Bourse de Montréal Inc.

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

CIRCULAR
June 22, 2005

REQUEST FOR COMMENTS

ADDITION OF GENERAL PROVISIONS TO MARGIN AND CAPITAL REQUIREMENTS FOR FUTURES CONTRACTS AND ADDITION OF NEW POSITION OFFSETS – RULE NINE OF BOURSE DE MONTRÉAL INC.

AMENDMENTS TO ARTICLES 9121, 9221, 9321 AND 9421

ADDITION OF ARTICLES 9326 AND 9426

Summary

The Rules and Policies Committee of Bourse de Montréal Inc. (the Bourse) has approved amendments to articles 9121, 9221, 9321 and 9421 of the Rules, as well as the addition of articles 9326 and 9426 to Rule Nine of the Bourse, which deal with margin and capital requirements applicable to options, futures contracts and other derivative instruments. These amendments and addition also have for purpose to harmonize the text of Rule Nine of the Bourse with the text of Regulations 100.8 of the Investment Dealers Association of Canada.

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.: 096-2005

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 9121, 9221, 9321 and 9421 of the Rules, and on the addition of articles 9326 and 9426 to Rule Nine 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”.

ADDITION OF GENERAL PROVISIONS TO MARGIN AND CAPITAL REQUIREMENTS FOR FUTURES CONTRACTS AND ADDITION OF NEW POSITION OFFSETS – RULE NINE OF BOURSE DE MONTRÉAL INC.

- **AMENDMENTS TO ARTICLES 9121, 9221, 9321 AND 9421**
- **ADDITION OF ARTICLES 9326 AND 9426**

I SUMMARY

A) Current Rules

In connection with some amendment projects to Rule Nine of Bourse de Montréal Inc. (the Bourse) including, among others, a project to integrate margin and capital requirements applicable to currency options, and another whose purpose is to update the provisions that relate to over-the-counter options, the Bourse has proceeded to a complete review of Rule Nine and wishes to implement amendments that will allow to harmonize its wording with the one used by the IDA in its corresponding Regulations, more precisely Regulation 100.8.

B) The Issue

The text of Rule Nine of the Bourse does not contain all the provisions that are found in Regulation 100.8 of the IDA. Some of these provisions allow clarifying the application and the interpretation of the regulations that relate to margins that must be applied to futures contracts and options on futures contracts.

Furthermore, the IDA has proposed to amend its Regulation 100.8 (f) in order to permit, for margin purposes, the pairing of spread positions involving futures contracts on Government of Canada Bonds and futures contracts on U. S. Treasury Bonds. The Bourse wishes to add a similar provision to its rules.

C) Objective

The objective of the proposed amendment is to harmonize the provisions of Rule Nine relating to margin and capital requirements applicable to futures contracts with those of Regulation 100.8 of the IDA.

The proposed amendments will also eliminate interpretation and application difficulties that can arise from regulatory texts worded differently.

Finally, the proposed amendments also have as an objective to expand the number of possible offsets for margin and capital purposes by permitting margin offsets between futures contracts on Government of Canada Bonds and futures contracts on U. S. Treasury Bonds.

D) Effect of proposed amendments

The proposed amendments will have no effect on market structure, on competition between approved participants and other brokers and on compliance costs. The proposed amendments will permit the regulatory texts of the Bourse to be harmonized with those of the corresponding texts of the IDA.

II DETAILED ANALYSIS

A) Current Rules and Proposed Amendments

Amendments to articles 9121, 9221, 9321 and 9421 – Exchange Traded Futures Contracts – General Provisions

These four (4) articles are fundamentally identical. Articles 9121 and 9321 apply to client accounts while articles 9221 and 9421 apply to approved participants' accounts. Articles 9121 and 9221 concern futures contracts and options on futures contracts whose underlying interest is an index or an equity while articles 9321 and 9421 concern futures contracts and options on futures contracts on interest rates.

Paragraphs a) to d) of Regulation 100.8 of the IDA contain provisions which, in the opinion of the Bourse, permit to clarify the interpretation and the application of margin and capital rules that are applicable to futures contracts and options on futures contracts. The Bourse therefore proposes to add these provisions to the above-mentioned articles.

