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CIRCULAR
April 6, 2011

REQUEST FOR COMMENTS

ADOPTION OF RULES APPLICABLE TO MARKET MAKERS FOR FUTURES CONTRACTS

AMENDMENT TO RULE SIX OF BOURSE DE MONTRÉAL INC.

The Rules and Policies Committee of Bourse de Montréal Inc. (“**Bourse**”) has approved amendments to Rule Six of Bourse in order to add a specific section applicable to market makers for futures contracts. Therefore, the Bourse shall harmonize the regulatory framework applicable to the futures contracts with the existing framework applicable to options contracts.

Comments on the proposed amendments must be submitted within 30 days following the date of publication of the present, at the latest on **May 9, 2011**. Please submit your comments to:

Mr. François Gilbert
Vice-President, Legal Affairs, Derivatives
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 des marchés financiers (the “**Autorité**”) to:

Ms. Anne-Marie Beaudoin
Director – Secretariat of L'Autorité
Autorité des marchés financiers
Tour de la Bourse
P.O. Box 246, 800 Victoria Square, 22nd Floor
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Circular no.: 063-2011

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Appendix

For your information, you will find in appendix an analysis of the proposed amendments. The implementation date of the proposed amendments will be determined by 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

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 Bourse has delegated to the Rules and Policies Committee of Bourse its powers to approve and amend the Rules and Procedures. The Rules of 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).

François Gilbert
Vice President, Legal Affairs, Derivatives
Bourse de Montréal Inc.



ADOPTION OF RULES APPLICABLE TO MARKET MAKERS FOR FUTURES CONTRACTS

AMENDMENTS TO THE RULES OF BOURSE DE MONTRÉAL INC.

Amendments to Rule Six - Addition of Article 6820

I. Introduction

Bourse de Montréal Inc. (the “Bourse”) has many fixed income futures contracts listed on its market. The majority of them are fixed income futures contracts on Canadian Government Bonds. Trading volume on certain fixed income futures contracts never gained traction and as a result liquidity and ideal market quote never materialized. Therefore, the Bourse intends to implement market making programs to increase volume and liquidity for its futures contracts.

Market making programs have been proved efficient in adding liquidity and depth to a market. Market makers operate by taking a short or long position for a time, thus assuming some risk in return for the chance of a small profit. The market makers provide liquidity to the market, they are required to maintain two-sided markets and take the opposite side of trades when there are short-term imbalances in orders. This helps prevent excess volatility, and in return, the market maker is granted fee waivers and other trade execution advantages.

As a recognized self-regulatory organization (“SRO”), the Bourse has to insure that the regulatory framework of the Bourse is adequate and that all market making activities are appropriately supervised. Oversight and selection of market makers is the responsibility of the Bourse. The Rules of the Bourse for market makers for options are already in place. However, the Bourse does not have a formal set of rules for market makers for futures contracts. Therefore, the Bourse shall harmonize the regulatory framework applicable to the futures contracts with the existing framework applicable to options contracts by adding a specific section applicable to market makers for futures contracts to its rules. Additionally, this would position the Bourse on a level playing field with other derivatives exchanges that list futures contracts.

As part of a renewed effort to increase volume and liquidity for its futures contracts, the Bourse has launched a market making program for fixed income futures contracts. However, to do so, the Bourse must add an article to Rule Six of the Bourse to comply with regulatory requirements to launch market making program for futures contracts. The implementation of this market making program is subject to the completion of the appropriate regulatory amendment.

II. Rationale

A - Harmonization of the Bourse’s Rules for Market Makers on Options and Futures Contracts

Rules applicable to market makers for option contracts are already in place and are being enforced by the Bourse. The current Rules of the Bourse applicable to market makers on option contracts were initially

drafted and approved in 2001. At the time, it was not deemed relevant to adopt rules applicable to market makers for futures contracts.

In the current version of the Rules of the Bourse, *Article 6395 Market Makers – Options* provides requirements applicable to market makers for option contracts. However, Rule Six of the Bourse is mute with regards to requirements applicable to market makers for futures contracts. In the absence of specific terms for market making on futures contracts, the Bourse proposes to add article 6820 to Rule Six of the Bourse in order to implement requirements applicable to market makers for futures contracts. This must be completed in order to comply with regulatory requirements.

