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		<input type="checkbox"/>	MCeX

**CIRCULAR
April 3, 2013**

REQUEST FOR COMMENTS

EXECUTION OF CROSS TRANSACTIONS FOR EQUITY OPTION STRATEGIES

**AMENDMENTS TO THE PROCEDURES APPLICABLE TO THE EXECUTION OF
CROSS TRANSACTIONS AND
THE EXECUTION OF PREARRANGED TRANSACTIONS**

AND

**PROCEDURES APPLICABLE TO THE EXECUTION OF STRATEGIES
INVOLVING OPTIONS**

The Rules and Policies Committee of Bourse de Montréal Inc. (the “**Bourse**”) has approved amendments to the *Procedures Applicable to the Execution of Cross Transactions and the Execution of Prearranged Transactions* (“Cross Procedures”), and the *Procedures Applicable to the Execution of Strategies Involving Options* (“Option Strategy Procedures”) of the Bourse in order to permit the execution of cross transactions for the benefit of equity option strategies executed via the Bourse’s Intra-Day User Defined Strategy (“UDS”) trade facility.

Comments on the proposed amendments must be submitted within 30 days following the date of publication of this notice, at the latest on **May 3, 2013**. Please submit your comments to:

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Vice-President, Legal Affairs, Derivatives
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Circular no.: 056-2013

Tour de la Bourse
P.O. Box 61, 800 Victoria Square, Montréal, Québec H4Z 1A9
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A copy of these comments shall also be forwarded to the *Autorité des marchés financiers* (the “**Autorité**”) to:

M^e Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800 Victoria Square, 22nd Floor
P.O. Box 246, Tour de la Bourse
Montréal (Québec) H4Z 1G3
E-mail: consultation-en-cours@lautorite.qc.ca

Appendices

For your information, you will find in appendices an analysis of the proposed amendments as well as the New Procedures and the amended Cross Procedures. The implementation date of the proposed amendments will be determined by the Bourse, in accordance with the self-certification process as determined by the *Derivatives Act* (R.S.Q., 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 (SRO) 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 and Procedures. The Rules of the Bourse are submitted to the Autorité in accordance to the self-certification process as determined by the *Derivatives Act* (R.S.Q., chapter I-14.01).

Circular no.: 056-2013

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EXECUTION OF CROSS TRANSACTIONS FOR EQUITY OPTION STRATEGIES

AMENDMENTS TO THE PROCEDURES APPLICABLE TO THE EXECUTION OF CROSS TRANSACTIONS AND THE EXECUTION OF PREARRANGED TRANSACTIONS

AND

PROCEDURES APPLICABLE TO THE EXECUTION OF STRATEGIES INVOLVING OPTIONS

I. INTRODUCTION

Bourse de Montréal Inc. (the “Bourse”) intends to permit the execution of cross transactions for the benefit of equity option strategies executed via the Bourse’s Intra-Day User Defined Strategy (“UDS”) trade facility. In order to implement the changes described above the Bourse hereby proposes to amend the Procedures Applicable to the Execution of Cross Transactions and the Execution of Prearranged Transactions (“Cross Procedures”), and the Procedures Applicable to the Execution of Strategies Involving Options (“Option Strategy Procedures”).

Definitions

Implied Pricing Algorithm (IPA):

A tool within the SOLA trading engine that creates implied orders on instruments that are derived from regular orders on different, but related instruments.

Implied Orders:

Orders generated by the IPA (using regular orders) and registered in the order book by the trading engine.

Implied In Orders:

Implied orders derived and generated by the IPA on strategies using regular posted orders on individual instruments (legs).

Implied Out Orders:

Implied orders derived and generated by the IPA on individual instruments (legs) using regular posted orders on both a strategy instrument and an individual contract (leg) composing the strategy.

Strategy:

The combination of two or more derivative instruments.

