

CIRCULAR 129-23

October 25, 2023

REQUEST FOR COMMENTS

AMENDMENTS TO THE RULES OF BOURSE DE MONTRÉAL INC. TO INTRODUCE REFERENCE RATE FALLBACK PROCEDURES

On October 24, 2023, the President and Chief Executive Officer of Bourse de Montréal Inc. (the “**Bourse**”) approved amendments to the rules of the Bourse (the “**Rules**”) in order to include fallback procedures for benchmark reference rates, namely to modify the settlement price procedure for Three-month Canadian Bankers’ Acceptance Futures (BAX) contracts to allow for their conversion to Three-Month CORRA Futures (CRA) contracts, before the discontinuation of CDOR.

Comments on the proposed amendments must be submitted at the latest on **November 27, 2023**. 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
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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).



AMENDMENTS TO THE RULES OF BOURSE DE MONTRÉAL INC. TO INTRODUCE REFERENCE RATE FALLBACK PROCEDURES

Description

Bourse de Montréal Inc. (the “Bourse”), in response to the announced permanent cessation of the calculation and publication of all tenors of the Canadian Dollar Offered Rate (CDOR)¹, hereby proposes to amend its rules (the “Rules”) to include fallback procedures for benchmark reference rates, namely to modify the settlement price procedure for Three-month Canadian Bankers’ Acceptance Futures (BAX) contracts to allow for their conversion to Three-Month CORRA Futures (CRA) contracts, before the discontinuation of CDOR (the “Cessation Event”).

To that effect, the fallback procedures proposed in response to the Cessation Event would be aligned with fallback provisions published by the International Swaps and Derivatives Association (ISDA) for the Canadian Market in October 2020² and with other comparable jurisdictions³, accordingly including an applicable fallback rate and a final settlement price determination methodology comparable to contractual provisions in the industry (i.e. to the same degree as that of the ISDA fallback conventions for the Canadian over-the-counter (“OTC”) derivatives market).

The proposed changes would therefore support a seamless interest rate transition from CDOR-based underlying derivatives to CORRA⁴-based underlying derivatives. The Bourse submits that these amendments will serve the needs of market participants and facilitate greater market efficiency through improved execution quality.

Outline of the Amendments

The Bourse proposes to introduce Article 12.14A in Part 12 of the Rules, which will provide the market with a clear fallback procedure with regards to the final settlement price calculation of the BAX contract, for which it is proposed that, on or around April 26, 2024, all remaining open positions that expire after the Cessation Event will be terminated and replaced with a corresponding open position in CRA contracts. Following conversion, the June 2024 BAX contract - the only BAX contract expiring before the Cessation Event, and therefore not in scope for conversion - will be the only remaining listed BAX contract and will remain available for trading until its expiration on June 17, 2024.

¹ The discontinuation of CDOR will come into effect on June 28, 2024, as announced on May 16, 2022 by Refinitiv Benchmark Services (UK) Limited (“Refinitiv”), the administrator of CDOR.

² [ISDA 2020 IBOR Fallbacks Protocol](#)

³ E.g.: CME converting Eurodollar-based futures to SOFR-based futures in preparation for the discontinuation of the USD LIBOR.

⁴ Canadian Overnight Repo Average

In addition, the Bourse recommends complementing Appendix 6E-4.1 from Part 6 of the Rules by introducing a fallback settlement procedure for BAX contracts. The new provision would facilitate the determination of settlement prices in times of diminished liquidity, relying upon the ISDA spread adjustment⁵ for the 3-Month tenor. Of note, a similar approach was undertaken for Eurodollar in anticipation of LIBOR's cessation. Given that liquidity in the BAX can be expected to decrease as we approach the Cessation Event in June 2024, the Bourse is of the view that it is prudent and appropriate to add such a mechanism to the rules so as to promote stability of settlement prices and be consistent with the conversion process into CRA contracts.

The proposed amendments are deemed essential in response to Canada's interest rate benchmark transition caused by the Cessation Event, and the resulting planned conversion of BAX contracts into CRA contracts. As liquidity in BAX products starts to fade, as it is expected in the market as we approach the Cessation Event, a strong underlying fallback procedure will further assist with the market's adoption of CORRA and provide participants with a holistic solution for transitioning short-term price risk. The Bourse is of the view that the proposed amendments are consistent with its objective of providing market participants with an efficient price discovery mechanism and hedging utility.

