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

CIRCULAR
August 15, 2006

REQUEST FOR COMMENTS

UNHEDGED FOREIGN EXCHANGE MARGIN RATES

AMENDMENTS TO ARTICLE 7210

Summary

The Rules and Policies Committee of Bourse de Montréal Inc. (the Bourse) has approved amendments to article 7210 of the Rules of the Bourse. The purpose of these amendments is to put in place a more accurate methodology for calculating the unhedged foreign currency positions.

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.: 147-2006

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 article 7210 of the Rules 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”.

UNHEDGED FOREIGN EXCHANGE MARGIN RATES

-AMENDMENTS TO ARTICLE 7210

I SUMMARY

A) Current Rules

Under the current rules of Bourse de Montréal Inc. (the Bourse) margin requirements applicable to unhedged foreign currency positions are determined by using a methodology which compares, for each of the currencies in Groups 1, 2 and 3[1], the foreign currency's close price on each of the four trading days succeeding the foreign currency's base day[2].

If the percentage change in the foreign currency's close price on a succeeding day is greater that the current margin rate applicable to unhedged positions in that currency, that day is considered an offside day and then serves as the new base day for the subsequent comparisons. If the number of offside days exceeds three during a 60-day trading period, there is a violation and the foreign currency's margin rate is increased so that there are no more than two offside days during the preceding 60 trading days. The increased margin rate would then apply for a minimum of 30 trading days.

Following this 30-day trading period, the margin rate for the foreign currency is reduced to the extent that the number of offside days does not exceed three. Over time, the foreign currency's margin rate is progressively reduced to its Group base margin rate.

B) The Issue

One of the main concerns raised with the methodology currently used to determine margin rates applicable to foreign currencies is that this methodology does not allow to obtain a margin rate that adequately reflects the risk related to these currencies. As a result, margin rates are either too high or too low to what they would be if a more precise methodology, better reflecting the risk, was used.

It is therefore proposed to use the same methodology than the one currently used by the Bourse for products related to the S&P/TSX 60 Index, sectorial indices and currency options, the "floating margin rate" methodology.

This methodology is the one described in current paragraph e) of article 9001 of the Rules of the Bourse which reads as follows:

"***floating margin rate****" means:*

i) the last calculated regulatory margin interval, effective for the regular reset period or until a violation occurs, such rate to be reset on the regular reset date, to the calculated regulatory margin interval determined at that date; or

ii) where a violation has occurred, the last calculated regulatory margin interval determined at the date of the violation, effective for a minimum of twenty trading days, such rate to be reset at the close of the twentieth trading day, to the calculated regulatory margin interval determined at that date, where a reset results in a lower margin rate.

1 See attached appendix for a list of currencies being in each of these groups.

2 The "base day" is the trading day preceding these four days.

For the purposes of this definition, the term "regular reset date" is the date subsequent to the last reset date where the maximum number of trading days in the regular reset period has passed.

For the purposes of this definition, the term "regular reset period" is the normal period between margin rate resets. This period must be determined by the Canadian self-regulatory organizations with member regulation responsibilities and must not be longer than sixty trading days.

For the purpose of this definition, the term "regulatory margin interval", when calculated, means the product of:

i) the maximum standard deviation of percentage changes in daily closing prices over the most recent 20, 90 and 260 trading days; and

ii) 3 (for a 99% confidence interval); and

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

rounded up to the next quarter percent.

