



<input checked="" type="checkbox"/>	Trading – Interest Rate Derivatives	<input checked="" type="checkbox"/>	Back-office - Options
<input checked="" type="checkbox"/>	Trading – Equity and Index Derivatives	<input checked="" type="checkbox"/>	Technology
<input checked="" type="checkbox"/>	Back-office – Futures	<input checked="" type="checkbox"/>	Regulation

CIRCULAR
April 8, 2013

REQUEST FOR COMMENTS

AMENDMENTS TO THE PROCEDURES APPLICABLE TO THE EXECUTION OF RISKLESS BASIS CROSS TRANSACTIONS ON FUTURES CONTRACTS ON S&P/TSX INDICES AND FUTURES CONTRACTS ON CANADIAN SHARES

AND TO

THE PROCEDURES FOR THE EXECUTION AND REPORTING EXCHANGE FOR PHYSICAL (EFP), EXCHANGE FOR RISK (EFR) AND SUBSTITUTION OF OTC DERIVATIVE INSTRUMENTS FOR FUTURES CONTRACTS TRANSACTIONS

CHANGES TO THE PRESCRIBED REPORTING FORM FOR SPECIAL TERMS TRANSACTIONS

The Rules and Policies Committee of Bourse de Montréal Inc. (the Bourse) has approved amendments to the procedures applicable to the execution of special terms transactions. Consequently, the reporting form title and content will change as well as the Bourse's trading procedures that are applicable to such special terms transactions. These amendments are aimed at offering a more accurate wording of the procedures and reporting form concerned.

Comments on the proposed amendments to trading procedures that are applicable to special terms transactions must be submitted within 30 days following the date of publication of the present notice, at the latest on May 8, 2013. 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, Quebec H4Z 1A9
E-mail: legal@m-x.ca

Circular no.: 061-2013

Tour de la Bourse
P.O. Box 61, 800 Victoria Square, Montréal, Quebec H4Z 1A9
Telephone: (514) 871-2424
Toll-free within Canada and the U.S.A.: 1 800 361-5353
Website: www.m-x.ca

A copy of these comments shall also be forwarded to the Autorité to:

M^e Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800 Victoria Square, 22nd Floor
P.O. Box 246, Tour de la Bourse
Montréal (Quebec) H4Z 1G3
E-mail: consultation-en-cours@lautorite.qc.ca

Appendices

For your information, you will find in appendices an analysis document of the proposed amendments as well as the procedures concerned by these amendments. The implementation date of the proposed amendments will be determined by the Bourse, in accordance with the self certification process as established in the Derivatives Act (2008, c.24).

Process for Changes to the Rules

Bourse de Montréal Inc. is authorized to carry on business as an exchange and is recognized as a self-regulatory organization (SRO) by the Autorité des marchés financiers (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 its Rules. The Rules of the Bourse are submitted to the Autorité in accordance to the self-certification process as established in the Derivatives Act (2008, c.24).

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.



**AMENDMENTS TO THE
PROCEDURES APPLICABLE TO THE EXECUTION OF RISKLESS BASIS
CROSS TRANSACTIONS ON FUTURES CONTRACTS ON S&P/TSX INDICES AND
FUTURES CONTRACTS ON CANADIAN SHARES**

AND TO

**THE PROCEDURES FOR THE EXECUTION AND REPORTING EXCHANGE FOR PHYSICAL
(EFP), EXCHANGE FOR RISK (EFR) AND SUBSTITUTION OF OTC DERIVATIVE
INSTRUMENTS FOR FUTURES CONTRACTS TRANSACTIONS**

**CHANGES TO THE PRESCRIBED REPORTING FORM FOR
SPECIAL TERMS TRANSACTIONS**

I. INTRODUCTION

Bourse de Montréal Inc. (the Bourse) is proposing to revamp the current prescribed Contingent Trade Reporting Form and the EFP/EFR/Substitution Reporting Form that must be used by approved participants of the Bourse to report Exchange for Physical (EFP), Exchange for Risk (EFR) and Riskless Basis Cross (RBC) transactions to the Market Operations Department (MOD) of the Bourse¹. The proposed modifications will result in the creation of a new and improved Reporting Form which will include the use of credentials, drop down menus, reference numbers, and mandatory/conditional fields. The Bourse is also proposing to change the Reporting Form title from “Contingent Trade Reporting Form” to “Special Terms Transactions Reporting Form”. Consequential amendments are also proposed to the Bourse’s trading procedures that are applicable to such special terms transactions

