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CIRCULAR
March 20, 2008

REQUEST FOR COMMENTS

OPTIONS ON THREE-MONTH CANADIAN BANKERS ACCEPTANCE FUTURES CONTRACTS (OBX) CABINET TRADES

AMENDMENTS TO ARTICLE 6755 TO RULE SIX OF BOURSE DE MONTRÉAL INC.

Summary

The Rules and Policies Committee of Bourse de Montréal Inc. (the Bourse) has approved amendments to article 6755 of Rule Six of the Bourse. The purpose of these amendments is to allow cabinet trades to be executed on the Bourse's electronic trading platform for Options on Three-Month Canadian Bankers' Acceptance Futures Contracts (OBX).

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.: 046-2008

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 article 6755 of Rule Six 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*

A copy of these comments shall also be forwarded to the Autorité to:

*Ms. Anne-Marie Beaudoin
Director – Secretariat of L'Autorité
Autorité des marchés financiers
800 Victoria Square, 22nd Floor
P.O. Box 246, Tour de la Bourse
Montréal (Quebec) H4Z 1G3
E-mail: consultation-en-cours@lautorite.qc.ca*

Appendices

For your information, you will find in appendices an analysis document of the proposed rule amendments, the proposed regulatory text as well as the amended specifications. 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".



OPTIONS ON THREE-MONTH CANADIAN BANKERS' ACCEPTANCE FUTURES CONTRACTS (OBX) - CABINET TRADES

AMENDMENTS TO ARTICLE 6755 TO RULE SIX OF BOURSE DE MONTREAL INC.

I. OVERVIEW

A -- Proposed regulatory amendments

It is proposed to amend article 6755 of Rule Six of Bourse de Montréal Inc. (the Bourse) in order to allow cabinet trades to be executed on the Bourse's electronic trading platform for Options on Three-Month Canadian Bankers' Acceptance Futures Contracts (OBX).

OBX cabinet trades will allow OBX options traders to liquidate deep out-of-the-money OBX options by trading them at less than 0.01 point (or 1 tick or 1 basis point). For the purpose of the contemplated OBX cabinet trades, OBX options trading at less than 0.01 point would automatically be considered as being deep out-of-the-money options.

B -- Rationale

□ *Market-Interest expressed*

Market participants have expressed interest in having cabinet trades allowed on OBX.

□ *Worldwide practice*

Cabinet trades are allowed on several options and futures exchanges. Definitions of a cabinet trade that these exchanges provide converge. In this section, we will only discuss options on short term interest rate futures contracts that are equivalent to the OBX options, i.e. options on

Three Month Eurodollar futures contracts traded on the Chicago Mercantile Exchange (CME), options on Three Month Euribor futures contracts and options on Three Month Sterling futures, both traded on Euronext Liffe.

- **Chicago Mercantile Exchange:** The CME defines a cabinet trade (also called "cab") as a trade that allows options traders to execute deep out of the money options transactions by trading the option at a price less than the minimum tick (based on the minimal allowable tick convention). The CME defines the cabinet price as being the nominal price for liquidating deep-out-of-the-money options contracts. It is defined as the lowest possible tradable price for this option, and is determined within the Clearing System. Trades on options done at a price equal to zero are considered cabinet trades.

The CME allows cabinet trades on options on the Three Month Eurodollar futures contract with a minimum price fluctuation of $0.0025 = \$6.25$, when the regular minimum price fluctuation is $0.005 = \$12.50$.

- **Euronext Liffe:** in its LIFFE CONNECT® Release Changes No 9, 2005, Euronext Liffe defines a cabinet trade as a trade which allows options traders to trade deep out-of-the-money options by trading the option at less than the value of the minimum price movement within the expiry month.

At Euronext Liffe, the cabinet transaction prices of options on Short Term Interest Rate futures are the following:

	Option on Three Month Euribor	Option on Three Month Sterling
Minimum price movement (tick size and value)	0.005 (€12.50)	0.005 (£6.25)
Cabinet transaction price	0.001 or 0.1 basis point (€2.50)	0.0008 or 0.08 basis point (£1.00)

II. DETAILED ANALYSIS

A – Proposed regulatory amendments

Article 6755 of Rule Six currently specifies that the minimum price fluctuation of the premium for the OBX option is, unless otherwise determined by the Bourse, 0.005 point representing \$ 12.50 per contract.

The Bourse considers that market participants should be allowed to use cabinet trades on OBX contracts when such contracts are deeply out-of-the money.

It is therefore proposed to amend article 6755 of Rule Six of the Bourse in order to specify that in the case of cabinet trades the actual minimum price fluctuation of the premium of 0.005 point representing CAN \$12.50 per contract does not apply and that for this type of transaction the minimum price fluctuation of the premium would be 0.001 point representing CAN \$2.50 per contract.

In addition, it is proposed to add to article 6755 a new paragraph defining what is a cabinet trade (a trade that allows to liquidate deep out-of-the-money options by trading the option at less than 0.01 point (or 1 tick or 1 basis point)) with a further specification that any option having a premium lesser than 0.01 will be considered to be a deep out-of-the-money option and a requirement that the premium for an options cabinet trade shall be in a 0.001 to 0.009 price range.

It is important to mention that cabinet trades will be permitted only for OBX options since article 6755 is in the section of Rule Six (Section 6751 – 6770) that is specific to this instrument.

