Bourse de Montréal Inc.

TO: Approved Participants **September 23, 2002**
Chief Financial Officers
External Auditors
Holders of the Rules and Policies Manual

CAPITAL REQUIREMENTS FOR FINANCING TRANSACTIONS
AMENDMENTS TO SCHEDULES 1, 7 AND 7A OF POLICY C-3

The Executive Committee of Bourse de Montréal Inc. (the "Bourse") has approved amendments to Policy C-3 of the Bourse entitled Joint Regulatory Financial Questionnaire and Report ("JRFQ&R"), which relates to the capital requirements for financing transactions. These amendments become effective upon the filing of the August 31, 2002 Monthly Financial Report (MFR). A copy of the amendments is attached.

BACKGROUND

With the last major revision of the capital formula in 1993, four classifications of counterparties were introduced as follows:

1. Acceptable institutions;
2. Acceptable counterparties;
3. Regulated entities; and
4. Other counterparties.

Under this new capital formula, approved participants were permitted to deal with counterparties considered to be "acceptable institutions" on an unsecured basis and with counterparties considered to be either "acceptable counterparties" or "regulated entities" on a "value for value"[1] basis, with no regulatory capital implications.

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[1] Transactions made on a "value for value" basis are those where the market value of the cash or securities held as collateral by the approved participant is equal to the market value of the cash or securities related credit exposure to the counterparty.

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However, there are certain transactions where legislative or regulatory requirements imposed on a counterparty make it impossible for an approved participant to deal with that counterparty on a value for value basis. A prime example is securities borrowing arrangements. In a situation where an approved participant wishes to borrow securities from a chartered bank, the said bank, pursuant to the requirements of the Office of the Superintendent of Financial Institutions (OSFI), is required to ask for collateral with a market value of at least 105 percent of the market value of the securities lent to the approved participant. If the bank happens to be an "acceptable institution", the approved participant would not have a problem as it is permitted to deal with an "acceptable institution" on an unsecured basis, with no regulatory capital implications. However, if the bank happens to be an "acceptable counterparty", the approved participant would be subject to an immediate 5 percent capital penalty.

From a risk perspective, it was felt that it was not appropriate to charge the approved participant this 5 percent capital penalty when the reason for this additional collateral being provided by the approved participant is because the counterparty is required by its regulator or by legislation to ask for it. As a result, in order to not unduly restrict the ability of an approved participant to enter into financing transactions[2] with "acceptable counterparties", amendments to the existing capital requirements have been made as follows:

- The Notes and Instructions to Schedules 1 and 7 of Policy C-3 have been revised from the current "market value deficiency" requirement to the excess of the approved participant's actual collateralization level over the counterparty's regulatory or legislative requirements, to be referred to as the "excess collateral deficiency"; and

- The total "acceptable counterparties" market value exposure relating to financing transactions will be limited by the "Financing Activities Concentration Charge", a concentration charge set out in new Schedule 7A of Policy C-3, to 100 percent of the approved participant's net allowable assets.

For further information, please contact Eric Bernard, Financial Analyst, Regulatory Division at (514) 871-4949, ext. 373, or via e-mail at ebernard@m-x.ca.

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Encl.

[2] For the purposes of these amendments, "financing transactions" include all transactions whose balances are reportable on Schedules 1 and 7 of Policy C-3. These transactions include all call loans and reverse call loans, loans payable and receivable, securities loaned and borrowed and repurchase and resale agreements.