



CIRCULAR
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**EARLY WARNING SYSTEM –
AMENDMENTS TO ARTICLE 7010**

The Special Committee – Regulatory Division of Bourse de Montréal Inc. (the “Bourse”) has approved amendments to article 7010 of the Rules of the Bourse relating to the early warning system. These amendments become effective immediately.

The purpose of the amendments made to article 7010 is to allow the vice-president of the Regulatory Division to impose discretionary business restrictions to an approved participant that is classified in level 2 of the early warning system. However, for fairness purposes, article 7010 was also amended in order to establish an appeal procedure allowing approved participants to request that such decision be revised on an independent basis by the Examination Subcommittee of the Bourse before said decision applies.

As a mechanism of review, the Bourse will give approved participants three business days from the date of the order to request that it be reviewed by the Examination Subcommittee. This Subcommittee will hear representations from both the approved participant and the Bourse staff on the matter within the seven business days following the request for a review by the approved participant or within such longer delay as may be agreed upon. The Subcommittee will then determine whether to revoke, amend or confirm the business restrictions imposed by the vice-president of the Regulatory Division. During the three business days given to the approved participant to request a review of the business restrictions and until the results of such review are announced, the prohibitions or restrictions will not apply. However, when they become effective, they will be kept in force until the approved participant is designated as no longer being in level 2 of the early warning system.

For further information, please contact Mr. Jacques Tanguay, Vice-President, Regulatory Division at (514) 871-3518 or via email at jtanguay@m-x.ca.

Joëlle Saint-Arnault
Vice-president, Legal affairs and secretary

Encl.

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Tour de la Bourse
C. P. 61, 800, square Victoria, Montréal (Québec) H4Z 1A9
Téléphone : (514) 871-2424
Sans frais au Canada et aux États-Unis : 1 800 361-5353
Site Internet : www.m-x.ca

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

7010 Early Warning System

(01.09.89, 01.07.91, 01.10.92, 01.04.93, 11.03.98, 08.05.03, 29.07.03)

- 1) No transaction, of the type of those described in subparagraph 2 e) iv) of the present article and the undertaking of which would place the approved participant into the Early Warning System, must be done without prior notice to the vice-president of the Regulatory Division of the Bourse and prior written authorization from him to complete such transaction.
- 2) LEVEL 1 An approved participant is deemed to be in the early warning category Level 1 when one of the following situations occurs:
 - a) the risk adjusted capital of the approved participant is less than 5% of the aggregate of the total margin required for the approved participant;
 - b) the quotient based upon dividing the risk adjusted capital by the average (when the average is a loss) of the preceding six months net profits or losses (before interest on subordinated debt, bonuses, income taxes and extraordinary items) is:
 - i) for two consecutive months, greater or equal to 3, but less than 6;
 - ii) for the current month, greater or equal to 3, but less than 6 and for the preceding month, less than 3;
 - c) the risk adjusted capital of the approved participant is less than 6 times the net loss (before interest on subordinated debt, bonuses, income taxes and extraordinary items) of the approved participant for the current month;
 - d) the Early Warning Reserve is negative; or
 - e) the condition of the approved participant, at the discretion of the vice-president of the Regulatory Division of the Bourse, is not satisfactory for any reason including, without limitation, financial or operating difficulties, problems arising from record keeping conversion or significant changes in clearing methods, the fact that the approved participant is a new approved participant or that he has been late in filing reports required pursuant to the regulations;

then, in these cases, the following provisions apply:

- i) when in the normal course of its capital surveillance activities, the approved participant realizes that he has crossed the threshold that activates the Early Warning System Level 1, then he must promptly notify in writing the vice-president of the Regulatory Division of the Bourse. The notice must be provided by letter signed by the Chief Executive Officer and the Chief Financial Officer, of the approved participant and, must contain the following information:
 - [1] which circumstances in paragraphs a), b), c) or d) are applicable;
 - [2] an outline of the problems associated with the circumstances that triggered the Early Warning;
 - [3] an outline of the proposal of the approved participant to rectify the problems identified; and

- [4] an acknowledgment that the approved participant is in an Early Warning category and that the restrictions contained in sub-paragraph iv) of the present article apply;

A copy of said notice must be provided to the approved participant's external auditor and to the Canadian Investor Protection Fund.

