CIRCULAR
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MARGIN AND CAPITAL REQUIREMENTS FOR POSITIONS IN AND OFFSETS INVOLVING INTEREST RATE AND TOTAL PERFORMANCE SWAPS

AMENDMENTS TO ARTICLE 7226

ADDITION OF ARTICLE 7226A

The Executive Committee of Bourse de Montréal Inc. (the "Bourse") approved amendments to article 7226 and the addition of article 7226A to Rule Seven of the Bourse, which deal with margin and capital requirements for positions in and offsets involving interest rate and total performance swap agreements. These amendments and this addition will become effective on January 1, 2004.

The current rules relating to swaps in the Bourse regulation relate to interest rate swap agreements and are of limited use in determining the margin requirements for positions in and offsets involving total performance swaps. The amendments made to the existing rules establish formal margin and capital requirements for positions in and offsets involving total performance swaps. The implementation of these amendments has resulted in the cancellation of the guidelines on equity swaps, which were set out in circular no. 062-97 issued by the Bourse on April 3, 1997. Furthermore, some changes have been made to the existing rules for interest rate swaps in order to harmonize them with the present amendments.

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Encl.

Circular no.: 170-2003
Amendment no.: 020-2003

7226 Margin on Swaps
(01.05.92, 01.04.93, 01.01.04)

A) Interest Rate Swaps

For the purposes of the present article, a "fixed interest rate" is an interest rate, which is not reset at least every 90 days and a "floating interest rate" is an interest rate, which is not a fixed interest rate. On interest rate swap agreements where payments are calculated with reference to a notional amount, the obligation to pay and the entitlement to receive must each be margined as separate components as follows:

i) where a component is a payment calculated according to a fixed interest rate, the margin required must be the margin rate specified in article 7204 - Group I for a security with the same term to maturity as the outstanding term of the swap, multiplied by 125% and in turn multiplied by the notional amount of the swap;

ii) where a component is a payment calculated according to a floating interest rate, the margin required must be the margin rate specified in article 7204 - Group I for a security with the same term to maturity as the remaining term to the swap reset date, multiplied by the notional amount of the swap.

The counterparty to the interest rate swap agreement must be considered the approved participant's client. No margin is required in respect of an interest rate swap entered into with a client which is an acceptable institution. The margin requirement for clients, which are acceptable counterparties, must be any market value deficiency calculated relating to the interest rate swap agreement. The margin requirement for clients which are other counterparties shall be any loan value deficiency calculated relating to the interest rate swap agreement, determined by using the same margin requirements for each swap component as calculated in clauses (i) and (ii) above.

B) Total Performance Swaps

On total performance swap agreements, the obligation to pay and the entitlement to receive must each be margined as separate components as follows:

i) where a component is a payment calculated based on the performance of a stipulated underlying security or basket of securities, with reference to a notional amount, the margin requirement must be the normal margin required for the underlying security or basket of securities relating to this component, based on the market value of the underlying security or basket of securities;

ii) where a component is a payment calculated according to a floating interest rate, the margin required must be the margin rate specified in article 7204 -Group I for a security with the same term to maturity as the remaining term to the swap reset date, multiplied by the notional amount of the swap.

The counterparty to the total performance swap agreement must be considered the approved participant's client. No margin is required in respect of a total performance swap entered into with a client which is an acceptable institution. The margin requirement for clients, which are acceptable counterparties, must be any market value deficiency calculated relating to the total performance swap agreement. The margin requirement for clients which are other counterparties must be any loan value deficiency calculated relating to the total performance swap agreement, determined by using the same margin requirements for each swap component as calculated in clauses i) and ii) above.

7226A Swap Positions Offsets
(01.01.04)

For the purposes of the present article, a “fixed interest rate” is an interest rate which is not reset at least every 90 days, a “floating interest rate” is an interest rate, which is not a fixed interest rate and “realization clause” is an optional clause within a total performance swap agreement which allows the approved participant to close out the swap agreement at the realization price (either the buy-in or sell-out price) of the security position involved in the offset.

