

CIRCULAR 062-24

May 27, 2024

SELF-CERTIFICATION

AMENDMENTS TO THE RULES OF BOURSE DE MONTREAL INC. IN ORDER TO INTRODUCE THE GUARANTEED CROSS AUCTION FUNCTIONALITY AND AUTOMATE CONTINGENT OPTION TRADES

On **October 26, 2023**, the Rules and Policies Committee of Bourse de Montréal Inc. (the “**Bourse**”) approved proposed amendments to the Rules of Bourse de Montreal Inc. in order to introduce the Guaranteed Cross Auction functionality and automate contingent option trades. These amendments were self-certified in accordance with the self-certification process as established in the *Derivatives Act* (CQLR, Chapter I-14.01).

The amendments attached hereto will become effective on **May 31, 2024**, after market close¹. Please note that the revised articles will also be available on the Bourse’s website (www.m-x.ca).

The amendments covered by this circular were the subject of a request for comments published by the Bourse on November 9, 2023 (see Circular [133-23](#)). Further to the publication of this circular, the Bourse received comments. A summary of the comments received as well as responses from the Bourse to these comments is attached hereto.

For additional information, please contact Dima Ghozaiel, Legal Counsel, by email at dima.ghozaiel@tmx.com.

Dima Ghozaiel
Legal Counsel
Bourse de Montréal Inc.

¹ The Guaranteed Cross Auction functionality will be activated on June 3rd, 2024, for Equity options, ETF Options and User Defined Strategies (UDS) on Equity options and ETF options. The Covered with Stocks functionality will be launching on a later date, subject to completion of the regulatory process.

PROPOSED AMENDMENTS TO THE RULES

BLACKLINED VERSION

Article 1.101 Definitions

[...]

Auction: means an auction phase in which a single order, the Must Be Filled order, is exposed to the Bourse market for a prescribed period of time.

Auction ID: means a unique identifier attributed to each Auction

Must Be Filled (MBF): means an order in an Auction that is guaranteed to be filled.

[...]

Article 6.110 Orders

(a) To be considered valid, an order must specify the name or symbol of the Listed Product, whether it is a buy or sell order, the quantity of the order, explicit instructions regarding the trading price and the conditions which must be met prior to the order becoming effective and the type and duration qualifier of the order.

(b) The types of which entered into the Electronic Trading System are as follows:

[...]

(ix) Auction Order: An Auction Order is composed of a buy and sell order in which one of the orders, defined as the Must Be Filled.

(x) Improvement Order: an Improvement Order is linked to an Auction Order and it must reference a specific Auction via the Auction ID. Any residual quantity from all Improvement Orders following the Auction completion will get canceled.

Article 6.115 Order Identification

[...]

(b) Approved Participants must ensure that the “prearranged transaction marker” is included for each order entered into the Trading System under Article 6.202 or Article 6.205. This requirement does not apply to paragraph (c), sub-paragraph (d)(i), ~~or~~ paragraph (e) or paragraph (f) of Article 6.205.

[...]

Article 6.205 Prearranged Transactions

(a) In general. For the purpose of this Article, “communication” means any communication for the purpose of discerning interest in the execution of a Transaction in the Electronic Trading System prior to the exposure of the order to the market. Any communication that relates to the size, side of market or price of an order, or a potentially forthcoming order, constitutes a communication to prearrange a Transaction.

(b) The parties to a Transaction may engage in communications to prearrange a Transaction on the Electronic Trading System in an eligible derivative in the minimum amount specified where one party wishes to be assured that there will be a counterparty willing to take the opposite side of the Transaction, in accordance with the following conditions:

(i) A customer consent to the Approved Participant engaging in prearranging communications on the customer’s behalf. The consent of the client, in whatever form, must be communicated to the Bourse upon request;

(ii) After the first order for the prearranged Transaction is entered into the Electronic Trading System the parties may not enter the second order for the prearranged Transaction until the following specified time period has elapsed as follows:

[...]

