



CIRCULAR 069-20

April 27, 2020

REQUEST FOR COMMENTS

AMENDMENTS TO ARTICLE 6.208 OF THE RULES OF BOURSE DE MONTREAL INC.: EXCHANGE OF FUTURES FOR RELATED PRODUCTS

The Rules and Policies Committee of Bourse de Montréal Inc. (the “**Bourse**”) and the Special Committee of the Regulatory Division of the Bourse approved amendments to article 6.208 of the Rules of the Bourse to change the requirement relating to ‘arranging’ an Exchange of Futures for Related Products (“EFRP”) transaction linked to an Approved Person and iterate the obligations of an Approved Participant regarding an EFRP.

Comments on the proposed amendments must be submitted at the latest on **May 27, 2020**. Please submit your comments to:

Alexandre Normandeau
Legal Counsel
Bourse de Montréal Inc.
1800-1190 av des Canadiens-de-Montréal
P.O. Box 37
Montreal, Quebec H3B 0G7
E-mail: legal@tmx.com

A copy of these comments shall also be forwarded to the *Autorité des marchés financiers* (the “**Autorité**”) to:

M^e Philippe Lebel
Corporate Secretary and
Executive Director, Legal Affairs
Autorité des marchés financiers
Place de la Cité, tour Cominar
2640 Laurier boulevard, suite 400
Québec (Québec) G1V 5C1
Fax : (514) 864-8381
E-mail: consultation-en-cours@lautorite.qc.ca

Please note that comments received by one of these recipients will be transferred to the other recipient and that the Bourse may publish a summary of such comments as part of the self-certification process concerning this file. Unless specified otherwise, comments will be published anonymously by the Bourse.

Appendices

You will find in the appendices an analysis as well as the text of the proposed amendments. The implementation date of the proposed amendments will be determined by the Bourse, in accordance with the self-certification process as established by the *Derivatives Act* (CQLR, 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, the Policies and the Procedures, which are thereafter submitted to the Autorité in accordance with the self-certification process as determined by the *Derivatives Act* (CQLR, chapter I-14.01).

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.

The Division is under the authority of a Special Committee (the "**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 of the Bourse governing approved participants. The Board of Directors has delegated to the Rules and Policies Committee of the Bourse its powers to approve or amend these Rules upon recommendation from the Special Committee.



**EXCHANGE OF FUTURES FOR RELATED PRODUCTS
AMENDMENTS TO ARTICLE 6.208 OF THE RULES OF BOURSE DE MONTREAL INC.**

Table of Contents

DESCRIPTION	2
PROPOSED AMENDMENTS	2
ANALYSIS	2
Background	2
Objectives	2
Comparative Analysis	5
Analysis of Impacts	5
Impacts on Market	5
PROCESS	5
ATTACHED DOCUMENTS	6

I. DESCRIPTION

The Regulatory Division (the “Division”) of Bourse de Montréal Inc. (the “Bourse”) wishes to update the Rules of the Bourse (the “Rules”) to change the requirement relating to ‘arranging’ an Exchange of Futures for Related Products (“EFRP”) transaction linked to an Approved Person and iterate the obligations of an Approved Participant regarding an EFRP.

II. PROPOSED AMENDMENTS

Please refer to the proposed amendments described in the attached Annex 1.

III. ANALYSIS

a. Background

An EFRP transaction is composed of a privately negotiated execution of a Futures contract listed on the Bourse and the simultaneous execution of either (i) a corresponding cash market transaction, (ii) a corresponding OTC swap, or (iii) another OTC derivative transaction. The execution of such transactions must meet the requirements specified under Article 6.208 of the Rules, such as (i) ensuring that each party to an EFRP Transaction is an accredited counterparty, defined under Section 3 of the *Derivatives Act* (Quebec), R.S.Q., chapter I-14.01 (ii) ensuring the accounts involved on each side of the transaction have a different beneficial owner; the accounts are under separate control if the beneficial owners are the same; involve separate legal entities if commonly controlled; or represent a legitimate transaction entered at arms-length, (iii) ensuring that the specific requirements related to the cash market or OTC practices are met, and (iv) respecting pricing requirements of the Futures contract. In this current proposal the above requirements are listed for reference and are not subject to a review or any changes.

