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**CIRCULAR**  
August 15, 2006

## **REQUEST FOR COMMENTS**

### **CLARYFYING AMENDMENTS**

#### **DEBT SECURITIES OFFSETS ACCEPTABLE FOR MARGIN REDUCTION PURPOSES**

#### **AMENDMENTS TO GROUP XI AND GROUP XII OF ARTICLE 7204 AND TO ARTICLE 7204A**

#### **EXCEPTIONS TO MARGIN RULES – SECURITIES CALLED FOR CASH REDEMPTION OR FOR WHICH A LEGAL AND BINDING CASH OFFER HAS BEEN MADE**

#### **AMENDMENTS TO PARAGRAPH 1) OF ARTICLE 7213**

### **Summary**

The Rules and Policies Committee of Bourse de Montréal Inc. (the Bourse) has approved amendments to Group XI and Group XII of article 7204, to article 7204A and to paragraph 1) of article 7213 of the Rules of the Bourse. The purpose of these amendments is to allow client accounts to take advantage of the same margin reducing debt offsets than those available to approved participants. The amendments to article 7213 are aimed at harmonizing the language of this regulation with the wording used by the IDA eliminating therefore any risk of different interpretation between the Investment Dealers Association of Canada (IDA) Regulation 100.13 and paragraph 1) of article 7213.

### **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.: 149-2006

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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 Group XI and Group XII of article 7204, to article 7204A and to paragraph 1) of article 7213 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](mailto: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  
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800 Victoria Square, 22<sup>nd</sup> Floor  
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## **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".



## CLARYFYING AMENDMENTS

### DEBT SECURITIES OFFSETS ACCEPTABLE FOR MARGIN REDUCTION PURPOSES

- Amendments to Group XI and Group XII of article 7204 and to article 7204A

### EXCEPTIONS TO MARGIN RULES – SECURITIES CALLED FOR CASH REDEMPTION OR FOR WHICH A LEGAL AND BINDING CASH OFFER HAS BEEN MADE

- Amendments to paragraph 1) of article 7213

## I - SUMMARY

### A) Current Rules

#### 1) Debt securities offsets acceptable for margin reduction purposes

Some provisions of articles 7204 and 7204A of the Rules of Bourse de Montréal Inc. (the Bourse) allow margin reductions when an approved participant simultaneously holds long and short positions in specific debt instruments.

For instance, Group XI of article 7204, which sets the margin requirements for stripped coupons and for residual debt securities, also allows margin reductions when these types of securities are paired with various debt securities. Group XII of this same article, which sets margin requirements for mortgage-backed securities also allows

margin reductions when this type of debt instruments is paired with some specified debt securities.

Article 7204A, entitled “Pairing for Margin Purposes”, allows margin reductions on numerous pairings of debt instruments.

#### 2) Exceptions to margin rules – securities called for cash redemption or for which a legal and binding cash offer has been made

Paragraph 1) of article 7213 of the Rules of the Bourse provides that no margin is required in the case of securities that have been called for cash redemption or of securities for which a legal and binding cash offer to purchase has been made. However, to be eligible to the margin exemption, the relevant securities must satisfy the specific conditions set forth in the Rule.

### B) The Issue

#### 1) Debt securities offsets acceptable for margin reduction purposes

As already mentioned, Groups XI and XII of article 7204 of the Rules of the Bourse and article 7204A allow a significant number of margin reducing debt offsets. However these margin reductions are, according to the current wording of the Rules, available only to approved participants and not to client accounts.

#### 2) Exceptions to margin rules – securities called for cash redemption or for which a legal and binding cash offer has been made

The Investment Dealers Association of Canada (IDA) recently proposed some housekeeping amendments to its Regulation 100.13 regarding margin requirements on securities that have been called for cash redemption or on securities for which a legal and binding cash offer to purchase has been made. The equivalent rule of the Bourse is paragraph 1) of article 7213. The IDA

redrafted the wording of its Regulation 100.13 so that it be in a clearer language.

As a result of the changes made by the IDA to its Regulation 100.13, paragraph 1) of article 7213 of the Rules of the Bourse, although meaning exactly the same thing as IDA Regulation 100.13, is worded differently. The fact that corresponding rules of two SROs read differently, although having the same purpose, creates a risk of differing interpretation of each respective rule.

## **II - DETAILED ANALYSIS**

### **A) Current Rules and proposed amendments**

#### **1) Debt securities offsets acceptable for margin reduction purposes**

In 2003 and 2004 the Bourse proceeded to a complete review of its Rules regarding capital and margin requirements applicable to derivative instruments. This review led to the implementation of new Rule Nine on January 1, 2005.

In the course of this review, one of the major issues that were raised was the fact that under the then existing regulatory framework many margin reducing derivative offsets were permitted for approved participant accounts but not for client accounts. However, when looking at the list of strategies where reduced margin for a client position was being denied, it was clear that these strategies were efficient in reducing the risk to be supported by a client account. As a result, it was concluded that it did not make sense to not allow the application on client accounts of margin reducing derivative offsets that were currently available for approved participant accounts.

