**  
March 28, 2003

**MAIL INSURANCE FOR APPROVED PARTICIPANTS AND  
CALCULATION OF FINANCIAL INSTITUTION BOND COVERAGE  
FOR TYPE 1 AND TYPE 2 INTRODUCING BROKERS**

**AMENDMENTS TO ARTICLES 7076, 7470 AND TO POLICY C-3**

The Special Committee – Regulatory Division of Bourse de Montréal Inc. (the “Bourse”) has approved amendments to articles 7076 and 7470 of the Rules of the Bourse and to Schedule 10 of Policy C-3 of the Bourse, which deal with mail insurance requirements for approved participants and Financial Institution Bond (FIB) requirements for Type 1 and Type 2 introducing brokers. These amendments become effective on April 1, 2003.

**MAIL INSURANCE**

The amendments to article 7076 of the Rules of the Bourse aim to exempt an approved participant from the requirement to subscribe to a mail insurance if it delivers a written undertaking to the Vice-President, Regulatory Division of the Bourse, that it will not use the mail for outgoing shipments of money or securities, negotiable or non-negotiable, whether by first class mail, registered mail, registered air mail, express or air express.

**CALCULATION OF FINANCIAL INSTITUTION BOND (FIB) REQUIREMENTS FOR TYPE 1 AND TYPE 2 INTRODUCING BROKERS**

So far, Type 1 and Type 2 introducing brokers were not required to include their client net equity in the calculation of the required FIB coverage because it is the carrying broker that includes this element in its own calculation of insurance coverage. The result was that for most of the introducing brokers, the coverage was limited to the minimum amounts provided for in the Rules: \$200,000 for Type 1 introducing brokers and \$500,000 for Type 2 introducing brokers. However, since the introduction of those minimums, it has been noticed that not only the client net equity of Type 1 and Type 2 introducing brokers has grown to a relatively larger size but also

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there was a certain risk of fraud not adequately covered by the actual regulation. The amendments to article 7076 of the Rules and to Schedule 10 of Policy C-3 of the Bourse aim to fill this deficiency by requiring Type 1 and Type 2 introducing brokers to include in the calculation of the insurance coverage the client net equity. However, since it is recognized that there is less risk of fraud associated with Type 1 and Type 2 introducing brokers than for other broker categories, the percentage used by Type 1 and Type 2 introducing brokers for the calculation stipulated has been fixed to ½ percent instead of 1 percent.

Finally, amendments were made to article 7470 of the Rules of the Bourse in order to harmonize insurance requirements between this article and article 7076 of the Rules of the Bourse. Henceforth, article 7470 stipulates that Type 1 and Type 2 introducing brokers must include the balance of the client accounts they have introduced to their carrying brokers in their calculations of the minimum FIB coverage.

For further information, please contact Ms. Chantal Villeneuve, Legal Counsel, Regulatory Division at (514) 871-4949, extension 360 or via email at [cvilleneuve@m-x.ca](mailto:cvilleneuve@m-x.ca).

Joëlle Saint-Arnault  
Vice-President, Legal Affairs and Secretary

Encl.

**Section 7076 - 7150**  
**Insurance**

**7076 Insurance**

(28.02.87, 09.10.87, 30.12.88, 06.08.90, 20.12.91, 01.05.92, 03.03.93, 01.04.93, 01.12.94, 08.11.95, 20.12.96, 01.07.97, 01.04.03)

1) Mail Insurance

Every approved participant must effect and keep in force mail insurance against loss arising by reason of any outgoing shipments of money or securities, negotiable or non negotiable, by first class mail, registered mail, registered air mail, express or air express, such insurance to provide at least 100% cover.

The Vice-President of the Regulatory Division of the Bourse may exempt an approved participant from the requirement of the present paragraph if the approved participant delivers a written undertaking to the Vice-President Regulatory Division, that it will not use the mail for outgoing shipments of money or securities, negotiable or non-negotiable, by first-class mail, registered mail, registered air mail, express or air express.