II. DETAILED ANALYSIS

Nature and Purpose of Proposed Changes

Firstly, it is proposed to change the Reporting Form’s title from “Contingent Trade Reporting Form” to “Special Terms Transactions Reporting Form” in order to utilize a term that offers a more accurate description of the financial transaction undertaken. More specifically, the term “Contingent Trade” is vague as it may be used in numerous contexts and therefore does not offer an accurate depiction of the types of off-exchange transactions for which the Form is intended (EFP, EFR and RBC transactions) as described in article 6815 and in paragraph 5 of article 6380 of the Rules of the Bourse. A “Contingent Trade” has a much broader connotation as it may refer to any simultaneous and interdependent executions of two or more securities or instruments.

¹ The currently prescribed form is available on the Bourse’s website at http://www.m-x.ca/efp_formulaire_en.php

APPENDIX A

Some examples of “Contingent Trades” other than those described in articles 6815 and 6380 of the Rules of the Bourse are.

- Bear Call spread
- Bull Call Spread
- Bear Put Spread
- Bull Call Spread
- Buy Write
- Ratio Trade
- Delta Neutral Trade

It should be noted that the above mentioned contingent trades can be executed as part of the Bourse’s competitive auction process. The Chicago Mercantile Exchange (CME) and the Australian Securities Exchange (ASX) point this out in their descriptions of an “Exchange for Physical” (EFP) transaction.

The CME describes an EFP transaction as follows: “An Exchange for Physical (EFP) is a **privately negotiated, non competitive futures trade transacted apart from the public auction market** of a futures exchange but submitted for clearing through a futures clearing house².” (our bolding and underlining)

The ASX, for its part, defines an EFP transaction as follows: “The EFP is an **off market trading mechanism** that enables customers to swap futures and options exposure for an offsetting stock position. It offers the flexibility and certainty of an over-the-counter (OTC) market, plus the counterparty guarantee of an exchange market³” (our bolding and underlining)

Therefore, given the aforementioned descriptions offered by the CME and ASX, which emphasize the execution of a financial transaction outside the realm of the competitive auction process (off market), it would be inaccurate to lump the financial transactions described in article 6815 and in paragraph 5 of article 6380 of the Rules of the Bourse in the same basket as other contingent trades that are executed on the regular market.

It should also be noted that the CME refers to Exchange for Physical (EFP) and Exchange for Risk (EFR) transactions as Exchange for Related Position (EFRP) transactions⁴. This demonstrates that the term “Contingent Trade” should not be considered as the most suitable term for these types of financial transactions. The term “Special Terms Transaction” offers a relatively better depiction of the transactions described in article 6815 and in paragraph 5 of article 6380 of the Rules of the Bourse and provides a higher degree of accuracy.

Additionally, the Bourse is proposing that the “Special Terms Transactions Reporting Form” be restricted to the use of approved participants of the Bourse. The form will be accessible through the Bourse’s website and login credentials will be required.

The proposed modifications to the current reporting form aim to:

² Trading Practices Overview – CME Group - <http://www.cmegroup.com/clearing/trading-practices/>

³ Exchange for Physical – Australian Securities Exchange (ASX) - <http://www.asx.com.au/products/exchange-for-physicals.htm>

⁴ See CME Rulebook - Chapter 5. Trading Qualifications and Practices - Rule 538 - Exchange for Related Positions - <http://www.cmegroup.com/rulebook/CME/1/5/38.html>

APPENDIX A

- reduce deficiencies that have been observed in the information that is reported to the Bourse
- prevent the entry of incorrect / inconsistent data
- improve record keeping
- provide consistent and readily available empirical data
- limit errors
- provide a detailed audit trail of the submission/approval/dissemination process
- permit a more efficient market dissemination

These objectives will be achieved, notably, by implementing the use of standardized data fields (drop down menus), reference numbers, and mandatory/conditional fields and by automating the data dissemination process.