ELIGIBLE DERIVATIVES	PRESCRIBED TIME PERIOD	MINIMUM VOLUME THRESHOLD*
Equity and ETF Options:		
All expiry months	0 seconds	≥ 500 <u>250</u> contracts
All expiry months	5 seconds <u>(no prescribed time period for Auction Orders) 4-second</u>	< 500 <u>250</u> contracts
All UDS Strategies	04 second	≥ <u>500 contracts</u> No Threshold
<u>All UDS Strategies</u>	<u>5 seconds</u> <u>(no prescribed time period for Auction Orders)</u>	<u><500 contracts</u>

Currency Options		
All expiry months	0 seconds	≥ 100 contracts
All expiry months	1 second	< 100 contracts
All UDS Strategies	1 second	No Threshold
Index Options:		
All expiry months	0 seconds	≥ 50 contracts
All expiry months	1 second	< 50 contracts
All UDS Strategies	1 second	No Threshold

The minimum volume threshold described in the table above, when applicable to a strategy, refers to the negotiated volume of a given strategy instrument and not to the sum of its legs.

The volume considered as the minimum volume threshold will be the residual volume after any applicable resting limit orders at or better than the prearranged Transaction price have been given priority.

(iii) The party that initiates communication regarding a prearranged Transaction shall have his or her order entered into the Electronic Trading System first, unless the parties as part of their negotiation agree otherwise. The consent of the client, in whatever form, must be communicated to the Bourse upon request; *provided however*, that in a prearranged Transaction between an Approved Participant and a customer for an equity, ETF or Index Option, the customer's order shall always be entered into the Electronic Trading System first, regardless of which party initiated the communication.

(iv) Limit orders resting in the central limit order book at the time that the first order of the prearranged Transaction is entered at or better than the price of the first order shall be matched with the first order entered. Any residual, unfilled amount of the first order may be matched against the second order of the prearranged Transaction when the second order is entered.

(v) Parties may not aggregate unrelated orders to meet the minimum threshold for a prearranged Transaction.

(vi) The parties to the prearranging communications shall not disclose to any other party details of the negotiation or otherwise enter an order to take advantage of the negotiation during such communications except as permitted in this Article.

(c) **Committed Orders.** Committed orders may not be used to execute any Transaction under this Article or Article 6.202 having a prescribed time delay longer than zero seconds, and may be used for such Transactions only for the following products subject to the minimum volume threshold:

ELIGIBLE DERIVATIVES FOR COMMITTED ORDERS	MINIMUM VOLUME THRESHOLD
All expiry months and excluding UDS strategies	
Equity and ETF Options	500 250 contracts

The minimum volume threshold described in the table above, when applicable to a strategy, refers to the negotiated volume of a given strategy instrument and not to the sum of its legs.

(d) **Transactions on eligible products with a prescribed time delay.** The parties may engage in communications to prearrange a Transaction on the Electronic Trading System where one party wishes to be assured that there will be a counterparty willing to take the opposite side of the Transaction, in accordance with the conditions in paragraph (a) of this Article; *provided however:*

(i) in the case of a prearranged Transaction that is between the bid and ask on the Electronic Trading System and for an amount at or greater than the minimum threshold, the parties in their discretion may enter the prearranged Transaction as an Auction Order or as a committed order with no delay, subject to the conditions in paragraph (c) and (f) of this Article, or

(ii) in the case of a prearranged Transaction that is on or outside the bid and ask on the Electronic Trading System and for an amount at or greater than the minimum threshold, the parties enter the first and second orders of the prearranged Transaction with no delay between the two, but nevertheless subject to execution risk (including the priority given resting limit orders at or better than the prearranged Transaction price).

iii) in the case of a prearranged Transaction for an amount that is lower than the minimum threshold, the parties may enter the prearranged Transaction as an Auction Order, subject to conditions in paragraph (f) of this Article, or by exposing one side of the transaction to the market, for the minimum prescribed time period established in paragraph

(b) of this Article, before entering the opposite side of the transaction, in accordance with Article 6.114.