2) Financial Institution Bond

Every approved participant must, by means of a Financial Institution Bond or Bonds (with Discovery Rider attached or Discovery Provisions incorporated in the Bond), effect and keep in force insurance against losses arising as follows as provided for in the standard-form contract:

a) Clause (A) - Fidelity

Any loss through any dishonest or fraudulent act of any of its employees, committed anywhere and whether committed alone or in collusion with others, including loss of property through any such act of any of its employees;

b) Clause (B) - On Premises

Any loss of money and securities or other property through robbery, burglary, theft, hold-up or other fraudulent means, mysterious disappearance, damage or destruction while within any office of the insured, of a banking institution or clearing house or within any recognized place of safe deposit, as more fully defined in the Standard Form Number 14 of Financial Institution Bond, herein referred to as the Standard Form;

c) Clause (C) - In Transit

Any loss of money and securities or other property through robbery, burglary, theft, hold-up, misplacement, mysterious disappearance, damage or destruction, while in transit in the custody of any employee or any person acting as messenger except while in the mail or with a carrier for hire other than an armoured motor vehicule company, as more fully defined in the Standard Form;

d) Clause (D) - Forgery, Alterations

Any loss through forgery or alteration of any cheques, drafts, promissory notes or other written orders or directions to pay sums in money, excluding securities, as more fully defined in the Standard Form;

e) Clause (E) - Securities

Any loss through having purchased or acquired, sold or delivered, or extended any credit or acted upon securities or other written instruments which prove to have been forged, counterfeited, raised or altered, or lost or stolen, or through having guaranteed in writing or witnessed any signatures upon any transfers, assignments or other documents or written instruments, as more fully defined in the Standard Form.

3) a) Notice of termination

Each Financial Institution Bond maintained by an approved participant must contain a rider containing provisions to the following effect:

- i) the underwriter must notify the Bourse at least 30 days prior to the termination or the cancellation date of the bond, except in the event of termination of the bond due to:
  - a) the expiration of the bond period specified;
  - b) the receipt of written notice from the insured of its desire to cancel the bond;
  - c) upon the taking over of the insured by a receiver or other liquidator, or by provincial, federal or state officials; or
  - d) upon the taking over of the insured by another institution or entity.
- ii) In the event of termination of bond as an entirety in accordance with sub-paragraphs i) b), c) or d), the underwriter must, upon becoming aware of such termination, give immediate written notice of the termination to the Bourse. Such notice shall not impair or delay the effectiveness of the termination.

b) Termination or cancellation as a result of a take-over

In the event a Financial Institution Bond is to be terminated or cancelled as a result of the take-over of an approved participant by another institution or entity as described in paragraph 3 a) i) d), the approved participant must ensure that bond coverage is in place and provides a period of 12 months from the date of such take-over within which to discover the losses, if any, sustained by the approved participant prior to the effective date of such take-over. The approved participant must then pay, or cause to be paid, any applicable additional premium.

4) Amounts required

The minimum amounts of insurance to be maintained for each clause in the aggregate under paragraph 2 of this article must be the greater of:

- a) \$500,000 or, in the case of a Type 1 Introducing broker , \$200,000; and
- b) 1% of the balance of the base amount or, in the case of a Type 1 and Type 2 introducing broker, one half of one percent of the base amount (½%);

provided that, for each clause, such minimum amount of insurance need not exceed \$25,000,000.

For the purposes of this paragraph, the term "base amount" means the greater of:

- i) the aggregate of net equity for each customer, such aggregate being determined by taking the total value of cash and securities owed to the customer by the approved participant less the total value of cash and securities owed by the customer to the approved participant; and
- ii) the aggregate of total liquid assets and total other allowable assets of the approved participant determined in accordance with Statement A of the Joint Regulatory Financial Questionnaire and Report.