Presently, authorized persons⁵ of approved participants must complete the current “Contingent Trade Reporting Form” available on the Bourse’s website at http://www.m-x.ca/efp_formulaire_en.php. Most fields in this Form are not hard coded and may therefore be populated at the discretion of the individual who is submitting it. Once completed, the Form is transmitted to the MOD for approval. Although many of the fields are mandatory, the current Form does not ensure data uniformity or erroneous data entry prevention which would render the process most efficient. There is also a lack of efficiently available and clear electronic audit trail concerning the data submitted and the approval process. Additionally, a wider range of details than what is provided by the current Form would benefit the MOD during its approval process and the Regulatory Division of the Bourse when it undertakes a review of these special terms transactions. The lack of data standardization in the current Form leads to various and sometimes confusing field entries, such as, for example:

- Inconsistency in the entry of values
- Inconsistency in the entry of descriptions
- Inconsistency in the entry of symbols

Such inconsistencies result in difficulties for the MOD to validate and approve the submitted transactions. It should be noted that the Australian Securities Exchange (ASX) currently uses a web based system, called ASX TradeAccept for the submission of EFP transactions. The solution proposed by the Bourse is very similar to the ASX system. Essentially, ASX TradeAccept allows ASX participants to report EFP transactions and their respective details through the use of drop down selections within the online portal⁶.

Impacts on Technological Systems

The impacts on technological systems of both the Bourse and approved participants are expected to be minimal. The proposed form will be made available via the Bourse’s website and will contain a graphical user interface (GUI) that will be used by the approved participants to

⁵ For the purposes of completing and transmitting the reporting form to the Market Operations Department of the Bourse, “authorized persons” are persons that have been approved by the Bourse as “SAM Authorized Persons”. These persons are employees of approved participants who, pursuant to their approval by the Bourse, have been granted a direct access to the electronic trading system of the Bourse. The proposed changes will not affect the requirement that transaction reporting be made only by these persons.

⁶ More information about the ASX TradeAccept system is available at <http://www.asx.com.au/clearing/asxtradeaccept.htm>

APPENDIX A

convey the details of their special terms transactions submissions. Approved participants will not have to make any changes to their technological infrastructure.

III. PROPOSED AMENDMENTS TO THE TRADING PROCEDURES OF THE BOURSE

In connection with the above proposal to modify the reporting form for Special Terms Transactions, it is also proposed to amend the Bourse's *Procedures Applicable to the Execution of Riskless Basis Cross Transactions on Futures Contracts on S&P/TSX Indices and on Share Futures* by replacing, on pages 2 and 5 of these Procedures the term "Contingent Trade Reporting Form" by the term "Special Terms Transaction Reporting Form".

It is also proposed to amend the Bourse's *Procedures for the Execution and Reporting Exchange for Physical (EFP), Exchange for Risk (EFR) and Substitution of OTC Derivative Instruments for Futures Contracts Transactions* as follows

- 1o By replacing, on pages 4 and 5 of these Procedures, the term "EFP/EFR/Substitution reporting form" by the term "Special Terms Transaction Reporting Form".
- 2o By replacing, in the English version, as a housekeeping amendment, the term "Market Monitoring Department" by the term "Market Operations Department" since this is the term that currently designates the concerned department.

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

1. The objective of the form's title change from "Contingent Trade Reporting Form" to "Special Terms Transaction Reporting Form" is to provide a title that accurately reflects the particular types of transaction (EFP, EFR and RBC) that are covered by the form.
2. The implementation of a "smart form" containing hard coded standardized fields that provide for all contingencies will greatly reduce the number of erroneous submissions and will increase the approval process efficiency.
3. The requirement of a wider range of details along with a readily available electronic database will increase the efficiency of the approval and review process.
4. The use of login credentials will allow for an accrued automation process and audit trail.
5. The process will allow for automatic market dissemination of trade related information.

V. PUBLIC INTEREST

The proposed reporting form title change and amendments to this form and to the related trading procedures of the Bourse are of public interest since they will permit to obtain a significantly more accurate description of the special terms transactions that are being undertaken. The proposed changes will also contribute to a more efficient approval and execution process of the transactions by eliminating any inconsistencies in the information that must be provided thus reducing significantly the risk of misinterpretation. It will also contribute to the creation of a more complete audit trail thus facilitating the review of special terms transactions by the Regulatory Division of the Bourse. Finally, the automatic dissemination of trade related information following the approval process will provide the public with accurate information in a more timely fashion.

VI. PROCESS

APPENDIX A

The proposed changes to the reporting form for special terms transactions as well as consequential amendments to the relevant trading procedures of the Bourse must first be approved by the Bourse's Special Committee – Regulatory Division and subsequently by the Rules and Policies Committee of the Bourse. Once the proposed amendments have been approved by these committees, they must be submitted to the *Autorité des marchés financiers* in accordance with the self-certification process and to the Ontario Securities Commission for information. They will also be published by the Bourse for a 30-day request for comment period.

