



**CIRCULAR 008-21**

January 22, 2021

**SECOND REQUEST FOR COMMENTS**

**AMENDMENTS TO ARTICLE 6.206 OF THE RULES OF BOURSE DE MONTREAL INC. TO MODIFY THE MINIMUM VOLUME THRESHOLD FOR BLOCK TRANSACTIONS ON THE THREE-MONTH CANADIAN BANKERS' ACCEPTANCE FUTURES**

On July 7, 2020, Bourse de Montréal Inc. (the “**Bourse**”) published the Request for Comments circular [120-20](#) regarding amendments to Article 6.206 of the Rules of the Bourse in order to reintroduce a minimum volume threshold for block transactions on Three-Month Canadian Bankers’ Acceptance Futures (quarterlies one to four) during the regular trading hours.

Following this initial publication, the Bourse has modified the proposed minimum volume threshold from 2,000 to 4,000 contracts. A modified version of the proposed amendments and detailed analysis is attached and the modifications are underlined.

Comments on the proposed amendments must be submitted at the latest on **March 1<sup>st</sup>, 2021**. Please submit your comments to:

Alexandre Normandeau  
Legal Counsel  
Bourse de Montréal Inc.  
1800-1190 av des Canadiens-de-Montréal  
P.O. Box 37  
Montreal, Quebec H3B 0G7  
**E-mail: [legal@tmx.com](mailto:legal@tmx.com)**

A copy of these comments shall also be forwarded to the *Autorité des marchés financiers* (the “**Autorité**”) to:

M<sup>e</sup> Philippe Lebel  
Corporate Secretary and  
Executive Director, Legal Affairs  
Autorité des marchés financiers  
Place de la Cité, tour Cominar  
2640 Laurier boulevard, suite 400  
Québec (Québec) G1V 5C1  
Fax : (514) 864-8381  
**E-mail: [consultation-en-cours@lautorite.qc.ca](mailto:consultation-en-cours@lautorite.qc.ca)**

Please note that comments received by one of these recipients will be transferred to the other recipient and that the Bourse may publish a summary of such comments as part of the self-certification process concerning this file. Unless specified otherwise, comments will be published anonymously by the Bourse.

## **Appendices**

You will find in the appendices an analysis as well as the text of the proposed amendments. The implementation date of the proposed amendments will be determined by the Bourse, in accordance with the self-certification process as established by the *Derivatives Act* (CQLR, chapter I-14.01).

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

The Bourse is authorized to carry on business as an exchange and is recognized as a self-regulatory organization by the Autorité. The Board of Directors of the Bourse has delegated to the Rules and Policies Committee of the Bourse its powers to approve and amend the Rules, the Policies and the Procedures, which are thereafter submitted to the Autorité in accordance with the self-certification process as determined by the *Derivatives Act* (CQLR, chapter I-14.01).



**AMENDMENTS TO ARTICLE 6.206 OF BOURSE DE MONTREAL INC. TO MODIFY THE MINIMUM  
VOLUME THRESHOLD FOR BLOCK TRANSACTIONS ON THE THREE-MONTH CANADIAN  
BANKERS' ACCEPTANCE FUTURES**

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## I. DESCRIPTION

Bourse de Montréal Inc. (the Bourse) hereby proposes to reintroduce a minimum volume threshold for block transactions on the Three-Month Canadian Bankers' Acceptance Futures (BAX) during the regular trading hours ("RTH"), such that the minimum volume threshold for the first four quarterly BAX contract months, as well as for the two nearest non-quarterly contract months (together, the "BAX Whites") be 4,000 contracts between 6:00 am and 4:30 pm ET. The Bourse considers that a well-functioning block transactions market is desirable for the growth of its products and wishes to ensure its offering is in line with the needs of market participants. The Bourse believes this proposed amendment will better serve the needs of market participants and facilitate greater market efficiency through improved execution quality.

As capital markets continuously evolve and grow, participants are increasingly looking for more efficient ways to transact, including the transaction of large orders. To that extent, the Bourse's block facility offers a convenient way for market participants to execute large transactions on a specific contract at a single price while minimizing disruption to the overall market. These transactions are privately negotiated between counterparties and once agreed upon, must be submitted to the Bourse within a prescribed time delay for reporting purposes.

