



**CIRCULAR**  
March 26, 2003

## **REQUEST FOR COMMENTS**

### **OBLIGATION TO PROVIDE A LEVERAGE RISK DISCLOSURE STATEMENT TO RETAIL CLIENTS**

#### **AMENDMENTS TO ARTICLE 7452**

#### **Summary**

The Special Committee – Regulatory Division of Bourse de Montréal Inc. (the "Bourse") has approved amendments to article 7452 of the Rules of the Bourse concerning the requirement to provide a Leverage Risk Disclosure Statement to retail clients. Considering the importance to be properly informed with regards to the risks incurred by leveraging, the Bourse proposes to amend its Rules in order to oblige approved participants and their approved persons to deliver to each retail client a Leverage Risk Disclosure Statement at the time a new account is opened, when a recommendation is made to purchase securities using, in whole or in part, borrowed money or when they become aware through any other means of a retail client's intent to purchase securities using, in whole or in part, borrowed money. However, approved participants and their approved persons will not be required to provide a Leverage Risk Disclosure Statement to retail clients holding a margin account managed in compliance with the regulations of the Bourse.

#### **Process for Changes to the Rules**

Bourse de Montréal Inc. is recognized as a self-regulatory organization (SRO) by the Commission des valeurs mobilières du Québec ("the Commission"). 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 broker-dealer regulation responsibilities. The broker-dealers regulated by the Bourse are 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.: 027-2003

**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](http://www.m-x.ca)

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

The Board of Directors of the Bourse has delegated to the Special Committee – Regulatory Division its powers to approve or amend some aspects of the Rules and Policies of the Bourse governing approved participants, among which, the Rules and Policies relating to admission as approved participant, approval of persons, disciplinary matters and the management of client accounts. These changes are submitted to the Commission for approval.

Comments on the proposed amendments to article 7452 must be submitted within 30 days following the date of publication of the present notice in the bulletin of the Commission. Please submit your comments to:

*Mr. Jacques Tanguay  
Vice-President, Regulatory Division  
Bourse de Montréal Inc.  
Tour de la Bourse  
P.O. Box 61, 800 Victoria Square  
Montréal, Quebec H4Z 1A9  
E-mail: [reg@m-x.ca](mailto:reg@m-x.ca)*

A copy of these comments shall also be forwarded to the Commission to:

*Ms. Denise Brosseau  
Secretary  
Commission des valeurs mobilières du Québec  
800 Victoria Square, 22<sup>nd</sup> Floor  
P.O. Box 246, Tour de la Bourse  
Montréal (Quebec) H4Z 1G3  
E-mail: [consultation-en-cours@cvmq.com](mailto:consultation-en-cours@cvmq.com)*

## **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 with the other Canadian self-regulatory organizations, if applicable, following approval by the Commission des valeurs mobilières du Québec.



### REQUIREMENT TO PROVIDE A LEVERAGE RISK DISCLOSURE STATEMENT TO RETAIL CLIENTS

#### – AMENDMENTS TO ARTICLE 7452

#### I OVERVIEW

Bourse de Montréal Inc. (The "Bourse") wishes to require, in certain situation, its approved participants or their partners, directors, officers or any approved persons of an approved participant to provide to their retail clients a Leverage Risk Disclosure Statement.

#### II DETAILED ANALYSIS

##### A – Current Rules

Currently, the Bourse has no rule requiring approved participants or their approved persons to provide to their retail clients a Leverage Risk Disclosure Statement when these clients use borrowed funds to purchase securities.

##### B – The Issue

Leveraging is an important factor that approved participants, partners, directors, officers and approved persons must consider when determining the suitability of a trade and therefore allowing them to better fulfill their obligations toward their clients.

In addition, clients who borrow funds to purchase securities must be properly informed with regards to the risks incurred by leveraging. When they borrow funds, clients bind themselves to repay the capital and to pay

interests. The securities purchased with borrowed funds may increase in value or decrease in value. Whatever the variation in the value of these securities, clients must fulfill the terms of the loan agreement. If there is a decrease in the value of the securities purchased, clients may lose in whole or in part their own funds in addition of being bound by the terms and conditions of the loan agreement.