The proposed amendments are provided herein in Appendix "A".

Background

International context

In 2013, following the London IBOR scandal, the Financial Stability Board (the "FSB") established a group composed of central banks and regulatory agencies, which focused on reforming the benchmark interest rate landscape (the "Steering Group"). The main recommendations of the Steering Group were: 1) the development of alternative reference rates (mainly overnight risk-free rates, as they have more desirable features of reliable reference rates), and 2) a transition away from Interbank Offered Rates ("IBORs") across all major currencies. Since then, working groups across all main IBOR jurisdictions have been formed to select alternative reference rates and provide an orderly transition.

In 2016, alongside this initiative, the FSB mandated ISDA to work towards the development of fallback language for derivative contracts referencing IBORs. In the context of interest rate derivatives, fallback language refers to the contractual provisions that describe the process through which an alternative rate is selected if a benchmark is not available. Fallback language for a benchmark rate usually includes three different components: trigger events, replacement rate and replacement adjustment.

Robust fallback language is required in financial derivatives contracts to enable a smooth transition in the event of a benchmark cessation event. In fact, many regulators have recommended that firms implement robust, well-defined fallbacks in their derivatives contracts to mitigate the impact of an IBOR cessation event. Firms would then be safe in the knowledge that if they don't finish their transition efforts in time, a workable back-up will automatically kick in.

⁵ [IBOR Fallbacks: Spread fixing event for CAD CDOR](#)

In October 2020, after multiple market consultations with regulators, industry associations and market participants, ISDA published two documents that have been in effect since January 25, 2021: the IBOR Fallbacks Supplement and IBOR Fallbacks Protocol. This marked a major step towards reducing the systemic risk of a key IBOR becoming unavailable while market participants continue to have exposure to that rate. Since then, more than 5,900 entities across 70 jurisdictions have adhered to the new ISDA protocol that allows firms to incorporate new, more robust fallbacks into existing derivatives contracts linked to IBORs.

Canadian context

In May 2022, Refinitiv announced the official discontinuation of CDOR⁶, stating that the calculation and publication of all tenors of CDOR will permanently cease immediately following a final publication on June 28, 2024. As CDOR is the underlying driving rate for the BAX, the Bourse announced a new Fallbacks Implementation Plan⁷ in June 2023, including a conversion process from BAX to CRA in anticipation of the cessation. The Bourse now intends on supporting the announced conversion with the proposed amendments to its Rules.

Rationale for the Amendments and Approach

OBJECTIVES: The Bourse proposes to amend the Rules to introduce new fallback procedures for discontinued reference rates, namely CDOR, fulfilling the following objectives:

- Provide guidance to the market regarding the soon-to-be-discontinued CDOR-based BAX product and its conversion to CRA;
- Offer participants greater visibility and understanding of their risk positions;
- Provide Rules alignment with regulatory initiatives associated with the benchmark reference rate reform in the industry;
- Set clear settlement procedures for discontinued reference rates.

The Bourse further submits that the proposed modifications will increase the utility and the effectiveness of its short-term Canadian interest rate market, strengthen the functioning of the Canadian derivatives market generally, and better serve the interests of market participants.

COMPARATIVE ANALYSIS: Global derivative exchanges and clearing houses throughout the world have also reviewed or are currently reviewing the fallback procedures for all of their respective products referencing IBORs:

- OTC Cleared Derivatives

The CME Group (“CME”) and the LCH Group (“LCH”) have each issued a statement supporting ISDA’s work on fallback language at the end of 2018. For cleared derivatives, CME has updated its rulebook to align with ISDA standards and include revised fallback language, following consultations with its clients. LCH has also announced its intentions to align with ISDA’s amended definitions for new transactions entered on or after the fallback protocol effective date. LCH also

⁶ Refinitiv Benchmark Services (UK) Limited Issues [Canadian Dollar Offered Rate Cessation Notice](#)

⁷ [Advisory Notice A23-007](#) - BAX Fallbacks Implementation Plan

specified that outstanding legacy transactions will be amended to incorporate the corresponding revised definition. These announcements mean that cleared Canadian OTC swaps based on three-month CDOR will rely on the ISDA fallback protocols in the case of an index cessation event⁸.