A) Interest Rate Swap Versus Interest Rate Swap Offset

Where an approved participant

i) is a party to an interest rate swap agreement requiring it to pay (or entitling it to receive) Canadian dollar or United States dollar fixed (or floating) interest rate amounts calculated with reference to a notional amount, and

ii) is a party to another offsetting interest rate swap agreement entitling it to receive (or requiring it to pay) fixed (or floating) interest rate amounts calculated with reference to the same notional amount denominated in the same currency and is within the same maturity band for margin purposes as the interest rate swap referred to in i),

the margin required in respect of the positions in i) and ii) may be netted, provided that margin on fixed interest rate component payment (or receipt) positions may only be offset against margin on fixed interest rate component receipt (or payment) positions, and margin on floating interest rate component payment (or receipt) positions may only be offset against margin on other floating interest rate component receipt (or payment) positions.

B) Fixed Interest Rate Swap Component and Securities Position Offset

Where an approved participant

i) is a party to an interest rate swap agreement requiring it to pay (or entitling it to receive) Canadian dollar or United States dollar fixed interest rate amounts calculated with reference to a notional amount, and

ii) holds a long (or short) position in securities described in article 7204 - Group I with a principal amount equal to and denominated in the same currency as the notional amount of the interest rate swap and with a term to maturity that is within the same maturity band for margin purposes as the interest rate swap,

the margin required in respect of the positions in i) and ii) may be netted.

C) Floating Interest Rate Swap Component and Securities Position Offset

Where an approved participant

i) is a party to an interest rate swap agreement requiring it to pay (or entitling it to receive) Canadian dollar or United States dollar floating interest rate amounts calculated with reference to a notional amount, and

ii) holds a long (or short) position in securities described in articles 7204 - Group I or 7205, maturing within one year with a principal amount equal to and denominated in the same currency as the notional amount of the swap,

the margin required in respect of the positions in i) and ii) may be netted.

D) Total Performance Swap versus Total Performance Swap offset

Where an approved participant

i) is a party to a total performance swap agreement requiring it to pay (or entitling it to receive) Canadian dollar or United States dollar amounts calculated based on the performance of a stipulated underlying security or basket of securities, with reference to a notional amount; and

ii) is a party to another total performance swap agreement entitling it to receive (or requiring it to pay) amounts calculated based on the performance of the same underlying security or basket of securities, with reference to the same notional amount and denominated in the same currency;

the margin required in respect of the position in i) and ii) may be netted, provided that margin on performance component payment (or receipt) positions may only be offset against margin on performance component receipt (or payment) positions, and margin on floating interest rate component payment (or receipt) positions may only be offset against margin on other floating interest rate component receipt (or payment) positions.

E) Total Performance Swap Component and Securities Position Offset

i) Short Performance Swap Component and Long Underlying Security or Basket of Securities

Where an approved participant

a) is a party to a total performance swap agreement requiring it to pay amounts calculated based on the performance of a stipulated underlying security or basket of securities, with reference to a notional amount; and

b) holds long an equivalent quantity of the same underlying security or basket of securities;

the capital required in respect of the position described in a) and b) must be either:

c) nil, where it can be demonstrated that sell-out risk relating to the offset has been mitigated:

I) through the inclusion of a realization clause in the total performance swap agreement, which allows the approved participant to close out the swap agreement using the sell-out price(s) for the long position in the underlying security or basket of securities; or

II) since, due to the features inherent in the long position in the underlying security or basket of securities or the market on which the security or basket of securities trades, the realization value of the long position in the underlying security or basket of securities is determinable at the time the total performance swap agreement is to expire and this value will be used as the closeout price for the swap;

or

d) 20% of the normal capital required on the long position in the underlying security or basket of securities where sell-out risk relating to the offset has not been mitigated.

ii) Long Performance Swap Component and Short Underlying Security or Basket of Securities

Where an approved participant

a) is a party to a total performance swap agreement entitling it to receive amounts calculated based on the performance of a stipulated underlying security or basket of securities, with reference to a notional amount; and

b) holds short an equivalent quantity of the same underlying security or basket of securities;

the capital required in respect of the positions described in a) and b) must be:

c) nil, where it can be demonstrated that buy-risk relating to the offset has been mitigated:

I) through the inclusion of a realization clause in the total performance swap agreement, which allows the approved participant to close out the swap agreement using the buy-in price(s) for the short position in the underlying security or basket of securities; or

II) since, due to the features inherent in the short position in the underlying security or basket of securities or the market on which the security or basket of securities trades, the realization value of the short position in the underlying security or basket of securities is determinable at the time the total performance swap agreement is to expire and this value will be used as the closeout price for the swap.

or

d) 20% of the normal capital required on the short position in the underlying security or basket of securities where buy-in risk relating to the offset has not been mitigated.