Amendments were therefore made to the Rules to expand the number of margin reducing offsets available in client accounts by permitting the use of offset strategies that were until then exclusive to approved participant accounts.

While the revised derivative offsets margin rules that were implemented on January 1, 2005 now permit client accounts to take advantage of an expanded number of margin reducing offsets, the current rules regarding margin requirements applicable to debt securities have recently been questioned. The situation in this case is identical to the one that had been noticed during the revision of margin requirements applicable to derivative instruments, the current rules allowing numerous margins reducing debt offsets but limiting the application of these offsets only to approved participant accounts.

First, as was the case when the issue was raised in the course of the derivative instruments margin requirements review that led to the implementation of Rule Nine, no valid justification could be found on the reasons why client accounts could not take advantage of margin reducing debt offsets identical to those allowed to approved participants. Second, looking at other margin reducing security offsets in Rule Seven of the Bourse, it was noticed that customers can use margin reduction offsets in the same manner as approved participants for various types of securities such as capital share offsets, convertible and exercisable security offsets and stock offsets. It could not be concluded that these other available margin reducing securities offsets were unique and easier to manage than debt offsets.

Finally, it is worth mentioning that Rule Nine of the Bourse permits margin reduction for client accounts for offsets involving derivatives and debt instruments. For example, article 9323 allows, for client accounts, to offset for margin purposes the following futures contracts and debt instruments:

- a) bond futures contracts combinations with debt securities of Group I of article 7204 (Governments of Canada, United States, United Kingdom and other foreign national governments debt securities that are rated AAA);

- b) bond futures contracts combinations with debt securities of Group II of article 7204 (Provinces of Canada and International Bank of Reconstruction and Development debt securities);
- c) bond futures contracts combinations with debt securities of Group III of article 7204 (Municipal, school and hospital corporations and religious orders debt securities);
- d) bond futures contract combinations with Group V securities (Corporations and trust and mortgage loan companies – non-negotiable and non-transferable securities); and
- e) Canadian banker’s acceptance futures contract combinations with banker’s acceptance.

In consideration of the above, it is therefore proposed to allow customer accounts to use the debt offsets in Group XI and Group XII of article 7204 of the Rules of the Bourse and in article 7204A since such offsets represent valid market risk reduction strategies and that client accounts, as is the case for approved participants accounts, should be able to benefit from lower margin requirements permitting these offsets.

**2) Exceptions to margin rules – securities called for cash redemption or for which a legal and binding cash offer has been made**

As already mentioned, the Investment Dealers Association of Canada (IDA) recently proposed some housekeeping amendments to its Regulation 100.13 regarding margin requirements on securities that have been called for cash redemption or on securities for which a legal and binding cash offer to purchase has been made. The IDA redrafted the wording of this Regulation 100.13 so that it be in a clearer language.

As a result of the changes made by the IDA to its Regulation 100.13, paragraph 1) of article 7213 of the Rules of the Bourse, although meaning exactly the same thing as IDA Regulation 100.13,

uses a different wording. The fact that corresponding rules of different SROs read differently, although having the same purpose, creates a risk of differing interpretation of each respective rule.

To eliminate any risk of a different interpretation between the IDA’s and Bourse’s rules, it is proposed to amend the wording of paragraph 1) of article 7213 of the Rules of the Bourse so that it reads exactly as the wording of IDA’s regulation 100.13. The proposed amendments are of an housekeeping nature and do not change in any manner the purpose of the rule which is to allow margin exemption for securities that have been called for cash redemption or for which a legal and binding cash offer has been made.

**C) Objectives**

**1) Debt securities offsets acceptable for margin reduction purposes**

The objective of the proposed amendments to Group XI (stripped coupons and residual debt securities) and Group XII (mortgage-backed securities) of article 7204 of the Rules of the Bourse and to article 7204A is to allow client accounts to take advantage of the same margin reducing debt offsets than those available to approved participants given that such debt offsets contribute to reduce the risk of positions held by clients in the same manner as they reduce such risk for approved participants.

**2) Exceptions to margin rules – securities called for cash redemption or for which a legal and binding cash offer has been made**

With regards to paragraph 1) of article 7213 of the Rules of the Bourse, the purpose of the proposed amendments is to harmonize the language of this regulation with the wording used by the IDA in its Regulation 100.13. The proposed amendments will not only clarify the language used but will also eliminate any risk of

different interpretation between IDA Regulation 100.13 and paragraph 1) of article 7213.

**D) Effect of Proposed Amendments**

The proposed amendments to Group XI and Group XII of article 7204 and to article 7204A of the Rules of the Bourse will allow client accounts to take advantage of possible margin reductions for debt offsets positions thus recognizing the fact that such offsets are reducing risk for clients as efficiently as they do for approved participants holding similar positions. Furthermore, making these margin reducing debt offsets available to client accounts will make the debt margin rules consistent with the margin rules applicable to derivative instruments and to various other securities since these other rules allow client accounts to use margin reducing offsets identical to those available to approved participants.