These provisions can be summarized as follows:

a) positions in futures contracts and options on futures contracts must be valued on a daily basis and the margin and capital required must be determined by using the greater of the following rates
   i) the rate prescribed by the exchange on which the contract has been traded or the one prescribed by the clearing corporation of this exchange; or
   ii) the rate asked for by the clearing broker, when an approved participant has the clearing of its transactions done by another approved participant;

b) when the exchange on which a contract is traded prescribes an initial margin rate and a maintenance margin rate, the amount of margin or capital required at the time of the conclusion of the transaction must be the initial rate prescribed by the exchange. Subsequently, if, in the case of a client, unfavourable fluctuations reduce the margin deposited initially by this client to an amount lesser than the maintenance margin rate prescribed by the exchange, an additional deposit must be required from the client in order to reset the amount of margin to the initial rate. In the case of positions held by an approved participant, the required capital must be the maintenance margin rate;

c) when transactions are made for an "omnibus" account, the margin required must be at least equal to the one that would be required if each of the clients included in the "omnibus" account was treated separately. This means in fact that in the case of an "omnibus" account, the positions held in the account must not be paired or netted when determining the margin requirements that are applicable to such an account;

d) particular margin and capital requirements may apply to spread positions. Approved participants' records relating to margin calculations must clearly identify spread positions that are subjected to such particular margin requirements.

Paragraphs a), b) and d) of Regulation 100.8 apply to both clients and approved participants. Paragraph c) applies to clients.

<u>Addition of articles 9326 and 9426 – Pairing of futures contracts on Government of Canada Bonds with futures contracts on U.S. Treasury Bonds</u>

In connection with the updating of its Regulation 100.8, the IDA has proposed to permit the pairing for margin purposes of futures contracts on Government of Canada Bonds with futures contracts on U. S. Treasury Bonds.

The purpose of this proposal is to reflect the fact that the U. S. and Canadian economies are closely linked and that the interest rate policy of the Bank of Canada is significantly influenced by the one followed by the U. S. Federal Reserve. There exists therefore a relatively important correlation between the interest rates of both countries.

Pursuant to the proposed provisions, such a pairing would be permitted subject to the following conditions:

a) the futures contracts used for the pairing must both be traded on a recognized exchange;
b) the U. S. exchange on which the U. S. portion of the position is taken must be an exchange recognized by the *Commodity Exchange Act* of the United States;
c) the margin required must be the greater of the margin required on the long and the short position; and
d) the pairing must be done at a rate of $1 CAD for each $1 USD based on the notional value of the futures contracts.

Allowing this type of pairing should contribute to expand the choice of strategies involving futures contracts on Government of Canada Bonds listed on the Bourse while permitting approved participants and their clients to take advantage of margin and capital requirements reductions when such positions are held.

B) Public Interest

The objective of the proposed amendments is to harmonize the provisions of Rule Nine relating to margin and capital requirements applicable to futures contracts with those of Regulation 100.8 of the IDA.

The proposed amendments will eliminate interpretation and application difficulties that can result from regulatory texts worded differently.

The proposed amendments also intend to expand the number of pairings possible for margin and capital purposes by allowing the pairing of positions in futures contracts on Government of Canada Bonds with positions in futures contracts on U. S. Treasury Bonds.

Consequently, the proposed amendments are considered to be of public interest.

III COMMENTS

A) Efficiency

The effect of the proposed amendments will be to eliminate interpretation and application difficulties of the Rules regarding margin and capital requirements applicable to futures contracts.

Furthermore, the proposed addition of articles 9326 and 9426 will allow approved participants and their clients to take advantage, as far as margin and capital requirements are concerned, of the risk reduction resulting from the pairing of futures contracts on Government of Canada Bonds with futures contracts on U. S. Treasury Bonds.

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 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 is obtained, the project is published by the Bourse for a 30-day comment period and submitted to the Autorité des marchés financiers for approval and to the Ontario Securities Commission for information.