II. DETAILED ANALYSIS

A. Rationale

On March 21, 2011, the Bourse introduced UDS on the Bourse's SOLA™ trading engine for the benefit of the Equity, Index, Exchange-Traded Funds (ETF), and Currency options markets ("Options Markets"). With the implementation of UDS, Approved Participants ("AP") can now create customized strategies based on their unique risk management needs. The newly formulated UDS are then subsequently disseminated via the Bourse's High Speed Vendor Feed ("HSVF") on an intra-day basis to all APs.

The implementation of UDS has provided a faster and more efficient alternative to the creation and execution of strategy transactions that current manually created and executed strategy transactions can provide. Furthermore, strategies executed on the Bourse's UDS facility are Implied Pricing ("IP") enabled. The IP feature of the UDS facility ensures that bid/ask prices posted on the legs instruments comprising the strategy will imply prices on the strategy instrument (implied in), and conversely strategy bid/ask prices posted on the strategy instrument, will imply bid/ask prices on the leg instruments composing the strategy (implied out). As a result, strategies executed via the UDS facility significantly enhance the liquidity and transparency of the Bourse's options markets.

In the Bourse's current trading environment the majority of option strategy orders are transmitted by APs for manual execution to Market Supervisors in the Bourse's Market Operations Department ("MOD") for the following reasons:

1. In some instances APs have no alternative, as the strategy type is not accepted by the Bourse's trading system and thus the strategy cannot be created. Examples of this are delta trades whereby one leg of the strategy is a listed option traded on the Bourse's markets and the second leg is the underlying instrument (stock) which is listed on the Toronto Stock Exchange;
2. In other instances Independent Software Vendors ("ISV") that provide APs with software applications to connect to the Bourse, have not made the necessary upgrades to the software application that would permit an AP to create and execute strategies via the Bourse's UDS facility.

In both the cases described above, APs wishing to execute option strategy transactions manually, must contact Market Supervisors in the MOD and indicate the option strategy. The information provided must also contain the options series involved, the quantity ratio for each leg of the strategy, the price, and the total quantity of the strategy. In the case of a delta trade the AP must also provide a reference price for the equity leg of the strategy.

Market Supervisors will subsequently contact qualifying market makers assigned to the options class who are showing a bid/ask market on each instrument of the strategy no wider than the no cancel range of the instruments composing the strategy, with a minimum of ten contracts per side to ascertain whether they wish to be a counterparty to the strategy transaction described above.

Qualifying market makers will be contacted and shown the strategy as submitted by the AP. If the market maker(s) accepts the prices provided by the MOD, the transactions will be entered and broadcast to all relevant parties (APs, market makers, and stock exchange, if necessary). Conversely if after all qualifying market makers have been contacted, and there is no interested counterparty to the transaction, then the strategy order is cancelled. In both scenarios described above, the AP who submitted the strategy order will be notified of the outcome.

Recently the use of the UDS trade facility by the Bourse's APs has increased substantially

	NO. OF STRATEGIES CREATED	VOLUME
janv-12	6	0
févr-12	4	0
mars-12	2	0
avr-12	0	0
mai-12	0	0
juin-12	6	0
juil-12	2	0
août-12	1	0
sept-12	2	0
oct-12	6	0
nov-12	6	0
déc-12	43	6 292
janv-13	41	5 004
Total	119	11 296

In the Bourse's current trading environment cross transactions with a 50% guaranteed minimum fill are permitted by the cross procedure, but must be called in to the MOD for manual execution as the UDS facility was not designed to ensure that the AP introducing the transaction is guaranteed to retain 50% of the total quantity for the purpose of a cross transaction. Consequently some APs have inquired as to whether cross transactions on UDS are permitted. After a review of the Bourse's Rules and Procedures it has been determined that although an AP can theoretically create strategies and execute cross transactions via the UDS facility, the Bourse procedures do not provide for a clear regulatory framework to do so. Namely, the Cross Procedures does not offer guidance as to how APs must proceed when crossing strategy transactions. Furthermore, the language used in the options strategy procedure seems to infer that strategy transactions cannot be executed via the UDS facility.