Participants involved in the BAX market are finding that the absence of a block offering for the BAX White contracts does not allow them to express a strong market view or to offset risk in the market without impacting market dynamics (creating excess volatility, price dislocation, etc). Given the evolution of BAX Whites liquidity conditions in recent months, large size transactions are more challenging to execute in the listed market and counterparties are more frequently choosing to break up large transactions into smaller orders or delay transactions to avoid market friction, leading to inefficiencies. Therefore, the Bourse proposes to offer participants desiring to execute large transactions the possibility to do so without incurring costs associated with current liquidity levels. The introduction of a block threshold for BAX Whites would facilitate greater market efficiency through improved execution quality.

## II. PROPOSED AMENDMENTS

The Bourse proposes to amend article 6.206 of its Rules to reintroduce a minimum volume threshold for block transactions on the BAX Whites during RTH. Therefore, the minimum block volume threshold between 6:00 am and 4:30 pm ET shall be 4,000 contracts for the first year of BAX expiries, 1,000 contracts for the second year of BAX expiries ("BAX Reds") and 500 contracts for the third year of BAX expiries ("BAX Greens").

**Table 1: Proposed modifications to the block thresholds for BAX contracts**

Current minimum volume thresholds during RTH (6:00 am to 4:30 pm)	Proposed minimum volume thresholds during RTH (6:00 am to 4:30 pm)
BAX Whites: No threshold (blocks not allowed) BAX Reds: 1,000 contracts BAX Greens: 500 contracts	BAX Whites: <u>4,000 contracts</u> BAX Reds: 1,000 contracts BAX Greens: 500 contracts

In order to determine the appropriate minimum volume threshold for BAX Whites, the Bourse analyzed internal market data, surveyed market participants and market makers, and benchmarked block trade thresholds with comparable products at major international derivatives exchanges. The Bourse also took into consideration the minimum quantity thresholds in place for the Bourse's other block trade-eligible products, and compared the trading volumes and open interest of those products to those of BAX Whites. The findings of this analysis have led the Bourse to propose a minimum quantity threshold of 4,000 contracts for BAX Whites. The Bourse believes this threshold strikes a healthy balance between providing market transparency and fairness, while protecting clients from excess volatility and price disruption. The maximum prescribed time delay for reporting the trade to the Bourse would be 15 minutes, as with the Bourse's other block trade-eligible products. The Bourse considers that the proposed amendments remain consistent with its objective of providing market participants with an efficient price discovery mechanism and hedging utility.

### **III. ANALYSIS**

#### **a. Background**

The block transaction minimum volume thresholds are determined by the Bourse on the basis of market liquidity conditions. Clients involved in block markets are usually buy-side institutions that need to transact large sizes. When working with large positions, participants are often concerned that a large order size may have a negative and disruptive impact on the market by inducing excess volatility and price dislocations. When the order book cannot absorb sizeable orders in an efficient manner, it creates unnecessary volatility which can disrupt orderly efficient markets and affect investor confidence. For these reasons, participants often prefer off-exchange transactions facilities to ensure that they can have all their contracts filled at a single price, with minimum market impacts.

The Bourse offered a block trade facility for all BAX contracts until 2006, at which time it was concluded that a block trade facility was no longer required due to insignificant activity in the Reds and Greens and that it was no longer needed in the Whites because of sufficient liquidity. At that time the minimum volume threshold was 5,000 contracts and the prescribed time delay to report block transactions to the Bourse was 15 minutes.

In 2015, following an increased interest in these products and a consultation with the market, the Bourse reintroduced block thresholds for BAX Reds and BAX Greens contracts. The objective was to improve efficiency in situations where sizable orders could not be assimilated without market impacts directly in the order book. The block thresholds implemented at that time were 1,000 contracts for BAX Reds and 500 contracts for BAX Greens. Since the implementation of these thresholds, block transactions in the BAX Reds and Greens contracts only represent a handful of trades per year:

- 2017: 1 block transaction (BAX Reds) of 3,000 contracts
- 2018: 7 block transactions (BAX Reds) averaging 2,420 contracts per trade
- 2019: 2 block transactions (BAX Reds) averaging 1,500 contracts per trade
- 2020: 1 block transaction (BAX Reds) of 1,000 contracts

