☒	Trading – Interest Rate Derivatives	☒	Back-office - Options
☒	Trading – Equity and Index Derivatives	☒	Technology
☒	Back-office – Futures	☒	Regulation

CIRCULAR 135-14
September 29, 2014

REQUEST FOR COMMENTS

METHODOLOGY PROPOSED TO ESTABLISH POSITION LIMITS AND PUBLICATION FREQUENCY OF THE POSITION LIMITS

AMENDMENTS TO ARTICLES 15508, 15608, 15908 AND 15998.7

The Rules and Policies Committee and the Special Committee – Regulatory Division of Bourse de Montréal Inc. (the Bourse) have approved amendments to articles 15508, 15608, 15908 and 15998.7 of the Rules of the Bourse in order to amend the methodology used for establishing the first contract month position limit for Government of Canada Bond futures contacts and to amend the publication frequency of the Bourse's position limits.

Comments on the proposed amendments must be submitted within 30 days following the date of publication of this notice, at the latest on **October 29, 2014**. Please submit your comments to:

M^e^ Pauline Ascoli
Vice-President, Legal Affairs, Derivatives
Bourse de Montréal Inc.
Tour de la Bourse
P.O. Box 61, 800 Victoria Square
Montréal, Québec 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:

M^e^ Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800 Victoria Square, 22^nd^ Floor
P.O. Box 246, Tour de la Bourse
Montréal (Québec) H4Z 1G3
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.

Appendices

For your information, you will find in the appendices an analysis of the proposed amendments as well as the amended articles 15508, 15608, 15908 and 15998.7 of the Rules 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* (R.S.Q., 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 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.

METHODOLOGY PROPOSED TO ESTABLISH POSITION LIMITS AND PUBLICATION FREQUENCY OF THE POSITION LIMITS

AMENDMENTS TO ARTICLES 15508, 15608, 15908 AND 15998.7

I. INTRODUCTION

Bourse de Montréal Inc. (the Bourse) proposes to amend the methodology used for establishing the first contract month position limit for Government of Canada Bond futures contacts (the "First-Month Limit"), described in article 15608 – Position Limits of the Rules of the Bourse. It is proposed that the First-Month Limit be based on 20% of the open interest, for that contract month, at the open of the first business day prior to the First Delivery Notice day and that this position limit remain fixed until the expiration of the contract.

The Bourse also proposes to amend the publication frequency of its position limits as outlined in articles: 15508 – Position Limits, 15908 – Position Limits, and 15998.7 – Position Limits of the Rules of the Bourse. It is proposed that the publication frequency be removed from the preceding articles.

The present proposal will involve the modification of the methodology used to compute the First-Month Limit for Government of Canada Bond futures contracts as well as the frequency at which all position limits are published, as outlined in articles 15508, 15908, and 15998.7.

II. DETAILED ANALYSIS

Nature and Purpose of Proposed Changes

The proposed amendment regarding the First-Month Limit component of article 15608 aims at addressing practical issues posed by the current computation methodology. As indicated in the methodology: "*Effective at the start of trading on the first business day prior to the First Delivery Notice day of the first contract month, the position limit shall be 20% of the open interest of that contract month*.[1]"

It is important to note that the purpose of this provision is to prevent excessive position concentration and potential disorderly pricing in the market for the contract that is going to delivery. These limits are intended specifically for speculative traders, and in the United States are often specifically referred to as Speculative Position Limits. According to the CFTC the

[1] http://www.m-x.ca/f_regles_en/15_en.pdf

purpose of these limits - both First contract month (spot month) and non—spot month position limits are to *"prevent excessive speculation and manipulation while ensuring sufficient market liquidity for bona fide hedgers and protecting the price discovery process.*[2]*"*

The current Bourse methodology for setting First-Month Limits requires that a new limit be calculated on a daily basis based on daily open interest. While this methodology can prevent excessive concentration, it presents serious challenges for market participants and can lead to a reduction in market liquidity as well as the potential exacerbation of disorderly pricing as opposed to its prevention.

Typically, the open interest of the First contract month decreases dramatically as the First Delivery Notice day approaches since the great majority of positions for that contract month are typically rolled over to the next contract month. The current First-Month Limit methodology results in a dynamic limit that most often decreases every day.

This daily reduction in open interest of the First contract month may cause market participants who wish to legitimately take their positions to delivery to inadvertently exceed the prescribed limit. Market participants needing to reduce their positions on the First contract month following the First Delivery Notice day may find themselves in contravention of the article without being able to efficiently remedy the situation since they may be unable to find counterparties in order to reduce the position.