In addition to the above requirements, paragraph(f) of Article 6.208 of the Rules provides as follows:

“In all circumstances, an EFRP Transaction can only be arranged by the Approved Participant’s Approved Persons”

Hence under the Rules only an Approved Person, being an employee of an Approved Participant (the “Participant”) or the employee of an affiliate or subsidiary, duly approved under Article 3.400 of the Rules, is allowed to ‘arrange’ (conclude) an EFRP transaction. In the course of conducting its regulatory activities, the Division has noted that this requirement may not accurately reflect the business or operational models of some Participants and/or their affiliates.

b. Objectives

One of the Division’s mandates is to ascertain whether Participants’ trading practices are in compliance with the Rules. When a potential situation is identified as being an unnecessary regulatory burden, consistent with its vision to consider market challenges, the Division endeavours to make an assessment. In the present proposal, the Division is primarily reviewing the obligation imposed under paragraph (f) of Article 6.208 of the Rules and consider whether, from a regulatory perspective, there is an added value to

tie the responsibility of negotiating and executing an EFRP to an individual approved as an Approved Person.

The main purpose of the provisions relating to EFRP transactions in the Rules, is to provide Participants with the required framework within which an EFRP can be traded. Participants have the obligation to ensure compliance with the requirements of the Rules. In accordance with Article 3.100 of the Rules, Participants must have a reasonably designed supervisory system acceptable to the Bourse to achieve compliance with the Rules and with any legislation and regulations applicable to securities and derivative instruments related activities. Furthermore, regarding clients having direct electronic access to the Bourse, Participants remain responsible for compliance with the requirements of the Rules (Article 3.5 (c) of the Rules). Regarding EFRP transactions, such a supervisory system should include notably written policies and procedures, maintenance of adequate records of supervisory activity in order to ensure that all requirements relating to an EFRP are met, including requirements that may be applicable to the cash/swap leg.

Thus, the Participant must be able to demonstrate it had reasonable supervisory controls in place to ensure compliance with the Rules and to identify a potential breach. In case of a breach, the Participant is expected to demonstrate that it has taken adequate actions. In the absence of reasonable controls or if adequate actions were not taken, disciplinary procedures may be issued against a Participant for contravening its supervision obligation under Article 3.100 of the Rules.

Given the growing diversity of Participants on the Bourse, and based on market feedback, the Division understands that Participants may have different business or operational models for trading EFRP transactions. The individuals involved in these trades are not necessarily Approved Persons. The Division is conscious of the impact of restrictive provisions on the global trading activities of Participants, especially if such limitations do not exist in other jurisdictions where they operate.

In addition to the general supervision and compliance requirement, currently, Article 6.208 expressly imposes responsibilities on the Participant for these types of transactions. Namely, (i) paragraph(a)(vii) provides that the Participant is responsible in demonstrating the correlation requirement under this provision; (ii) paragraph(d) imposes on the Participant the responsibility of reporting an EFRP transaction; and (iii) paragraph(e) describes the responsibility of the Participant to obtain and provide books and records maintained in compliance with this provision.

To ensure consistency with its regulatory standard and with the standards of other exchanges, the Division has completed a comparative analysis with the rules of major exchanges such as the CME, ICE, ASX, EUREX on the obligation and responsibility related to EFRP transactions. The common approach identified through this exercise was that exchanges impose on the participating firm the responsibility of ensuring that all conditions related to trading EFRP are met. These exchanges do not impose an eligibility requirement on the individual concluding an EFRP, like the one imposed in the Rules on Approved Persons.

Taking into account all of the above considerations, the Division proposes to amend the Rules to remove the requirement limiting the arrangement of an EFRP transaction to an Approved Person. This amendment applies to requirements for trading products listed on the Bourse and does not supersede or exempt parties from other applicable requirements. With this change, the Division also proposes to add clarity to the Participant's obligations under the Rules, to ensure compliance with the requirements regarding EFRP transactions and maintain an adequate supervisory system.