In 2018, as part of its extended hours initiatives, the Bourse proposed to update the block table to include minimum volume thresholds equivalent to ¼ of the regular hours thresholds during the overnight session (2:00 am to 5:59:59 am ET). The Bourse is of the view that having lower block thresholds during non-local trading hours helps promote trading opportunities and will be more adapted to a market environment in which liquidity may initially be more challenging. To take into account the potential lower market liquidity in the early trading hours, the Bourse also introduced a block threshold on BAX Whites during the extended hours. Note that the reporting time for block transactions during the overnight session is one hour. The minimum volume thresholds for block transactions on BAX contracts during the overnight session are as follows (effective as of October 9, 2018):

- BAX Whites: 500 contracts
- BAX Reds: 250 contracts
- BAX Greens: 100 contracts

BAX volume and the distribution of such volume per contract expiry have been relatively stable in the last three years. However, different statistical measures indicate that liquidity conditions are more challenging in the BAX contracts, especially in BAX Whites markets. Specifically, the average bid-ask spread and the market depth of BAX contracts have shown signs of deterioration, which supports the argument that large orders are impacting the order book in the BAX White contracts and normal market dynamics. This could be caused by a multitude of factors such as:

- shifts in BAX participants mix
- shifts in BAX participants trading behaviors
- increased regulation impacting trading costs and trading capacity
- less favorable trading environment

The change of market environment observed in recent months following the three successive Bank of Canada key overnight rate cuts in March 2020 and the commitment from the central bank to keep this rate at a record-low level temporarily reversed this trend, affecting the size of orders posted. This can be seen by the increase in average bid and ask order sizes shown in table 4 below. It is worth emphasis that this increase is due to the liquidity observed in the first BAX Whites contract and that the proposed block threshold is still much higher than the average bid and ask order sizes at the first level of order book for the BAX Whites. After more than six months in these new (but stable) market conditions, the Bourse is confident that the proposed block threshold remains appropriate and relevant for its market going forward.

**Table 2: BAX Average daily volume (“ADV”)**

Year	BAX Whites ADV	BAX Reds ADV	BAX Greens ADV	Total
2017	80 991	33 346	1 977	116 314
2018	81 818	32 615	1 639	116 072
2019 <sup>1</sup>	82 480	34 725	2 065	119 270
<u>2020</u>	<u>63 067</u>	<u>28 926</u>	<u>1 838</u>	<u>93 831</u>

Source: Montreal Exchange

<sup>1</sup> ADV for 2019 and 2020 was achieved with an additional 4 hours of trading (extended hours), implying that RTH ADV for BAX Whites lost some activity. This supports the fact that liquidity has diminished recently.

**Table 3: Average bid-ask spread for quarterly BAX contracts during RTH**

Average bid-ask spread	White 1	White 2	White 3	White 4	Red 1	Red 2	Red 3	Red 4	Green 1	Green 2	Green 3	Green 4
2017	0.0050	0.0050	0.0050	0.0050	0.0101	0.0103	0.0107	0.0115	0.0128	0.0175	0.0219	0.0283
2018	0.0051	0.0051	0.0051	0.0052	0.0065	0.0068	0.0071	0.0080	0.0141	0.0200	0.0240	0.0279
2019	0.0053	0.0056	0.0058	0.0060	0.0063	0.0067	0.0069	0.0075	0.0158	0.0197	0.0247	0.0300
2020	0.0057	0.0057	0.0058	0.0061	0.0068	0.0075	0.0080	0.0096	0.0151	0.0171	0.0272	0.0343

Source: Montreal Exchange

**Table 4: Average bid and ask order sizes for BAX contracts at the first level of order book depth during RTH**

Average order book depth (level 1)	BAX Whites (Bid)	BAX Whites (Ask)	BAX Reds (Bid)	BAX Reds (Ask)	BAX Greens (Bid)	BAX Greens (Ask)
2017	726	724	732	738	160	158
2018	728	731	553	563	315	309
2019	560	574	307	301	214	208
2020	1,690	1,707	579	451	191	146

Source: Montreal Exchange

Additionally, we can see from Table 5 below that the average volume executed per 15-minute period for a particular BAX White contract is considerably lower than the proposed block threshold of 4,000 contracts. The figures presented in this table also showcase the challenging liquidity conditions for market participants desiring to execute large transactions without impacting market dynamics.