For the purpose of this definition, the term "violation" means the circumstance where the maximum 1 or 2 day percentage change in the daily closing prices is greater than the margin rate;"

A comparison made as at October 31, 2005 of the current methodology with the proposed "floating margin rate" methodology (see Appendix) resulted in margin rate reductions varying between 0.60 percent and 7.59 percent for 12 of the 18 currencies tested and margin rates increases varying between 0.12 percent and 0.70 percent for the six other currencies. The margin rates obtained by using the floating margin rate methodology ranged from 2.41 percent to 5.18 percent compared to those under the current methodology which ranged from 2.30 percent to 10 percent. It is also to be noted that if the floating margin rate methodology had been used during the 260-day trading period preceding October 31, 2005, margin rates would have been changed 13 times during that period. Under the current methodology, margin rates were actually changed only five times and all these changes were on the U.S. Dollar margin rate. If the floating margin rate methodology had been used during that same period, the U.S. Dollar margin rate would have been changed only once. Although the floating margin rate methodology requires that margin rates applicable to currency groups 1, 2 and 3 be modified more frequently, it allows obtaining margin rates that better reflect the risk related to those currencies.

It is also proposed to reduce the minimal margin rates applicable to currency groups 2 and 3. Currently, the minimal margin rate applicable is 3 percent for currency group 2 and 10 percent for currency group 3. In the case of group 3, the analysis made using the floating margin rate methodology resulted in margin rates varying between 2.41 percent and 5.18 percent. Considering these results, it appears that the current 10 percent minimal rate is too high. It is therefore proposed to reduce it to 7 percent. For what concerns currency group 2, the margin rates obtained by using the floating margin rate methodology vary between 3.12 percent and 3.70 percent. It is proposed to reduce the minimal margin rate applicable to these currencies from 3 percent to 2 percent.

C) Objective

The objective of the proposed amendments to article 7210 of the Rules of the Bourse is to replace the current margin requirements calculation methodology for unhedged foreign currency positions by a methodology, the floating margin rate methodology, that not only is already used for other types of financial instruments such as S&P/TSX index products and currencies options, but which also results in margin measurements that better reflect the risk related to positions held in a financial instrument or in a foreign currency. The proposed amendments are also aimed at reducing minimal margin rates applicable to some foreign currencies.

D) Effect of Proposed Rules

The proposed amendments will allow harmonizing the margining methodology for unhedged foreign currency positions with the one currently in place for S&P/TSX 60 Index and index related products and for currencies options. The new methodology should have no major impact on approved participants and will result in a more responsive and accurate risk measurement.

E) Public Interest Objective

The objective of the proposed amendments being the implementation of a more accurate risk measurement methodology for unhedged positions in foreign currencies, which should result in lower margin rates for most foreign currencies, the present proposal is therefore considered to be of public interest.

II COMMENTS

A) Efficiency

As indicated above, the objective of the proposed amendments is to implement a more responsive and accurate risk measurement methodology for unhedged foreign currency positions and to reduce the minimal margin rate applicable to foreign currency groups 2 and 3.

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. Once the approval of the Special Committee has been obtained, the proposed amendments, if they relate to capital and margin matters, are subsequently submitted to the Rules and Policies Committee of the Bourse for further approval. Once the approval process is completed, the proposed amendments, including this document, are simultaneously 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.

III REFERENCES

- Articles 9001 and 7210 of the Rules of Bourse de Montréal Inc.
- Regulations 100.2 and 100.9 (x) of the Investment Dealers Association of Canada

APPENDIX B

7210 Margin requirements on Unhedged Foreign Exchange Positions
(03.09.96, 13.09.05, 00.00.06)

Unhedged foreign exchange positions of an approved participant or customer of an approved participant must be margined in accordance with the present article. Foreign exchange positions are monetary assets and liabilities (as hereinafter defined) and must include currency spot transactions, futures contracts, forward contracts, swaps and any other transaction which results in exposure to foreign exchange rate risk.

1) GENERAL PRINCIPLES

A) Each unhedged foreign exchange position must be margined in the manner provided in the present article, on a currency by currency basis, according to the four currency groups defined in paragraph 5) at the following margin rates, subject to an adjustment to the margin rate of a group 1, 2 or 3 currency pursuant to sub-paragraph 5 C) of the present article:

	CURRENCY GROUPS			
	1	**2**	**3**	**4**
Spot Risk Margin Rate	1.0%	~~3.0%~~2.0%	~~10.0%~~7.0%	25.0%
Term Risk Margin Rate	1.0%	3.0%	5.0%	12.5%

B) All calculations in respect of unhedged positions must be made on a trade date basis.