Article 6.208 (f)

The content of this paragraph, which currently requires an Approved Person to arrange an EFRP transaction, will be modified to remove this current limitation. Instead, the Division is proposing to insert under this paragraph the clarification regarding the regulatory expectation towards a Participant. In other words, paragraph (f) will iterate the Participant's obligation under the Rules to ensure that every EFRP transaction is concluded and executed in accordance with the requirements under the Rules and to any other legal or regulatory requirements that may be applicable.

With this amendment, Participants will now have the option to adapt their operational model, and consequently establish and maintain a system to supervise the arrangement and execution of an EFRP which is reasonably designed to achieve compliance with the requirements of EFRP transactions in the Rules and with any legislation and regulations that may be applicable to them, its affiliates and/or its clients. For example, Participants may choose to continue limiting the execution of EFRP transactions to their Approved Persons. As such they will not need to modify their supervisory system as long as the current one allows the Participant to reasonably ensure its Approved Persons are complying with the requirements relating to EFRP transactions and identify a potential breach of the Rules¹. On the other hand, Participants can choose to adapt their operations to consider the removal of the limitation aforementioned and, for example, allow an employee of its affiliate (who is not an Approved Person) to arrange an EFRP transaction. In which case the Participant will have to ensure to adapt its supervisory system to ensure that (i) the individual trading an EFRP understands and complies with the requirements in the Rules; (ii) it has the means to comply with the requirements of the Rules in terms of its obligations, such as, but without limitation, to Article 6.208(e) by retrieving any information and documentation the Division may request regarding the EFRP; and (iii) it ensures the collaboration of the individual trading the EFRP in any request the Division may initiate.

Clarification regarding the Reporting requirements under paragraph (d) of Article 6.208: There will be no change to the reporting requirement as prescribed under paragraph (d) and the information required to be included when reporting an EFRP transaction. Therefore the following will continue to be applicable (i) the reporting of an EFRP transaction can be performed by any employee of the Participant or a designated third party (e.g. employee of an affiliate) with the proper access; (ii) with regards to the reporting time, the one hour starts counting from the moment of the execution of the EFRP, that is when all the terms of the EFRP, such as the contract, quantity and price, have been agreed upon by both parties, or for EFRP transactions executed after the trading hours of the Bourse, the reporting shall be no later than 10:00 a.m. (Montreal Time); and (iii) the reporting shall be communicated to the Market Operations Department of the Bourse ("MOD") on the Special Terms Transaction Reporting Form. Notwithstanding the changes to paragraph (f), for administrative purposes, when reporting an EFRP transaction the details of an Approved Person will still need to be associated with each report on the Special Terms Transaction Reporting Form. The reason is (i) to have a contact person with whom MOD or the Division can communicate regarding any information on a specific EFRP transaction, and (ii) to have an MX-ID associated with the Approved Person for purposes of printing the futures leg of the EFRP on SOLA Trading.

Amendment to paragraph (b) of Article 3.105

As a peripheral amendment, the Division proposes to add reference to Article 6.208 relating to EFRP to the potential violations listed under Article 3.105 (b). This amendment is in line with the Division's objective to clarify its expectations towards Participant's obligations when an EFRP transaction is executed.

¹ Without limitation, Article 3.101, Article 3.5(c) and Article 6.208 refer

c. Comparative Analysis

The Division has conducted a benchmarking exercise with other major exchanges (CME, ICE, ASX, EUREX) to determine if elsewhere this responsibility was restricted to an individual registered with the respective exchange as the current Approved Person requirement under the Rules. The common approach identified through this exercise is that exchanges impose the responsibility on the participating firm to ensure that all the conditions related to trading EFRP are being met and does not impose an eligibility requirement on the person negotiating and executing an EFRP. This amendment proposal is in line with these standards and helps the Bourse to establish itself as a global player without detriment to the Division's regulatory activities.

