



**TO: Approved participants
Registered Options Contracts Principals
Options Contracts Traders
Restricted Trading Permit Holders**

July 23, 2002

**EXERCISE OF CLIENTS' OPTIONS FOR THE
BENEFIT OF APPROVED PARTICIPANTS**

The Regulatory Division of Bourse de Montréal Inc. (the "Bourse") has recently become aware of the existence of a practice at some approved participants which consists in exercising clients' in-the-money call or put options to the benefit of these approved participants, their registered representatives or their options contracts traders. Such exercise is done on clients' long call or long put options that are not subjected, upon expiry, to the automatic exercise procedure of the Canadian Derivatives Clearing Corporation ("CDCC") and that clients do not wish to exercise or for which they have not given any specific instruction regarding such exercise.

At each expiry of options, approved participants who are members of CDCC receive an expiry report for the options series coming to expiry (MX01 Report). When clients do not give instructions before the deadlines set by approved participants regarding the exercise of options for which the in-the-money amount is below the automatic exercise threshold level established by CDCC, such options should normally expire. In the absence of such instructions from clients, some approved participants have established a practice of sending instructions to CDCC in order to exercise some of their clients' in-the-money options and the receipt or the delivery of the underlying securities is recorded in the approved participants' firm accounts or in the accounts of options contracts traders or of registered representatives. The clients are usually not aware of such transactions since entries in their accounts are done in such a way that options appear to have expired without having been exercised.

In addition to allowing approved participants or their approved persons to take away economic gains that effectively belong to their clients, this practice is somewhat detrimental to the counterparties who hold short in-the-money call or put options positions that are not subjected to the CDCC automatic exercise procedure and who do not necessarily expect to have their options positions exercised.

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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

The Regulatory Division of the Bourse is of the opinion that this practice is unacceptable and that it contravenes paragraph 4 of article 7452 of the Rules of the Bourse which provides that:

- 4) Every approved participant must ensure that his registered representatives and other concerned personnel comply with the Code of Ethics and the General Rules of Conduct for Registered Representatives as stated in the Conduct and Practices Handbook for Securities Industry Professionals published by the Canadian Securities Institute.*

And more specifically with Standard A. 4. of the Conduct and Practices Handbook for Securities Industry Professionals of the CSI which provides that:

- A. The Registered Representative must display absolute trustworthiness since the client's interest must be the foremost consideration in all business dealings.*

- 4. The client's assets are the property solely of the client and are to be used only for the client's purposes.*

The Regulatory Division is also in the opinion that this kind of practice constitutes a discretionary transaction since it is executed without the prior approval of the client and without having obtained his instructions. Unless complying with the requirements of Section 7476 – 7500 of the Rules of the Bourse relating to discretionary and managed accounts and with those of article 11154 relating to discretionary options accounts, it is forbidden to make any type of discretionary transaction whatsoever in a client's account. Furthermore, even if all the requirements relating to a discretionary or a managed account are complied with, the exercise of any option belonging to a client as well as the resulting underlying securities receipt or delivery must be recorded in the client's account.

The Examination Department and the Market Surveillance Department will, in the course of their examinations, bring a special attention to such a practice and approved participants who are identified as using it could be subjected to a complaint by the Bourse pursuant to article 4101 of the Rules and to disciplinary sanctions.

For additional information, please contact Jean Bérard, Manager, Examinations and Market Surveillance, at (514) 871-3516 or by e-mail at jberard@m-x.ca.

Jacques Tanguay
Vice-President, Regulatory Division