- ii) the vice-president of the Regulatory Division of the Bourse must immediately designate the approved participant as being in Level 1 of the Early Warning System and must deliver to each of the Chief Executive Officer and Chief Financial Officer a letter containing the following:
 - [1] advice that the approved participant is designated as being in level 1 of the Early Warning System;
 - [2] a request that the approved participant files its next monthly financial report no later than 10 business days thereafter or, in the discretion of the vice-president of the Regulatory Division of the Bourse if he considers it to be necessary, at such earlier time following the end of the relevant month;
 - [3] a request that the approved participant provides the notice required under sub-paragraph e) i), if this has not already been done, and any additional information as required in sub-paragraph e) iii) and a statement that the notices received pursuant to sub-paragraphs e) i) and e) iii) will be forwarded to the Canadian Investor Protection Fund and may be forwarded to any securities commission having jurisdiction over the approved participant;
 - [4] advice that the restrictions referred to in subparagraph e) iv) of the present article apply to the approved participant; and
 - [5] such other information as the vice-president of the Regulatory Division of the Bourse considers relevant.
- iii) within five business days of receipt of the letter referred to in subparagraph e) ii), the Chief Executive Officer and the Chief Financial Officer of the approved participant must respond to the vice-president of the Regulatory Division of the Bourse by letter signed by them both, with a copy to be sent to the auditor of the approved participant. This letter must contain the information and acknowledgment required pursuant to sub-paragraph e) i) 2), 3) and 4), to the extent not previously provided, or an update of such information if any circumstances or facts have changed materially;
- iv) if and so long as the approved participant remains designated as being in this Early Warning category, it must not, without the prior written consent of the vice-president of the Regulatory Division of the Bourse:
 - [1] reduce its capital in any manner including the re-purchase or cancellation of any of its shares;
 - [2] reduce or repay any indebtedness, which has been subordinated with the approval of the Bourse;
 - [3] make directly or indirectly any payments by way of loan, advance, bonus, dividend, repayment of capital or other distribution of assets to any director, officer, partner, shareholder, related company or subsidiary; or

- [4] increase its non-allowable assets unless a prior binding commitment to do so exists or enter into any new commitments, which would have the effect of materially increasing to non-allowable assets of the approved participant;
 - v) if and so long as the approved participant remains designated as being in this Early Warning category, it must continue to file its monthly financial reports within the time specified pursuant to subparagraph e) ii) 2) of the present article;
 - vi) as soon as practicable after the approved participant is designated as being in this Early Warning category, the vice-president of the Regulatory Division of the Bourse must conduct an on-site review of the approved participant's procedures for monitoring capital on a daily basis and prepare a report as to the results of this review;
 - vii) the vice-president of the Regulatory Division of the Bourse must also advise the Examination Subcommittee of the fact that an approved participant has been designated as being in an Early Warning Category Level 1 without naming the approved participant.
- 3) LEVEL 2 An approved participant is deemed to be in Early Warning category Level 2 when one of the following situations occurs:
- a) risk adjusted capital of the approved participant is less than 2% of the aggregate of the total margin required for the approved participant;
 - b) the quotient based upon dividing the risk adjusted capital of the approved participant by the average (where the average is a loss) of the preceding six months net profits or losses (before interest on subordinated debt, bonuses, income taxes and extraordinary items) is:
 - i) less than 3, for two successive months;
 - ii) greater or equal to 3, but less than 6 for the current month and less than 3 for the preceding month;
 - c) the sum (where the sum is a loss) of the preceding three months net profit or loss (before interest on subordinated debt, bonuses, income taxes and extraordinary items) exceeds the risk adjusted capital at the end of the third month;
 - d) the risk adjusted capital of the approved participant is less than three times its net loss (before interest on subordinated debt, bonuses, income taxes and extraordinary items) for the immediately preceding completed month;
 - e) the Early Warning Excess is negative;
 - f) the approved participant has been on Early Warning 3 times in the last 6-month period;
 - g) one or the other of the two profitability tests triggers Level 1 in conjunction with capital or liquidity tests of Level 1;
 - h) the condition of the approved participant, at the sole discretion of the vice-president of the Regulatory Division of the Bourse, is not satisfactory for any reason including, without

limitation, financial or operating difficulties, problems arising from record keeping conversion or significant changes in clearing methods, the fact that the approved participant is a new approved participant or that he has been late in filing the reports required by the regulations;

then, the following provisions must apply in addition to the provisions of Level 1 which must continue to apply, except to the extent inconsistent with paragraph 3:

