

MONTREAL EXCHANGE

Basis Trade on Close Functionality (BTC)

The Montréal Exchange (MX) activated the Basis Trade on Close (BTC) functionality for share futures contracts and stock index futures contracts in June 2018; its intent was to bridge the gap between equities and derivatives. Through a two-way anonymous continuous basis market, TMX introduced Canada's first electronic trading functionality linking Canada's flagship S&P/TSX 60[®] futures (SXF) product to the S&P/TSX 60[®] index market. This will further increase transparency and liquidity to a market that has historically been an over-the-counter (OTC) market. The goal is to provide an electronic basis trade venue for the optimal cash management of client positions.

This document presents the foundations of the product and the details on how to trade it.

BTC in a Nutshell

BTC is a functionality that allows participants to trade the future at a price equivalent to the official close of its underlying cash market plus a predetermined agreed-upon price differential (positive or negative) known as "the basis".

The basis of an equity trade is a function of the expected dividends, carry cost, and time to maturity. Because BTC is quoted as the price differential between the future's price and the spot price (either the index constituent basket or the single-share), this price differential can be either positive or negative.

BTC provides the possibility to buy and sell S&P/TSX 60 index futures or share futures using the market end-of-day closing price of the underlying as a reference price. Orders can be posted at any moment during the regular market hours, offering an additional tool for investors in search of an efficient way to hedge their market exposure. This solution further optimizes Canada's equity markets while inherently reducing the gap with OTC markets.

Investors facing daily inflow or outflow of capital (in the form of new investments, dividends or withdrawals) usually receive or distribute it by the end of the day. In order to avoid a drag on their fund returns ("tracking error"), portfolio managers can easily use a market on close (MOC) order to equitize this new money, aligning their execution prices with that of market closes. However, without a BTC functionality, no efficient or seamless way is available to hedge their end of the day price risk exposure using a traditional futures contract. To solve this

Through a two-way anonymous continuous basis market, TMX is introducing Canada's first electronic trading functionality which links Canada's flagship S&P/TSX 60[®] futures product to the S&P/TSX 60[®] index market.

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BTC Example

A Canadian mutual fund manager benchmarked against the S&P/TSX 60 index receives the information that by the end of the day, her fund will receive a cash inflow of \$1M. She wants to make sure that this inflow of money will be equitized as soon as possible to minimize the fund's tracking error.

At 11:30 a.m., the S&P/TSX 60 index is quoted at 975. After calculating what she considers the right basis, she posts a bid to buy five (5) S&P/TSX 60 futures contracts at a basis of -\$3.00 against the closing level of the S&P/TSX 60 index for the day. If a counterparty seeking to open a short position agrees on this basis in the S&P/TSX 60 index futures contract, a match occurs and a BTC trade is published in the BTC book.

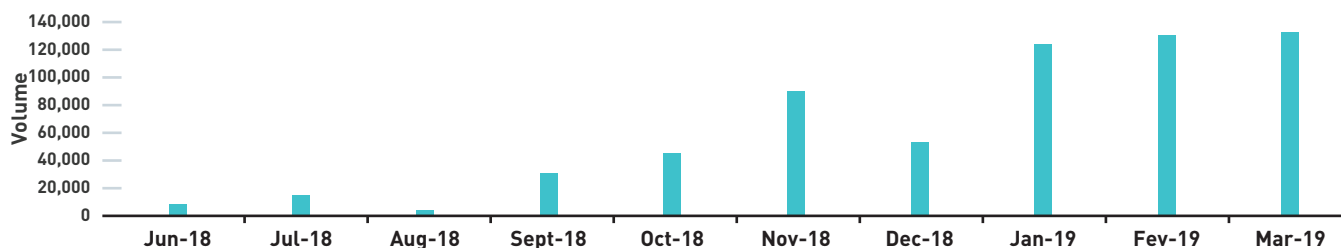
At the close of the cash market, the S&P/TSX 60 index is quoted at 976. Subsequently, the Bourse platform calculates the BTC price on the S&P/TSX 60 index futures contract as 973 (976-3.00) and allocates a long position of five (5) contracts to the portfolio manager and a short position of five (5) contracts to the counterparty at the future price of 973.

In addition to equity financing, the BTC functionality can also improve the experience for index arbitrage traders, market makers, institutional swap desks, brokers on the stock loan business and index options traders seeking to hedge their equity exposure. By serving as an organized market for index futures and share futures basis risk, BTC provides an important price discovery space, facilitating the transition between cash and derivatives that replicate index exposure.

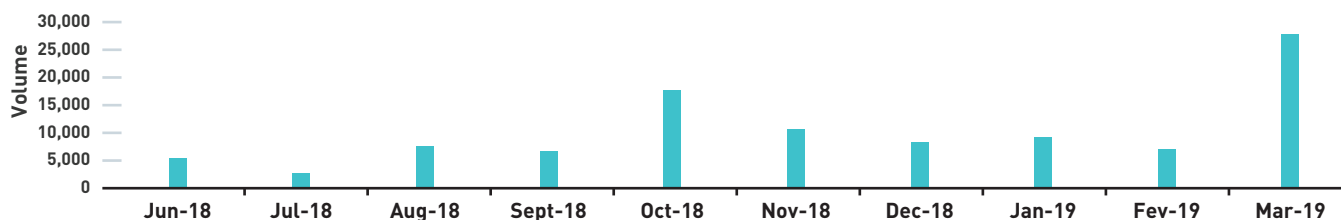
Overview

The tables below present the Share Futures and SXF volume via the Basis Trade on Close (BTC) functionality.

BTC Volume on Share Futures



BTC Volume on SXF



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