C) Approved participants are permitted, at their option, to margin certain inventory positions in accordance with paragraph 3, instead of the other applicable provisions of this article.

D) References to conversion to Canadian dollars at the spot exchange rate must be to the rate quoted by a recognized quote vendor for contracts with a term to maturity of one day.

E) Monetary assets and liabilities are assets and liabilities, respectively, of an approved participant in respect of money and claims to money, whether denominated in foreign or domestic currency, which are fixed by contract or otherwise.

F) Long or short currency futures contracts held in inventory and listed on a recognized exchange, which are included in the unhedged foreign exchange calculations hereunder, are not required to be margined pursuant to articles 14201 and 14209.

G) Approved participants are permitted, at their option, to exclude non-allowable monetary assets from monetary assets for the purpose of calculating the margin requirements under the present article.

H) For the purpose of this article, the Chicago Mercantile Exchange and the Philadelphia Board of Trade are deemed to be recognized exchanges.

2) FOREIGN EXCHANGE MARGIN REQUIREMENTS

The margin requirements for foreign exchange positions must correspond to the aggregate of the spot risk margin requirement and the term risk margin requirement, calculated based on the spot risk margin rate and the term risk margin rate, respectively, specified in sub-paragraph 1 A) of this article.

A) Spot Risk Margin requirement

i) The spot risk margin requirement must apply to all monetary assets and liabilities, regardless of term to maturity.

ii) The spot risk margin requirement must be calculated as the product of the net monetary position and the spot risk margin rate.

iii) Monetary assets and liabilities will be considered to be spot positions, unless they have a term to maturity of more than 3 days.

iv) The spot risk margin requirement must be converted to Canadian dollars at the then current spot exchange rate.

B) Term Risk Margin requirement

i) The term risk margin requirement must apply to all monetary assets and liabilities which have a term to maturity of more than 3 days, the term to maturity being defined as the amount of time to when the right to the monetary asset or the obligation to satisfy monetary liability expires.

ii) The term risk margin requirement is calculated as the product of the market value of the monetary asset or liability, the weighting factor and the term risk margin rate. The weighting factor of a monetary asset or liability having a term to maturity of 2 years or less must correspond to the number of days to maturity of the monetary asset or liability divided by 365 days, provided that if the term to maturity is 3 calendar days or less, the weighting factor must be zero.

iii) The term risk margin rate for an unhedged foreign exchange position must not exceed the following rates:

	CURRENCY GROUPS			
	1	**2**	**3**	**4**
Maximum Term Risk Margin Rate	4.0%	7.0%	10.0%	25.0%

iv) Where the approved participant has both monetary assets and monetary liabilities, the term risk margin requirements may be netted as follows:

i) 2 years or less to maturity

The term risk margin requirements in respect of monetary assets or liabilities denominated in the same currency, which both have a term to maturity of 2 years or less, must correspond to the net of the term risk margin requirements of the monetary assets and liabilities;

ii) Over 2 years to maturity

The term risk margin requirements in respect of monetary assets or liabilities denominated in the same currency, which both have a term to maturity of more than 2 years, must correspond to the greater of the term risk margin requirements of the monetary assets and liabilities;

iii) Provisos

a) The term risk margin requirements in respect of monetary assets or liabilities denominated in the same currency, where one has a term to maturity of 2 years or less and the other has a term to maturity of more than 2 years and which have a difference in their respective terms to maturity of 180 days or less, must correspond to the net of the term risk margin requirements of the monetary assets and liabilities.

b) Where an approved participant has offsetting positions, one having a term to maturity of 2 years or less and the other having a term to maturity of more than 2 years, the sum of the term risk margin requirements of the offsetting positions must not exceed the product of the market value which is offsetted and the following rates:

CURRENCY GROUPS

1	**2**	**3**	**4**
5.0%	10.0%	20.0%	50.0%

v) The term risk margin requirement must be converted to Canadian dollars at the then current spot exchange rate; and

vi) The sum of the security margin requirement and of the foreign exchange margin requirement must not exceed 100%.