5) Provisos

- a) the value of securities in transit in the custody of any employee or any person acting as a messenger must not at any time exceed the protection provided under paragraph 2 of this article;
- b) the amounts of insurance required to be maintained by an approved participant must as a minimum be by way of a Financial Institution Bond with a double aggregate limit or a provision for full reinstatement of the amount of coverage;
- c) should there be insufficient coverage, an approved participant will be deemed to be complying with the requirements of this article provided that any such deficiency does not exceed 10 percent of the insurance coverage required and that evidence is provided within two months of the dates of completion of the quarterly operations questionnaires or the annual audit that the deficiency has been corrected. If the deficiency of the insurance coverage required is 10 percent or more, measures must be taken by the approved participant in order to correct the said deficiency within 10 days of its determination and the approved participant must immediately notify the Chief Examiner of the Exchange;
- d) insurance against losses under sub-paragraph 2) e), Clause (E) (Securities), may be incorporated in the Financial Institution Bond or may be carried by means of a rider attached thereto or by a separate Securities Forgery Bond;
- e) the Financial Institution Bond maintained pursuant to paragraph 2 of this article may contain a clause or rider stating that all claims made under the bond are subject to a deductible;
- f) for the purposes of calculating insurance requirements, no distinction must be made between securities in non-negotiable form and those in negotiable form.

6) Insurer

Insurance required to be effected and kept in force by an approved participant pursuant to this article 7076 may be underwritten directly with either (i) an insurer registered or licensed under the laws of Canada or any province of Canada or (ii) any foreign insurer approved by the Bourse. No foreign insurer will be approved by the Bourse if its net worth, according to the last audited balance sheet, is

lesser than \$75 millions, provided acceptable financial information with respect to such insurer is available for inspection and the Bourse is satisfied that the insurer is subject to supervision by regulatory authorities in the jurisdiction of incorporation of the insurer which is substantially similar to the supervision of insurance companies in Canada.

7) Global Insurance Policies

Where the insurance maintained by an approved participant in respect of any of the requirements under this article 7076 names as the insured or benefits the approved participant, together with any other person or group of persons, whether within Canada or elsewhere, the following must apply:

- a) the approved participant must have the right to claim directly against the insurer in respect of any loss, and any payment or satisfaction of such loss must be made directly to the approved participant; and
- b) the individual or aggregate limits under the policy may only be affected by claims made by or on behalf of:
  - i) the approved participant;
  - ii) any of the approved participant's subsidiaries whose financial results are consolidated with those of the approved participant; or
  - iii) a holding company of the approved participant provided that this holding company does not carry on any business or own any investment other than its interest in the approved participant,

without regard to the claims, experience or any other factor referable to any other person.

8) Exemption

The Special Committee may exempt an approved participant from the requirements of this article where the approved participant is not dealing with the public and/or is not a clearing member.

**7470 Introducing/carrying broker agreements**  
(26.07.88, 01.04.93, 01.07.97, 05.07.00, 07.05.02, 01.04.03)

**2) Introducing broker Type 1 Agreement**

For an introducing/carrying broker agreement to be considered an Introducing broker Type 1 Agreement, the parties must execute an agreement in the form prescribed and approved by the Chief Examiner of the Exchange and the agreement must meet the following criteria:

a) Minimum capital requirement

An introducing broker that is a party to an Introducing broker Type 1 Agreement must maintain at all times a minimum capital of \$75,000 for the purposes of calculating its risk adjusted capital.

b) Margin arising from principal and agency business

i) The carrying broker must calculate and maintain the margin for any agency business that it carries on behalf of the introducing broker, in accordance with the relevant margin requirements of the By-Laws and Rules of the Exchange.

ii) The introducing broker must calculate and maintain the margin for any principal business that the carrying broker carries on its behalf, in accordance with the relevant margin requirements of the Exchange. The carrying broker must provide for margin for any principal business which it carries on behalf of the introducing broker, to the extent of any equity deficiency in the introducing broker's trading account.