IV SOURCES

- Rule Nine of Bourse de Montréal Inc.;
- Regulation 100.8 of the Investment Dealers Association of Canada (IDA)

APPENDIX B

9121 Exchange Traded Futures Contracts – General
(00.00.05)

a) The Bourse shall establish margin requirements applicable to futures contracts positions held by clients and no approved participant shall effect a futures contract transaction or carry an account for a client without proper and adequate margin, which must be obtained as promptly as possible and maintained in conformity with the provisions of this section;

b) positions of clients must be marked to market daily and the required margin must be determined by using the greatest of:

i) the rate required by the futures contract exchange on which the contract is entered into or its clearing corporation; or

ii) the rate required by the broker through which the approved participant ensures the clearing of the futures contract;

c) in the case of a futures contract exchange or its clearing corporation that prescribes margin requirements based on initial and maintenance rates, the initial margin must be required from the client at the time the contract is entered into and such margin must not be for an amount less than the prescribed initial rate. When subsequent adverse price movements in the value of the futures contract reduce the margin on deposit to an amount below the maintenance level, a further amount to restore the margin on deposit to the initial rate must be required. The approved participant may, in addition, require such further margin or deposit as it may consider necessary as a result of fluctuations in market prices;

~~b~~d) margin requirements established by the Bourse may be made applicable to one or more rather than all approved participants or clients if deemed necessary by the Bourse;

~~c~~e) for clients, the margin requirements will be satisfied by the deposit of cash, margin receipts or securities for which the loan value, as established pursuant to articles 7202 to 7206, equals or exceeds the margin required. In the case of a margin receipt, the receipt must certify that government securities are held for futures contract~~s~~ positions of a named client. For the purposes of this receipt, the allowable government securities must mature within one year from the date of the deposit and the required margin covered by the receipt must not be greater than 90% of the par value of such securities held on deposit. All government securities which are an acceptable form of margin for the clearing corporation are acceptable;

f) every approved participant must require from each of its customers for whom trades are effected through an omnibus account, not less than the amount of margin that would be required from such customers if their trades were effected through fully disclosed accounts;

g) specific margin requirements may be applicable on spread positions when a client account holds such positions. Every approved participant must clearly identify such spread positions in its records relating to margin calculations;

~~d~~h) from time to time, the Bourse may impose special margin requirements with respect to particular futures contracts or particular positions in futures contracts.

9221 Exchange Traded Futures Contracts – General
(00.00.05)

a) With respect to an account of an approved participant, market-maker, or restricted trading permit holder for which a clearing approved participant has issued a letter of guarantee, the Bourse may establish certain charges against the capital of the approved participant carrying the account, which charges may be less onerous than margin requirements applicable to clients but for which the approved participant must maintain adequate capital resources at all times;

b) positions of approved participants and customers must be marked to market daily and the required capital must be determined by using the greatest of:

   i) the rate required by the futures contract exchange on which the contract is entered into or its clearing corporation; or

   ii) the rate required by the broker through which the approved participant ensures the clearing of the futures contract;

c) in the case of a futures contract exchange or its clearing corporation that prescribes margin requirements based on initial and maintenance rates, initial capital is required at the time the contract is entered into and the amount of such capital must not be less than the prescribed initial rate. Subsequently, the approved participant must maintain, for each position held, a capital amount equivalent to the prescribed maintenance rate;

~~b~~d) capital requirements established by the Bourse may be made applicable to one or more rather than all approved participants if deemed necessary by the Bourse;

e) specific capital requirements may be applicable on spread positions when an approved participant account holds such positions. Every approved participant must clearly identify such spread positions in its records relating to margin calculations;

~~c~~f) from time to time the Bourse may impose special capital requirements with respect to particular futures contracts or particular positions in futures contracts.

APPENDIX B

9321 Exchange ~~t~~Traded ~~f~~Futures ~~c~~Contracts – General
(00.00.05)

a) The Bourse shall establish margin requirements applicable to futures contracts positions held by clients and no approved participant shall effect a futures contract transaction or carry an account for a client without proper and adequate margin, which must be obtained as promptly as possible and maintained in conformity with the provisions of this section;

b) positions of clients must be marked to market daily and the required margin must be determined by using the greatest of:

i) the rate required by the futures contract exchange on which the contract is entered into or its clearing corporation; or

ii) the rate required by the broker through which the approved participant ensures the clearing of the futures contract;

c) in the case of a futures contract exchange or its clearing corporation that prescribes margin requirements based on initial and maintenance rates, the initial margin must be required from the client at the time the contract is entered into in and such margin must not be for an amount less than the prescribed initial rate. When subsequent adverse price movements in the value of the futures contract reduce the margin on deposit to an amount below the maintenance level, a further amount to restore the margin on deposit to the initial rate must be required. The approved participant may, in addition, require such further margin or deposit as it may consider necessary as a result of fluctuations in market prices;