3) ALTERNATIVE MARGIN ON FUTURES AND FORWARD CONTRACTS HELD IN INVENTORY

As an alternative to the foreign exchange margin requirement determined under the present article, for futures contracts and forward contracts positions held in inventory and denominated in a currency for which a currency futures contract is traded on a recognized exchange, the foreign exchange margin requirement may be calculated as follows:

A) Futures Contracts

Foreign exchange positions consisting of futures contracts may be margined at the margin rates prescribed by the exchange on which such futures contracts are listed.

B) Forward Contracts Pairings

Forward contracts positions which are not denominated in Canadian dollars may be margined as follows:

i) the margin must be the greater of the margin as prescribed in paragraphs 1) and 2) of this article for each position; and

ii) two forward contracts held by an approved participant which (a) have one currency common to both contracts, (b) are for the same settlement date and (c) have equal and offsetting amounts of common currency positions may be treated as a single contract for the purposes of this sub-paragraph 3 B).

C) Futures and Forward Contract Pairings

Futures contracts and forward contracts positions which are not denominated in Canadian dollars may be margined as follows:

i) a) margin must be the greater of the margin as prescribed in paragraphs 1) and 2) of this article for each position;

b) margin rates applicable to unhedged positions under this sub-paragraph 3 C) must be the rates established by the present article and not the rates prescribed by the exchange on which the futures contracts are listed; and

ii) two forward contracts held by an approved participant which (a) have one currency common to both contracts, (b) have the same settlement date and (c) have equal and offsetting amounts of common currency positions may be treated as a single contract for the purposes of this sub-paragraph 3 C).

4) CLIENT ACCOUNTS MARGIN

Unhedged foreign exchange positions of clients must be margined in accordance with paragraphs 1, 2, and 5 of this article, provided that:

i) no margin is required in respect of the accounts of clients who are acceptable institutions, as defined in Policy C-3 of the Bourse entitled "Joint Regulatory Financial Questionnaire and Report";

ii) the margin required in respect of acceptable counterparties and regulated entities, as defined in Policy C-3 of the Bourse entitled "Joint Regulatory Financial Questionnaire and Report", must be calculated on a mark-to-market basis;

iii) the margin required in respect of foreign exchange positions (excluding cash balances) held in accounts of clients who are classified as other counterparties, as defined in Policy C-3 of the Bourse entitled "Joint Regulatory Financial Questionnaire and Report", which are denominated in a currency other than the currency of the account, must correspond to the aggregate of the security margin requirement and the foreign exchange margin requirement, provided that where the margin rate applicable to the security is greater than the spot risk margin rate specified in sub-paragraph 1 A) of this article, the foreign exchange margin requirement must be nil. The sum of the security margin requirement and the foreign exchange margin requirement must not exceed 100%; and

iv) listed futures contracts must be margined in the same manner as prescribed in articles 14201 and 14209.

5) CURRENCY GROUPS

A) Currency Groups Criteria

The qualitative and quantitative criteria for each currency group are as follows:

Group 1

- the volatility of the currency must be below the volatility threshold specified in sub-paragraph 5 B) i) of this article; and
- it is the primary intervention currency of the Canadian dollar.

Group 2

- the volatility of the currency must be below the volatility threshold specified in sub-paragraph 5 B i) of this article; and
- there must be a daily quoted spot rate by a Canadian Schedule 1 chartered bank, and one of the following:
  - a daily quoted spot rate by a member of the European Monetary System and a participant in the Exchange Rate Mechanism; or
  - a listed futures contract for the currency on a recognized exchange.

Group 3

- the volatility of the currency must be below the volatility threshold specified in sub-paragraph 5 B) i) of this article;
- there must be a daily quoted spot rate by a Canadian Schedule 1 chartered bank; and
- the currency must be of a member country of the International Monetary Fund with Article VIII status, and there are no capital payment restrictions as they relate to security transactions.

