



**CIRCULAR**  
September 30, 2003

## **REQUEST FOR COMMENTS**

### **INSURING AGREEMENT C OF FINANCIAL INSTITUTION BOND – IN TRANSIT COVERAGE**

#### **AMENDMENTS TO ARTICLE 7076**

#### **Summary**

The Special Committee – Regulatory Division of Bourse de Montréal Inc. (the "Bourse") has approved amendments to subparagraph 2 c) of article 7076 of the Rules of the Bourse concerning the Insuring Agreement C of the Financial Institution Bond that must be subscribed by the approved participants of the Bourse. This Insuring Agreement concerns the loss of property in transit. The purpose of the proposed amendments is to clarify the actual wording and make its interpretation easier. The amendments are also aimed at avoiding any ambiguities by inducing the approved participant, if it wants more information on the nature and extent of the available insurance coverage, to refer to the insurance policy issued by its insurer.

#### **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.: 133-2003

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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 subparagraph 2 c) of article 7076 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.



### INSURING AGREEMENT C OF FINANCIAL INSTITUTION BOND – IN TRANSIT COVERAGE

#### – AMENDMENTS TO ARTICLE 7076

#### I SUMMARY

Bourse de Montréal Inc. (the “Bourse”) proposes to amend subparagraph 2 c) of article 7076 of the Rules of the Bourse concerning Insuring Agreement C of the Financial Institution Bond that must be subscribed by the approved participants of the Bourse. This Insuring Agreement concerns the loss of property in transit.

##### A – Current Rules

Subparagraph 2 c) of article 7076 of the Rules of the Bourse currently reads as follows :

*“Clause (C) - In Transit - Any loss of money and securities or other property through robbery, burglary, theft, hold-up, misplacement, mysterious disappearance, damage or destruction, while in transit in the custody of any employee or any person acting as messenger except while in the mail or with a carrier for hire other than an armoured motor vehicle company, as more fully defined in the Standard Form”.*

##### B – The Issue

The current wording of subparagraph 2 c) of article 7076 of the Rules of the Bourse sometimes causes confusion and some interpretation problems in reason of the fact that

the terms used therein, regarding, for example, the causes and circumstances of a loss, are not necessarily uniform with the standard wording used by the insurers that issue this type of insurance. Furthermore, although the Rule mentions some coverage exclusions, Financial Institution Bonds contain many other exclusions. Finally, some types of property are either specifically excluded from the insurance coverage by the insurers or are not included in the insurance coverage. It is the case, for example, for certified cheques and bank drafts which are not covered by Insuring Agreement C of the Financial Institution Bond.

##### C – Objective

The purpose of the proposed amendments is to improve the clarity of the wording and thus make its interpretation easier. They also intend to avoid any ambiguity by inducing the approved participant, if it wants more information on the nature and extent of the available insurance coverage, to refer to the insurance policy issued by its insurer.

##### D – Effect of the proposed Rules

The Bourse is of the opinion that the proposed amendments will have no impact on the market structure or on other rules.

#### II DETAILED ANALYSIS

##### A – Proposed amendments

The Bourse considers that the wording of subparagraph 2 c) of article 7076 must be more concise. Furthermore, in order to make the reading and the interpretation of this subparagraph easier, the Bourse also proposes to move the text of subparagraph 5 a) in order to integrate it into subparagraph 2 c). This way, all the provisions relating to Insuring Agreement C of the Financial Institution Bond will be in the same location.

The proposed amendments to subparagraph 2 c) of article 7076 first consist in specifically designating some types of property that are not covered by Insuring Agreement C of the Financial Institution Bond, namely certified cheques and bank drafts. The reason for this specification is that the standard wording used by insurers that issue this type of coverage neither excludes nor includes this type of instruments. Effectively, when analyzing the coverage exclusions that are found in this type of insurance policy, these types of instruments are not mentioned. On the other hand, the definitions of the words “money”, “securities” and “property” do not include certified cheques and bank drafts. Approved participants making an intensive use of these types of instruments, it was not clear for them to determine whether or not they had to take them into account when establishing the necessary amount of coverage to cover risks incurred while in transit.

