CIRCULAR 124-21
July 5, 2021

REQUEST FOR COMMENTS

**AMENDMENTS TO ARTICLE 9.4 OF THE RULES OF BOURSE DE MONTREAL INC.
SPAN METHODOLOGY FOR CLIENT ACCOUNT**

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 9.4 of the Rules of the Bourse in order to permit the use of the Standard Portfolio Analysis of Risk ("SPAN") methodology to determine margin requirements for futures and options on futures.

Comments on the proposed amendments must be submitted at the latest on **September 3, 2021**. Please submit your comments to:

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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.

AMENDMENTS TO ARTICLE 9.4 RULES OF BOURSE DE MONTREAL INC. - SPAN METHODOLOGY FOR CLIENT ACCOUNT

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I. DESCRIPTION

Bourse de Montréal Inc. (the “Bourse”) and the Regulatory Division (the “Division”) of the Bourse propose to modify the Rules of the Bourse (the “Rules”) to permit the use of the Standard Portfolio Analysis of Risk (“SPAN”) methodology to determine margin requirements for futures and options on futures with respect to a Client Account under circumstances further described in this analysis. The Canadian Derivatives Clearing Corporation (“CDCC”) is introducing a Gross Client Margin Regime (“GCM Regime”)[1] consistent with the regulatory requirements under the Principles for Financial Market Infrastructures (“PFMI”). Applying SPAN methodology for Futures and Options on Futures to a Client Account under the GCM Regime, would increase transparency and alignment with global industry standards, thereby reducing uncertainty between different margin calculation methods.

Unless otherwise defined herein, any defined term used in this analysis will have the meaning described in the Rules.

[1] As per the definition that CDCC will be proposing under its Gross Client Margin Regime.

II. PROPOSED AMENDMENTS

The Bourse and the Division are proposing amendments to Article 9.4 to permit the optional use of SPAN methodology for Client Accounts under the GCM Regime to calculate margin requirements for Futures and Options on Futures. Please refer to the proposed amendments described in the attached Annex 1.

III. ANALYSIS

a. Background

Margin requirements are an essential tool for risk management in the futures markets. CDCC, as the central counterparty to every trade on the Bourse, is responsible for managing and mitigating the risk of default. At the present time, the Bourse, in collaboration with CDCC, establishes these minimum requirements. They are calculated using a strategy-based method described in Chapter B of Part 9 of the Bourse Rules, for positions held by Approved Participants on all positions in Derivative Instruments listed on the Bourse. These positions are either held for Approved Participants' own account or for the accounts of their clients. The Division publishes these margin requirements daily (CSV files), including specific margin requirements for futures contracts and for intra-commodity spreads.

When determining the applicable minimum margin requirements, Article 9.4 of the Rules currently permits Approved Participants to use the SPAN methodology for positions held in an Approved Participant's account, but prohibits SPAN when determining the margin required for a Client Account. These conditions are similar to those applicable under the Investment Industry Regulatory Organization of Canada ("IIROC") rules[2]. Positioning the Bourse margin rules to be aligned with IIROC margin rules originates from when member regulation activities were transferred to IIROC[3] after 2004. As part of this transfer of duties, several provisions on margin and capital requirements were subsequently removed from the Rules of the Bourse, with the exception of some that do not appear in the IIROC rules, namely those requirements that the Bourse maintains to develop the derivatives market. Additionally, when it comes to Derivative Instruments listed on the Bourse, IIROC rules accordingly refer to margins established by the Bourse. Over the years, the Bourse and IIROC have had multiple arrangements to jointly implement any new margin rule. As such, the Bourse and IIROC continue to collaborate on rule amendments relating to margin.

b. Objectives

Complying with principle 14 of the PFMI[4] on segregation and portability, CDCC is amending its rules and procedures. CDCC is proposing to i) introduce a GCM Regime applicable to all open

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[2] IIROC margin requirements are found under Rule 100 in Dealer Member Rules until December 30, 2021 and, thereafter under Series 5000 of IIROC Rules.

[3] After its merger with Market Regulation Services Inc. on June 1, 2008, the IDA changed its name to "Investment Industry Regulatory Organization of Canada – IIROC".

[4] Principles for Financial Market Infrastructures: Principle 14 - Segregation and portability

positions on Futures and Options on Futures, excluding Hedge Open Positions[5], and ii) modify related margin requirements for certain accounts[6]. The margin requirement calculation methodology, set out in the Risk Manual of the CDCC, will be updated accordingly.

As stated, Article 9.4 of the Rules of the Bourse permits the use of SPAN methodology for Approved Participants accounts but prohibits the use of SPAN for Client Accounts. Therefore, the margin that CDCC charges a clearing Approved Participant ("Clearing Member") is established by applying the SPAN methodology. However, Approved Participants are not allowed to use SPAN methodology to determine margin for their clients, regardless of the status of their client. More specifically, if the client of an Approved Participant is another Approved Participant or a Foreign Approved Participant, a non-IIROC member, the SPAN methodology is not permitted to determine margin requirements. As a result, there is a misalignment between the margin charged to the Approved Participant and the one charged to the clients of the Approved Participant.

This proposal seeks to amend the Rules to allow for the Approved Participant adoption of SPAN for client margining purposes on targeted Futures and Options on Futures. Allowing the use of SPAN methodology to calculate margin for Client Accounts within the new GCM Regime would align the margin calculation for clients at both the Canadian Approved Participant of the Bourse and Clearing Member of CDCC levels, if the Approved Participant selects the use of SPAN methodology to calculate margin for their Client Accounts. Such an approach would achieve operational efficiencies by including any margin relief provided by CDCC which is not currently possible under the dual SPAN and strategy-based regimes.