As a SRO, the Bourse does not grant direct access to its trading platform to entities that are not recognized as approved participants or foreign approved participants. As a result, only an approved participant or foreign approved participant shall be admissible as counterparty to a market making agreement with the Bourse.

B - Benchmarking with international peers - Rules for Futures Contracts Market Makers

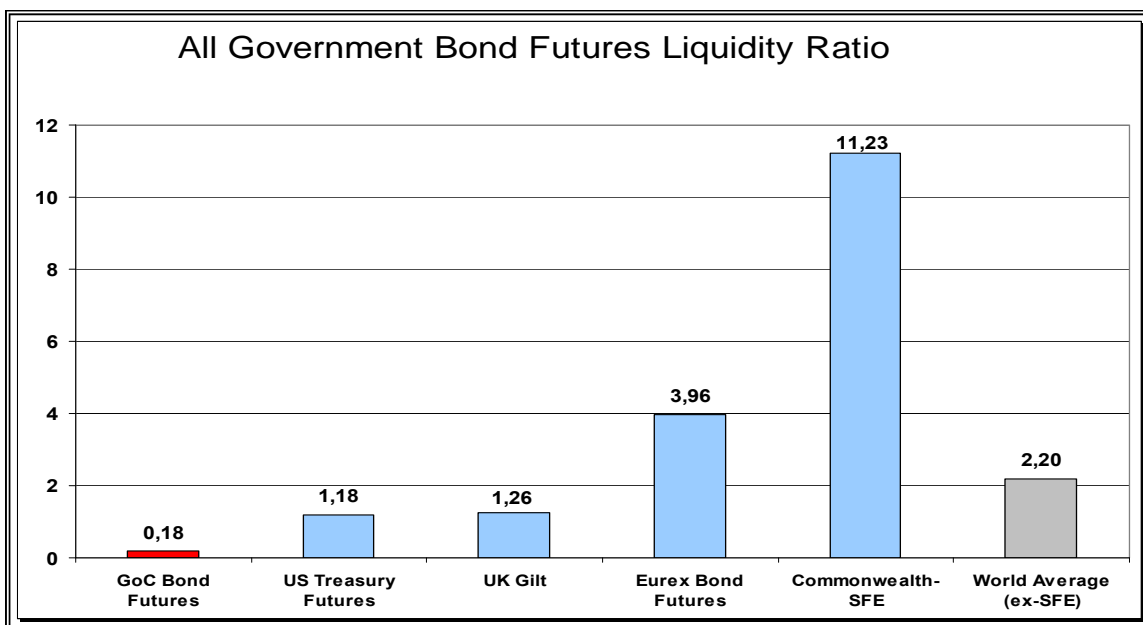
A recent survey of derivatives exchange rulebooks has revealed that derivatives exchanges similar to the Bourse, that have listed futures contracts, have adopted rules applicable to market makers for futures contracts. Adopting a unobtrusive approach to regulation, all derivatives exchange have rules referring to the terms of the market maker programs implemented by the exchange.

CME, CBOT, NYMEX and COMEX are independent exchanges, each responsible for maintaining its own set of rules. From a regulatory point of view, each exchange remains a separate SRO, although all four exchanges are part of the CME Group. The rulebooks of these entities have been substantially harmonized in order to provide a common regulatory framework for market users. Their respective rules sections applicable to market makers for futures contracts show no difference and offer a version of rulemaking referring to the terms of the market maker programs implemented by the exchange.

The Bourse's positioning will follow the model adopted by derivatives exchange in the United States and in Europe. A model that favours reference to the terms of the market maker programs.

C - Room for improvement towards a full Government of Canada yield curve

Recent statistics prove the Canadian fixed income futures market is underdeveloped relative to its peers. A recent survey among Canadian banks, pension funds, insurance companies and broker dealers has shown an interest for the development of a full Government of Canada yield curve and a more liquid fixed income futures contract market.



The adoption of rules for market makers for futures contracts would facilitate the implementation of a market maker program that would in turn facilitate the development of a full Government of Canada yield curve.

