AMENDMENT OF INCREMENTS RELATED TO GOVERNMENT OF CANADA BOND FUTURES CONTRACTS AND OPTIONS ON GOVERNMENT OF CANADA BOND FUTURES FOR PURPOSES OF CALCULATING THE NO CANCEL RANGE

AMENDMENTS TO ARTICLE 5.3 OF THE PROCEDURES FOR THE CANCELLATION OF TRADES

Introduction

The objective of the Procedures for the Cancellation of Trades (the "Procedures") of Bourse de Montréal inc. (the "Bourse") is to ensure that all transactions are executed at a price coherent with prevailing market conditions and to ensure that input errors can be corrected.

To this end, article 5.3 of the Procedures provides that when a transaction outside the No Cancel Range is identified by Market Supervisors, the parties involved will be contacted within a reasonable delay by the Market Operations Department of the Bourse in order to adjust the trade price within the No Cancel Range.

When any potential erroneous trade is brought to the attention of a Market Supervisor by a market participant, the Market Supervisor will determine whether the trade price is in the No Cancel Range for the particular derivative instrument.

The No Cancel Range is defined as the price interval within which a trade cannot be cancelled. To establish the No Cancel Range, Market Supervisors:

- Determine, in accordance with article 6383 of the Rule 6 of the Bourse, what the acceptable market price for the derivative instrument was before the trade occurred. In making that determination, the Market Supervisor will consider all relevant information, including the last trade price, a better bid or offer, a more recent price for a related derivative instrument (for example a different expiry month) and the prices of similar derivative instruments trading on other markets; and
- Apply the increments provided for in paragraph 5.3(3) of the Procedures (add and deduct) to the acceptable market price.

In order to adapt to new market conditions, the Bourse proposes to amend certain increments provided for in the Procedures.

I. Proposed amendments

The Bourse proposes to amend the increments related to Government of Canada bond futures contracts ("CGB") and options on CGB provided for in paragraph 5.3(3) of the Procedures from 20 to 40 basis points.

The proposed amendments take into account the price volatility and liquidity of the products concerned, as well as the increments related to similar products set by other exchanges.

II. Argument

Article 5.5 of the Procedures provides that if the Market Supervisor determines that the price of the erroneous trade is outside the No Cancel Range, then all parties involved in the transaction will be contacted and advised of the situation.

If all parties involved are in agreement, the transaction will be cancelled.

If one of the parties involved refuses, the transaction will be adjusted to the limit of the No Cancel Range. In such a case, the price will then be adjusted to the lower limit of the Range if the transaction was entered at a price below the lower limit of the Range or to the upper limit of the Range if the transaction was entered at a price over the upper limit of the Range.

This article also provides that the main objective when adjusting erroneous trades is to minimize the impact for all approved participants involved in the erroneous transaction, particularly those who had a regular order in the order book.

However, in the case of CGB and options on CGB, significant price volatility and reduced liquidity prevent the Bourse from meeting this objective given the increments currently provided for in paragraph 5.3(3) of the Procedures.

For example:

On November 4, 2009, a trader mistakenly sold 140 CGB at a price of 119.15. This price was outside the lower limit of the No Cancel Range since the acceptable market price of CGB, as determined according to the provisions of paragraph 5.3(3) of the Procedures, was then of 119.96 and the lower limit of the No Cancel Range was therefore of 119.76, (or the acceptable market price minus 20 basis points).

In accordance with the provisions of the Procedures, the Bourse contacted all the parties involved. However, during the 20 minutes that lapsed before the last participant was reached, the value of the contract concerned dropped and the latter was then traded at 119.80. Since the transactions had been adjusted to the lower limit of the Range, or 119.76, the Bourse's intervention left very little flexibility to participants who had a regular order and who wished to hedge their undesirable position by reselling their contract following the Bourse's intervention.

If the increment related to the futures contracts had been of 40 basis points, as proposed herein, the Bourse would have adjusted the transactions to 119.56 (or the acceptable market price of 119.96 minus 40 basis points), which would have provided reasonable flexibility to participants who had a regular order and who wished to hedge their undesirable position by reselling their contract following the Bourse's intervention.