~~b~~d) margin requirements established by the Bourse may be made applicable to one or more rather than all approved participants or clients if deemed necessary by the Bourse;

~~c~~e) for clients, the margin requirements will be satisfied by the deposit of cash, margin receipt or securities for which the loan value, as established pursuant to articles 7202 to 7206, equals or exceeds the margin required. In the case of a margin receipt, the receipt must certify that government securities are held for futures contract~~s~~ positions of a named client. For the purposes of this receipt, the allowable government securities must mature within one year from the date of the deposit and the required margin covered by the receipt must not be greater than 90% of the par value of such securities held on deposit. All government securities which are an acceptable form of margin for the clearing corporation are acceptable;

f) every approved participant must require from each of its customers for whom trades are effected through an omnibus account not less than the amount of margin that would be required from such customers if their trades were effected through fully disclosed accounts;

g) specific margin requirements may be applicable on spread positions when a client account holds such positions. Every approved participant must clearly identify such spread positions in its records relating to margin calculations;

h~~d~~) from time to time, the Bourse may impose special margin requirements with respect to particular futures contracts or particular positions in futures contracts.

9421 Exchange Traded Futures Contracts – General
(00.00.05)

a) With respect to an account of an approved participant, market-maker, or restricted trading permit holder ~~account~~ for which a clearing approved participant has issued a letter of guarantee, the Bourse has established certain charges against the capital of the approved participant carrying the account, which charges may be less onerous than margin requirements applicable to clients but for which the approved participant must maintain adequate capital resources at all times;

b) positions of approved participants and customers must be marked to market daily and the required capital must be determined by using the greatest of:

i) the rate required by the futures contract exchange on which the contract is entered into or its clearing corporation; or

ii) the rate required by the broker through which the approved participant ensures the clearing of the futures contract;

c) in the case of a futures contract exchange or its clearing corporation that prescribes margin requirements based on initial and maintenance rates, initial capital is required at the time the contract is entered into and the amount of such capital must not be less than the prescribed initial rate. Subsequently, the approved participant must maintain, for each position held, a capital amount equivalent to the prescribed maintenance rate;

~~b~~d) capital requirements established by the Bourse may be made applicable to one or more rather than all approved participants or clients if deemed necessary by the Bourse;

e) specific capital requirements may be applicable on spread positions when an approved participant account holds such positions. Every approved participant must clearly identify such spread positions in its records relating to margin calculations;

~~e~~f) from time to time the Bourse may impose special capital requirements with respect to particular futures contracts or particular positions in futures contracts.

9326 Pairing of Government of Canada Bond Futures Contracts with U. S. Treasury Bond Futures Contracts
(00.00.05)

Where a client's account holds inter-commodity spreads in Government of Canada Bond futures contracts and US Treasury Bond futures contracts traded on recognized exchanges, the margin required is the greater of the margin required on either the long position or the short position.

For the purpose of this article, the foregoing spreads must be on the basis of one Canadian dollar for each U.S. Dollar of the contract size of the relevant futures contracts and, with respect to the United States side of the above inter-commodity spreads, such positions must be maintained on a contract market as designated pursuant to the United States *Commodity Exchange Act.*

9426 Pairing of Government of Canada Bond Futures Contracts with U. S. Treasury Bond Futures Contracts
(00.00.05)

Where an approved participant's account holds inter-commodity spreads in Government of Canada Bond futures contracts and US Treasury Bond futures contracts traded on recognized exchanges, the margin required is the greater of the margin required on either the long position or the short position.

For the purpose of the present article, the foregoing spreads must be on the basis of one Canadian dollar for each U.S. Dollar of the contract size of the relevant futures contracts and, with respect to the United States side of the above inter-commodity spreads, such positions must be maintained on a contract market as designated pursuant to the United States *Commodity Exchange Act*.