(e) Equity, ETF, Index and Currency Option Strategy Transactions ~~With 50% Guaranteed Minimum~~. The parties to an Option strategy Transaction may engage in communications to prearrange the Transaction where one party wishes to be assured that there will be a counterparty willing to take the opposite side of the Transaction. Under specific circumstances prescribed by the Bourse, the Approved Participant may contact a Market Supervisor and provide details of the intended Transaction including total quantity, price, side(s) of the Transaction, a description of the legs comprising the strategy and identification of the agreed counterparty. , in accordance with the following conditions:

- (i) — Market Makers are permitted to participate on the Transaction up to a total maximum of 50% of the volume of the intended Transaction;
- (ii) — each Approved Participant must contact a Market Supervisor and provide details of the intended Transaction including total quantity, price, side(s) of the Transaction, a description of the legs comprising the strategy and identification of the agreed counterparty; and
- (iii) — the Approved Participant will be permitted to execute the Transaction for the remaining volume (a minimum of 50% plus any volume not taken of the 50% that had been offered to the Market Makers).

(f) Auction Orders. Auction Orders may be used to execute any transaction under this Article or Article 6.202, as prescribed by the Bourse, in accordance with Article 6.114 and subject to the following:

i) In the case of a prearranged Transaction for an amount that is lower than the minimum volume* threshold, the parties in their discretion, may enter the prearranged Transaction as an Auction Order which will trigger an Auction.

ii) In the case of a prearranged Transaction for an amount at or greater than the minimum volume* threshold, the parties may, in their discretion, select to execute the Auction Order as a cross Transaction having a prescribed time delay of zero seconds, without triggering an Auction, only for the following products subject to the minimum volume threshold:

<u>ELIGIBLE OPTIONS FOR AUCTION ORDERS SUBMITTED AS CROSS TRANSACTION WITH A TIME DELAY OF ZERO SECONDS</u>	<u>Minimum volume* threshold</u>
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All expiry months and including UDS strategies

Equity and ETF Options

500 contracts

*The volume considered as the minimum volume threshold will be the residual volume after any applicable resting limit orders at or better than the prearranged Transaction price have been given priority.

iii) During an Auction, each beneficial owner can submit a maximum of one Improvement Order or regular order per price point.

Article 11.306 Minimum Fluctuation of Option Premium

Unless determined otherwise by the Bourse, the minimum fluctuation of the Premium is:

- (a) For equity Options excluded from the penny trading program:
 - (i) Option Series priced below \$0.50 are quoted in increments of \$0.01.
 - (ii) Option Series priced at \$0.50 or more are quoted in increments of \$0.05.
- (b) For equity Options included in the penny trading program:
 - (i) Option Series priced below \$3.00 are quoted in increments of \$0.01.
 - (ii) Option Series priced at \$3.00 or more are quoted in increments of \$0.05.

(c) For equity and ETF Options, Auctions Orders and Improvement Orders that match an Auction Order can be quoted in increments of \$0.0001. Improvement Orders that improve the price of an Auction Order must respect the increments mentioned in Article 11.306 (a) and (b) above.

Appendix 6B-2 DESCRIPTION

[...]

- (c) Execution by Market Operations Department.

All option strategies must be executed using the Bourse's UDS facility. Notwithstanding the aforementioned, if a strategy cannot be created and broadcasted using the UDS because the strategy type is not supported by the UDS facility, or because one of the strategy legs is the

underlying share, the Approved Participant may submit to the Bourse a strategy order for execution using the following procedure:

(i) The Approved Participant must contact the Market Operations Department 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 Market Operations Department. 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.

[...]

~~(d) — Execution of Cross Transaction on Strategies Involving Options.~~

~~(i) — Cross Transactions with a 50% Guaranteed minimum will not be accepted electronically. Please refer to Article 6.205.~~

~~(ii) — Cross Transactions on equity Options strategies without a 50% Guaranteed minimum will be accepted electronically. Please refer to Article 6.202.~~

CLEAN VERSION

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[...]

Auction: means an auction phase in which a single order, the Must Be Filled order, is exposed to the Bourse market for a prescribed period of time.

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(ix) Auction Order: An Auction Order is composed of a buy and sell order in which one of the orders, defined as the Must Be Filled.