**Table 5: 2019 - Average BAX Whites volume per 15-minute period<sup>2</sup>**

Trading Period	Average volume done per 15-minute period			
	White 1	White 2	White 3	White 4
2:00 am - 6:00 am	21	34	36	36
6:00 am - 8:00 am	133	177	151	134
8:00 am - 12:00 pm	412	652	707	521
12:00 pm - 3:00 pm	190	271	280	219
3:00 pm - 4:30 pm	189	284	293	227

Source: Montreal Exchange

In light of the current and upcoming initiatives to improve its Canadian listed yield curve product offering, the Bourse wishes to offer participants desiring to execute large block transactions the possibility to do so without impacting the market conditions. An appropriate block threshold for BAX Whites would therefore facilitate greater market efficiency through improved execution

<sup>2</sup> Representing the outright BAX volume (not including volume coming from strategies, which represents about 25% of BAX volume. 2020 numbers are roughly the same for the first BAX White while lower for the other BAX Whites contracts.

quality. Some participants occasionally need to execute large block transactions and the absence of a block facility is detrimental to the efficient execution of such transactions.

**b. Objectives**

The Bourse proposes to add a block threshold for BAX White contracts during regular trading hours to the list of eligible securities and derivative instruments under Article 6.206 Block Trades, in order to fulfill the objectives detailed below:

- To accommodate large order activity that would otherwise be negotiated away from the organized market;
- To facilitate greater market efficiency through improved execution quality and price certainty for large transactions;
- To align the Bourse with international best practices of major electronic derivatives exchanges.

The objective is to strengthen the functioning of the Canadian derivatives market and better serve the interests of market participants. Block trades are intended to meet institutional demand for prompt and straightforward execution of large orders, as well as to mitigate the detrimental impact of large market-clearing trades on the quality of the order book. The intention of the Bourse is to make this facility available for trades that would otherwise be disruptive to the marketplace and not for block volumes to become a significant part of the market. The central limit order book (“CLOB”) is expected to remain intact and the price discovery benefit offered by the market is expected to remain consistent.

**c. Comparative Analysis**

Reintroducing a minimum volume threshold for block transactions on BAX White contracts will harmonize the BAX with Short-Term Interest Rate (“STIR”) Futures markets around the world, such as the Eurodollar on CME, the Euribor and the Short Sterling on ICE, and 90-day Bank Bills on ASX. Table 6 below demonstrates that other major and peripheral international STIR contracts have minimum volume thresholds for block transactions on the first four quarterly expiries that are similar to what is proposed by the Bourse. The proposed amendments are particularly in line with the block threshold structure of ASX for its 90-day Bank Bill futures contract. Compared to international standards for short-term interest rate futures contracts on benchmark rates, the Bourse’s proposed amendment is relatively conservative because the ADV to block threshold ratio (column 4 of table 6) is smaller than comparable products, which indicates that the threshold represents a higher percentage of the product's daily volume.

**Table 6: 2019 - Minimum volume threshold for block transactions on STIR futures**

Futures contract (Exchange)	Average daily volume per contract year in 2019	Current minimum volume threshold (during regular trading hours)	Ratio: (Whites ADV / Whites block threshold)
BAX (MX)	Whites: 82 480 Reds: 34 725 Greens: 2 065	Whites: blocks not allowed Reds: 1 000 contracts Greens: 500 contracts	Proposition would result in Whites ADV being <u>21</u> times higher than the block threshold of <u>4,000 contracts</u>



Eurodollar (CME)	Whites: 1 147 488 Reds: 849 611 Greens: 380 300	Whites: 4 000 contracts Reds: 4 000 contracts Greens: 4 000 contracts	Whites ADV is 287 times higher than the block threshold
3M Euribor (ICE)	Whites: 246 889 Reds: 228 563 Greens: 142 169	Whites: 3 000 contracts Reds: 1 500 contracts Greens: 500 contracts	Whites ADV is 82 times higher than the block threshold
3M Short Sterling (ICE)	Whites: 255 752 Reds: 214 327 Greens: 126 842	Whites: 3 000 contracts Reds: 1 000 contracts Greens: 500 contracts	Whites ADV is 85 times higher than the block threshold
90-day Bank Bills (ASX)	Spot month: 25 424 Months 2-5: 85 169 Months 6-7: 13 566 Months 8+: 3 888	Spot month: blocks not allowed Months 2-5: 2 000 contracts Months 6-7: 1 000 contracts Months 8+: 500 contracts	Whites ADV is 43 times higher than the block threshold* *for contract months 2-5

Source: Exchanges websites

In light of the above benchmarking and given the fact that similar products with much higher volumes have a minimum block volume threshold in place for large transactions, the Bourse considers the proposed amendment to be reasonable.