Concerning the amendments proposed to paragraph 1) of article 7213 of the Rules of the Bourse, they will clarify the text of the rule and eliminate any risk of differing interpretation between this rule and the corresponding regulation of the IDA.

**E) Public Interest Objectives**

The objective of the proposed amendments to Group XI and Group XII of article 7204 and to article 7204A of the Rules of the Bourse being to allow client accounts to take advantage of debt offsets identical to those available to approved participants for margin purposes and, since such offsets will result in significantly reduced margin requirements for client accounts, the proposed amendments are considered to be of public interest.

Regarding the proposed amendments to paragraph 1) of article 7213 of the Rules of the Bourse, since they will clarify the wording as well as the meaning of such paragraph and, since the purpose of the proposed amendments is to eliminate any risk of a different interpretation with the corresponding provisions of IDA

Regulation 100.13, they are also considered to be of public interest.

**III COMMENTS**

**A) Efficiency**

For what regards the proposed amendments to Group XI and Group XII of article 7204 and to article 7204A of the Rules of the Bourse, the extension to client accounts of margin reducing debt offsets will not only ensure that clients and approved participants will be treated in the same manner for margin purposes but will also permit to recognize that debt offset positions are a way of reducing market risk that is as efficient for client accounts as it is for approved participants. As a result of the recognition of this reduction of risk, client accounts will benefit from lower margin requirements.

For what regards the proposed amendments to paragraph 1) of article 7213, they will permit, by harmonizing the wording with the one used by the IDA in its corresponding Regulation 100.13, to facilitate the interpretation of the relevant provisions.

**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 7213, 7204, 7204A, and 9323 of the Rules of Bourse de Montréal Inc.;
- Regulations 100.4 and 100.13 of the Investment Dealers Association of Canada

**7204 Bonds, Debentures, Treasury Bills and Notes**

(01.07.86, 04.02.87, 15.09.89 30.04.91, 09.10.91, 01.03.93, 01.05.93, 05.07.93, 01.04.93, 27.05.97, 18.02.98, 29.08.01, 17.05.04, 13.09.05, [00.00.06](#))

**GROUP I Governments of Canada, United States, United Kingdom and other foreign national governments**

The margins required on bonds, debentures, Treasury bills, and other securities of or guaranteed by the Government of Canada, of the United States, of the United Kingdom and of any other national foreign government (provided such foreign government securities are currently rated Aaa or AAA by Moody's Investors Service Inc. or Standard & Poor's Corporation, respectively), and maturing (or called for redemption) in the periods indicated below, are as follows:

**Margin Required**

1 year or less	1% of market value multiplied by the fraction determined by dividing the number of days to maturity by 365.
over 1 year to 3 years	1% of market value
over 3 years to 7 years	2% of market value
over 7 years to 11 years	4% of market value
over 11 years	4% of market value

**GROUP II Provinces of Canada and International Bank of Reconstruction and Development**

The margins required on bonds, debentures, treasury bills and other securities of or guaranteed by any Province of Canada, bonds of the International Bank of Reconstruction and Development, and bonds and debentures guaranteed by the deposit in trust of a grant payable by a province in Canada covering the principal and the interest maturing, or called for redemption in the time periods indicated below are as follows:

**Margin required**

1 year or less	2% of market value multiplied by the fraction determined by dividing the number of days to maturity by 365
over 1 year to 3 years	3% of market value
over 3 years t 7 years	4% of market value
over 7 years to 11 years	5% of market value
over 11 years	5% of market value



**GROUP III** Municipal, school and hospital corporations and religious orders

Margins required on bonds, debentures or notes (not in default) of or guaranteed by any municipal corporation in Canada or in the United Kingdom, maturing in the time periods indicated below, are as follows:

**Margin required**

1 year or less	3% of market value multiplied by the fraction determined by dividing the number of days to maturity by 365
over 1 year to 3 years	5% of market value
over 3 years to 7 years	5% of market value
over 7 years to 11 years	5% of market value
over 11 years	5% of market value

Bonds and debentures (not in default) of or guaranteed by any school corporation, religious order or hospital corporation in Canada, 5% of market value.

**GROUP IV** Other non-commercial bonds and debentures

The margin required on other non-commercial bonds and debentures (not in default), is equal to 10% of market value.