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(b) The parties to a Transaction may engage in communications to prearrange a Transaction on the Electronic Trading System in an eligible derivative in the minimum amount specified where one party wishes to be assured that there will be a counterparty willing to take the opposite side of the Transaction, in accordance with the following conditions:

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All expiry months	0 seconds	≥ 500 contracts
All expiry months	5 seconds (no prescribed time period for Auction Orders)	< 500 contracts
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All expiry months	0 seconds	\geq 100 contracts
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ELIGIBLE OPTIONS FOR AUCTION ORDERS SUBMITTED AS CROSS TRANSACTION WITH A TIME DELAY OF ZERO SECONDS	Minimum volume* threshold
All expiry months and including UDS strategies	
Equity and ETF Options	500 contracts

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[...]

MX – Guaranteed Cross
Summarized comments received and MX responses

No.	Participant Category	Summary of comments	Summary of responses
1.	Bank	Exactly how long is the auction process?	For single options, options to options strategies: 1 sec For options with stocks strategies: 5 sec
2.		The following is stated in the circular: iii) During an Auction, each beneficial owner can submit a maximum of one Improvement Order or regular order per price point. Can you please clarify exactly what is meant by the point above?	During an Auction, only one Improvement Order (For the definition of Improvement Order, please refer to Article 6.110 in the Appendix of the Analysis) per Auction. Regular Orders can be sent on multiple price points (provided they are at different prices than the Improvement Order).
2a.		Our understanding is that as a market maker we can send one order per price from the moment the auction opens until it closes. So for instance, if a cross is done at 1.00 (client sells), then the following can be sent without the ability to update the order after it has been sent unless it is at a new price: Bid 300x at 1.00 Bid 20x at 1.01 Bid 20x at 1.02 Bid 20x at 1.03 Bid 20x 1.04 Please confirm if our understanding is correct and please clarify if it is not.	Yes, your understanding is correct. Keep in mind that in your example, only one of these orders can be an Improvement Order (from a unique connection) and the others (or all) will have to be regular orders. Note: As mentioned in the definition, Improvement Orders get canceled at the end of the Auction while regular orders do not and will remain in the order book.
3.		Can auction participants see the live order book during the auction process?	Yes.

4.		What are the rules for splitting a trade given identical prices?	Even split.																
4a.		<p>Our understanding is that there is not any advantage given to time priority and that allocations are not pro-rated based on indicated size (rather evenly split based on price), please confirm.</p> <p>Consider the following example:</p> <ul style="list-style-type: none"> • 400 contracts crossed at 1.00 (client sells). B/A at 0.90 / 1.20 at moment of trade • Three improvement order are sent by three market makers (MM A, MM B and MM C). <p>Time sent was A first, B second and C third. Prices sent were A bid 1.02 400x, B bid 1.02 200x and C bid 1.03 100x</p> <table border="1" data-bbox="464 732 999 862"> <thead> <tr> <th>Market Maker</th> <th>Time sent</th> <th>Price</th> <th>Qty</th> </tr> </thead> <tbody> <tr> <td>A</td> <td>t+.01s</td> <td>1.02</td> <td>400</td> </tr> <tr> <td>B</td> <td>t+.02s</td> <td>1.02</td> <td>200</td> </tr> <tr> <td>C</td> <td>t+.03s</td> <td>1.03</td> <td>100</td> </tr> </tbody> </table> <ul style="list-style-type: none"> • How will this trade be split between the three market makers? 	Market Maker	Time sent	Price	Qty	A	t+.01s	1.02	400	B	t+.02s	1.02	200	C	t+.03s	1.03	100	<p>Yes, it is even split.</p> <p>This trade would be split as :</p> <ul style="list-style-type: none"> - Market Maker C gets 100 - Market Maker A gets 150 - Market Maker B gets 150
Market Maker	Time sent	Price	Qty																
A	t+.01s	1.02	400																
B	t+.02s	1.02	200																
C	t+.03s	1.03	100																
5.C		Consider the example given in question 4. If the cross initiator wishes to match the improvement at 1.02 for maximum size, what quantity will the cross initiator receive?	<p>The Cross initiator will receive 50%</p> <p>This trade would be split as :</p> <ul style="list-style-type: none"> - Market Maker C gets 100 - Cross Initiator gets 200 (50% of initial quantity) - Market Maker A gets 50 - Market Maker B gets 50 																