Furthermore, it is important to mention that the loss, the disappearance or the destruction of this type of instrument can generally be compensated by subscribing to a Lost Instrument Bond. This type of surety is not included in the insurance coverage of the Financial Institution Bond and must be subscribed separately by the beneficiary of the instrument in favour of the financial institution that issued the certified cheque or the bank draft. In counterparty of the surety bond given to it, the financial institution will then issue a new certified cheque or a new bank draft.

Secondly, it is proposed to withdraw from the Rule any reference to the causes and circumstances of the loss such as theft, burglary, etc. These causes and circumstances, such as they are listed in the current Rule are incomplete and do not reflect adequately the coverages granted by the insurers neither the exclusions that may apply. Furthermore, they create a risk of contradiction between what is listed in the Rule and the provisions of the insurance policy. The deletion of the concerned text will allow avoiding any risk of incorrect interpretation of

the coverage offered by Insuring Agreement C of the Financial Institution Bond and of the exclusions that may apply to this Insuring Agreement. To determine what are the protections offered and the exclusions that may apply, approved participants must refer to the document issued by their insurer. This is the only mean for them to well understand the extent of the protection available to them.

Finally, a precision has been added specifying that money, securities and other property covered by Insuring Agreement C can be negotiable or non-negotiable. Effectively, for some types of property insurers cover them regardless of the fact that they are negotiable or not while, for some other types of property, these must be in a non-negotiable form like, for example, securities certificates registered in the name of a designated holder and that have not been endorsed.

### **B – Problem and alternative solutions considered**

An alternative solution could have consisted in arranging for the regulatory texts to reflect as well as possible the wording of the Financial Institution Bond. However, this would have resulted in a lengthy and complicated regulatory text since it would have had to incorporate not only the details of the coverages provided but also those of the coverage exclusions as well as the various definitions that are found in this type of insurance policy. Furthermore, such an approach could have resulted in practical problems because although the wording of these insurance policies is relatively uniform among insurers, there can be some differences between some of them.

It was therefore considered preferable to opt for a regulatory text worded in an as general manner as possible so that approved participants refer directly to their insurance policy in order to understand its coverage, exclusions and definitions.

### **C – Objective of proposed amendments relatively to public interest**

The Bourse considers that the proposed amendments are of public interest and that they will not result into an unfair discrimination between clients, issuers, brokers or other persons. They do not impose an unnecessary or inappropriate burden on competitiveness.

## **III COMMENTARIES**

### **A – Comparison with Similar Provisions**

The Investment Dealers Association of Canada (IDA) had a similar amendment to its Regulations (Regulation 400.2) approved by its Board of Directors on June 19, 2001. This amendment was approved by the Ontario Securities Commission in July 2001. However it has not yet been implemented by the IDA, this one having indicated that they wanted that such an implementation be made simultaneously with the Bourse.

An amendment similar to the one proposed by the IDA was submitted a first time to the Compliance Subcommittee of the Regulatory Division of the Bourse in June 2002 but was rejected by the Subcommittee in reason of the fact that the then proposed wording did not identify what were the instruments excluded from the insurance coverage. Instead of reading “*except certified cheques and bank drafts*” as proposed in the present amendment, the text was reading “*exceptions to be contained in list to be approved by the Bourse*”. Since it appeared that the only instruments affected by the exception were certified cheques and bank drafts and that even two years after the approval of the amendment by the IDA there does not seem that other instruments will be added to the exception provided by the Rule, the Bourse therefore opted to specifically designate these instruments in its amendment proposal.

### **B -- Filing in Other Jurisdictions**

The proposed amendments will be filed with the Commission des valeurs mobilières du Québec for approval and with the Ontario Securities Commission for information.

### **C – Effectiveness**

Proposed amendments are simple and efficient. They will clarify the requirements that are applicable regarding insurance.

### **D – Process**

The first step of the approval process for the regulatory amendments discussed in the present document consists in having the proposed amendments approved by the Compliance Subcommittee of the Regulatory Division of the Bourse. The amendments must then be submitted to the Special Committee – Regulatory Division. Once the approval of the Special Committee obtained, the project will be simultaneously published by the Bourse for a 30-day comment period and submitted to the Commission des valeurs mobilières du Québec for approval.