c) Margin offsets permitted

The carrying broker must be permitted to offset any margin required to be maintained, as determined in subparagraph b), against the loan value of any deposits made by the introducing broker to the extent of the excess risk adjusted capital of the introducing broker. The carrying broker must notify the introducing broker of all such offsets at the time they are made. Upon receiving notification of such offset, the introducing broker must reclassify that portion of the comfort deposit, which relates to the margin offset, as a non-allowable asset on its Joint Regulatory Financial Questionnaire and Report or its Monthly Financial Report.

d) Reporting of clients balances

In calculating the risk adjusted capital required pursuant to article 7006 of the Rules of the Exchange and to the Joint Regulatory Financial Questionnaire and Report, the carrying broker must, and the introducing broker must not, report all accounts of clients introduced to the carrying broker by the introducing broker on the carrying broker's Joint Regulatory Financial Questionnaire and Report or Monthly Financial Report.

e) Net clients balances and funding deployment

In relation to the accounts of clients introduced to the carrying broker by the introducing broker, the carrying broker must be responsible for meeting any financing requirements of such clients accounts.

f) Comfort deposit

Any deposit provided to the carrying broker by the introducing broker pursuant to the terms of the agreement between them must be segregated by the carrying broker and, in the case of a cash deposit, such deposit must be held by the carrying broker in a separate bank account in trust for the introducing broker.

The comfort deposit provided by the introducing broker to the carrying broker must be reported by the introducing broker as an allowable asset on its Joint Regulatory Financial Questionnaire and Report or its Monthly Financial Report. However, any portion of the comfort deposit that may be impaired in value due to the fact that the carrying broker carries clients accounts having unsecured debit balances on behalf of the introducing broker, must be reclassified as a non-allowable asset on the Joint Regulatory Financial Questionnaire and Report or the Monthly Financial Report of the introducing broker.

g) Concentration calculation

For the purposes of the concentration calculations required in Schedules 9 and 12 of the Joint Regulatory Financial Questionnaire and Report, the carrying broker must include, and the introducing broker must not include, all clients positions which the carrying broker maintains on behalf of the introducing broker in the carrying broker's calculation.

h) Segregation of clients securities

The carrying broker must be responsible for segregating all securities which it holds for clients which have been introduced to it by the introducing broker, in accordance with the segregation requirements of the By-Laws and Rules of the Exchange.

i) Free credit balances segregation

The carrying broker must be responsible for the compliance with the free credit balances segregation requirements of the By-Laws and Rules of the Exchange in relation to accounts of clients which have been introduced to it by the introducing broker.

j) Insurance

- i) The introducing broker must maintain a minimum insurance of \$200,000, for the purposes of article 7076 of the Rules of the Exchange.
- ii) The introducing broker and the carrying broker must each be responsible for providing Financial Institution Bond Clause (A) coverage for fidelity insurance, pursuant to article 7076 of the Rules of the Exchange.
- iii) The carrying broker must include all accounts which have been introduced to it by the introducing broker in its calculation of the asset measurement for minimum Financial Institution Bond coverage for Clauses (A) through (E), pursuant to article 7076 of the Rules of the Exchange.
- iv) The introducing broker must include all accounts which have been introduced to the carrying broker in its calculation of the asset measurement for minimum Financial Institution Bond coverage for Clauses (A) through (E), pursuant to article 7076.



- v) Both the introducing broker and the carrying broker must maintain adequate mail insurance, as required pursuant to article 7076 of the Rules of the Exchange.

- k) Required disclosure of the opening of clients accounts

At the time of opening of each client account, the introducing broker must, in a form satisfactory to the Chief Examiner of the Exchange, obtain from the client an acknowledgement that the introducing broker has advised him of the introducing broker's relationship to the carrying broker and of the relationship between the client and the carrying broker.

- l) Contracts, statements and correspondence

The name and role of each of the introducing broker and carrying broker must be shown on all contracts, statements, correspondence and other documentation. Both the introducing broker and the carrying broker must be parties to any margin agreements and guarantee documentation with clients that the carrying broker carries.