As illustrated by the previous example, in an environment where the CGB is very volatile, the 20 basis point adjustment does not make it possible to minimize the impact for all approved participants involved in the erroneous trade, particularly those who had a regular order in the order book, since they find themselves with insufficient flexibility.

III. Similar contracts traded elsewhere in the world

United States

Rule 588.G of the Chicago Mercantile Exchange Rulebook provides for an increment of $^{30}/_{32}$, or 93.75 basis points, regarding the U.S. Treasury Bond futures contract (10-year).

Appendix 1 of the NYSE Euronext Rulebook provides for an increment of 15 basis points regarding the *Long Gilt* and the Japanese Government Bond futures contract.

Australia

The Operational Policies of the Sydney Futures Exchange provide for an increment of 50 basis points regarding the Australian Treasury Bond futures contract (10-year).

Comparison

Of the above-mentioned similar contracts, the Australian contract is the one that is the most similar to the CGB in terms of volatility and liquidity. The proposed amendments therefore take into account the 50 basis point increment provided for in the Operational Policies of the Sydney Futures Exchange.

IV. Summary of proposed amendments to the Rules of the Bourse

Paragraph 5.3(3) of the Procedures for the Cancellation of Trades

The Bourse proposes to amend the increments related to CGB and options on CGB from 20 to 40 basis points.

V. Purpose of proposed amendments

By amending the increments related to CGB and options on CGB from 20 to 40 basis points, the Bourse seeks to provide sufficient flexibility to parties involved in erroneous trades whose prices are outside the No Cancel Range given the price volatility and liquidity of these products.

The above-mentioned goal makes it possible to achieve the main objective of the adjustment of erroneous trades, as provided for in article 5.5 of the Procedures, that is, to minimize the impact for all market participants involved in the erroneous transaction, particularly those who had a regular order in the order book.

VI. Public interest

The Bourse considers that the proposed amendments are not against public interest as they will allow the latter to fulfill the objective provided for in article 3 of the Procedures, that is, to ensure that all transactions are executed at a price coherent with prevailing market conditions and to ensure that input errors can be corrected.

VII. Process

The proposed amendments to the Procedures will be presented to the Bourse's Rules and Policies Committee for approval. They will then be submitted to the Autorité des marchés financiers for purposes of the self-certification process. These amendments will be transmitted to the Ontario Securities Commission for information purposes. They will also be published by the Bourse for a 30-day comment solicitation period.

VIII. References

- Rule 588.G of the Chicago Mercantile Exchange Rulebook
  http://www.cmegroup.com/rulebook/CME/I/5/

- Appendix 1 of the NYSE Euronext Trading Manual
  http://www.euronext.com/fic/000/027/347/273472.pdf

- Sydney Futures Exchange Operational Policies
  http://www.asx.com.au/supervision/pdf/sfe_operating_rules/sfe_operational_policies.pdf

IX. Appended documents

Procedures for the Cancellation of Trades

PROCEDURES FOR THE CANCELLATION OF TRADES

1. APPLICABLE RULES

The procedures herein are consistent with and refer to the following Rule Six articles of the Bourse:

6303 - Validation, Alteration or Cancellation of a Trade
6381 - Cancellation of Trades
6383 - Acceptable Market Price
6384 - Decision by the Market Supervisor of the Bourse
6385 - Delays of Decision and Notifications

2. SUMMARY OF THE RELATED RULES

In order to maintain a fair and equitable market, trades may be cancelled by a vice-president or a senior vice-president of the Bourse if such transactions are detrimental to the normal operation or quality of the market or in any other circumstance deemed appropriate considering market conditions at the time of the trade or if the parties involved in the trade agree to the cancellation.

3. OBJECTIVE

The objective of the procedures described herein is:

- To ensure that all transactions are executed at a price coherent with prevailing market conditions (integrity) and to ensure that input errors can be corrected.