Group 4

- None

B) Monitoring adherence to currency groups criteria

The ~~Vice-President of the~~ Regulatory Division of the Bourse is responsible for monitoring the adherence of each group 1, 2 or 3 currency to the quantitative and qualitative criteria described in sub-paragraph 5 A) of the present article.

i) Currency Volatility and Foreign Exchange Margin

The volatility of each group 1, 2 or 3 currency must be monitored ~~as follows:~~

~~- The Canadian dollar equivalent closing price on each of the four trading days succeeding the "base day" must be compared to the base day closing price. The first of four succeeding trading days on which the percentage change in price (negative or positive) between the closing price on the succeeding day and the closing price on the base day is greater than the unhedged positions margin rate prescribed for this currency in sub-paragraph 1 A) of this article must be designated an "offside base day".~~

~~- If an offside base day has been designated, this offside base day must be designated as a new base day for the purpose of making further base day closing price comparisons, as aforesaid. If the number of offside base days during any 60 trading days period is greater than 3, the currency shall be deemed to have exceeded the volatility threshold of the currency group~~and margined in accordance with the floating margin rate methodology as defined in paragraph e) of article 9001 provided that .for the purpose of the application of this definition to Group 1, 2 and 3 unhedged foreign currencies, the regulatory margin interval is subject to a minimum margin rate of 1% for Group 1, 2% for Group 2 and 7% for Group 3 currencies.

ii) Qualitative Criteria

The ~~vice-president of the~~ Regulatory Division of the Bourse, at least on an annual basis, must assess the adherence, by each currency in a group, to the qualitative criteria of this currency group to determine whether the currency continues to satisfy the qualitative criteria of the currency group.

~~**C) Foreign Exchange Margin Surcharge**~~

~~If the volatility of a group 1, 2 or 3 currency exceeds the volatility threshold defined in sub-paragraph 5 B) i), then the margin rate must be increased by increments of 10% until the application of the increased margin rate results in no more than two offside base days during the preceding 60 trading days. The increased margin rate must apply for a minimum of 30 trading days and must be automatically decreased to the margin rate otherwise applicable when, after such 30 trading day period, the volatility of the currency is less than the volatility threshold defined in sub-paragraph 5 B) i) of the present article.~~

~~The vice-president of the Regulatory Division of the Bourse is responsible for determining the required increase or decrease in foreign exchange margin rates under this sub-paragraph 5 C) of this article.~~

~~D~~C)Currency Groups Downgrades and Upgrades

Where:

i) the ~~vice-president of the~~ Regulatory Division of the Bourse determines that a particular currency no longer satisfies the criteria of this currency group, as defined in sub-paragraph 5 A) of this article; or

ii) an approved participant has provided to the ~~vice-president of the~~ Regulatory Division of the Bourse information demonstrating that a currency satisfies the criteria specified in sub-paragraph 5 A) of this article for a currency group other than the one for which the currency is then designated, and the ~~vice-president of the~~ Regulatory Division of the Bourse has verified such information to his or her satisfaction, the ~~vice-president of the~~ Regulatory Division of the Bourse must decide that the currency be moved to the currency group with the lower or higher margin rate, as the case may be, and notify approved participants of the change.

~~E~~D)Foreign Exchange Concentration Capital Charge

When, in respect of any group 2, 3 or 4 currency, the aggregate of the foreign exchange margin provided under the present article on an approved participant's monetary assets and liabilities and the foreign exchange margin on client accounts exceeds 25% of the firm's net allowable assets, net of minimum capital required (as determined for the purposes of the Joint Regulatory Financial Questionnaire and Report of Policy C-3 of the Bourse), a concentration capital charge, in addition to the foreign exchange margin already provided under this article, must apply. The concentration capital charge must be equal to the amount of the foreign exchange margin provided under this article, which is in excess of 25% of the approved participant's net allowable assets, net of minimum capital required.