- m) Clients introduced to the carrying broker

Each client introduced to the carrying broker by the introducing broker must be considered a client of the carrying broker for the purposes of complying with the By-Laws and Rules of the Exchange.

- n) Responsibility for compliance with all non-financial requirements

Unless otherwise specified in the present paragraph 2), the introducing broker and the carrying broker must be jointly and severally responsible for compliance with all non-financial requirements of the By-Laws and Rules of the Exchange for each account introduced to the carrying broker by the introducing broker.

- o) Cash transactions

The introducing broker may facilitate cash transactions on behalf of clients that the carrying broker carries, only with the approval of the carrying broker and through the use of an account in the name of the carrying broker.

- p) Reporting of principal positions

The introducing broker must report all principal positions, introduced to the carrying broker by the introducing broker, as inventory on its Joint Regulatory Financial Questionnaire and Report or its Monthly Financial Report. The carrying broker must report all principal positions, which have been introduced to it by the introducing broker, as a client account on its Joint Regulatory Financial Questionnaire and Report or its Monthly Financial Report.

### 3) Introducing broker Type 2 Agreement

For an introducing/carrying broker agreement to be considered an Introducing broker Type 2 Agreement, the parties must execute an agreement in the form prescribed and approved by the Chief Examiner of the Exchange and the agreement must meet the following criteria:

a) Minimum capital requirement

An introducing broker that is a party to an Introducing broker Type 2 Agreement must maintain at all times a minimum capital of \$250,000 for the purposes of calculating its risk adjusted capital.

b) Margin arising from principal and agency business

i) The carrying broker must calculate and maintain the margin for any agency business that it carries on behalf of the introducing broker, in accordance with the relevant margin requirements of the By-Laws and Rules of the Exchange.

ii) The introducing broker must calculate and maintain the margin for any principal business that the carrying broker carries on its behalf, in accordance with the relevant margin requirements of the Exchange. The carrying broker must provide for margin for any principal business which it carries on behalf of the introducing broker, to the extent of any equity deficiency in the introducing brokers' trading account.

c) Margin offsets permitted

The carrying broker must be permitted to offset any margin required to be maintained, as determined in subparagraph b), against the loan value of any deposits made by the introducing broker to the extent of the excess risk adjusted capital of the introducing broker. The carrying broker must notify the introducing broker of all such offsets at the time they are made. Upon receiving notification of such offset, the introducing broker must reclassify that portion of the comfort deposit, which relates to the margin offset, as a non-allowable asset on its Joint Regulatory Financial Questionnaire and Report or its Monthly Financial Report.

d) Reporting of clients balances

In calculating the risk adjusted capital required pursuant to article 7006 of the Rules of the Exchange and to the Joint Regulatory Financial Questionnaire and Report, the carrying broker must, and the introducing broker must not, report all accounts of clients introduced to the carrying broker by the introducing broker on the carrying broker's Joint Regulatory Financial Questionnaire and Report or Monthly Financial Report.

e) Net clients balances and funding deployment

In relation to the accounts of clients introduced to the carrying broker by the introducing broker, the carrying broker must be responsible for meeting any financing requirements of such clients accounts.

f) Comfort deposit

Any deposit provided to the carrying broker by the introducing broker pursuant to the terms of the agreement between them must be segregated by the carrying broker and, in the case of a cash deposit, such deposit must be held by the carrying broker in a separate bank account in trust for the introducing broker.

The comfort deposit provided by the introducing broker to the carrying broker must be reported by the introducing broker as an allowable asset on its Joint Regulatory Financial Questionnaire and Report or its Monthly Financial Report. However, any portion of the comfort deposit, which may be impaired in value due to the fact that the carrying broker carries clients accounts having unsecured debit balances on behalf of the introducing broker, must be reclassified as a non-allowable asset on the Joint Regulatory Financial Questionnaire and Report or the Monthly Financial Report of the introducing broker.

