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CIRCULAR 116-15
September 23, 2015

REQUEST FOR COMMENTS

AMENDMENTS TO ARTICLE 6602 OF RULE SIX OF BOURSE DE MONTRÉAL INC.

ELIGIBILITY OF CRITERION FOR INDEX OPTIONS

The Rules and Policies Committee of Bourse de Montréal Inc. (the “**Bourse**”) has approved amendments to article 6602 of Rule Six of the Bourse, in order to change the eligibility criterion for indices to qualify as underlying interests for an option listed on the Bourse. The proposed amendments seek to introduce a qualitative criterion specifying the considerations taken into account by the Bourse in selecting an index as an underlying interest for one of its options.

Comments on the proposed amendments must be submitted within thirty (30) days following the date of publication of this notice, at the latest on October 23, 2015. Please submit your comments to:

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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.gc.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.

Appendices

For your information, you will find in the appendices an analysis of the proposed amendments and the proposed amendments to article 6602 of Rule Six of the Bourse. 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* (CQLR, chapter I-14.01).



**AMENDMENTS TO ARTICLE 6602 OF RULE SIX
OF BOURSE DE MONTRÉAL INC.
ELIGIBILITY CRITERION FOR INDEX OPTIONS**

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I. SUMMARY

Bourse de Montréal Inc. (the “Bourse”) proposes to amend paragraph h) of article 6602 of Rule Six of its rules, in order to change the eligibility criterion for indices to qualify as underlying interests for an option listed on the Bourse to a qualitative criterion specifying the considerations taken into account by the Bourse in selecting an index as an underlying interest for one of its options.

II. ANALYSIS

a. Background

Paragraph h) of article 6602 constitutes the eligibility criterion for indexes to qualify as underlying interests for an option listed on the Bourse and reads as follows: “In the case of an index, the index must be referenced in the Rules of the Bourse”. To select such an index, the Bourse takes into account two main considerations, namely, integrity and transparency. The criterion, as currently written in the Rules of the Bourse, does not specify these considerations. Given the international context around administration of indices, the Bourse considers it is appropriate to adopt a criterion that reflects the qualitative considerations taken into account in the selection of an index as an underlying interest for an option. The Bourse therefore proposes to replace the current criterion of paragraph h) of article 6602 with the following criterion: “In the case of an index, the index administrator must have governance arrangements in place designed to protect the integrity of the index and must be considered to have a methodology for constructing and maintaining the index that is sufficiently transparent to facilitate a stakeholder’s ability to understand the methodology and to evaluate the credibility of the index.”

In July 2013, the International Organization of Securities Commissions (“IOSCO”) published the “Principles for Financial Benchmarks”¹ (the “IOSCO Principles”), the objective of which is stated as follows:

“As stated in the January Consultation Report, IOSCO’s objective is to create an overarching framework of Principles for Benchmarks used in financial markets. Specifically, the IOSCO Board seeks to articulate policy guidance and principles for Benchmark-related activities that will address conflicts of interest in the Benchmark-setting process, as well as transparency and openness when considering issues related to transition.”²

Several index administrators have publicly confirmed the nature and extent of their compliance with the IOSCO Principles³. The IOSCO Principles are actually becoming an international standard and benchmark in terms of index administration, although index administrators are not directly constrained by the IOSCO Principles.

¹ Online: <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf>.

² Idem on page 3.

³ See notably S&P Dow Jones Indices, July 21, 2015, online: https://us.spindices.com/documents/legal/spdij-iosco-summary-statement-2015.pdf?force_download=true, FTSE Russell, July 17, 2015, online: http://www.ftse.com/products/indices/media/getpressrelease?title=FTSE+Russell+Confirms+Compliance+with+IOSCO+Principles_1358546 and Morgan Stanley July 17, 2015, online: https://www.morganstanley.com/assets/pdfs/sales_and_trading_disclosures/MS_IOSCO_Compliance_Statement.pdf.

In this international context of establishing the best practices for index administrators, the Bourse wishes to adopt a qualitative eligibility criterion that more specifically reflects the considerations taken into account by the Bourse in selecting an index as an underlying interest for one of its options. Disclosing these qualitative criteria will help make the Bourse's participants aware of these considerations, as well as the fact that the indices selected as underlying interests for options listed on the Bourse meet minimum integrity and transparency standards. Considering that currently, index administrators are not directly constrained by the IOSCO Principles, the Bourse has decided to formulate its own qualitative considerations for underlying indices, by proposing a criterion inspired by the IOSCO Principles.

b. Description and Analysis of Market Impacts

The criterion proposed by the Bourse is directly inspired by the IOSCO Principles.

The main global index administrators – such as Standard and Poor's, MSCI, FTSE and the Dow Jones – confirm their compliance with the IOSCO Principles annually. It should be noted that when an index administrator confirms its compliance with the IOSCO Principles, it does so for all the indices it publishes throughout the world, without exception.

At the time this analysis was written, the underlying interests for index options listed on the Bourse were indices published by Standard & Poor's and FTSE. Given that the administrators of these indices have confirmed their compliance with the IOSCO Principles and that the criterion proposed by the Bourse is inspired by the IOSCO Principles, the Bourse does not foresee any impact on its current products. However, the Bourse believes that introducing this criterion will reassure participants regarding the reliability of the indices chosen by the Bourse in the future as underlying interests for its options.

c. Comparative Analysis

To the best of its knowledge, the Bourse is the first derivatives exchange to adopt an eligibility criterion for indices qualifying as underlying interests for its options.