VII. REFERENCES

Article 6815 (Exchanges for Physical and Exchanges for Risk Transactions) and paragraph 5 of article 6380 (Riskless Basis Cross Transactions) of the Rules of Bourse de Montréal Inc. - http://www.m-x.ca/f_regles_en/06_en.pdf

Procedures for the Execution and Reporting Exchange for Physical (EFP), Exchange for Risk (EFR) and Substitution of OTC Derivative Instruments for Futures Contracts Transactions http://www.m-x.ca/f_en/procedure_execution_efpEFRsubs_en.pdf

Procedures Applicable to the Execution of Riskless Basis Cross Transactions on Futures Contracts on S&P/TSX Indices and on Share Futures - http://www.m-x.ca/f_en/procedure_obsr_en.pdf

Bourse de Montréal Inc. - Contingent Trade Reporting Form - http://www.m-x.ca/efp_formulaire_en.php
Trading Practices Overview - CME Group - <http://www.cmegroup.com/clearing/trading-practices/>

Australian Securities Exchange (ASX) - Exchange for Physicals
<http://www.asx.com.au/products/exchange-for-physicals.htm>

CME Group Rulebook - Chapter 5. - Trading Qualifications and Practices - Rule 538. Exchange for Related Positions - <http://www.cmegroup.com/rulebook/CME/I/5/38.html>

ASX 24 EFP, Strip and Block Trade Registration Access
<http://www.asx.com.au/clearing/asxtradeaccept.htm>

Bourse de Montréal Inc. - Exchange for Physical (EFPs)
http://www.m-x.ca/marc_terme_echange_contrat_en.php

Data Fields Content Comparison

Current Contingent Trade Reporting Form vs. Proposed Special Terms Transaction (STT) Reporting Form

Currently, the “**Contingent Trade Reporting Form**” is an electronic form accessible via the Bourse’s website; it allows authorized employees (known as SAM Authorized Persons) of Canadian and foreign approved participants to manually enter details in the following fields:

- Contingent transaction type
- Individual Submitting Report
 - Name of approved participant firm
 - Name of individual
 - Title
 - E-mail address
- SAM Authorized Person executing the contingent transaction
 - Name
 - SAM User ID
 - Telephone
 - Fax
- Details of the contingent transaction
 - Transaction Type
 - Counterparty Name
- Futures Contract Component
 - Symbol
 - Contract month & year
 - Quantity
 - Transaction Price
 - Buyer/Seller
- Cash Component or OTC derivatives instrument of the contingent transaction
 - Description
 - Quantity or Value
 - Market Value
 - Correlation
 - Buyer/Seller

The proposed “**Special Terms Transaction Reporting Form**” will be available through a secure portal which will be accessible via the Bourse’s website using a login ID and password, once entered in the portal, authorized employees (i.e. SAM Authorized Persons) of Canadian and foreign approved participants will be able to report special terms transaction details by using drop down menus and conditional fields to populate a quasi error proof smart form. All fields shall be required to be filled and information entered therein shall meet certain pre specified criteria so that it will not be possible to enter invalid variables. What follows is a list of drop down menus and conditional fields that will be present in the portal (highlighted fields are new ones that were not present in the contingent trade reporting form) :

- **User ID and login ID** will be created, distributed and maintained by the Chief Compliance Officer of the approved participant
- Each User ID will have a distinct user profile associated to it
- **Submission Reason** – Mandatory Field - Drop Down Menu with the following choices:
 - - New Submission

APPENDIX A

APPENDIX 1

- - Correction to a Previously Submitted Form
- - Cancellation of a Previously Submitted Form
- - Counterparty Approval Form
- Special Terms Transaction Type – Mandatory Field - Drop Down Menu with the following choices:
 - - Exchange for Physical (EFP)
 - - Exchange for Risk (EFR)
 - - Riskless Basis Cross (RBC)
- General Information
 - Individual Submitting Report – The fields for this information will be populated automatically based on the credentials used to enter the system.
 - Name of individual
 - Title
 - E-mail address
 - Approved participant firm
 - SAM Authorized Person executing the special term transaction - The fields for this information will be populated automatically based on the credentials used to enter the system.
 - Name of individual
 - Title
 - E-mail address
 - Approved participant firm
 - Fax
- Transaction Type Details – Mandatory Field - Drop Down Menu with the following choices:
 - - Cross Transaction
 - - Trade against another firm
- **Counterparty Details** – If the transaction has been identified as a cross transaction, the fields for this information will be populated automatically based on the credentials used to enter the system. If the transaction has been identified as a trade against another firm, the first two fields below will offer a drop down menu from which to choose the name of the approved participant who acted as a counterparty and the name of the authorized person of that firm who did the transaction. The other two fields will be populated automatically based on the choices made for the first two fields
 - Approved Participant Firm
 - Name of individual
 - SAM user ID (Populate Automatically)
 - E-mail (Populate Automatically)
- Futures Contract Component of the transaction – Mandatory Fields
 - Symbol (Drop Down Menu)
 - Contract Month & Year (Drop Down Menu)
 - Quantity
 - Price of Transaction
 - Buyer/Seller (Drop Down Menu)
 - **Buyer Account Type (Drop Down Menu)**
 - **Seller Account Type (Drop Down Menu)**
- Cash or OTC Derivative Component – Mandatory Fields with Drop Down Menus
 - Description of Cash Component

