CIRCULAR
April 24, 2003

REQUEST FOR COMMENTS

MARGIN AND CAPITAL REQUIREMENTS FOR CAPITAL TRUST SECURITIES

AMENDMENTS TO ARTICLES 7202, 7204 AND 7213

Summary

The Executive Committee of Bourse de Montréal Inc. (the "Bourse") approved amendments to articles 7202, 7204 and 7213 of the Rules of the Bourse, dealing with margin and capital requirements for capital trust securities. The proposed amendments seek to establish specific capital and margin requirements for capital trust securities that are reflective of their market risk. As a result, the amendments will permit any security considered to be regulatory capital of a financial institution issuer to qualify for a 25 percent margin rate for approved participant positions and for a 30 percent margin rate for client account positions, provided that at least one issue of the financial institution is included on the List of Securities Eligible to a Reduced Margin Rate published periodically by the Bourse in a circular.

Process for Changes to the Rules

Bourse de Montréal Inc. is recognized as a self-regulatory organization (SRO) by the Commission des valeurs mobilières du Québec (the "Commission"). 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-dealer 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.: 052-2003

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 Executive Committee of the Bourse its powers to approve or amend these Rules and Policies upon recommendation from the Special Committee. These changes are submitted to the Commission for approval.

Comments on the proposed amendments to articles 7202, 7204 and 7213 must be submitted within 30 days following the date of publication of the present notice in the bulletin of the Commission. 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 Commission to:

Ms. Denise Brosseau
Secretary
Commission des valeurs mobilières du Québec
800 Victoria Square, 22nd Floor
P.O. Box 246, Tour de la Bourse
Montréal (Quebec) H4Z 1G3
E-mail: consultation-en-cours@cvmq.com

Appendices

For your information, you will find in the 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 Commission des valeurs mobilières du Québec.

APPENDIX A

MARGIN AND CAPITAL REQUIREMENTS FOR CAPITAL TRUST SECURITIES

– AMENDMENTS TO ARTICLES 7202 AND 7213 (INCLUDING REFERENCE AMENDMENTS IN ARTICLES 7204 AND 7213)

I OVERVIEW

A) Introduction

Rule Seven of Bourse de Montréal Inc. (the "Bourse") sets out the capital and margin requirements to be used by approved participants for security and other positions[1] held in their inventory and the accounts of their customers. These requirements do not currently consider the unique features of capital trust securities and, as a result, require that capital trust securities be margined as any other non-debt security. The proposed amendments seek to establish a specific rule setting out the capital and margin requirements for capital trust securities.

B) The Issue

Under the current rules most capital trust securities have a margin rate of 50 percent. This rate is seen as being too high in relation to the overall risk of loss as a capital trust security because this type of security:

- is considered to be regulatory capital[2] of a related financial institution;
- provides the holder a return based on the performance of an underlying portfolio of low risk assets[3]; and
- is convertible, at a future date or by default, into preferred shares of a related financial institution.

Based on these elements, it has been determined that the market risk associated with a capital trust security is no greater than the market risk associated with holding preferred shares issued by the related financial institution. As a result, the margin rate assigned to a particular trust security should be no greater than the margin rate used for capital related issues of the financial institution.

C) Objective

The objective of the proposed amendments is to establish specific capital and margin requirements for capital trust securities that are reflective of their market risk. It is believed this objective would be achieved by allowing these securities the same margin treatment as any other issue that qualifies as regulatory capital for an individual financial institution, provided the financial institution is under the regulatory oversight of the Office of the Superintendent of Financial Institutions (OSFI)

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[1] Other positions addressed by the capital and margin requirements include commodity positions and derivatives positions relating to securities and commodities.

[2] In all cases, all other capital related issuances of these related financial institutions qualify for a margin rate of 25% for positions held by approved participants and 30% for positions held by clients.

[3] All capital trust securities issued to date are backed by a portfolio of mortgage loans.

D) Effect of Proposed Rules

As there was approximately $7 billion worth of capital trust securities outstanding as at March 31, 2002, the effect of these proposed amendments on capital and margin requirements will be material. However, since reduced capital and margin requirements will be available to all approved participants and their clients it is felt that these proposed amendments will have no competitive environment effects.