## **IV SOURCES**

- Article 7076 of the Rules of Bourse de Montréal Inc.
- Form 14 – Financial Institution Bond
- Proposed amendment to Rule 400.2 of the Investment Dealers Association of Canada

**Section 7076 - 7150  
Insurance**

**7076 Insurance**

(28.02.87, 09.10.87, 30.12.88, 06.08.90, 20.12.91, 01.05.92, 03.03.93, 01.04.93, 01.12.94, 08.11.95, 20.12.96, 01.07.97, 01.04.03, 00.00.03)

1) Mail Insurance

Every approved participant must effect and keep in force mail insurance against loss arising by reason of any outgoing shipments of money or securities, negotiable or non negotiable, by first class mail, registered mail, registered air mail, express or air express, such insurance to provide at least 100% cover.

The Vice-President of the Regulatory Division of the Bourse may exempt an approved participant from the requirement of the present paragraph if the approved participant delivers a written undertaking to the Vice-President Regulatory Division, that it will not use the mail for outgoing shipments of money or securities, negotiable or non-negotiable, by first-class mail, registered mail, registered air mail, express or air express.

2) Financial Institution Bond

Every approved participant must, by means of a Financial Institution Bond or Bonds (with Discovery Rider attached or Discovery Provisions incorporated in the Bond), effect and keep in force insurance against losses arising as follows as provided for in the standard-form contract:

a) Clause (A) - Fidelity

Any loss through any dishonest or fraudulent act of any of its employees, committed anywhere and whether committed alone or in collusion with others, including loss of property through any such act of any of its employees;

b) Clause (B) - On Premises

Any loss of money and securities or other property through robbery, burglary, theft, hold-up or other fraudulent means, mysterious disappearance, damage or destruction while within any office of the insured, of a banking institution or clearing house or within any recognized place of safe deposit, as more fully defined in the Standard Form Number 14 of Financial Institution Bond, herein referred to as the Standard Form;

c) Clause (C) - In Transit

Any loss of money and securities or other property ~~through robbery, burglary, theft, hold-up, misplacement, mysterious disappearance, damage or destruction, while in transit in the custody of any employee or any person acting as messenger except while in the mail or with a carrier for hire other than an armoured motor vehicle company, as more fully defined in the Standard Form;(except certified cheques and bank drafts), whether negotiable or non-negotiable, must be covered by insurance. The value of securities in transit in the custody of any employee or any~~

[person acting as a messenger must not at any time exceed the protection provided under the present subparagraph:](#)

d) Clause (D) - Forgery, Alterations

Any loss through forgery or alteration of any cheques, drafts, promissory notes or other written orders or directions to pay sums in money, excluding securities, as more fully defined in the Standard Form;

e) Clause (E) - Securities

Any loss through having purchased or acquired, sold or delivered, or extended any credit or acted upon securities or other written instruments which prove to have been forged, counterfeited, raised or altered, or lost or stolen, or through having guaranteed in writing or witnessed any signatures upon any transfers, assignments or other documents or written instruments, as more fully defined in the Standard Form.

3) a) Notice of termination

Each Financial Institution Bond maintained by an approved participant must contain a rider containing provisions to the following effect:

- i) the underwriter must notify the Bourse at least 30 days prior to the termination or the cancellation date of the bond, except in the event of termination of the bond due to:
  - a) the expiration of the bond period specified;
  - b) the receipt of written notice from the insured of its desire to cancel the bond;
  - c) upon the taking over of the insured by a receiver or other liquidator, or by provincial, federal or state officials; or
  - d) upon the taking over of the insured by another institution or entity.
- ii) In the event of termination of bond as an entirety in accordance with sub-paragraphs i) b), c) or d), the underwriter must, upon becoming aware of such termination, give immediate written notice of the termination to the Bourse. Such notice shall not impair or delay the effectiveness of the termination.

b) Termination or cancellation as a result of a take-over

In the event a Financial Institution Bond is to be terminated or cancelled as a result of the take-over of an approved participant by another institution or entity as described in paragraph 3 a) i) d), the approved participant must ensure that bond coverage is in place and provides a period of 12 months from the date of such take-over within which to discover the losses, if any, sustained by the approved participant prior to the effective date of such take-over. The approved participant must then pay, or cause to be paid, any applicable additional premium.