4. PROCEDURES' LIMITATION

The present procedures have a limited application in the case of trading sessions during which the underlying exchange-traded products are not open for trading.

In the event of erroneous trades during such trading sessions, the Market Operations department of the Bourse will not establish a No Cancel Range. As a result, such trades will not be adjusted by the Market Operations department of the Bourse and will stand at the traded price level unless both parties consent to cancel the erroneous trade. In such case the trade will be cancelled by the Market Operations department of the Bourse.

During trading sessions where the underlying exchange-traded instruments are not open for trading, a trading range (based on previous day's settlement price) will be established by the Bourse. Trading will be allowed only within that range for that given session (orders outside of that trading range will not be accepted by the system). Should either the high or the low of that range be reached, trading will be allowed at that limit level only until the market re-aligns itself back within the trading range.

5. DESCRIPTION

5.1 DETECTION AND DELAYS

Market participants have the responsibility to identify without delay erroneous trades. As soon as an erroneous transaction resulting from an entry error is identified, the approved participant must advise a Market Supervisor of the Bourse by calling the Market Operations Department of the Bourse at 514 871-7871 or 1-888-693-6366. A Market Supervisor will then contact the counterparties to the trade in order to reach an agreement within the 15 minutes that follow the execution of the transaction as prescribed by article 6381 of the Rules of the Bourse.

5.2 IMPLIED SPREAD ORDERS

"Regular orders": Orders routed by approved participants to the Montréal Exchange trading system.

"Implied orders": Orders generated by the implied pricing algorithm (using regular orders) and registered in the order book by the trading engine.

A spread trade resulting from an implied spread order is in reality constituted from each of the individual legs regular outright orders. For the purpose of this procedure, an erroneous trade occurring on an implied spread order will be treated as if the spread trade was executed using regular posted orders of each individual leg separately.

As a result, the prescribed increment utilized to establish the No Cancel Range to adjust an erroneous spread trade resulting from an implied spread order will be at least the increment on one of the individual legs (5 basis points) and at the most, the sum of each individual legs' increments (10 basis points).

5.3 VALIDATION – NO CANCEL RANGE

In order to maintain market integrity, when a transaction outside the No Cancel Range is identified by Market Supervisors, the parties involved will be contacted within a reasonable delay by the Market Operations Department of the Bourse in order to adjust the trade price within the No Cancel Range.

When any potential erroneous trade is brought to the attention of a Market Supervisor by a market participant, the Market Supervisor will determine whether the trade price is in the No Cancel Range for the particular derivative instrument.

The No Cancel Range is defined as the price interval within which a trade cannot be cancelled. To establish the No Cancel Range, Market Supervisors:

- Determine, in accordance with article 6383 of the Rules, what was the acceptable market price for the derivative instrument was before the trade occurred. In making that determination, the Market Supervisor will consider all relevant information, including the last trade price, a better bid or offer, a more recent price for a related derivative instrument (for example a different expiry month) and the prices of similar derivative instruments trading on other markets;

- Apply (add and deduct) the following increments to the acceptable market price:

DERIVATIVE INSTRUMENT	INCREMENT
Three-Month Canadian Banker's Acceptance Futures – BAX (all quarterly and serial months)	5 basis points
Three-Month Canadian Banker's Acceptance Futures – BAX SPREADS: - Regular spread orders - Implied spread orders	 5 basis points 5 to 10 basis points; sum of the spread's individual legs' increments.
Options on Three-Month Canadian Banker's Acceptance Futures – OBX	5 basis points
Government of Canada Bond Futures	40~~20~~ basis points
Options on Government of Canada Bond Futures	40~~20~~ basis points
Futures Contracts on S&P/TSX Indices	1% of the acceptable market price of these futures contracts
Options on S&P/TSX Indices First three serial months	0.5 index point
Options on S&P/TSX Indices Next two quarterly months	1 index point
EQUITY OPTIONS PRICE RANGES: $0.00 to $5.00 $5.01 to $10.00 $10.01 to $20.00 $20.00 up	 $0.10 $0.25 $0.50 $0.75
SPONSORED OPTIONS PRICE RANGES: $0.001 to $0.99 $1.00 up	 $0.25 $0.50
SINGLE STOCK FUTURES	$2.00

5.4 TRADE PRICE INSIDE THE NO CANCEL RANGE

If the Market Supervisor determines that the price of the reported erroneous trade was inside the No Cancel Range, then the trade will be maintained and no further action will be taken unless the counterparty to the erroneous trade has agreed to cancel it.