II DETAILED ANALYSIS

A) Current Rules

Capital trust securities are being issued both as listed and unlisted securities. As a result, the general rules relating to the margin requirements applicable to listed and unlisted securities (other than bonds and debentures), as set out in article 7202 and article 7203 of the Rules of the Bourse, apply. These rules effectively require that a security with a unit price of greater than $2.00 be margined at 50 percent[4] of its market value, unless the security or a related junior security of the same issuer qualifies for inclusion on the List of Securities Eligible to a Reduced Margin Rate (LSERMR) published periodically by the Bourse in a circular. However, because a special purpose vehicle issues capital trust securities[5], they must qualify on their own under the current rules in order to be margined at a rate of less than 50 percent[6].

B) Proposed Rules

The proposed amendments would permit any security considered to be regulatory capital of a financial institution issuer to qualify for a 25 percent margin rate for approved participant positions and a 30 percent margin rate for client account positions, provided that at least one issue of the financial institution is included on the LSERMR. This will allow the securities of one issuer, in this case the special purpose vehicle issuing the capital trust securities, to be margined on the same basis as another issuer, the related financial institution, on the basis that it qualifies as capital of the financial institution. The proposed amendments also seek to limit this ability by defining the expression "regulatory capital of an issuer" to mean the "Tier 1 capital of a financial institution that is under the regulatory oversight of the Office of the Superintendent of Financial Institutions of Canada."

C) Comparison with Similar Provisions

Normally, comparisons are made with similar rules in the United States and the United Kingdom. However, as capital trust securities are unique to Canada, there are no comparable rules in the United States and the United Kingdom.

It is however relevant to note that OSFI has published guidelines setting out which innovative instruments, including capital trust securities, may be considered to be Tier 1 capital. These

[4] Unlisted securities issued by insurance companies licensed in Canada, Canadian banks and Canadian trust companies are eligible for the same margin treatment as listed securities. As a result, current issues of capital trust securities qualify for a margin rate of not more than 50%.

[5] In the guidance issued by the Office of the Superintendent of Financial Institutions, the term "special purpose vehicle" is defined to be "a consolidated non-operating entity whose primary purpose is to raise capital".

[6] As at March 31, 2002, 3 of the 13 capital trust security issues qualified on their own for inclusion on the LSERMR allowing them to be margined at a rate of 25% for positions held by approved participants and 30% for positions held by clients.

guidelines also place limits on innovative instruments as a percentage of Tier 1 capital.

D) Public Interest Objective

This proposal is designed to establish capital and margin requirements for capital trust securities based on their market risk. As a result, the proposed amendments are considered to be in the public interest.

III COMMENTARIES

A) Effectiveness

As stated above, the purpose of this proposal is to establish specific capital and margin requirements for capital trust securities that are reflective of their market risk.

It is believed that the adoption of the proposed amendments will result in the setting of margin rates for capital trust securities that are more in line with their actual risk of loss.

IV REFERENCES

- Rule Seven of Bourse de Montréal Inc.;
- OSFI Interim Appendix to Guideline A-2, “Principle Governing Inclusion of Innovative Instruments in Tier 1 Capital”, August 2001.

Section 7201 - 7250
Margins

7202 Listed Securities
(15.12.86, 30.09.87, 18.06.88, 01.04.93, 11.02.00, 29.04.02, 16.09.02, 00.00.03)

1) The margins required on securities including rights and warrants (other than bonds and debentures) 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:

	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 CDNX, securities of companies classified as inactive Tier 2 or Tier 3 issuers on CDNX 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

~~Note: On securities approved by the Canadian Derivatives Clearing Corporation or by Options Clearing Corporation, as underlying securities including securities that are convertible or exchangeable into underlying securities, the margin rate is 30% on long securities and the credit required is 130% on short positions.~~

On Index Participation Units (IPU), the margin, in the case of a long position, is the floating margin rate percentage (calculated for the S&P/TSE 60 IPU by the Bourse) multiplied by the market value of the S&P/TSE 60 IPU. The margin, in the case of a short position, is 100% plus the floating margin rate percentage (calculated for the S&P/TSE 60 IPU by the Bourse) multiplied by the market value of the S&P/TSE 60 IPU.