Consequently, the Bourse intends to modify its Cross Procedures and Option Strategy Procedures to clarify this and ensure that APs have a clear regulatory framework that allows for cross transactions on option strategies executed via the UDS facility.

B. Benchmarking

The following derivatives exchanges allow for equity option strategy executions:

	Products	Implied Pricing	Prescribed Time Delay
CBOE	Equity, Index, and ETF options Strategies	Yes	1 second
Australian Securities Exchange ASX	Index and ETF options	Yes	5 seconds
Eurex	Equity, Index, and ETF options Strategies	Yes	5 seconds

III. PROPOSED REGULATORY AMENDMENTS

A. The Procedure Applicable to the Execution of Cross Transactions and the Execution of Prearranged Transactions

The Bourse hereby proposes to amend the Procedures Applicable to the Execution of Cross Transactions and the Execution of Prearranged Transactions as follows:

1. Amend the table in the Cross Procedures such that under the “Equity and Currency Options” and “Index Options” headings “UDS Strategies” are included as eligible products.
2. Amend the table in the Cross Procedures such that the newly created eligible product “UDS Strategies” described above has a prescribed time delay of “5 seconds”
3. Amend the table in the Cross Procedures such that the minimum quantity thresholds for the newly created eligible product “UDS Strategies” is “No Threshold”.

B. The Procedures Applicable to the Execution of Strategies Involving Options

The Bourse hereby proposes to amend the Procedures Applicable to the Execution of Strategies Involving Options as follows:

1. Amend Paragraph D of the Option Strategy Procedures such that there is a heading “Execution of Cross Transactions on a Strategy Involving Options”.

2. Amend Paragraph D of the Option Strategy Procedures such that there under the heading “Execution of Cross Transactions on a Strategy Involving Options” there are two distinct possibilities when executing cross transactions on equity option strategies:
 - a) Cross transactions on equity options strategies executed with a 50% guaranteed minimum fill will not be accepted electronically.
 - b) Cross transactions on equity options strategies executed **without** a 50% guaranteed minimum fill will be accepted electronically.

In both cases APs are instructed to consult the Cross Procedures for guidance.

IV. OBJECTIVES AND CONSEQUENCES

The objective of the proposed amendments to the Bourse’s procedures described in this document is to allow cross trades on equity option strategies that are executed via the Bourse’s UDS facility. .

The amendments should provide a clear regulatory framework in which APs can execute cross transactions in equity option transactions executed via the UDS facility.

The increased use of the UDS facility to execute strategy transactions in the equity options markets should enhance liquidity and transparency in the options markets

V. PUBLIC INTEREST

The proposed modifications will provide a clear regulatory framework in which cross trades on equity option strategies via the UDS facility can be executed thereby enhancing the transparency of the equity options markets. This in turn should lead to the increased use of the UDS facility which in turn should enhance the market quality as well as the liquidity of the equity options market. Transparency, liquidity, and market quality are key objectives of the Bourse, and the Bourse considers the proposed amendments to the procedures that would allow for the execution of cross transaction on equity option strategies via the UDS facility serves the public interest.

VI. PROCESS

The proposed modifications, including this analysis, will be presented for approval to the Rules and Policies Committee of the Bourse and submitted to the *Autorité des marchés financiers* in accordance with the self-certification process and to the Ontario Securities Commission for information.

