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MONTRÉAL EXCHANGE

Canada Bank Credit Futures (BCS) FAQ

Understanding Canada's new Bank Credit Futures (BCS)

The Montréal Exchange (MX) is expected to launch a new Canadian Credit Futures. Please refer to our FAQs below for more information about these contracts, including information on product characteristics, features, and mechanics.

Q1 What is the Canada Bank Credit Futures (BCS)?

BCS is a Canadian exchange-traded contract based on Financial Times Stock Exchange (FTSE) Canada Bank Credit Spread Index which references a basket of up to 24 Canadian Bank Bonds.

Q2 What are the contract specifications?

The Futures contracts offer exposure to the underlying FTSE Canada Bank Credit Spread Index and are denominated in Canadian dollars. They are cash settled based on the value of the respective Index on quarterly IMM dates (i.e. the 3rd Wednesday of the contract month).

Full contract specifications are accessible here.

Q3 What represents the underlying Index value and consequently, the BCS contract price?

The underlying Index represents a credit spread measure and is expressed in basis point terms (example: an Index level of 85 means a credit spread of 85 basis points). As such, the BCS contract price (quoted as 100 minus the Underlying Index)) represents a view of that credit spread at maturity of the contract. Importantly, a long position in the contract benefits from credit spread tightening and conversely, a short position is a hedge against a rising credit spread.

Q4 How is the underlying Index determined?

A reference Index is created by tracking the FTSE Canada Corporate Financial Bank Bond Index with a subset of liquid representative Canadian Financials. In determining the selected bond universe, a process composed of security screening, bucketing and profiling is applied. The second step consists in mapping a Benchmark Government of Canada bond to each reference bond and calculating a Yield-to-Worst spread per bond. The resulting spreads are market cap-weighted to generate the final FTSE Canada Bank Credit Spread Index.

The detailed methodology can be accessed under FTSE methodology documentation.

Q5 What is the duration of the Index?

The Index modified duration is estimated to be in the 3 to 3.5 years range.

Q6 Is the Index representative of the Canadian Corporate market?

The Index basket closely tracks the Canadian corporate sector with a 0.9R^2 correlation metric.

Q7 How many contracts will be listed?

The Bourse will list the nearest 4 contracts in the March quarterly cycle (Mar, June, Sep, Dec). Each contract month is associated with a specific Index series, please see our [Futures timeline illustration] for more details.

Q8 How is the final settlement price of the BCS determined?

Final settlement occurs on the Third Wednesday of the contract's delivery month (IMM date) with the last trade date falling a day before. The Final settlement price is 100 minus the relevant closing FTSE Canada Bank Credit Spread Index series value calculated according to the 4:00 pm E.T. mid-market close CanDeal Composite prices for each bond.

Q9 Are these BCS contracts eligible for block trading?

Yes, BCS contracts are block-eligible. More details about block thresholds can be accessed in the Rules of the Montréal Exchange.

Q10 How does Credit Futures compare to Credit Default Swap Index (CDX)?

While Credit Futures can provide an attractive alternative to CDX (both being expressed in credit spread terms), they are unique in that they (1) are exchange-traded and cost-efficient, (2) provide a better proxy to the Canadian corporate sector, (3) provide a simpler construction as evidenced with the composition of the Index, and (4) do not require ISDA agreements.

Q11 What are some of the typical use cases?

Credit Futures offer multiple use cases including but not limited to (1) Liquidity management: managing daily portfolio liquidity, (2) Duration and spread hedging vis-a-vis a portfolio of bond issues, (3) Tactical view/speculation, (4) Portfolio overlay: Increasing or reducing exposure compared to other portfolio instruments, and (5) Gaining Canadian Credit Exposure.

Q12 How do I calculate the fair value of the Credit Futures contract?

The theoretical fair value of the BCS contract can be determined based on a model that assumes an arbitrage-free relationship between investing in the portfolio of bonds composing the Index and in the Futures contract. The indicative fair value representation is a level of where the Index should trade considering the funding and carry cost associated with holding a portfolio of long Bank bond and short GoC bond positions (Index constituents). More details on the model can be found on the product landing page.

Q13 How do I calculate the fair value of the Futures roll?

The fair value of the roll is equal to the difference between the fair value of the nearby and deferred futures contracts.

Roll Fair Value = Fair value of nearby Futures - Fair value of the deferred Futures contract.

Note that BCS roll strategy consists of one long position in the nearby contract month and one short position in the deferred contract month.

Q14 What is the credit spread value of a 1 basis point movement (CS01) of the BCS contract?

The BCS contract trading units C$5,000 x the Contract Index, the latter defined as 100 minus the underlying credit spread index (expressed in %). If the credit spread index increases by 1 basis point (0.01%), the BCS contract price would decrease by C$0.01 and its market value by C$50 (C$5,000 × 0.01). Therefore, the contract CS01 is C$50 per basis point of credit spread. This remains constant during the life of the contract.

Q15 What is the minimum fluctuation price and what does it represent?

The tick size of the BCS contract is set at 0.005 Contract Index points, representing ½ basis point of credit spread. This price increment of 0.005 Contract Index pointss = $25 per tick (C$5,000 × 0.005).

For more information about the product offering, please visit the Montréal Exchange Credit Futures landing page. For more information about the Index, please visit the FTSE website.

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