g) Concentration calculation

For the purposes of the concentration calculations required in Schedules 9 and 12 of the Joint Regulatory Financial Questionnaire and Report, the carrying broker must include, and the introducing broker must not include, all clients positions which the carrying broker maintains on behalf of the introducing broker in the carrying broker's calculation.

h) Segregation of clients securities

The carrying broker must be responsible for segregating all securities which it holds for clients which have been introduced to it by the introducing broker, in accordance with the segregation requirements of the By-Laws and Rules of the Exchange.

i) Free credit balances segregation

The carrying broker must be responsible for the compliance with the free credit balances segregation requirements of the By-Laws and Rules of the Exchange in relation to accounts of clients which have been introduced to it by the introducing broker.

j) Insurance

i) The introducing broker must maintain a minimum insurance of \$500,000, for the purposes of article 7076 of the Rules of the Exchange.

ii) The introducing broker and the carrying broker must each be responsible for providing Financial Institution Bond Clause (A) coverage for fidelity insurance, pursuant to article 7076 of the Rules of the Exchange.

iii) The carrying broker must include all accounts which have been introduced to it by the introducing broker in its calculation of the asset measurement for minimum Financial Institution Bond coverage for Clauses (A) through (E), pursuant to article 7076 of the Rules of the Exchange.

iv) The introducing broker must include all accounts which have been introduced to the carrying broker in its calculation of the asset measurement for minimum Financial Institution Bond coverage for Clauses (A) through (E), pursuant to article 7076.

- v) Both the introducing broker and the carrying broker must maintain adequate mail insurance, as required pursuant to article 7076 of the Rules of the Exchange.

# JOINT REGULATORY FINANCIAL QUESTIONNAIRE AND REPORT TABLE OF CONTENTS

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(Firm Name)

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(Date)

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Note: Schedules 2C, 2D, 3, 3A, 4B, 8 and 12A have been eliminated.

**PART II  
JOINT REGULATORY FINANCIAL QUESTIONNAIRE AND REPORT**

\_\_\_\_\_  
(Firm Name)

**INSURANCE**

**PART A. FINANCIAL INSTITUTION BOND (FIB) CLAUSES (A) TO (E)**

1. Coverage required for FIB

(a) Client Net Equity:

i) Firm's Own \_\_\_\_\_

ii) Carriers Introducing Firms \_\_\_\_\_

Total \$\_\_\_\_\_ x 1%\* \_\_\_\_\_ [Note 3]

(b) Total Liquid Assets (A-13) \_\_\_\_\_

Total Other Allowable Assets (A-19) \_\_\_\_\_

Total \$\_\_\_\_\_ x 1%\* \_\_\_\_\_

The actual coverage required for each clause is the Greater of (a) and (b), with a Minimum Requirement of \$500,000 (\$200,000 for a Type 1 Introducing Broker), and a Maximum Requirement of \$25,000,000. \_\_\_\_\_

\*based on one half of one percent for Types 1 and 2 Introducing Brokers

2. Coverage maintained per FIB \_\_\_\_\_ [Notes 4 & 8]

3. Excess / (Deficiency) in coverage \$\_\_\_\_\_ [Note 5]

4. Amount deductible under FIB (if any) \$\_\_\_\_\_ [Note 6]

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**PART B. REGISTERED MAIL INSURANCE**

1. Coverage per mail policy \$\_\_\_\_\_ [Note 7]

**PART C. FIB AND REGISTERED MAIL POLICY INFORMATION [Note 9]**

<u>Insurance Company</u>	<u>Name of the Insured</u>	<u>FIB/ Registered Mail</u>	<u>Expiry Date</u>	<u>Coverage</u>	<u>Type of Aggregate Limit</u>	<u>Provision for full Reinstatement</u>	<u>Premium</u>
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**PART D. LOSSES AND CLAIMS [Note 10]**

<u>Date of Loss</u>	<u>Date of Discovery</u>	<u>Amount of Loss</u>	<u>Deductible Applying to Loss</u>	<u>Description</u>	<u>Claim Made?</u>	<u>Settlement</u>	<u>Date Settled</u>
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