VII. REFERENCES

CBOE C2 Rules – Page 66 Section D Paragraph 6.50: Order Exposure Requirement

<http://www.c2exchange.com/publish/C2Rules/C2Rules.pdf>

Australian Securities Exchange: ASX 24 Operating Rules: Procedure 4401 Paragraph 4

http://www.asxgroup.com.au/media/PDFs/asx_24_procedures.pdf

Eurex Paragraph 2.6 Cross Trades and Pre-Arranged Trades subparagraph (3)

[https://www.eurexchange.com/blob/exchange-en/3138-](https://www.eurexchange.com/blob/exchange-en/3138-47006/294830/2/data/trading_conditions_en_ab-03122012.pdf.pdf)

[47006/294830/2/data/trading_conditions_en_ab-03122012.pdf.pdf](https://www.eurexchange.com/blob/exchange-en/3138-47006/294830/2/data/trading_conditions_en_ab-03122012.pdf.pdf)

VIII. ATTACHED DOCUMENTS

Procedures Applicable to the Execution of Cross Transactions and the Execution of Prearranged Transactions.

Procedures Applicable to the Execution of Strategies Involving Options.



PROCEDURES APPLICABLE TO THE EXECUTION OF CROSS TRANSACTIONS AND THE EXECUTION OF PREARRANGED TRANSACTIONS

In accordance with the provisions of article 6380 of the Rules of Bourse de Montréal Inc. (the Bourse) regarding the execution of cross transactions and prearranged transactions, the following are the eligible products, the prescribed exposure time delays between the input of two orders and the minimum quantity thresholds.

ELIGIBLE PRODUCTS	PRESCRIBED TIME DELAY	MINIMUM QUANTITY THRESHOLD
Three-Month Canadian Bankers' Acceptance Futures Contracts (BAX):		
1 st four quarterly months – not including serial months	5 seconds	No threshold
Remaining expiry months and strategies	15 seconds	No threshold
Thirty-Day Overnight "Repo" Rate Futures Contracts (ONX):		
Front month	5 seconds	No threshold
Remaining expiry months and strategies	15 seconds	No threshold
Overnight Index Swap (OIS):		
Front month	5 seconds	No threshold
Remaining expiry months and strategies	15 seconds	No threshold
Government of Canada Bond Futures Contracts:		
All expiry months and strategies	5 seconds	No threshold
Futures Contracts on S&P/TSX Indices:		
All expiry months	0 second	≥ 100 contracts
All expiry months and strategies	5 seconds	< 100 contracts
Futures Contracts on Canada Carbon Dioxide Equivalent (CO₂e) Units:		
All expiry months and strategies	5 seconds	No threshold
Futures Contracts on Canadian Crude Oil:		
All expiry months and strategies	5 seconds	No threshold
Options on Three-Month Canadian Bankers' Acceptance Futures Contracts:		
All expiry months and strategies	0 second	≥ 250 contracts
All expiry months and strategies	5 seconds	< 250 contracts
Options on Ten-Year Government of Canada Bond Futures Contracts (OGB):		
All expiry months and strategies	0 second	≥ 250 contracts
All expiry months and strategies	5 seconds	< 250 contracts

Equity and Currency Options:

All expiry months	0 second	≥ 100 contracts
All expiry months	5 seconds	< 100 contracts
All UDS Strategies	5 seconds	No Threshold

Index Options:

All expiry months	0 second	≥ 50 contracts
All expiry months	5 seconds	< 50 contracts
All UDS Strategies	5 seconds	No Threshold

Canadian Share Futures Contracts:

All expiry months and strategies	0 seconds	≥ 100 contracts
All expiry months and strategies	5 seconds	< 100 contracts

Futures and Options on Futures Inter-Group Strategies

All strategies	5 seconds	No threshold
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Chronological priority of orders must be respected with regards to the posting of the originating order first, when executing a cross or prearranged transaction.

The market participant must ensure that all existing orders in the central order book, regardless of the type of orders, which are at limit prices better than or equal to the cross or prearranged transaction price are executed before completing such transaction.

