MEMBER REGULATION

notice

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Update and Replacement of CIB C-70

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ATTENTION:

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Capital and Margin Requirements for Special Warrants, Subscription Receipts and Restricted Securities

A. INTRODUCTION

With the promulgation of Multilateral Instrument 45-102 in November 2001 there has been a decrease in the use of special warrants as issuers meeting the definition of "qualifying issuer" are opting for the use of restricted securities, subject to four month trading restriction, that do not require the clearance of a prospectus. The IDA's current rules and interpretations do not deal specifically with this new type of security. As the restricted securities have features similar to special warrants and subscription receipts these securities shall be margined in a similar way.

The purpose of this member regulation notice is to clarify the capital and margin requirements for special warrants, subscription receipts and restricted securities, as defined herein. Requirements for any differing products, not covered by existing by-laws or member regulation notices, must be determined on a case-by-case basis by the audit jurisdiction Self-Regulatory Organization ("SRO"), or be margined at a 100% margin rate.

B. DEFINITIONS

For the purposes of this member regulation notice:

"special warrants" are defined as those limited term securities issued via prospectus exemptions under the securities acts of the selling jurisdictions, which are convertible into another security class of the issuer (predominantly common shares) at a set conversion rate upon clearance of a final prospectus at no additional cost to the subscriber.

"subscription receipts" are defined as those limited term securities issued via prospectus, which are convertible into another security class of the issuer (predominantly common shares) at a set conversion rate based on the successful completion of a planned reorganization or transaction. Where completion is not successful, security proceeds are either returned to the subscriber or a more generous conversion rate is made available to the subscriber.

"restricted securities" are defined as securities with resale restrictions initially distributed pursuant to Multilateral Instrument 45-102 or Quebec Securities Commission[1] prospectus exemption rules. The resale restrictions are four months for qualifying issuers[2]/(reporting issuer in Quebec) and twelve months for non-qualifying issuers. At the end of trading restriction period the restriction legend is removed and the shares trade as common shares. Investors typically receive restricted securities through private placement offers.

C. TYPES OF SPECIAL WARRANTS

Special warrants may differ in the treatment of the issue proceeds from the purchase date to the date of expiry or receipt for a final prospectus and in the events occurring upon expiry. Currently existing variations are as follows:

1. The proceeds of the issue are required to be held in trust until the expiry or conversion of the special warrants, at which time, if no receipt for a final prospectus has been obtained from the selling jurisdiction securities commission, the cash proceeds plus interest are returned to the subscriber.

2. The proceeds of the issue are not restricted and are available to the issuer immediately. Upon expiry of the special warrants, if no receipt for a final prospectus has been obtained from the selling jurisdiction securities commission, the subscribers receive common shares based on a set conversion rate subject to the requirements of the selling jurisdiction securities act for the exemption used.

D. TYPES OF SUBSCRIPTION RECEIPTS

As with special warrants, subscription receipts may differ in the treatment of the issue proceeds from the purchase date to the date of expiry of the original conversion rate terms and in the events occurring upon expiry of such terms. Currently existing variations are as follows:

1. The proceeds of the issue are required to be held in trust until the expiry of original conversion rate terms or conversion of the subscription receipts, at which time, if the planned reorganization or transaction is not successful:

   (a) the cash proceeds plus interest are returned to the subscriber; or

   (b) the common shares are made available to the subscriber at a more generous conversion rate; or

   (c) both of the options under (a) and (b) are made available to the subscriber.

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[1] Quebec Securities Commission Decision No 2001-C-0507 sets out circumstances under which resale restrictions on privately placed securities in that province are reduced from 12 months to 4 months.

[2] A "qualifying issuer" is defined generally as a reporting issuer having either a class of equity securities listed or quoted on certain specified exchange or markets or has outstanding securities that have received approved rating.

2. The proceeds of the issue are not restricted and are available to the issuer immediately. Upon expiry of the original conversion rate terms, if the planned reorganization or transaction is not successful, the subscribers receive common shares at a more generous conversion rate.

E. RESTRICTED SECURITIES

The proceeds of restricted securities are usually available to the issuer immediately but there may be instances where the proceeds are held in trust in an escrow account with an acceptable institution and returnable to subscribers under certain conditions.

F. MARKET VALUE DETERMINATION

The market value of special warrants, subscription receipts and restricted securities may be difficult to determine. If indeterminable directly, the market value of these securities may be determined based on the market value of the underlying common shares.

In the case of underwriting commitments for special warrants, subscription receipts and restricted securities, the market value reported for the underwriting commitment position shall be the lesser of:

(a) The market value determined for the security position; and

(b) The value of the security position determined based on its issue price.

G. CAPITAL AND MARGIN REQUIREMENTS

1. In the case where the underwriting proceeds are held in trust in an escrow account at an acceptable institution and may be returned to the subscriber, the capital / margin requirement shall be that ordinarily required for the underlying security plus any conversion loss (should the special warrant/subscription receipt have a market value greater than the value of the equivalent underlying security position). However, the resultant loan value (market value of the special warrant/subscription receipt/restricted securities less applicable margin) determined for the position cannot exceed the underwriting cash proceeds being held in trust.

2. In the case where the underwriting proceeds are available to the issuer:

During underwriting period

The capital requirement shall be 100% of the market value reported for the underwriting commitment position subject to the capital requirement reductions permitted pursuant to IDA Regulation 100.5.

Post underwriting period

- For special warrants where the “underwriting commitment position” is held on or after the settlement date of the underwriting. The capital requirement shall be 100% of the market value of the underwriting commitment position.

- For subscription receipts that trade on a recognized exchange; the capital requirement shall be ordinarily required for the underlying security plus any conversion loss should their market value be greater than the value of the equivalent underlying security position).

- For restricted securities, after the underwriting period but before trading restrictions are removed. The capital requirement shall 100% of the market value of the position, as the restricted securities are not readily marketable. Once the trading restrictions are removed, the margin requirement shall be that ordinarily required for an unrestricted listed security.

3. Members are reminded that only long positions in "currently convertible or exchangeable" securities are eligible to offset margin requirements for short positions in underlying securities pursuant to Regulations 100.4H, I and J. Therefore, no margin offsets involving long positions in special warrants or subscription receipts are available unless they have been determined to be "currently convertible or exchangeable".