In addition, the current provisions do not make it practical for participants acting as liquidity providers to facilitate orders from market participants wishing to reduce or close out their First month positions since liquidity providers may, themselves, be at risk of exceeding the limit from one day to the next. The dramatic daily reduction of the First contract month open interest and related position limit may thereby lead to a decrease in potential counterparties which may increase the potential for disorderly pricing.

[2] http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/pl_qa_final.pdf

The following benchmarking was undertaken in order to establish industry standards for First-Month Limits rules:

Exchange	Instrument Type Used for Benchmarking	Is a First contract month position limit applied?	Effective Period	Is the First contract month position limit static or dynamic during the effective period?
Montreal Exchange	Government of Canada Bond Futures Contract	Yes	Start of the first business day prior to the First Delivery Notice day of the first contract month	Dynamic
CBOT	US Treasury Bond Futures & US Treasury Notes Futures	Yes	Effective during the last 10 trading days in expiring month	Static
ASX	Treasury Bond Futures Position Limits	Yes	Effective at the close of trading on T-1 and the remaining life of the contract	Static
CFTC	Physical Commodity Futures Contract	Yes	The spot-month period is specific to each commodity contract, need not correspond to a month-long period, and may extend through the period when delivery obligations are incurred	Static

As indicated previously the reduction in open interest in the First contract month may in itself cause a self-perpetuating reduction in liquidity. Given the preceding it is concluded that the combination of a decreasing open interest for the First contract month and a daily re-assessment of its position limit may inevitably threaten the liquidity and price discovery process of Government of Canada Bond Futures contracts.

A further risk posed by the current methodology is that operational issues for market participants caused by the dynamic First-Month Limit may lead to an outflow of trading activity towards Over the Counter (OTC) markets. Therefore, rather than preventing possible disorderly pricing the First-Month Limit may lead to a decrease in transparency. This is especially true for the futures market which is predominantly comprised of sophisticated investors with access to OTC markets. OTC transactions may be used in an attempt to circumvent position limits imposed by regulatory bodies. This was acknowledged by the Securities and Exchange Commission (SEC) when it stated that position and exercise limits for standardized equity options should allow exchanges to compete with the OTC market and prevent the outflow of large customers (mutual funds, hedge funds, and pension funds) towards OTC markets:

"The Commission highlighted competition with the OTC markets as a reason for increasing the standard position and exercise limits in 1998. Specifically, the Commission stated:

The increase in position and exercise limits for standardized equity options should allow the Exchanges to better compete with the growing OTC market in customized equity options, thereby encouraging fair competition among brokers and exchange markets."[3]

Although the above text makes reference to OTC options transactions it recognizes the ability of market participants to circumvent market controls via OTC transactions, which is a reality that is also present in the futures industry.

[3] https://www.sec.gov/rules/sro/cboe/2008/34-57352.pdf

Lastly, as part of the second component of this amendment request, it is proposed that the wording, of articles 15508, 15908, and 15998.7, referring to the publication frequency of position limits be removed from the articles in question so as to permit for a more timely publication of position limits. A monthly position limit publication may quickly become obsolete, therefore frequent publications, such as a daily or weekly publication, would be more appropriate to reflect actual market conditions. The monthly publication requirement should not prevent the Bourse from publishing the required limits on a more frequent schedule if necessary.

Note that although the preceding amendment is being requested to permit the possible increase of the position limits publication frequency the First-Month Limit will be calculated once at the beginning of the effective period and will remain static throughout the effective period; the same first contract position limit would be published throughout the effective period.

Impacts on Technological Systems

The intended impacts on technological systems of both the Bourse and approved participants are considered to be minimal. Participants will not have to make any changes to their technological infrastructure.

Benchmarking

http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/pl_qa_final.pdf
http://www.cmegroup.com/rulebook/CBOT/V/18/18.pdf
http://www.cmegroup.com/rulebook/CBOT/I/5/5.pdf
http://www.sfe.com.au/content/notices/2014/notice2014_008.pdf

III. SUMMARY OF THE PROPOSED AMENDMENTS TO THE RULES AND/OR PROCEDURES OF THE BOURSE

Amendment to Bourse Rule 15, specifically:

1. The methodology outlined in the First-Month Limit component of article 15608 of the rules of the Bourse de Montréal Inc. (the Bourse).
2. The frequency at which position limits are published as outlined in articles: 15508, 15908, and 15998.7

IV. OBJECTIVE OF THE PROPOSED AMENDMENTS TO THE RULES OF THE BOURSE

- Amendment (1) is being proposed to reflect the practical realities of the Government of Canada Bond Futures contracts.
- Amendment (1) is being proposed to ensure that the liquidity and price discovery processes of Government of Canada Bond Futures contracts are not threatened.
- Amendment (2) is being proposed to permit for a more timely publication of position limits if deemed necessary.