EQUITY OPTIONS, INDEX OPTIONS AND CURRENCY OPTIONS CONTRACTS

Cross transactions and prearranged transactions can only be executed in accordance with one of the following procedures:

Procedure with a prescribed time delay for a quantity smaller than the eligible quantity threshold

A market participant wishing to execute a cross or a prearranged transaction must enter the order into the trading system for the total intended transaction quantity. The participant must then respect a delay equal to the prescribed time delay before executing an offsetting transaction on the residual quantity.

The **residual quantity** is the portion of the original quantity remaining after orders entered in the book with limit prices better than or equal to the intended transaction price have been filled. If no orders have been executed, the residual quantity is equal to the original intended transaction quantity.

Procedure without a prescribed time delay for a quantity equal to or greater than the eligible quantity threshold

If a market participant has a cross or prearranged order between the bid and ask:

- the participant can use a specific system function to enter a zero-second cross; or
- the participant can enter one side of the order and immediately trade against it if he wishes that the trade be executed directly on the market (with the possibility of execution risk).

Procedure for strategies executed via the User Defined Strategy (UDS) Facility

A market participant wishing to execute a cross or a prearranged transaction on a strategy via the UDS facility must enter the order into the trading system for the total intended transaction quantity. The participant must then respect a delay equal to the prescribed time delay before executing an offsetting transaction on the residual quantity.

The **residual quantity** is the portion of the original quantity remaining after orders entered in the book with limit prices better than or equal to the intended transaction price have been filled. If no orders have been executed, the residual quantity is equal to the original intended transaction quantity.

Note: The bundling of orders to meet the admissible minimum quantity threshold is not permitted.

Transactions with a 50% guaranteed minimum

If a market participant wishes to execute a cross or a prearranged transaction on an option strategy, he must contact a market official and provide details of the intended transaction: total quantity, price, side(s) of the transaction on which the approved participant is required to give priority.

Market makers will be permitted to participate on the transaction up to a total maximum of 50% of the quantity of the intended transaction.

The market participant will be permitted to execute the transaction for the remaining quantity (a minimum of 50% plus any quantity not taken of the 50% that had been offered to the market makers.)

MISCELLANEOUS

Eligible products, their respective minimum quantity thresholds and time delays will be modified from time to time in order to take into account the evolution of the trading environment and operational practices of the Bourse. A circular will be issued by the Bourse every time a modification or revision is made to either one of these criteria.

PROCEDURES APPLICABLE TO THE EXECUTION OF STRATEGIES INVOLVING OPTIONS

1. OBJECTIVE

The objective of these procedures is to provide and facilitate the trading of strategies involving equity options for approved participants. For the purposes of these procedures, equity options also include options on indices, currencies and exchange-traded funds. Approved participants may create user-defined strategies (“**UDS**”) via individual trading terminals which allow customized strategies to be disseminated and traded. When not feasible, an approved participant must contact Bourse de Montréal Inc.’s (“**Bourse**”) Market Operations Department (“**MOD**”) at 1 866 576-8836 or 514 871-7877 for assistance in creating a UDS, or in presenting an options strategy to designated market makers and, when applicable, ensuring its manual execution in the Bourse’s trading system.

2. DESCRIPTION

Creation by Approved Participant

An approved participant requests the creation of a UDS instrument by sending a message to the Bourse’s trading system in any of the supported protocols (SAIL, FIX or STAMP). This message contains the parameters of the strategy the approved participant wishes to display.

Bourse will determine from time to time the strategy types that will be accepted by the UDS functionality, and will notify the market of such acceptance criteria.

The UDS functionality will validate that the strategy created is among those that are accepted by the system. If accepted, the newly created strategy instrument will be broadcast to the market via Bourse’s High Speed Vendor Feed, similar to the broadcast of any instrument. If the strategy is not accepted by the UDS functionality, an error message will be returned to the approved participant submitting the message.

A throttling mechanism is engaged in order to limit the number of strategy instruments created by an approved participant. Each approved participant is configured by MOD with a maximum number of instrument creation requests per trading day. Bourse will determine that maximum number depending on the capacity of its systems and will notify the market of such number. If the counter falls to zero, the approved participant is not able to create any new strategy instrument on that day. Conversely, the counter is credited if a newly created strategy instrument generates at least one trade during that trading session.