On a basket of S&P/TSE 60 Index securities (complying with article 11280) the margin, in the case of a long position, is the floating margin rate percentage (calculated for a basket of S&P/TSE 60 Index securities by the Bourse) plus the calculated incremental basket margin rate for the qualifying basket of S&P/TSE 60 Index securities multiplied by the market value of the basket of S&P/TSE 60 Index securities. The margin, in the case of a short position, is 100% plus the floating margin rate percentage (calculated for a basket of S&P/TSE 60 Index securities by the Bourse) plus the calculated incremental basket margin rate for the qualifying basket of S&P/TSE 60 Index securities, multiplied by the market value of the basket of S&P/TSE 60 Index securities.

On Index Participation Units, the margin, in the case of a long position, is the floating margin rate percentage (calculated for the S&P/TSE sectorial Index Participation Units by the Bourse) multiplied by the market value of the S&P/TSE sectorial Index Participation Units. The margin, in the case of a short position, is 100% plus the floating margin rate percentage (calculated for the S&P/TSE sectorial Index Participation Unit by the Bourse) multiplied by the market value of the S&P/TSE sectorial Index Participation Units.

On a basket of S&P/TSE sectorial Index securities (complying with article 11601 of the Rules) the margin, in the case of a long position, is the floating margin rate percentage (calculated for a basket of S&P/TSE sectorial Index securities by the Bourse), multiplied by the market value of the basket of S&P/TSE sectorial Index securities. The margin, in the case of a short position, is 100% plus the floating margin rate percentage (calculated for a basket of S&P/TSE sectorial Index securities by the Bourse), multiplied by the market value of the basket of S&P/TSE sectorial Index securities.

For the purpose of the present article, the floating margin rate percentage is determined by the Bourse, in accordance with the following methodology:

The sum of:

a) the product of the three following elements:

   i) the maximum standard deviation of percentage fluctuations in daily settlement values over the most recent 20, 90 and 260 business days;

   ii) three (for a 99% confidence interval); and

   iii) the square root of 2 (for two days coverage);

plus

b) 0.50% (representing a cushion);

rounded up to the next quarter percent.

~~On non-convertible preferred shares of companies with securities which are eligible to a reduced margin rate as provided for in paragraph 1 of the present article, the margin rate is 30% on long positions and 130% of the market value of the short positions provided that if the eligible shares fail to continue to meet the requirements for a reduced margin rate eligibility, the margin rate and the credit required will be increased to 50% and 150% respectively.~~

2) Securities eligible to a reduced margin rate

The margin required is 30% of the market value 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 which qualify for approval by the Options Clearing Corporation as underlying securities;

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 that are classified as regulatory capital of an issuer any of whose securities qualify under subparagraph i).

For the purpose of the present paragraph 2) the Bourse and the Investment Dealers Association of Canada are designated as recognized self-regulatory organizations.

For the purpose of the present paragraph 2), the expression "regulatory capital of an issuer" means Tier 1 capital of a financial institution that is under the regulatory oversight of the Office of the Superintendent of Financial Institutions of Canada.

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, 00.00.03)

GROUP V Trust and mortgage loan companies

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 as follows :

	Margin Required
within 1 year	3% of market value a) and b)
over 1 year to 3 years	6% of market value a)
over 3 years to 7 years	7% of market value a)
over 7 years to 11 years	10% of market value a)
over 11 years	10% of market value a)

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, specialists and approved participants of the Bourse when convertible into shares eligible for a reduced margin rate as provided for in paragraph ~~1~~ 2 of article 7202 of the Rules of the Bourse) 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;

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, 00.00.03)

The following are exceptions to the margin rules as set out in this section:

~~3) Securities eligible to a reduced margin rate carried in approved participant, market-maker or specialist account;~~

~~Where the account of an approved participant, a market-maker, a specialist or a restricted trading permit holder contains securities which are eligible to a reduced margin rate as provided for in paragraph 1 of article 7202 of the Rules of the Bourse, including other listed equity issues that are convertible into such securities, the margin requirement for these securities is 25% of their market value provided that they continue to trade at $2.00 or more.~~

3) Securities eligible to a reduced margin rate

The margin required is 25% of the market value if such securities held by approved participant or market maker 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 which qualify for approval by the Options Clearing Corporation as underlying securities;

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 that are classified as regulatory capital of an issuer any of whose securities qualify under subparagraph i).