**GROUP V** Corporations and trust and mortgage loan companies – non-negotiable and non-transferable debt securities

The margins required on commercial and corporate bonds, debentures and notes (not in default) and non negotiable and non transferable trust company and mortgage loan company obligations registered in the approved participant's name, maturing in the time periods indicated below, are, subject to the provisions of paragraphs a) and b) hereafter, as follows :

**Margin Required**

1 year or less	3% of market value
over 1 year to 3 years	6% of market value
over 3 years to 7 years	7% of market value
over 7 years to 11 years	10% of market value
over 11 years	10% of market value

- a) i) if convertible and trading over par, apply the above rates on par value and add 50% (30% for clients' accounts, 25% for market-makers and approved participants of the Bourse when convertible into shares eligible for a reduced margin rate as provided for in paragraph 3 of article 7202) of the excess of market value over par when convertible into securities acceptable for margin purposes or 100% of the excess of market value over par when convertible into securities not acceptable for margin purposes with a minimum addition to the above rates of 10% of par value, whether convertible into securities acceptable or not for margin purposes. If convertible and selling at or below par, add 10% of par value to the quoted rates;
- ii) if trading at 50% of par value and under, and if rated "B" or lower by Canadian Bond Rating Service and Dominion Bond Rating Service for Canadian dollar pay securities or by Moody's and Standard and Poor's for U.S. dollar pay securities, the margin required is 50% of the market value;
- b) where such commercial bonds, debentures and notes are debt securities of companies whose notes are acceptable notes, as defined in Group VI of the present article, then the margin requirements of this Group VI must apply.

**GROUP VI Corporations and trust and mortgage loan companies – negotiable and transferable debt securities**

The margins required on acceptable commercial, corporate and finance company notes, and trust company and mortgage loan company bonds, readily negotiable and transferable and maturing in the time periods indicated below are as follows:

**Margin Required**

- 1 year or less                      3% of market value multiplied by the fraction determined by dividing the number of days to maturity by 365
- over 1 year                        apply rates for commercial and corporate bonds, debentures and notes

Acceptable commercial, corporate and finance company notes means notes issued by a company incorporated in Canada or in any province of Canada and a) having a net worth of not less than \$10,000,000 or b) guaranteed by a company having a net worth of not less than \$10,000,000 or c) a binding agreement exists whereby a company having a net worth of not less than \$25,000,000 is obliged, as long as the notes are outstanding, to pay to the issuing company or to a trustee for the noteholders, amounts sufficient to cover all indebtedness under the notes where the borrower, :

- a) files annually under the applicable provincial legislation a prospectus relating to its notes which have a term to maturity of one year or less and provides to approved participants acting as authorized agents the following information in written form:
  - i) disclosure of limitation, if any, on the maximum principal amount of notes authorized to be outstanding at any one time;

## APPENDIX B

- ii) a reference to the bank lines of credit of the borrower or of its guarantor if a guarantee is required;

or

- b) provides to approved participants acting as authorized agents an information circular or memorandum which includes or is accompanied by the following:

- i) recent audited financial statements of the borrower or of its guarantor if a guarantee is required;
- ii) an extract from the borrower's general borrowing by-law dealing with the borrower's corporate authorization to borrow;
- iii) a true copy of a resolution of directors of the borrower certified by the borrower's secretary, and stating in substance:

- [1] the limitation, if any, on the maximum amount authorized to be borrowed by way of issues or notes;

- [2] those officers of the borrower company who may legally sign the notes by hand or by facsimile;

- [3] the denomination in which notes may be issued;

- iv) where notes are guaranteed, a certified copy of a resolution of directors of the guarantor company, authorizing the guarantee of such notes;

- v) a certificate of incumbency and facsimile signatures of the authorized signing officers of the borrower and its guarantor, if any;

- vi) specimen copies of the note or notes;

- vii) a favorable opinion from the legal counsel of the borrower regarding the incorporation, the organization and the corporate status of the borrower, its corporate capacity to issue the notes and the due authorization by it of the issuance of the notes;

- viii) where notes are guaranteed, a favorable opinion from the legal counsel of the guarantor regarding the incorporation, the organization and the corporate status of the guarantor, its capacity to guarantee the notes and the due authorization, validity and effectiveness of its guarantee;

- ix) a summary setting forth the following:

- [1] a brief historical summary of the borrowing company and of its guarantor, if any;

- [2] the purpose of the issue;

[3] a reference to the bank lines of credit of the borrowing company or of its guarantor, if a guarantee is required;

[4] the denomination in which notes may be issued.

**GROUP VII Bonds in default**

The margin required on bonds in default must be equal to 50% of market value.

**GROUP VIII Income bonds**

The margins required on income bonds and debentures on which interest has been paid in full at the stated rate for the two preceding years as required by the related trust indenture which must specify that such interest be paid if earned, are as follows:

Currently paying interest at the stated rate :

**Margin required**

10% of market value

Not paying interest, or paying at less than the stated rate :

**Margin required**

50% of market value

**GROUP IX British Columbia Government guaranteed parity bonds:**

**Long Positions** : ¼ of 1 % of par value or rates prescribed under Group II above;

**Short Positions:** rates prescribed under Group II above.

**GROUP X Floating rate debt obligations:**

50% of the rates of margin otherwise required. If margin is otherwise required in respect of excess market value over par, 100 % of the margin rates otherwise required must apply to the excess market value.