- Exchange-traded Derivatives

The Intercontinental Exchange, Inc. (“ICE”) and CME⁹ have updated their rules and product offering to provide more transparency on the fallback provision of their IBOR-based futures in light of the upcoming benchmark cessation of their underlying rate. In both cases, the added language provided details on the conversion mechanism to the product referencing the recommended alternative benchmark rate.

The Bourse is now suggesting fallback provisions similar to those of comparable exchanges:

Exchange	Comparable Products	Trigger event	Replacement product based on the recommended fallback rate
Montréal Exchange	Three-month Canadian Bankers' Acceptance Futures	Cessation of CAD CDOR announced in May 2022	Three-Month CORRA Futures
CME	Three-month Eurodollar futures	Cessation of USD LIBOR announced in November 2022	Three-month SOFR Futures
ICE	Three-month Sterling futures	Cessation of GBP LIBOR announced in March 2021	Three-month SONIA Futures

Analysis of Impacts

(i) Impact on market

The proposed modifications aim to provide the market with a clear fallback procedure with regards to the final settlement price calculation of the widely used BAX contract. As global survey-based benchmarks continue to face increased discontinuation risk and as the Cessation Event approaches in Canada, appropriate fallback language is required in financial contracts to ensure a smooth transition before the discontinuation of CDOR.

The recommended amendments will provide the required transparency and structure underlying the transition that will allow participants to proactively manage their positions and reduce market disturbance in the months leading to the Cessation Event. Finally, on or around April 26, 2024, all participants' remaining open positions in BAX contracts that expire after the Cessation Event will be terminated and replaced with a corresponding open position in CRA contracts.

⁸ https://www.lch.com/system/files/media_root/lch-cad-cdor-conversion-consultation.pdf

⁹ <https://www.cmegroup.com/content/dam/cmegroup/notices/ser/2022/12/SER-9115.pdf>

(ii) *Impacts on technology*

The proposed changes will have no impact on the technological systems of the Bourse, CDCC, or any third-parties.

(iii) *Impacts on regulatory functions*

The Proposed Amendments will have no impact on the activities of the Regulatory Division of the Bourse. The amendments will provide a fallback process which sets out a consistent and transparent methodology in the event of a benchmark cessation event, as evidenced in the case of CDOR.

(iv) *Impact on clearing functions*

The proposed changes will have limited impacts on the clearing functions of CDCC; CDCC's Rules and Manuals will be amended to support the Bourse's proposed modifications and properly reflect the fallback provisions for BAX.

(v) *Impact on compliance with laws*

The proposed changes will have no impact on the Bourse's compliance with applicable securities law. As noted above, management is of the view that the proposed amendments will improve market integrity and efficiency in response to the announced discontinuation of CDOR by its administrator.

(vi) *Public interest*

The Bourse considers the proposed amendments to be in the interest of the public as the addition of fallback language aligned with industry conventions (i.e. ISDA fallback protocol and comparable jurisdictions) will provide the market with a transparent settlement procedure and eliminate any uncertainty associated with the transition from CDOR to CORRA. The amendments will provide participants with guidance and relevant conversion processes following the discontinuation of CDOR. These fallback principles are deemed operationally simple and preserve alignment with wider industry transition timelines. The marketplace will benefit from a path consistent with the intimately linked OTC market.

The implementation of clear fallback language will facilitate the management and smooth transitioning of existing positions for participants. The implementation plan underlying the rule changes has already been communicated to market participants¹⁰ and feedback from customers was gathered with respect to the conversion.

The proposed changes mark the final step to the Bourse's coordinated approach¹¹ to the discontinuation of CDOR.

Timing

¹⁰ [Advisory Notice A23-007](#) - BAX Fallbacks Implementation Plan

¹¹ The Bourse undertook various measures to support a seamless transition to CORRA, including: 1) [the listing cessation of BAX](#); 2) [the inclusion of CRA/BAX spreads on Bloomberg & Refinitiv](#); 3) [the listing of One-Month CORRA Futures](#); and 4) [an updated BAX expiry](#).