Creation by MOD

If an approved participant does not have the capability to create a UDS, the approved participant may contact the MOD and request the creation of the UDS. The UDS must conform to the acceptance criteria as determined by Bourse from time to time.

The UDS functionality will validate that the strategy created is among those that are accepted by the system. If accepted, the newly created strategy instrument will be broadcast to the market via the Bourse’s High Speed Vendor Feed, similar to the broadcast of any instrument.

In such cases, the MOD's assistance is limited to creating the UDS. Approved participants are responsible for entering orders.

Execution by MOD

If a strategy can not be created and broadcasted using the UDS because the strategy type is not accepted by Bourse, or because the approved participant does not have the capability to create and place orders on a UDS, the approved participant may submit a strategy order using the following procedure:

- A) The approved participant must contact the MOD and indicate its option strategy. The information provided must include the option series involved, the quantity ratio, the price and the total quantity of the order. Approved participants must have received and time-registered their order prior to contacting the MOD. If the intended strategy includes an equity leg, the approved participant must also indicate the reference price of the underlying interest and the number of shares to be executed in the strategy.
- B) The MOD will contact qualifying market makers assigned to the option class. A qualifying market maker is defined as a market maker that is showing a bid/ask market no wider than the no-bust range of that instrument, with a minimum of ten contracts per side. The MOD will respect the following procedure:
 - (i) For strategies involving less than 50 contracts per leg, market makers will be contacted individually as their turn comes up, according to a rotation kept by the MOD;
 - (ii) For strategies involving between 50 and 99 contracts per leg, market makers will be contacted by groups of two, according to their rank on the rotation;
 - (iii) For strategies involving 100 contracts or more per leg, all qualifying market makers will be contacted.

In the event that a strategy is comprised of multiple legs, the MOD will take into account the option with the furthest expiry to determine which participating market makers will be contacted. Qualifying market makers will be contacted and shown the strategy as submitted by the approved participant. If the market maker(s) accepts the prices provided by the MOD, the transaction will be entered and broadcast to all relevant parties (approved participants, market makers, and stock exchange, if necessary).

- C) The market makers may provide responding bids, offers and quantities:
 - (i) If market makers choose to participate on the strategy, they must be willing to trade all parts inherent to the transaction (all series, shares) but they will not be obligated to trade the entire quantity
 - (ii) If a particular market maker is not available within 15 seconds of the market supervisor of the MOD initiating the telephone call, no additional attempts to contact him will be made. The market maker should provide an answer to the MOD within approximately 30 seconds of the strategy description given by the MOD. Allowance will be made for a longer response time in the case of a particularly complex strategy. If all attempts fail the order will be rejected.

- D) In some situations where the strategy can not be executed, the MOD may inform the approved participant of the best corresponding bid/offer as well as the corresponding quantities obtained by market makers. Once the details of the transaction are negotiated and confirmed, information on the transaction will be entered into the Bourse's trading system by the MOD and broadcast to the marketplace. The strategy trade will be broadcast via the Bourse's Web site and the leg prices and volumes will be disseminated via the Bourse's data feed. If the transaction includes an equity leg and the option leg has been executed, the MOD will submit the equity portion of the strategy to the venue where the equity is traded.

Execution of a Cross Transaction on a Strategy Involving Options

- 1) Cross Transactions with a 50% guaranteed minimum will not be accepted electronically – Please refer to the *Procedures Applicable to the Execution of Cross Transactions and the Execution of Prearranged Transactions*.

- 2) Cross transactions on equity options strategies **without** a 50% guaranteed minimum will be accepted electronically - Please refer to the *Procedures Applicable to the Execution of Cross Transactions and the Execution of Prearranged Transactions*.