d. Analysis of Impacts

i. Impacts on Market

The proposed amendments will have no impact on the derivatives market. As indicated in earlier sections, the proposal is to remove a potential operational burden for Participants when engaging in EFRP transactions.

ii. Impacts on Technology

The proposed amendments will have no impact on the technological systems of the Bourse, its Participants or CDCC.

iii. Impacts on regulatory functions

The proposed amendments are initiated by the Division in order to remove a potential operational burden on obligations and responsibilities related to EFRP transactions. In light of these changes, the Division also took the opportunity to iterate the obligations of Participants regarding an EFRP transaction and clarified the requirements surrounding reporting of EFRP transactions on the Special Terms Transaction Reporting Form of the Bourse.

iv. Impacts on clearing functions & on trading functions

The proposed amendments will have no impact on the trading and clearing functions.

v. Public Interest

The Bourse is of the view that the proposed amendments are not contrary to the public interest. In fact, the public and market participants generally request clear rules that are consistent with the best practices of other international derivatives exchanges and, when applicable, other self-regulatory organizations.

IV. PROCESS

The proposed amendments are subject to the Special Committee and the Rules and Policies Committee of the Bourse for approval purposes. They will also be submitted to the Autorité des marchés financiers

in accordance with the self-certification procedure and to the Ontario Securities Commission for information.

V. ATTACHED DOCUMENTS

Annex 1 - Proposed amendments.

ANNEX 1 - PROPOSED AMENDMENTS

Article 3.105 Notification of Regulatory Division of Non-Compliance

[...]

(b) An Approved Participant must diligently conduct a review in accordance with its internal supervision policies and procedures upon becoming aware that, such Approved Participant, an employee, an Approved Person, or a client authorized pursuant to Article 3.5 possibly violated the Rules pertaining to:

- (i) Article 7.6 respecting front running;
- (ii) Article 7.5 respecting manipulative or deceptive methods of trading;
- (iii) Article 7.3 respecting best execution;
- (iv) Articles 3.4 and 3.5 respecting access to electronic trading;
- (v) Articles 6.114 and 6.116 respecting management of priorities;
- (vi) Articles 6.203, 6.204, 6.205, 6.206 and 6.207 respecting Transactions required on Bourse facilities;
- (vii) Article 6.200 respecting Off-Exchange Transfers of Existing Positions on a Listed Product;
- (viii) Article 6.208 respecting Exchange of Futures for Related Products.

Article 6.208 Exchange of Futures for Related Products

[...]

~~(f) In all circumstances, an EFRP Transaction can only be arranged by the Approved Participant's Approved Persons. The Approved Participant must achieve compliance with the Regulations of the Bourse and all other applicable legal and regulatory requirements with respect to the execution of an EFRP Transaction under this Article.~~

ANNEX 1 - PROPOSED AMENDMENTS

Article 3.105 Notification of Regulatory Division of Non-Compliance

[...]

(b) An Approved Participant must diligently conduct a review in accordance with its internal supervision policies and procedures upon becoming aware that, such Approved Participant, an employee, an Approved Person, or a client authorized pursuant to Article 3.5 possibly violated the Rules pertaining to:

- (i) Article 7.6 respecting front running;
- (ii) Article 7.5 respecting manipulative or deceptive methods of trading;
- (iii) Article 7.3 respecting best execution;
- (iv) Articles 3.4 and 3.5 respecting access to electronic trading;
- (v) Articles 6.114 and 6.116 respecting management of priorities;
- (vi) Articles 6.203, 6.204, 6.205, 6.206 and 6.207 respecting Transactions required on Bourse facilities;
- (vii) Article 6.200 respecting Off-Exchange Transfers of Existing Positions on a Listed Product;
- (viii) Article 6.208 respecting Exchange of Futures for Related Products.

Article 6.208 Exchange of Futures for Related Products

[...]

(f) The Approved Participant must achieve compliance with the Regulations of the Bourse and all other applicable legal and regulatory requirements with respect to the execution of an EFRP Transaction under this Article.