#### d. Analysis of Impacts

##### i. Impacts on Market

As stated earlier, the intention of the Bourse is to make this facility available for trades that would otherwise be market disruptive and not for block volumes to become a significant part of the market. Clients involved in the block market are usually big buy-side institutions that need to transact large sizes. When working with large positions, participants are often concerned that a large order size may have a negative and disruptive impact on the market by inducing excess volatility and price dislocations. When the order book cannot assimilate sizeable orders in an efficient manner, unnecessary volatility is often observed, which can disrupt orderly efficient markets and affect investor confidence. For these reasons, participants often prefer off-exchange transaction facilities to ensure they can have all their contracts filled at a single price, with minimal market impact. Many buy-side institutions have shown interest in having a block threshold for BAX Whites, as this would help them trade BAX contracts instead of relying on the opaque OTC market for large transactions.

Because block transactions are negotiated away from the prevailing best bid and offer in the central limit order book, the price of the block trade must be fair and reasonable in accordance with the prevailing rules. In determining the price, consideration must be given to factors such as the trade size, the trade prices observable in the market as well as bid and ask prices on the same contract at the relevant time period, the volatility and liquidity of the relevant market and general market conditions. Upon request, the approved participant who arranges a block trade must provide satisfactory evidence that the block trade has been arranged in accordance with the Rules of the Bourse. The control parameters (prescribed time delay and minimum quantity thresholds) of block transactions are determined in order not to adversely impact:

- liquidity;

- price;
- transparency;
- the Bourse's participants and their clients who are active on its market.

## **ii. Impacts on Technology**

The proposed changes should have no impact on the technological systems of the Bourse, CDCC, approved participants, independent software vendors, or any other market participants. The Bourse has not identified any impediments, whether technical, operational or other, to the implementation of the proposed amendments.

## **iii. Impacts on regulatory functions**

The proposal has no impact on the compliance, supervision and reporting rules on the Bourse. Participants engaged in block transactions (regardless of the size of the trade and the reporting time delay applicable) should comply with the Rules of the Bourse and are subject to the oversight of the Regulatory Division of the Bourse. As a reminder, participants must at all times adhere to the principles of good business practice in the conduct of their affairs. Specifically for block transactions, the Bourse would like to remind participants that practices such as front running (article 7.6) are prohibited.

## **iv. Impacts on clearing functions**

The proposed changes should have no impact on the clearing functions of CDCC, on CDCC's Rules and Operations Manual, nor on CDCC's Clearing Members, or other Industry participants dealing with CDCC.

## **v. Public Interest**

The Bourse is of the view that the proposed amendments are not contrary to the public interest. In fact, the public and market participants are generally requesting clear rules that are consistent with the best practices of other international derivatives exchanges.

The Bourse's proposal should attract additional trading volume by offering market participants certainty of price and immediacy of execution in the transaction of large orders, as well as the benefits of central counterparty clearing. As such, block transactions on BAX White contracts should result in greater market efficiency through improved execution quality. Block trades offer both clients and approved participants the convenience of privately negotiating a trade with a selected counterparty and the ability to execute a large transaction at a fair and reasonable single price. Furthermore, block trade data provides a useful means for the market to analyze and value a security.

The drafting process was initiated by the request of market participants desiring to have a block facility in the BAX Whites market. The Bourse considers these amendments to be in the interest of the public as they will allow for better trading and hedging practices for market participants.

Furthermore, details of block transactions are publicly available after the reporting delay, providing more transparency compared to the competing over-the-counter market.

#### **IV. PROCESS**

The proposed amendments, including this analysis, must be approved by the Bourse's Rules and Policies Committee and submitted to the Autorité des marchés financiers, in accordance with the regulatory self-certification process, and to the Ontario Securities Commission for information purposes. Subject to public comments, the proposed amendments will take effect immediately thereafter.