Erroneous transactions, for which there has been consent between the parties to cancel, may be cancelled within the trading session (early, regular or extended) during which they have occurred.

5.5 TRADE PRICE OUTSIDE THE NO CANCEL RANGE

If the Market Supervisor determines that the price of the erroneous trade is outside the No Cancel Range, then all parties involved in the transaction will be contacted and advised of the situation.

The transaction will be cancelled if all parties involved are in agreement.

The transaction will not be cancelled if one of the parties involved refuses. The residual trades (the ones not cancelled) will be readjusted to the limit of the No Cancel Range. In such a case, if the transaction involved a linked implied order, the initiator of the original error trade will take responsibility for the outcome. The error initiator may therefore have to take ownership of market positions for the directly resulting trades in the other linked contracts.

The Market Operations Department of the Bourse will adjust erroneous transactions in the best possible way. The main objective when adjusting erroneous trades is to minimize the impact for all market participants involved in the erroneous transaction and more particularly those who had a regular order in the order book.

5.6 OTHER SITUATIONS JUSTIFYING THE CANCELLATION OF TRANSACTIONS

The Market Operations Department of the Bourse will review all circumstances surrounding a transaction to determine whether the trade occurred in accordance with the rules of the Bourse. The factors that will be considered include, among other things, the market conditions immediately before and after the trade was executed; the volatility of the market; the prices of related instruments in other markets and the fact that one or many parties to the transaction consider that it was executed at a valid price.

In the case of a system failure, it is possible that the Bourse's automated trading system will freeze with orders queuing and waiting to be processed. Once the problem is resolved, the market will be placed into a pre-opening phase during which trading in each derivative instrument will be halted in order to modify the opening time parameters. This pre-opening phase will allow market participants to modify orders and will ensure that the system failure does not impact the integrity of the market. Nevertheless, when the system is not frozen, pending orders could be executed before the Bourse can halt the derivative instruments. In such circumstances, Market Supervisors could have to cancel trades resulting from such executions.

5.7 MULTIPLE MARKET MAKER TRANSACTIONS ON EQUITY, INDEX AND BOND OPTIONS

A Market Supervisor may also cancel transactions under the following conditions:

1. Multiple consecutive transactions can be cancelled if they consist of four (4) or more transactions against one market maker provided that:

    - all transactions were executed within a one (1) second interval;

    - the opposite side of the transactions consists of one or several market makers.

2. The market maker involved in the four (or more) transactions contacted a Market Supervisor at 514 871-7877 or 1-866-576-8836 within one (1) minute of the execution time of the multiple consecutive transactions, to request their cancellation.

5.8 DECISION

A decision to cancel or to refuse to cancel will be rendered by a Market Supervisor within 30 minutes following the cancellation request.

If the decision is to cancel the trade, the Market Supervisor will remove the trade from the records. Furthermore, if "stop" orders were triggered and therefore executed as a result of the cancelled trade, then these "stop" trades will also be cancelled and the "stop" orders will have to be re-instated in the order book by the initiators of such orders. Trade cancellation messages will be disseminated.

When a transaction is cancelled, if it originated from a regular order posted in the order book, the original price/time priority (FIFO) will not be maintained if the initiator of the original order wishes to re-instate his order after the cancellation. This cancelled order shall therefore be re-entered in the trading system by the initiator of the original order. This new order entry time will be the official entry time of the re-instated order.

If the Market Supervisor's decision is to not cancel the trade, the parties to the transaction can not themselves decide to cancel it by making a position transfer through the Canadian Derivatives Clearing Corporation.