For the purpose of this paragraph, the term "floating rate debt obligation" means a debt instrument described in Groups I, II, III and VI of the present article and in article 7205 for which the rate of interest is adjusted at least quarterly by reference to an interest rate for periods of 90 days or less.

This paragraph is applicable only to an account of a market-maker or to inventory accounts of an approved participant.

**GROUP XI Stripped Coupons and Residual Debt Securities**

- 1) The margin required for stripped coupons and residual debt securities, which is based on a percentage of the market value, is equal to:
  - a) for securities with a term to maturity of less than 20 years, one and a half times the margin rate applicable to the debt instrument which has been stripped or to which the detached coupon or other evidence of interest relates; and
  - b) for securities with a term of 20 years or more, three times the margin rate applicable to the debt instrument which has been stripped or to which the detached coupon or other evidence of interest relates.

In determining the term to maturity of a coupon or other evidence of interest, the payment date for such interest must be considered the maturity date for the purposes of the present paragraph).

- | 2) Where an approved participant or a client holds a short (or long) position in bonds or debentures denominated in Canadian dollars issued or guaranteed by either the Government of Canada or a Province of Canada and also holds a long (or short) position in the stripped coupons or residual portion of such debt securities, the margin required must be the excess of the margin required on the long (or short) position over the margin required on the short (or long) position, provided that the net margin may only be determined as aforesaid on the basis that:
  - a) margin required in respect of a short (or long) position in bonds or debentures may only be netted against margin required in respect of a long (or short) position in stripped coupons or residual portion to the extent that the market value of the two positions is equal. No offset is permitted in respect of the market value of a short (or long) position which is in excess of the market value of the long (or short) position;
  - b) margin required in respect of bonds or debentures issued or guaranteed by the Government of Canada may only be netted against the margin required for the stripped coupons or residual portion of other Government of Canada securities which mature within the same periods referred to in Group I of the present article;
  - c) margin required in respect of bonds or debentures issued or guaranteed by a Province of Canada may only be netted against the margin required for the stripped coupons or residual portion of another Province of Canada securities which mature within the same periods referred to in Group II of the present article.
- | 3) Notwithstanding the foregoing provisions of this Group XI, where an approved participant or a client holds:
  - a) a short (or long) position in bonds or debentures issued or guaranteed by the Government of Canada and a long (or short) position in the stripped coupons or residual portion of bonds or debentures issued or guaranteed by a province of Canada; or
  - b) a short (or long) position in bonds or debentures issued or guaranteed by a province of Canada and a long (or short) position in the stripped coupons or residual portion of bonds or debentures issued or guaranteed by the Government of Canada;

the margin required must be 50% of the total margin required for both positions otherwise determined under the Rules, provided that such margin may only be determined as aforesaid on the basis that:

- i) margin required in respect of a short (or long) position in bonds or debentures may only be netted against margin required in respect of a long (or short) position in stripped coupons or residual portion to the extent that the market value of the two positions is equal, and no such netting is permitted in respect of the market value of a short (or long) position which is in excess of the market value of the long (or short) position;
- ii) margin required in respect of bonds or debentures may only be netted against the margin required for the stripped coupons or residual portion of securities which mature within the same periods referred to in Group I and II of this article;
- iii) the bonds and debentures and the stripped coupons or residual portion of such debt instrument must be denominated in Canadian dollars.

| 4) Where an approved participant or a client holds a short (or long) position in bonds or debentures denominated in Canadian dollars issued by a corporation with a single A or higher rating by any of Canadian Bond Rating Service, Dominion Bond Rating Service, Moody's Investors Service or Standard and Poor's Bond Record, and also holds a long (or short) position in the stripped coupon or residual portion of such debt instruments, the margin required must be the lesser of 20% and the greater of the margin required on the long (or short) position and the margin required on the short (or long) position, provided that the margin may only be determined as aforesaid on the basis that:

- a) the offset is permitted only to the extent that the market value of the two positions is equal, and no offset is permitted in respect of the market value of a short (or long) position which is in excess of the market value of the long (or short) position; and
- b) margin required in respect of bonds or debentures issued by a corporation may only be offsetted against the margin required for the stripped coupons or residual portion of debt instruments of the same issuer, which mature within the same periods referred to in Group XI in this article for the purpose of determining margin rates.

| 5) Where an approved participant or a client holds a short (or long) position in bonds or debentures denominated in a foreign currency referred to in Group I of this article and also holds a long (or short) position in the stripped coupons or residual portion of such debt instruments denominated in the same currency, the margin required must be the excess of the margin required on the long (or short) position over the margin required on the short (or long) position, provided that the net margin may only be determined as aforesaid on the basis that:

- a) margin required in respect of a short (or long) position in bonds or debentures may only be netted against margin required in respect of a long (or short) position in stripped coupons or residuals to the extent that the market value of the two positions is equal, and no such netting or offset is permitted in respect of the market value of a short (or long) position which is in excess of the market value of the long (or short) position; and

- b) margin required in respect of bonds or debentures issued or guaranteed by a particular government may only be netted against the margin required for the stripped coupon or residual portion of debt instruments of the same government, which mature within the same periods referred to in Group I of this article for the purpose of determining margin rates.