		<p>Again consider the example given in question 4. If all three market makers (A, B, and C) are bid at 1.03 and the cross initiator is seeking to match at 1.03 at max size, what quantity will each party receive (including the cross initiator)?</p> <p>Can the cross initiator enter the auction posting orders (one order per price) similar to market makers, even with the possibility of taking the entire size if their final bid is above other market makers?</p>	<p>The cross initiator will buy 50% of the initial volume of 400, so 200 contracts.</p> <p>The remaining 200 contracts will be split evenly among the 3 market makers (67-67-66) allocated respecting FIFO.</p> <p>Yes, the cross initiator can enter regular orders similar to market makers.</p> <p>Keeping in mind regular orders can be sent on multiple price points (provided they are at different prices than the Initial Order).</p>
6.		<p>When discussing with a sales rep of the MX it was mentioned that upon the creation of a UDS it will be required to wait a certain amount of time before performing a cross (which would trigger an auction) on the recently created UDS. There is no mention of such a delay in the circular, is there an intention to enforce such a delay and if so what will the delay be?</p>	<p>There is no delay.</p>
	Comments	<ul style="list-style-type: none"> Our concern is that in the case where the length of the auction is known and orders can be observed and updated by all participants until the close of the auction, then the auction winner will become a function of technological superiority as opposed to superior pricing to the client. The market maker that is the fastest will observe other orders and update their order at the very last moment, resulting in optimal fills for them (never truly showing how much they are really willing to pay). Less technologically advanced market makers will always lose out at the moment right before the auction closes. 	<p>The Bourse based its proposed model on transparency, allowing the participants to compete for a better price and the possibility for the dealer to match that price, which would not be the case in a blind auction.</p>

		<ul style="list-style-type: none"> In the case of a blind auction, participants are encouraged to give their best pricing from the get go and the element of speed is taken out of the equation. 	The Bourse's auction mechanism also encourages participants to enter their best pricing from the start in order to provide the best fill for the end client.

No	Participant Category	Summary of comments	Summary of responses
1.	Bank	<p>As outlined in Article 6.205 Pre-Arranged Transactions, the proposed amendments will impact all pre-arranged options transactions despite the circular only outlining the rationale and benefits for</p> <p>automated on contingent option trades which currently account for less than 10% of the number of block transactions executed on the exchange.</p> <p>The amendments proposed in Article 6.205 (b) (ii) and (c) would require changes to all participants' technology platforms to facilitate despite any indication of interest from the majority in utilizing this new feature.</p>	<p>The circular also explains the rationale and benefits for the Guaranteed Cross Auction. One excerpt is "These benefits include the opportunity of improving the execution price and increasing interactions in the central limit order book which is expected to lead to better on-screen market quality and liquidity" and these benefits will automatically impact transactions under 500 contracts that are sent using the Guaranteed Cross Auction functionality. For transactions over 500 contracts, participants that wish to use the Guaranteed Cross Auction functionality may decide whether or not they want their transaction to go through the Auction, otherwise it can be sent as a zero second cross.</p> <p>Also, if participants do not wish to use the Guaranteed Cross Auction functionality, they can choose to send their cross transactions via the committed order functionality similar to the process currently in place, with the increase of the cross threshold from 250 contracts to 500 contracts.</p>

2.		<p>Accordingly, TDSI recommends keeping the existing rule as-is on regular prearranged transaction (i.e., prescribed time period 0s for minimum threshold $\geq 250x$, 1s otherwise), and committed order minimum threshold remains at 250x.</p> <p>On Article 6.205 (b) (ii), the additional language "The volume considered as the minimum volume threshold will be the residual volume after any applicable resting limit orders at or better than the prearranged Transaction price have been given priority." contradicts best execution practice.</p> <p>This language promotes end users to focus on the technicality of execution to preserve the originality of the pre-arranged transaction, rather than looking for improved pricing in the market on portions of the client orders before executing the pre-arranged transaction.</p>	<p>Can you please clarify what is meant by: "the additional language "The volume considered as the minimum volume threshold will be the residual volume after any applicable resting limit orders at or better than the prearranged Transaction price have been given priority." contradicts best execution practice. This language promotes end users to focus on the technicality of execution to preserve the originality of the pre-arranged transaction, rather than looking for improved pricing in the market on portions of the client orders before executing the pre-arranged transaction."</p>
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