V. PUBLIC INTEREST

The proposed amendments are in the public interest since amendment (1) will ensure that the principal objective of the First-Month Limit - the prevention of excessive concentration and disorderly pricing - is maintained while ensuring that the liquidity and price discovery processes of Government of Canada Bond Futures are not impaired. This change will result in a more efficient and equitable market Lastly, amendment (2) is aimed at facilitating the production and dissemination of timely position limits whose purpose is to prevent activities that are detrimental to the marketplace and permit for the maintaining of marketplace integrity.

VI. PROCESS

The first step in the approval process for the regulatory amendments discussed herein is to have them approved by the Special Committee – Regulatory Division. These amendments will then be submitted to the Bourse's Rules and Policies Committee.

Once approved by the Special Committee - Regulatory Division and the Rules and Policies Committee, the proposed amendments, including this document, will be published simultaneously by the Bourse for a 30-day comment period and submitted to the Autorité des marchés financiers (AMF) for self-certification. The AMF will also publish the proposed amendments as well as a 30-day request for comments in its weekly bulletin.

A copy of the proposed amendments will be delivered for information purposes to the Ontario Securities Commission.

VII. REFERENCES

Rule 15608, 15508, 15908, and 15998.7:
http://www.m-x.ca/f_regles_en/15_en.pdf
http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/pl_qa_final.pdf
http://www.cmegroup.com/rulebook/CBOT/V/18/18.pdf
http://www.cmegroup.com/rulebook/CBOT/I/5/5.pdf
http://www.sfe.com.au/content/notices/2014/notice2014_008.pdf

RULE FIFTEEN
FUTURES CONTRACTS SPECIFICATIONS

15508 Position Limits
(22.04.88, 08.09.89, 30.12.93, 07.04.94, 20.06.03, 15.05.09, 00.00.00)

The maximum number of net long or net short positions in all contract months combined in Canadian bankers' acceptance futures contracts which a person may own or control in accordance with article 14157 shall be as follows:

the greater of 4,000 contracts or of such a limit to be established and published ~~on a monthly basis~~ by the Bourse based on 20% of the average daily open interest for all Canadian bankers' acceptance futures contracts during the preceding three calendar months

or such other position limits as may be determined by the Bourse.

In establishing position limits, the Bourse may apply specific limits to one or more rather than all approved participants or clients, if deemed necessary.

15608 Position Limits
(08.09.89, 30.12.93, 07.04.94, 26.08.94, 19.01.95, 03.05.04, 17.04.09, 00.00.00)

The maximum net long or net short position in each designated Government of Canada Bond futures contract which a person may own or control in accordance with article 14157 shall be as follows:

Position limit for all delivery months combined for each designated Government of Canada bond futures contract:

The greater of 4,000 contracts, or of 20% of the average daily open interest for all contract months during the preceding three calendar months.

First contract month position limit:

The position limit for the first contract month shall be based on 20% of the open interest of that contract month at the start of trading ~~Effective at the start of trading~~ on the first business day prior to the First Delivery Notice day of the first contract month~~, the position limit~~ and will become effective on the first business day prior to the First Delivery Notice day ~~shall be 20% of the open interest~~ of that contract month.

In establishing position limits, the Bourse may apply specific limits to one or more rather than all approved participants or clients, if deemed necessary.

15908 Position Limits
(14.06.02, 15.05.09, 00.00.00)

The maximum number of net long or net short positions in all contract months combined in 30-day repo rate futures contracts which a person may own or control in accordance with article 14157 shall be as follows:

a) for speculators 5,000 contracts

b) for hedgers — the greater of 7,000 contracts or of such a limit to be established and published ~~on a monthly basis~~ by the Bourse based on 20% of the average daily open interest for all 30-day overnight repo rate futures contracts during the preceding three calendar months

or such other position limits as may be determined by the Bourse.

In establishing position limits, the Bourse may apply specific limits to one or more rather than all approved participants or clients, if deemed necessary.

15998.7 Position Limits
(16.02.12, 00.00.00)

The maximum number of net long or net short positions in all contract months combined in overnight index swap futures contracts which a person may own or control in accordance with article 14157 shall be as follows:

a) for speculators — 5,000 contracts

b) for hedgers — the greater of 7,000 contracts or of such a limit to be established and published ~~on a monthly basis~~ by the Bourse based on 20% of the average daily open interest for all overnight index swap futures contracts during the preceding three calendar months

or such other position limits as may be determined by the Bourse.

In establishing position limits, the Bourse may apply specific limits to one or more rather than all approved participants or clients, if deemed necessary.