**GROUP XII Mortgage-backed securities**

On securities which are based upon mortgages and are guaranteed as to timely payment of principal and interest by the issuer or its agent, the margin rate is the rate prescribed in articles 7204, 7205 and 7206 applicable to the securities of such guarantor according to the relevant maturity plus an additional margin of 25% of such applicable rate.

Where an approved participant or a client holds a short (or long) position in bonds or debentures issued or guaranteed by the Government of Canada and also holds a long (or short) position in mortgage-backed securities guaranteed by the Government of Canada, the margin required must be the excess of the margin required on the long (or short) position over the margin required on the short (or long) position, provided that the net margin may only be determined as aforesaid on the basis that:

- 1) Margin required in respect of a short (or long) position in bonds or debentures may only be netted against margin required in respect of a long (or short) position in mortgage-backed securities to the extent that the market value of the two positions is equal. No netting or offset is permitted in respect of the market value of a short (or long) position which is in excess of the market value of the long (or short) position;
- 2) Margin required in respect of bonds or debentures may only be netted against the margin required for the mortgage-backed securities which mature within the same periods referred to in the present article for the purpose of determining margin rates; and
- 3) Notwithstanding the foregoing, if the market value of a long (or short) position in mortgage-backed securities exceeds the remaining principal amount of such position and the mortgages underlying such mortgage-backed securities position are subject to being repaid in full at the option of the mortgagee prior to maturity, the margin required must be the greater of the individual margins for (i) the long (or short) position in mortgage-backed securities as determined under the present paragraph or (ii) the short (or long) position in bonds or debentures as determined under Group I of this article.

**7204A Pairing for Margin Purposes**

(09.10.91, 27.05.97, 18.02.98, 19.08.98, 17.12.02, 01.01.05, 13.09.05, 27.02.06, [00.00.06](#))

1) Where an approved participant or a client

- a) owns securities described in Group I or II of article 7204 whose maturity is over one year, and
- b) has a short position in securities
  - i) issued or guaranteed by the same issuer of the securities referred to in a) (provided that for these purposes each of the provinces of Canada must be regarded as the same issuer as any other province);
  - ii) maturing over one year;
  - iii) maturing within the same periods for the purpose of determining margin rates for the securities referred to in a); and
  - iv) with a market value equal to the securities referred to in paragraph a) (with the intent that no pairing is permitted in respect of the market value of a long [or short] position which is in excess of the market value of the short [or long] position);

the two positions may be offset and the required margin must be computed with respect to the net long or net short position only. This rule also applies to future purchase and sale commitments.

2) Where an approved participant or a client

- a) owns securities described in Group I or II of article 7204 maturing within one year, and
- b) has a short position in securities
  - i) issued or guaranteed by the same issuer of the securities referred to in a) (provided that for these purposes, each of the provinces of Canada must be regarded as the same issuer as any other province);
  - ii) maturing within one year; and
  - iii) with a market value equal to the securities referred to in paragraph a) (with the intent that no offset is permitted in respect of the market value of a long [or short] position which is in excess of the market value of the short [or long] position);

then the margin required must be the excess of the margin on the long (or short) position over the margin required on the short (or long) position. This rule also applies to future purchase and sale commitments.

3) A) Where an approved participant or a client has a short and long position in the following groups of securities of article 7204, the total margin required in respect of both positions must be 50% of the greater of the margin required on the long or short position:



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Long (Short)		Short (Long)
a) Group I (Canada only)	and	Group I (Canada only with different maturity bands)
b) Group I (Canada only)	and	Group II (province of Canada only with identical or different maturity bands)
c) Group I (Canada only)	and	Group III (municipality of Canada only)
d) Group II (province of Canada only)	and	Group II (province of Canada only with different maturity bands)
e) Group II (province of Canada only)	and	Group III (municipality of Canada only)

B) Where an approved participant or a client has a short and long position in the following groups of securities of article 7204, the total margin required in respect of both positions must be the greater of the margin required on the long or short position:

Long (Short)		Short (Long)
f) Group I (U.S. Treasury only)	and	Group I (Canada only)
g) Group I (U.S. Treasury only)	and	Group II (province of Canada only)
h) Group I (Canada and	and	Group III (municipality of Canada only) U.S. Treasury only)
i) Group I (Canada and U.S. Treasury only)	and	Group V (corporate)
j) Group II (province of Canada only)	and	Group III (municipality of Canada only)
k) Group II (province of Canada only)	and	Group V (corporate)
l) Group V (corporate)	and	Group V (corporate of the same issuer)

C) Furthermore, the offsets described above in paragraphs A) and B) may only apply if the following requirements are complied with:

- i) securities offsets described in subparagraphs a), b) and d) can be of different maturity bands, all other offsetting positions must mature within the same periods referred to in article 7204 for the purpose of determining margin rates;
- ii) securities described in Group III (municipality of Canada) of article 7204 are eligible for offsets described in subparagraphs c) and e) only if they have a long-term issuer credit

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rating of a single A or higher by any of Canadian Bond Rating Service, Dominion Bond Rating Service, Moody's Investors Service or Standard & Poor's Bond Record;

- iii) securities described in Group V (corporate) of article 7204 and securities described in article 7205 are eligible for offset only if they are not convertible and have a single A or higher rating by any of Canadian Bond Rating Service, Dominion Bond Rating Service, Moody's Investors Service or Standard & Poor's Bond Record;
- iv) securities in offsetting positions must be denominated in the same currency; and
- v) the market value of the offsetting positions is equal and no offset is permitted in respect of the market value of the short (or long) position which is in excess of the market value of the long (or short) position.

For the purpose of this article, securities described in article 7205 are eligible for an offset identical to the one applicable to securities described in Group V of article 7204.

**7213 Exceptions to Margin Rules**

(30.11.86, 15.12.86, 01.06.88, 01.01.92, 15.01.93, 10.05.93, 01.04.93, 25.02.94, 12.03.97, 21.12.98, 29.08.01, 18.07.03, 01.01.04, 17.05.04, 01.01.05, 13.09.05, 00.00.06)

Exceptions to the margin rules are the following:

- 1) No margin is required ~~on securities meeting the following conditions in respect of:~~ **of:**
  - a) securities which have been ~~formally~~ called for cash redemption, pursuant to the terms and conditions attached thereto; or
  - b) securities for which a legal and binding cash offer to purchase has been made in respect of which any conditions have been met, ~~provided that:~~
    - i) ~~all conditions of the offer have been met;~~
    - ii) ~~securities are not carried for an amount in excess of the price offered.~~

Provided that such securities are not carried for an amount in excess of the price offered, and all legal requirements have been met and all regulatory, competition bureau and court approvals to proceed with the redemption call or offer have been received and verified.

In the event that a cash offer is made for a fraction of the issued and outstanding class of securities, the above reduced margin requirements shall only apply to the same fraction of the position held in a particular account for that class of securities.

~~When the legal and binding cash offer is for less than 100% of the issued and outstanding securities and all conditions of the offer have been met, the margin required must be adjusted prorata to shares purchased by the offeror on the number of shares deposited;~~
  - c) deposit certificates issued by a Canadian chartered bank or a trust company in Canada qualifying as an acceptable institution or an acceptable counterparty, as these terms are defined in Policy C-3 of the Bourse, and having a 24-hour call feature that would not reduce the principal amount received on redemption if applicable.

- 2) Margin requirements for potential liability under an underwritten rights or warrants agreement.

Where an underwriter has a commitment to purchase securities in connection with a rights or warrants offering, such commitment must be margined at the following rates:

- a) if the market value of the security which can be acquired pursuant to the exercise of the rights or warrants is below the subscription price, the underwriter's commitment must be valued at the current market price for the security and the margin rates applicable to the security must be applied;
- b) if the market value of the security is equal to or greater than the subscription price, the commitment must be margined at rates, calculated on the subscription price, equal to the following percentage of the margin rate applicable to the security under the present section:

50%, where market value is 100% to 105% of the subscription price;

30%, where market value is more than 105% but not more than 110% of the subscription price;

10% where market value is more than 110% but not more than 125% of the subscription price;

no margin is required where market value is more than 125% of the subscription price.

3) Securities eligible to a reduced margin rate

The margin required is 25% of the market value if such securities held by an approved participant are:

- i) on the list of securities eligible to a reduced margin rate as approved by a recognized self-regulatory organization and such securities continue to trade at \$2.00 or more;
- ii) securities against which options issued by the Options Clearing Corporation are traded;
- iii) convertible into securities that qualify under the subparagraph i) or subparagraph ii);
- iv) non-convertible preferred and senior shares of an issuer any of whose securities qualify under subparagraph i); or
- v) securities whose original issuance generated Tier 1 capital for a financial institution any of whose securities qualify under subparagraph i) and the financial institution is under the regulatory oversight of the Office of the Superintendent of Financial Institutions of Canada.

For the purpose of the present paragraph 3), the Bourse and the Investment Dealers Association of Canada are designated as recognized self-regulatory organizations.

- 4) Whenever the Bourse decides not to open for trading any additional options of the class covering that underlying security according to article 6605, the margin rate as permitted in paragraph 3) of this article remains in force up to the expiration of the last series of options.
- 5) Any security which is part of a control block has no loan value for margin calculation purposes, except to the extent that the control block constitutes any or all of the securities which an approved participant has an obligation or commitment to acquire, or has acquired, under a prospectus filing. In such case, the appropriate margin requirement provided for in article 7224 applies as long as the criteria in said article have been met. For the purpose of the present paragraph, a "control block" means a sufficient number of any securities of the same issuer to affect materially the control of that issuer. In the absence of evidence to the contrary, any holding by any person, company or combination of persons or companies of more than 20% of the outstanding voting securities of an issuer is deemed to affect materially the control of that issuer.
- 6) Where the account of an approved participant, a market-maker or a restricted trading permit holder contains preferred shares for which the principal and dividends are unconditionally guaranteed by the

Canadian government or a provincial government, the margin rate for these securities must be 25% of their market value.