III. Proposed Regulatory Amendments

A – Objectives of Proposed Amendments

For the aforementioned reasons the Bourse proposes to amend Rule Six by adding article 6820 which stipulates that the Bourse may conclude market making agreement for futures contracts. This amendment to Rule Six of the Bourse will facilitate the implementation of market making program for futures contracts.

Article 6820 establishes the Bourse's ability to conclude market making agreements for futures contracts. As a recognized SRO, the Bourse must adopt rules applicable to market makers for futures contracts in order to comply with regulatory requirements. This is a prerequisite to the launch of market making programs for futures contracts.

As required by the rules, the proposed amendments will limit the admissible candidates to approved participants or foreign approved participants of the Bourse.

B – Consequences of Proposed Amendments

This addition to the Rules of the Bourse of rules applicable to market makers for futures contracts will favor the listing and trading of futures contracts on the Bourse's electronic trading platform. Furthermore, the adoption of rules applicable to market makers for futures contracts will allow the Bourse to evolve on even footing with similar exchanges around the globe and especially its counterparts in the United States.

C – Summary of Proposed Amendments

The current Rules of the Bourse provide requirements applicable to market makers for option contracts. However, the Bourse must modify Rule Six to obtain regulatory approval to launch market maker programs for futures contracts. Therefore, the Bourse will adopt rules applicable to market makers for futures contracts.

IV. Public Interest

The amendments to the Rules of the Bourse will permit the Bourse to implement market maker programs for futures contracts. It is of public interest that the Bourse adopt appropriate regulatory framework applicable to market makers for futures contracts.

V. Process

The proposed amendments to the Rules and Procedures of the Bourse are submitted for approval to the Rules and Policies Committee of the Bourse and will subsequently be submitted to the Autorité des marchés financiers (AMF) in accordance with the self-certification process and to the Ontario Securities Commission (OSC) for information.

VI. References

Chicago Merchantile Exchange (CME)

- CME Rulebook, Chapter 1 Membership, Section 195 Market Maker Programs
<http://www.cmegroup.com/rulebook/CME/I/1/>

Chicago Board of Trade (CBOT)

- CBOT Rulebook, Chapter 1 Membership, Section 195 Market Maker Programs
<http://www.cmegroup.com/rulebook/CBOT/1/1/>

New York Merchantile Exchange (NYMEX)

- NYMEX Rulebook, Chapter 1 Membership, Section 195 Market Maker Programs
<http://www.cmegroup.com/rulebook/NYMEX/1/1.pdf>

VII. Documents Attached

- Rule Six of Bourse de Montréal Inc.: proposed article 6820

RULE SIX

TRADING

D. SPECIAL RULES FOR TRADING FUTURES CONTRACTS

Section 6801 - 6820

Terms of Trade

Futures

6820 Market Makers - Futures
(XX.XX.XX)

- 1) In order to enhance the liquidity of the market and facilitate the handling of orders, the Bourse can execute a market making agreement with an Approved Participant or Foreign Approved Participant for one or many futures contracts listed on the Bourse. The market maker shall be required to maintain two-sided markets in the futures contracts designated by the Bourse.
- 2) Oversight and selection of market makers shall be the responsibility of the Bourse. Factors to be considered for the selection of market makers shall include the following: adequacy of capital, experience with trading of a similar derivative instrument, willingness to promote the Bourse as a market place, operational capacity, support personnel, history of compliance with the Rules of the Bourse and any other factor which the Bourse deems relevant.
- 3) Each market maker shall comply with the following obligations, including:
 - i) the market maker is obligated to promptly inform the Bourse of any material change in its financial or operational condition or in its personnel.
 - ii) A market making agreement cannot be transferred without the prior approval of the Bourse.
 - iii) The market maker must fulfill his commitments towards the Bourse until the term of the market making agreement or until its termination thereof by the Bourse.
- 4) The Bourse may, at its discretion, terminate a market making agreement:
 - i) if, upon review, the Bourse determines that the performance of a market maker does not comply with the terms of the market making agreement;
 - ii) if a market maker incurs a material financial, operational or personnel change which could negatively impact his ability to satisfactorily perform his duties;
 - iii) if for any reason the market maker no longer complies with the terms of the market making agreement or the rules and procedures of the Bourse, if he advises the Bourse that he intends to cease to comply with the terms of the market making agreement or fails to perform his duties.