- i) when in the normal course of its capital surveillance activities, the approved participant realizes that he has crossed the threshold that activates the Early Warning System Level 2, then he must promptly notify in writing the vice-president of the Regulatory Division of the Bourse. The notice must be provided by letter signed by the approved participant's Chief Executive Officer and Chief Financial Officer;
- ii) the approved participant must file a weekly financial report containing the same information required in a monthly financial report no later than 5 business days or, if the vice-president of the Regulatory Division of the Bourse considers it to be necessary, at such earlier time;
- iii) the Chief Executive Officer and the Chief Financial Officer of the approved participant must attend at the offices of the Bourse to outline the proposals of the approved participant for rectifying the problems which account for the approved participant being designated as being in Early Warning Category Level 2;
- iv) the approved participant must report weekly in a format satisfactory to the vice-president of the Regulatory Division of the Bourse aged segregation deficiencies and indicate their resolution;
- v) the approved participant must pay the costs associated with any special examination or monitoring deemed necessary by the vice-president of the Regulatory Division of the Bourse;
- vi) the approved participant may be subject, at the discretion of the vice-president of the Regulatory Division of the Bourse, to a reduced allowable free credit ratio;
- vii) the vice-president of the Regulatory Division of the Bourse may require from the approved participant and the latter must then elaborate and provide, in such time and for such period as the vice-president of the Regulatory Division of the Bourse deems expedient, a business plan relating to its business in order to answer his questions;
- viii) the vice-president of the Regulatory Division of the Bourse may request and the approved participant must provide in such time as the vice-president of the Regulatory Division of the Bourse considers necessary, such reports or information, on a daily or a less frequent basis, as may be necessary or desirable in the opinion of the vice-president of the Regulatory Division of the Bourse to assess and monitor the financial condition or operations of the approved participant;
- ix) the vice-president of the Regulatory Division of the Bourse, as soon as practicable after he has designated an approved participant as being in Level 2 of the Early Warning System, must prepare and submit a report to the Examination Subcommittee outlining the financial and operational conditions of the approved participant and must, at its request, identify the approved participant to the Examination Subcommittee;
- x) the vice-president of the Regulatory Division of the Bourse may, without according the approved participant a hearing, issue a proposed order that prohibits an approved participant

from opening any new branch offices, hiring any new registered representatives or investment representatives, opening any new customer accounts or changing in any material respect its inventory positions. If the vice-president of the Regulatory Division of the Bourse imposes any such prohibitions pursuant to the present article, he must give written notice to the approved participant and the approved participant may request in writing within three (3) business days of receipt of notice that the proposal be reviewed by members of the Examination Subcommittee. If no request for review is made, the order must apply as of such date designated by the vice-president of the Regulatory Division of the Bourse, occurring on or after the expiration of the three (3) business days. If such a request is made, the Examination Subcommittee must designate at least two (2) members of the Examination Subcommittee to review the order and to confirm, amend or revoke the proposal of the vice-president of the Regulatory Division of the Bourse within seven (7) business days of the request for review, or such longer time as may be agreed by the approved participant. The approved participant and the vice-president of the Regulatory Division of the Bourse must be permitted to make representations in such review in person (including by their staff, agents or counsels) or in writing. Pending the expiration of the said three (3) business days notice by the vice-president of the Regulatory Division of the Bourse and the result of the review, if applicable, the prohibitions must not apply but on becoming effective they must continue until the approved participant is so designated as not being in an early warning category level 2;

- xi) the vice-president of the Regulatory Division of the Bourse must promptly advise any other participating institution of the Canadian Investor Protection Fund of which the approved participant is also a member, of the fact that the approved participant has been designated as being in Level 2 of the Early Warning System, the reasons for such designation and any sanctions or restrictions that have been imposed upon the approved participant pursuant to paragraph 3 of the present article.
- 4) Requirements imposed in the present article must continue to apply until the approved participant is no longer designated as being in Level 1 or Level 2 of the Early Warning System as demonstrated by the latest filed monthly financial report of the approved participant or any such other evidence or assurance as may be appropriate in the circumstances. If the vice-president of the Regulatory Division is satisfied by the measures taken by the approved participant to improve its financial situation, he may release him from all or from some of the restrictions imposed under the present article.
- 5) An approved participant shall remain designated as being in level 1 or level 2 of the Early Warning System, as the case may be, and pursuant to the present article, until the latest filed Monthly Financial Report of the approved participant demonstrates, in the opinion of the vice-president of the Regulatory Division of the Bourse, that the approved participant is no longer required to be designated as being in one of the levels of the Early Warning System and that he has otherwise complied with the present article.