B – Detailed procedure of a cabinet trade on OBX traded at the Montreal Exchange

Implementing cabinet trades will allow OBX options traders to liquidate deep out of the money options by trading the option at a price less than 0.01 point (or 1 tick or 1 basis point). This procedure would be established for premiums valued at less than 0.01. Below that 0.01 threshold, the system would automatically

consider the option as being deeply out-of-the-money and would accept quotes in 1/10 of a tick (i.e.: 0.001, 0.002 up to 0.009 point). At or above the 0.01 threshold, the system would only accept quotes in 0.005 increments as is currently the case (i.e.: 0.01, 0.015, 0.02, etc.).

III. OBJECTIVE OF THE PROPOSED REGULATORY AMENDMENTS AND CONSEQUENCE

A -- Objective

The objective of the proposed regulatory amendments is to allow OBX cabinet trades to be executed on the Bourse's electronic trading platform thus facilitating the liquidation of OBX options that are deeply out-of-the-money.

B -- Consequence

The amendments proposed in this analysis will have no significant impact on approved participants, their clients or the public in general other than facilitating the pricing and trading of OBX options that are deeply out-of-the-money.

C - Other alternatives considered

No other alternatives were considered.

D - Impact of proposed amendments on systems

The Bourse considers that the regulatory amendments proposed in this analysis will have no impact on systems for approved participants, their approved persons, their clients or the public in general.

E - Interest of financial markets

The Bourse considers that the amendments proposed in this analysis will not affect the interests of financial markets. On the contrary, it will provide them with a more flexible and more efficient way for trading OBX options that are deeply out-of-the-money by allowing them to trade these options at a price that is a better reflection of their actual values.

F -- Public interest

Amendments to article 6755 of Rule Six of the Bourse are proposed in order to make the use of OBX cabinet trades accessible and efficient for market participants who have expressed their support for such a facility. The proposed amendments modifications will give market participants a more precise pricing mechanism to liquidate deep out-of-the-money options. The Bourse considers that the proposed amendments are of public interest.

IV. PROCESS

The first step of the approval process for the regulatory amendments proposed in this analysis is to have them approved by the Rules and Policies Committee. Once the approval obtained from this Committee, the proposed amendments, including this analysis will simultaneously published by the Bourse for a thirty (30) days comment period and submitted to the Autorité des marchés financiers for approval and to the Ontario Securities Commission for information.

V. SOURCES

- CME Glossary of terms:
<http://www.cme.com/glossary/C.html>
- CME options on Eurodollar futures contracts specifications:
http://www.cme.com/clearing/clr/spec/contract_specifications_cl.html?product=ED&foi=OOF
- Euronext Liffe – LIFFE Connect® Release Changes – Issued version 1.1;
<http://www.euronext.com/fic/000/010/645/106454.pdf> , Section 3.1, page 25
- Euronext Liffe - Exchange Contract No. 901 in Respect of Options on Short Term Interest Rate, Swapnote® and Government Bond Contracts - Contract Terms - (Issue Date: 11 January 2006):
<http://www.euronext.com/fic/000/001/019/10196.pdf> - Page 16

6755 Minimum Price Fluctuation (Tick Size)

(07.04.94, 15.10.02, 00.00.08)

Unless otherwise determined by the Bourse, the minimum price fluctuation of the premium shall be 0.005 point representing CAN \$12.50 per contract.

In the case of cabinet trades, the minimum price fluctuation of the premium shall be 0.001 point representing CAN \$2.50 per contract.

For the purpose of this article, a cabinet trade is a trade that allows to liquidate a deep out-of-the-money option at a premium that is lesser than 0.01 point. Options having a premium lesser than 0.01 point shall automatically be considered as being deep out-of the-money options. The premium for a cabinet trade shall range between 0.001 and 0.009 points.

Specifications

Option on Three-month Canadian Bankers' Acceptance Futures

Trading Unit	One Three-month Canadian Bankers' Acceptance Futures (BAX) contract.
Contract Months	Four nearest months in the BAX futures quarterly cycle (March, June, September and December).
Price Quotation	Quoted in points where each 0.01 point (1 basis point) represents C\$25. For example, a quote of 0.465 represents a total option premium of C\$1,162.50 (i.e. 46.5 basis points × C\$25). Cabinet trade : Quoted in 0.001 point (0.1 basis point) where each 0.001 point represents C\$2.50.
Last Day of Trading	Trading ceases at 10:00 a.m. (EST) on the 2 nd London (Great Britain) banking day prior to the 3 rd Wednesday of the contract month. If the determined day is an exchange or banking holiday in Montreal or Toronto, the last trading day shall be the previous banking day.
Contract Type	American style.
Minimum Price Fluctuation	0.005 = C\$12.50 per contract. Cabinet trade : 0.001 = C\$2.50 per contract.
Reporting Limit	300 options or futures equivalent contracts. For the purpose of calculating this limit, positions in the options contracts are aggregated with positions in the underlying futures contracts. For aggregation purposes, the futures equivalent of one in-the-money option contract is one futures contract and the futures equivalent of one at-the-money or out-of-the-money option contract is half a futures contract.
Position Limits	Information on Position Limits can be obtained from the Exchange as they are subject to periodic changes.
Strike Prices	Set at a minimum 0.125 point intervals.
Minimum Margin Requirements	Information on Minimum Margin Requirements can be obtained from the Exchange as they are subject to periodic changes.
Daily Price Limits	None
Trading Hours	8:00 a.m. to 3:00 p.m. (EST/EDT).
Clearing Corporation	Canadian Derivatives Clearing Corporation (CDCC).
Ticker Symbol	OBX.