The Bourse intends to implement the proposed amendments in Q4-2023 following applicable regulatory approval, for an expected conversion on or around April 26, 2024.

APPENDIX A: AMENDMENTS TO THE RULES

BLACKLINE VERSION

[...]

Article 1.101 Definitions

[...]

CDOR Cessation Event (Événement Déclencheur de l'Abandon du Taux CDOR) means the permanent cessation of the calculation and publication of all tenors of CDOR following a final publication on June 28, 2024, as announced on May 16, 2022 by the administrator of CDOR, currently Refinitiv Benchmark Services (UK) Limited (“**RBSL**”).

[...]

Appendix 6E-4.1 THREE-MONTH CANADIAN BANKERS' ACCEPTANCE FUTURES CONTRACTS (BAX)

[...]

(f) Fallback Procedure. If, as determined by the Bourse in its sole discretion, the level of liquidity in BAX is such that the procedures set out in this Appendix 6E-4.1 would not generate an appropriate Settlement Price with respect to any BAX contracts, the Bourse may calculate the daily Settlement Price of any such BAX contracts that expire after the CDOR Cessation Event under Article 12.14A(b) below by subtracting the ISDA spread adjustment (value adjustment under Article 12.14) from the Three-Month CORRA Futures (CRA) daily Settlement Price, rounded to the nearest price increment.

[...]

Article 12.14A Reference Rate Fallback Procedures

Notwithstanding anything to the contrary in the Rules, including Article 12.14, the following shall apply to the Three-month Canadian Bankers' Acceptance Futures:

a) BAX Fallback Effective Date

The BAX fallback effective date shall be April 26, 2024, except where the Bourse determines at any time and in its sole and absolute discretion that implementation of the fallback procedure on such date could result in an unacceptable level of operational or market disruption or where financial stability issues could

threaten the orderly transition of the contract. In such a case, the Bourse shall determine in its sole and absolute discretion an alternative BAX fallback effective date and notify Approved Participants (these alternatives constituting the “**BAX Fallback Effective Date**”).

b) BAX Fallback Procedure

Following close of business day on the BAX Fallback Effective Date, the Bourse shall convert all open positions in the BAX contract that expire after the CDOR Cessation Event as follows:

(i) each position in the contract that is affected by the CDOR Cessation Event shall be terminated at a price determined by the Bourse (the “Termination Price”) and replaced with a corresponding open position in Three-Month CORRA Futures (a “Replacement Position”);

(ii) the Termination Price of such contracts shall be equal to the truncated value, to four decimal places, of:

(A) the most recent daily Settlement Price for the Three-Month CORRA Futures on the BAX Fallback Effective Date,

minus

(B) a value adjustment amount which shall be equal to the spread adjustment for the rate in Article 12.14 published by Bloomberg Index Services Limited and equal to 0.32138% for the three-month tenor.

The Replacement Position shall be assigned to a position holder by the Bourse in accordance with the following procedure:

(i) the Replacement Position in Three-Month CORRA Futures shall be equal in trading unit size and direction to the position in the contract and with the same delivery month;

(ii) the price at which the Replacement Position is assigned to the position holder shall be the most recent daily Settlement Price for the contract on the BAX Fallback Effective Date.

c) Clearing of the Replacement Position

Clearing of the Replacement Position shall be subject to the rules of CDCC for Three-Month CORRA Futures, including for the avoidance of doubt the determination of daily and final Settlement Prices in respect of each Replacement Position.

d) Termination of Trading

(i) Following close of business day on the BAX Fallback Effective Date, trading in BAX contracts expiring after the CDOR Cessation Event shall be terminated and such contracts shall no longer be available for trading at the Bourse with immediate effect;

(ii) Trading in the contracts expiring before the CDOR Cessation Event shall continue after the BAX Fallback Effective Date until the date of termination of trading of each such contract under Article 12.11.

[...]

AMENDMENTS TO THE RULES

CLEAN VERSION

[...]

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Clearing of the Replacement Position shall be subject to the rules of CDCC for Three-Month CORRA Futures, including for the avoidance of doubt the determination of daily and final Settlement Prices in respect of each Replacement Position.

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