## 4) Amounts required

The minimum amounts of insurance to be maintained for each clause in the aggregate under paragraph 2 of this article must be the greater of:

- a) \$500,000 or, in the case of a Type 1 Introducing broker, \$200,000; and
- b) 1% of the balance of the base amount or, in the case of a Type 1 and Type 2 introducing broker, one half of one percent of the base amount (½%);

provided that, for each clause, such minimum amount of insurance need not exceed \$25,000,000.

For the purposes of this paragraph, the term "base amount" means the greater of:

- i) the aggregate of net equity for each customer, such aggregate being determined by taking the total value of cash and securities owed to the customer by the approved participant less the total value of cash and securities owed by the customer to the approved participant; and
- ii) the aggregate of total liquid assets and total other allowable assets of the approved participant determined in accordance with Statement A of the Joint Regulatory Financial Questionnaire and Report.

## 5) Provisos

- ~~a) the value of securities in transit in the custody of any employee or any person acting as a messenger must not at any time exceed the protection provided under paragraph 2 of this article;~~
- ab) the amounts of insurance required to be maintained by an approved participant must as a minimum be by way of a Financial Institution Bond with a double aggregate limit or a provision for full reinstatement of the amount of coverage;
- be) should there be insufficient coverage, an approved participant will be deemed to be complying with the requirements of this article provided that any such deficiency does not exceed 10 percent of the insurance coverage required and that evidence is provided within two months of the dates of completion of the quarterly operations questionnaires or the annual audit that the deficiency has been corrected. If the deficiency of the insurance coverage required is 10 percent or more, measures must be taken by the approved participant in order to correct the said deficiency within 10 days of its determination and the approved participant must immediately notify the Chief Examiner of the Exchange;
- cd) insurance against losses under sub-paragraph 2) e), Clause (E) (Securities), may be incorporated in the Financial Institution Bond or may be carried by means of a rider attached thereto or by a separate Securities Forgery Bond;
- de) the Financial Institution Bond maintained pursuant to paragraph 2 of this article may contain a clause or rider stating that all claims made under the bond are subject to a deductible;

e) for the purposes of calculating insurance requirements, no distinction must be made between securities in non-negotiable form and those in negotiable form.

#### 6) Insurer

Insurance required to be effected and kept in force by an approved participant pursuant to this article 7076 may be underwritten directly with either (i) an insurer registered or licensed under the laws of Canada or any province of Canada or (ii) any foreign insurer approved by the Bourse. No foreign insurer will be approved by the Bourse if its net worth, according to the last audited balance sheet, is lesser than \$75 millions, provided acceptable financial information with respect to such insurer is available for inspection and the Bourse is satisfied that the insurer is subject to supervision by regulatory authorities in the jurisdiction of incorporation of the insurer which is substantially similar to the supervision of insurance companies in Canada.

#### 7) Global Insurance Policies

Where the insurance maintained by an approved participant in respect of any of the requirements under this article 7076 names as the insured or benefits the approved participant, together with any other person or group of persons, whether within Canada or elsewhere, the following must apply:

- a) the approved participant must have the right to claim directly against the insurer in respect of any loss, and any payment or satisfaction of such loss must be made directly to the approved participant; and
- b) the individual or aggregate limits under the policy may only be affected by claims made by or on behalf of:
  - i) the approved participant;
  - ii) any of the approved participant's subsidiaries whose financial results are consolidated with those of the approved participant; or
  - iii) a holding company of the approved participant provided that this holding company does not carry on any business or own any investment other than its interest in the approved participant,

without regard to the claims, experience or any other factor referable to any other person.

#### 8) Exemption

The Special Committee may exempt an approved participant from the requirements of this article where the approved participant is not dealing with the public and/or is not a clearing member.