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

For the purpose of the present paragraph 3), the expression "regulatory capital of an issuer" means Tier 1 capital of a financial institution that is under the regulatory oversight of the Office of the Superintendent of Financial Institutions of Canada.

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.

5) Underlying securities approved by Options Clearing Corporation

~~Where the account of an approved participant, a market-maker, a specialist or a restricted trading permit holder contains securities which qualify for approval by the Options Clearing Corporation as underlying securities including other equity issued that are convertible into underlying securities, the margin required for these securities is 25% of their market value.~~

~~6) Nonconvertible preferred shares and senior shares of companies for which common shares are eligible to a reduced margin rate, as provided in paragraph 1 of article 7202 of the Rules of the Bourse, are entitled to a 25% margin rate provided that such common shares continue to be eligible to a reduced margin rate, failing which, the margin rate for nonconvertible preferred shares must be raised to 50% immediately (instead of after 6 months as it is the case for common shares in the event of a failure of payment of preferred shares dividends).~~

~~10~~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 ~~1~~ 2 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 ~~1~~ 2 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 ~~1~~ 2 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 ~~1~~ 2 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.

~~13~~11) Margin requirements for PEACs and SPECs

a) Simple positions

The margin required on a simple long or short position in a PEAC must be determined by using the same rates as those provided for in paragraph ~~1~~ 2 of Article 7202. However, if the underlying common stock has been approved by the Canadian Clearing Corporation of Derivative Products as being option eligible, then the margin rate must be 30% for long positions and the credit required must be 130% for short positions.

The margin required on a simple long or short position in a SPEC when held in a customer account, must be determined by applying the margin requirements provided for in articles 11202 and 11203 as if it was a stock option held in a customer account.

The margin required on a simple long or short position in a SPEC held in the account of a member, market-maker, specialist or restricted permit holder must be determined by applying the margin requirements provided for in article 11227 as if it was a stock option held in the account of one of the above mentioned person.

b) Paired positions

i) Long underlying common stock - Short SPEC

In the case of clients' accounts, the margin required on a long position in the underlying common stock which is paired with a short position in the corresponding SPEC must be the margin currently required on the common stock as provided by paragraph ~~1)~~2 of article 7202. However, in the case where the market value of the common stock exceeds the termination claim of the SPEC, the margin must then be determined by using the termination claim instead of the market value of the common stock.

In the case where such positions are held in accounts of members, market-makers, specialists or restricted permit holders, the margin required must be equal to 25% of the market value of the long position less the market value of the SPEC. However, margin required must not be less than zero.

ii) Long underlying common stock - Short PEAC

The margin required on a long position in the underlying common stock which is paired with a short position in the corresponding PEAC must be the greater of the margin required on the long position or the margin required on the short position.

iii) Long SPEC - Short underlying common stock

In the case of clients' accounts, the margin required on a long position in the SPEC paired with a short position in the underlying common stock must be equal to the termination claim of the

SPEC minus the difference between the market values of the underlying common stock and of the SPEC.

In the case where such a position is held in the account of a member, market-maker, specialist or restricted permit holder, the margin required must be equal to the market value of the SPEC plus the lesser of the amount by which the SPEC is out of the money or 25% of the market value of the underlying common stock. If the amount of the SPEC is in the money, then the margin required must be equal to the market value of the SPEC less the amount by which it is in the money. However, the margin required must not be less than zero.

iv) Long PEAC - Short underlying common stock

The margin required on a long position in a PEAC paired with a short position in the underlying common stock must be equal to the greater of the margin required on the long or short position.

v) Long PEAC and SPEC - Short underlying common stock

The margin required on a long position in a PEAC and a SPEC paired with a short position in the underlying common stock must be equal to the difference between the market values of the long position and the short position. For the purposes of this calculation, the difference must be determined by using the bid value for each of the long and short positions.

vi) Long underlying common stock - Short PEAC and SPEC

The margin required on a long position in the underlying common stock which is paired with a short position in the PEAC and the SPEC must be equal to the greater of the margin required on the long position or on the short positions.

c) Positions held in accounts of members, market-makers, specialists and restricted permit holders

For the purposes of subparagraphs a) and b) above and when not specified, the margin rate applicable to positions held by a member, market-maker, specialist or restricted permit holder must be the rate provided for in paragraphs 4, 7 and 8 of present article.