##### C – Comparison with Similar Provisions

The Commission des valeurs mobilières du Québec has adopted National Instrument 33-102, "Regulation of certain registrants activities" (the "National Instrument") that came into force on August 1<sup>st</sup> 2001. This National Instrument is an initiative of the Canadian Securities Authorities and aims to ensure that clients of approved participants and their approved persons are properly informed about the products they are buying and the associated risks.

Part 2 "Leverage Disclosure" of the National Instrument 33-102 inspires the new section 7 of article 7452. Both section 2.1 of the National Instrument and the new proposed section of article 7452 require that approved participants and their approved persons deliver to each retail client a Leverage Risk Disclosure Statement at the time a new account is opened, when a recommendation is made to purchase securities using, in whole or in part, borrowed money and when they become aware of a retail client's intent to purchase securities using, in whole or in part, borrowed money.

Section 2.2 of the National Instrument 33-102 provides an exemption pursuant to which there is no requirement to provide a Leverage Risk Disclosure Statement to retail clients who open a margin account. Similarly, the new section 7 of article 7452 also provides that there is no requirement to provide a Leverage Risk Disclosure Statement to retail clients holding a margin account managed in compliance with the regulations of the Bourse.

### **D – Effect of Proposed Policy**

The Bourse is in the view that the proposed provisions are in the best interest of the public since they aim to remind approved participants and their approved persons that leveraging is an important factor to consider when determining the suitability of a trade or when fulfilling their obligations toward the clients. In addition, the proposed amendments will protect the public since they aim to ensure that it is better informed and understands the risks related to leveraging.

## **II COMMENTARY**

### **A – Effectiveness**

The proposed amendments are simple and efficient. They clearly establish situations where approved participants and their approved persons must provide to their clients a Leverage Risk Disclosure Statement. These amendments will permit the clients to know the risks related to leverage while helping approved participants and their approved persons to fulfill their suitability obligations when providing recommendations to their clients.

## **IV REFERENCES**

- National Instrument 33-102, Regulation of certain registrants activities;
- Investment Dealers Association of Canada, By-Law 29.26, “Leverage Disclosure” and Bulletin n°3009, dated June 17, 2002;
- Bourse de Montréal Inc., article 7452 of Rule Seven.

16 – 23.08.2002, 00.00.2003

**Section ~~7451~~ 7450 - 7475**  
**Conduct of Accounts**

**7452 Diligence as to Accounts**

17.06.86, 01.08.87, 05.09.89, 15.09.89, 04.12.92, 01.04.93, 02.07.96, 09.03.99, 23.08.02, 00.00.03)

- 7) a) An approved participant, partner, director, officer or approved person of an approved participant must provide to each retail client a Leverage Risk Disclosure Statement:
- i) at the time a new account is opened,
  - ii) when a recommendation is made to a retail client to purchase securities using in whole or in part borrowed money,
  - iii) when an approved participant, partner, director, officer or approved person of the approved participant becomes aware of a retail client's intent to purchase securities using, in whole or in part, borrowed money.
- b) No approved participant, partner, director officer or approved person of the approved participant is required to comply with sub-paragraphs a ii) and a iii), if within the six preceding months a Leverage Risk Disclosure Statement has been provided to the retail client.
- c) The Leverage Risk Disclosure Statement must be similar to the following:
- Anyone using borrowed money to finance the purchase of securities is subject to a greater risk than if they were settling such purchase by using only their own funds. Anyone borrowing money to purchase securities engages in a responsibility to repay the loan and to pay interest, as required by the term of the loan agreement, even if the value of the securities purchased declines.
- d) The Leverage Risk Disclosure Statement is not required with respect to margin accounts operated in accordance with the Rules and Policies of the Bourse.