Allowing the optional use of SPAN for Client Accounts would have the added benefits of increased transparency and alignment with global industry standards[7], thereby reducing uncertainty between different margin calculation methods.

If the Approved Participant does not select the use of SPAN methodology to calculate client margin, the existing approach, currently published daily by the Division, will continue to apply. Moreover, it is important to note that margin relief between the GCM Regime and the Non-GCM Regime positions will not be permitted by the CDCC in its proposed amendments to the CDCC Rules. Under the GCM Regime, Hedge Open Positions and Short Positions in Futures or Options for which there are deposited Securities held in specific Deposits in accordance with Sections A-212 and A-706 of the CDCC Rules would be excluded.

c. Comparative Analysis

While developing its clearing model to support its GCM Regime, CDCC conducted a benchmarking analysis with other CCPs, namely, CME Clearing, ICE Clear U.S., Eurex Clearing, Australian Securities Exchange and LCH SA. The framework under the Commodity Futures Trading Commission ("CFTC") regulations and the European Market Infrastructure Regulation regulations

[5] As per the CDCC proposed definition of Hedge Open Positions that are identified by Clearing Members as eligible to reduce market risk for a Client Account Individual or a Market Maker Non-Firm Account.

[6] Please refer to the CDCC publications for more details on this proposal.

[7] CME has provided SPAN to other exchanges and clearing organizations through the Joint Audit Committee, which is a voluntary, cooperative organization composed of several derivatives exchanges and the National Futures Association.

were considered, and CDCC's GCM Regime is closer to that of the CFTC. The SPAN methodology launched by CME Group is the portfolio margining service, recognized by the CFTC, which has been adopted by a number of exchanges and their respective clearing houses, as indicated in the previous section.[8]

d. Analysis of Impacts

i. Impacts on Market

The proposed amendments will have no direct impact on the derivatives markets, other than to align the Bourse margin requirements with CDCC risk practices, and for changes IIROC is implementing to adapt the margin requirements accordingly.

ii. Impacts on Technology

The proposed amendments will have no impact on the technological systems of the Bourse but may have a potential impact on Approved Participants. The SPAN methodology is already widely understood and has been adopted by a vast number of market participants. Approved Participants are encouraged to assess the processes associated with using SPAN to calculate margin for those applicable clients. Any operational impact with vendors or service providers is being monitored to identify any possible challenges. While the implementation of the GCM Regime will require changes to the technological systems of CDCC, this proposal on its own will have no direct impact on the technological systems of CDCC.

iii. Impacts on regulatory functions

The proposed amendments will have no direct impact on the activities of the Division. These amendments have been initiated by the Division, with the support of the Bourse, to align the margin requirements with those of IIROC, and to support CDCC in the implementation of the GCM Regime.

iv. Impacts on clearing functions & on trading functions

The proposed amendments will have no impact on the trading of the Bourse. On the other hand, these changes will support the implementation of the GCM Regime in CDCC's clearing functions. For products not covered by the new GCM Regime, they will continue to be treated as they are today, i.e. as prescribed in the current regime under the Bourse and IIROC rules. Treatment of other listed derivatives not covered by the GCM Regime would also remain the same. For instance, for share futures contracts (under hedge accounts) and equity options with the same underlying, Approved Participants would continue to margin client portfolio exposures using the strategy-based method.

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[8] SPAN has been adopted by North American futures markets and global financial capitals including London, Paris, Tokyo, Osaka, Singapore, Hong Kong, Sydney and many others. Over the years, SPAN has been adopted by more than 50 exchanges and clearing organizations.
https://secure.fia.org/downloads/Mar-Apr_SPAN.pdf

v. Public Interest

The Bourse is of the view that the proposed amendments are not contrary to 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. Limiting the application of using SPAN methodology to Client Accounts under the GCM Regime only, will have the added benefit of lessening the complexity of the associated rule and operational changes.

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

AMENDED VERSION

[...]

PART 9 - CLEARING AND FINANCIAL INTEGRITY

Article 9.4 Use of SPAN Risk Margining System

(a) Approved Participant Account. The Margin required for the account of an Approved Participant constituted exclusively of positions in Derivative Instruments listed on the Bourse may be calculated using the Standard Portfolio Analysis (SPAN) methodology and the Margin interval calculated by, and assumptions used by, the Canadian Derivatives Clearing Corporation. If the Approved Participant selects the SPAN methodology, the Margin requirements calculated under this methodology will supersede the provisions stipulated in the Rules.

(b) Client Account. An Approved Participant may~~The~~ use SPAN methodology to determine Margin requirements with respect to a Client Account ~~is prohibited~~if the Client Account at CDCC complies with the Gross Client Margin Regime as defined under CDCC Rules. If the Approved Participant selects the SPAN methodology, the Margin requirements calculated under this methodology will supersede the provisions stipulated in the Rules.

<u>CLEAN VERSION</u>

[…]

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(b) <u>Client Account</u>. An Approved Participant may use SPAN methodology to determine Margin requirements with respect to a Client Account if the Client Account at CDCC complies with the Gross Client Margin Regime as defined under CDCC Rules. If the Approved Participant selects the SPAN methodology, the Margin requirements calculated under this methodology will supersede the provisions stipulated in the Rules.