According to the Bourse's analysis, no other exchange includes eligibility criteria for indices qualifying as underlying interests for an option in its rules for derivatives products. Instead, some exchanges proceed by designation, by mentioning the selected underlying indices individually in their rules without explaining the reasons or selection criteria for these indices, while other exchanges make no mention of the chosen indices at all in their rules.

The following chart gives a few examples:

Exchange	Rules	Comments
CBOE	5.3 – Criteria for Underlying Securities and 5.3.13 – Index-Linked Securities ⁴	No mention of specific selection criteria for underlying securities and no designation in the rules.
CME	52 to 901 ⁵	Proceeds by designation: one rule for each class of derivatives products, mentioning, if applicable, the underlying index but without selection criteria for such targeted underlying index.
EUREX	None ⁶	No mention and no designation: no rules for eligible products, underlying indices or criteria used for selecting these indices.
ASX	2210 & 2211 ⁷	Proceeds by designation: Both rules make reference to two lists of approved underlying indices without mentioning criteria used for selecting the indices included in these lists.

d. Proposed Amendment

The Bourse proposes replacing the current paragraph h) with the following paragraph: “In the case of an index, the index administrator must have governance arrangements in place designed to protect the integrity of the index and must be considered to have a methodology for constructing and maintaining the index that is sufficiently transparent to facilitate a stakeholder’s ability to understand the methodology and to evaluate the credibility of the index.”

III. AMENDMENT PROCESS

In an international context of establishing the best practices for index administrators, the Bourse considers that it is in the best interest of the market and its participants to disclose the considerations actually taken into account when the Bourse selects an index as an underlying interest for one of its options. Disclosing these considerations promotes greater transparency and allows market participants to evaluate the Bourse’s choices in light of these minimum criteria.

IV. IMPACTS ON TECHNOLOGICAL SYSTEMS

This amendment concerns the eligibility criteria for market indices qualifying as underlying interests for options listed on the Bourse and will therefore have no impact on the systems of the Bourse, the Bourse’s approved participants or any other market participants.

⁴ See the rules of CBOE at <http://cchwallstreet.com/CBOE/Rules/>

⁵ See the rules of CME at <http://www.cmegroup.com/rulebook/CME/>

⁶ See the rules of EUREX at <https://www.eurexchange.com/exchange-en/resources/rules-regulations/Exchange-rules/138364>

⁷ See the rules of ASX at <http://www.asx.com.au/regulation/rules/asx-operating-rules.htm>

V. OBJECTIVES OF PROPOSED AMENDMENT

The Bourse wishes to disclose to market participants the considerations taken into account in the selection of indices as underlying interests for options listed on the Bourse. These considerations are qualitative and based on minimum standards in terms of the integrity and transparency of the index. This approach promotes greater transparency of the index selection process and demonstrates the Bourse's commitment to selecting indices that are consistent with minimum international recommendations for index administration.

VI. PUBLIC INTEREST

It is in the interest of market participants and the general public that market indices selected as underlying interests for options listed on the Bourse meet minimum integrity and transparency criteria and that these criteria are also transparent. The adoption of this qualitative eligibility criterion will help make participants and the public aware of the minimum qualitative considerations that the Bourse takes into account in selecting a market index as an underlying interest for one of its options.

VII. EFFICIENCY

The proposed criterion is intended to assure market participants that the indices selected as underlying interests for options listed on the Bourse meet minimum integrity and transparency standards, as well as to promote a better understanding of the considerations taken into account by the Bourse in evaluating the integrity and transparency of an index. This approach promotes greater market efficiency, in that it makes information available to market participants allowing them to make more informed decisions.

VIII. PROCESS

The proposed amendments, including this analysis, must be approved by the Bourse's Rules and Policies Committee and submitted to the Autorité des marchés financiers, in accordance with the self-certification process, and to the Ontario Securities Commission for information purposes.

IX. ATTACHED DOCUMENTS

- Proposed amendment to article 6602

6602 Qualification for Underlying Interests

(13.03.87, 31.05.88, 10.11.92, 07.09.99, 28.01.02, 26.09.05, 04.06.15, [00.00.00](#))

Products qualify as underlying interests provided they meet certain requirements.

- a) Every equity issue shall be listed on a Canadian Exchange, meet the criteria of the Canadian Derivatives Clearing Corporation, or be a security recommended for approval by the Bourse.
- b) In the case of Government of Canada Bonds, every issue shall have an outstanding amount of at least \$500,000,000 face value at maturity.
- c) A Futures contract must be listed on the Bourse.
- d) In the case of a currency, it must have been priorily approved by the Bourse.
- e) In order for a Canadian sponsored option to be traded on the Bourse, the underlying interest must satisfy the options eligibility criteria defined in the Canadian Derivatives Clearing Corporation Rules.
- f) In order for an international sponsored option to be traded on the Bourse, the underlying interest must be currently traded on a recognized exchange and there must be options or futures contracts listed on this same exchange or on any other recognized exchange.

For the purpose of the present Rule, the term "recognized exchange" means any exchange carrying on its activities on the territory of one of the Basle Accord Countries and those countries that have adopted the banking and supervisory rules set out in the Basle Accord, and any other exchange or group of exchanges with whom the Bourse has signed a collaboration agreement.

- g) In the case of an index sponsored option, the sponsor must have a licensing rights agreement with the index supplier. A copy of the agreement must be filed with the Bourse before the sponsored option is launched.
- h) In the case of an index, the index ~~must be referenced in the Rules of the Bourse~~ administrator must have governance arrangements in place designed to protect the integrity of the index and must be considered to have a methodology for constructing and maintaining the index that is sufficiently transparent to facilitate a stakeholder's ability to understand the methodology and to evaluate the credibility of the index.

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