#### **V. ATTACHED DOCUMENTS**

Proposed rule changes.

**Blackline version**

**Article 6.206 Block Trades**

- (a) In general. Approved Participants may negotiate and execute a Transaction off of the Electronic Trading System pursuant to the following conditions:
- (i) A block trade Transaction may be arranged and executed only during trading hours on the Bourse for the eligible derivative.
  - (ii) Block trades are only permitted in the Derivative Instruments and for a quantity which meets or exceeds the minimum volume thresholds as follows (only to the extent the eligible security or derivative instrument is available for trading):

<b>Eligible derivatives instruments</b>	<b>Prescribed time delay (from 6AM until the end of the Trading Day)</b>	<b>Block - Minimum volume threshold (from 6AM until the end of the Trading Day)</b>	<b>Prescribed time delay (from 2AM until 5h59m59s)</b>	<b>Block - Minimum volume threshold (from 2AM until 5h59m59s)</b>
	<b>(As soon as practicable and in any event within the following time delay)</b>		<b>(As soon as practicable and in any event within the following time delay)</b>	
30-Day Overnight Repo Rate Futures Contracts (ONX)	15 minutes	1,000 contracts	1 hour	250 contracts
Overnight Index Swap Futures Contracts (OIS)	15 minutes	200 contracts	1 hour	50 contracts
Ten-Year Government of Canada Bond Futures Contracts (CGB)	15 minutes 30 minutes	1,500 contracts 3,500 contracts	1 hour	350 contracts
Two-Year Government of Canada Bond Futures Contracts (CGZ)	15 minutes	250 contracts	1 hour	100 contracts
30-Year Government of Canada Bond	15 minutes	100 contracts	1 hour	100 contracts

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Futures Contracts (LGB)				
Five-Year Government of Canada Bond Futures Contracts (CGF)	15 minutes	500 contracts	1 hour	100 contracts
Options on Three-Month Canadian Bankers' Acceptance Futures Contracts	15 minutes	2,000 contracts	1 hour	500 contracts
Three-Month Canadian Bankers' Acceptance Futures Contracts quarterlies one through four (BAX Whites)	<del>Not applicable</del> 15 minutes	<del>4,000 contracts</del> Not applicable	1 hour	500 contracts
Three-Month Canadian Bankers' Acceptance Futures Contracts quarterlies five through eight (BAX Reds)	15 minutes	1,000 contracts	1 hour	250 contracts
Three-Month Canadian Bankers' Acceptance Futures Contracts quarterlies nine through twelve (BAX Greens)	15 minutes	500 contracts	1 hour	100 contracts

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	(As soon as practicable and in any event within the following time delay)		(As soon as practicable and in any event within the following time delay)	
Three-Month Canadian Bankers' Acceptance Futures Contracts (BAX) / Options on Three-Month Canadian Banker's Acceptance Futures Contracts Strategy Instruments	15 minutes	Sum of the strategy legs: 2,000 contracts in which the options leg(s) volume must amount to at least 50% of the sum of the strategy legs	1 hour	Sum of the strategy legs: 2,000 contracts in which the options leg(s) volume must amount to at least 50% of the sum of the strategy legs
Ten-Year Government of Canada Bond Futures Contracts (CGB) / Options on Ten-Year Government of Canada Bond Futures Contracts (OGB) Strategy Instruments	15 minutes	Sum of the strategy legs: 2,000 contracts in which the options leg(s) volume must amount to at least 50% of the sum of the strategy legs	1 hour	Sum of the strategy legs: 2,000 contracts in which the options leg(s) volume must amount to at least 50% of the sum of the strategy legs

[...]

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Three-Month Canadian Bankers' Acceptance Futures Contracts quarterlies one through four (BAX Whites)	15 minutes	4,000 contracts	1 hour	500 contracts
Three-Month Canadian Bankers' Acceptance Futures Contracts quarterlies five through eight (BAX Reds)	15 minutes	1,000 contracts	1 hour	250 contracts
Three-Month Canadian Bankers' Acceptance Futures Contracts quarterlies nine through twelve (BAX Greens)	15 minutes	500 contracts	1 hour	100 contracts



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[...]