- 7) a) For the purposes of sub-paragraphs b) to f) of this paragraph, the term "floating rate preferred share" means a preferred share, for which the rate of dividend fluctuates at least quarterly, in relation with a prescribed short-term interest rate. The sub-paragraphs b) to f) of this paragraph are applicable only to an account of a market-maker, a restricted trading permit holder or inventory account of an approved participant.
  - b) Margin on floating rate preferred shares of companies with securities which are eligible to a reduced margin rate under paragraph 3 of article 7202 must be provided at the rate of 10% of the market value of such securities.
  - c) The margin rate which must be applied on floating rate preferred shares which qualify for margin under this paragraph, but which are of companies which do not have securities which are eligible to a reduced margin rate under paragraph 3 of article 7202, is 25% of the market value of such securities.
  - d) Where the issuer is in default of payment of a dividend due on floating rate preferred shares which qualify for margin purposes under this paragraph, margin must be provided at the rate of 50% of the market value of such securities.
  - e) Where the floating rate preferred shares of companies with securities which are eligible to a reduced margin rate under paragraph 3 of article 7202 are convertible and are trading over par, margin must be provided at the rate of 10% of the par value of such securities plus 25% of the excess of market value of such securities over par.
  - f) Where the floating rate preferred shares of companies which do not have securities which are eligible to a reduced margin rate under paragraph 3 of article 7202, but are convertible and are trading over par, margin must be provided at the rate of 25% of the par value of such securities plus 50% of the excess of market value of such securities over par.
- 8) a) For the purposes of sub-paragraphs b) to f) of this paragraph, the term "floating rate preferred share" means a preferred share, by the terms of which the rate of dividend fluctuates at least quarterly, in tandem with a prescribed short-term interest rate. The sub-paragraphs b) to f) of this paragraph are applicable only to an account of a market-maker, specialist, a restricted trading permit holder or inventory account of an approved participant.
  - b) Margin on floating rate preferred shares of companies with securities which are eligible to a reduced margin rate under paragraph 3 of article 7202 of the Rules of the Bourse must be provided at the rate of 10% of the market value of such securities.
  - c) The margin rate which must be provided on floating rate preferred shares which qualify for margin under this paragraph but which are of companies which do not have securities which are eligible to a reduced margin rate under paragraph 3 of article 7202 of the Rules of the Bourse, is 25% of the market value of such securities.

- d) Where the issuer is in default of payment of a dividend due on floating rate preferred shares which qualify for margin under this paragraph, margin must be provided at the rate of 50% of the market value of such securities.
  - e) Where the floating rate preferred shares of companies with securities which are eligible to a reduced margin rate under paragraph 3 of article 7202 of the Rules of the Bourse are convertible and are selling over par, margin must be provided at the rate of 10% of the par value of such securities plus 25% of the excess of market value of such securities over par.
  - f) Where the floating rate preferred shares of companies which do not have securities which are eligible to a reduced margin rate under paragraph 3 of article 7202 of the Rules of the Bourse, but are convertible and are selling over par, margin must be provided at the rate of 25% of the par value of such securities plus 50% of the excess of market value of such securities over par.
- 9) Consideration other than cash to be obtained following an offer
- a) For the purpose of computing the margin on shares which are the subject of an offer, and in respect of which all conditions have been met, the margin required may be computed on the consideration, other than cash, that would be obtained upon acceptance of the offer. The margin rate to be used is the one prescribed in articles 7201 and following on the consideration to be obtained.
  - b) Where the offer is made for less than 100% of the issued and outstanding shares, the preceding principle must be applied pro rata in the same proportion as the offer.

### 10) Bank warrants for governments securities

Where the account of a market maker or an approved participant contains bank warrants for government securities the margin rate must be the one required in respect of the securities to which the holder of the warrant is entitled upon exercise of the warrant provided that, in the case of a long position, margin need not exceed the market value of the warrant.

For the purpose of this paragraph, bank warrants for government securities means warrants issued by a Canadian chartered bank which are listed on any recognized stock exchange or other listing organization referred to in paragraph 1) of article 7202, and which entitle the holder to purchase securities issued by the Government of Canada or any province thereof.

### 11) Maximum Margin Required for Convertible Securities

The margin required for a security that is currently convertible or exchangeable into another security (the "underlying security") need not exceed the sum of:

- i) the margin required for the underlying security; and
- ii) any excess of the market value of the convertible or exchangeable security over the market value of the underlying security.