APPENDIX A

APPENDIX 1

- It will be mandatory to fill conditional fields which meet pre specified criteria. These fields will provide details on the execution of the cash component (Quantity/Value, Market Value, and Correlation).
- Buyer/Seller (Drop Down Menu)
- Buyer Account Type (Drop Down Menu)
- Seller Account Type (Drop Down Menu)
- Trade Date and Time
- Market where cash trade was executed
-
- It will be possible to attach proof of cash component (proof of correlation, trade ticket, blotter, etc...)

Differences between the Contingent Trade Reporting Form and Special Terms Transaction (STT) Reporting Form

- The STT reporting form password requirements will offer greater security
- The automatic population of fields and drop down menus will limit entry errors and will allow a speedier and more efficient process
- The existence of conditional fields will prevent the entry of dummy variables
- Additional information requested by STT reporting form on account type will allow identifying for which type of account (firm, client or pro) each leg of a transaction is made. Such account type information will be required for:
 - The buyer of the Future Component
 - The seller of the Future Component
 - The buyer of the Cash or OTC Derivative Component
 - The seller of the Cash or OTC Derivative Component
- The proposed STT reporting form will require that the date and time of Cash Component or OTC Derivative transaction be provided.

Finally, since there may be occurrences where additional details need to be provided, it will be possible to attach files to the reporting form submission (e.g.: proof of correlation, trade ticket, blotter, etc....)



**PROCEDURES APPLICABLE TO THE EXECUTION OF RISKLESS BASIS CROSS
TRANSACTIONS ON FUTURES CONTRACTS ON S&P/TSX INDICES AND
FUTURES CONTRACTS ON CANADIAN SHARES**

FUTURES CONTRACTS ON S&P/TSX INDICES:

Bourse de Montréal Inc. (the Bourse) authorizes riskless basis cross transactions on listed futures contracts on S&P/TSX indices. The Bourse provides approved participants with a facility that permits the purchase/sale of index futures contracts against cash instruments for an average cash market price plus a pre-negotiated basis. A riskless basis cross has no impact on the existing cash market as the initiated operation results in a riskless transaction in the books of the approved participant.

Approved participants receiving requests from clients who cannot or do not want to hold cash securities in their accounts but who wish to acquire market exposure in the most efficient way possible (either on the cash or exchange-traded fund “ETF” markets) are authorized to do a riskless basis cross. The sole intent and purpose of the riskless basis cross is to allow market participants to use the attributes of the underlying cash market to take on the market position requested by the client and then to replicate it through the use of futures contracts thus leaving the approved participant with no resulting market position and the client with a final position in the futures contract.

Once the terms of the riskless basis cross have been agreed to with the client, the approved participant begins the transaction by taking a position in the cash instruments in its own account on behalf of the client. The approved participant then has to execute the riskless basis cross transaction (by contacting the Market Operations Department of the Bourse) and allocate the futures contract position, functionally equivalent to the cash market exposure, (as initially requested by the client) into the client's account.

Approved participants must apply the following procedures when executing riskless basis crosses:

- The approved participant accepts the order to execute a transaction on behalf of its client (who wishes to acquire index market exposure with a resulting futures position) for an average cash market price plus a pre-negotiated basis (spread).
- The terms of the transaction should either be a fixed pre-negotiated basis established prior to execution of the transaction or a guaranteed (by the approved participant to the client) closing or executed price of the cash component in which circumstance the basis will be adjusted accordingly.
- The approved participant begins the transaction by acquiring exposure (long or short) in the cash market on its client's behalf, using securities, baskets of securities, index participation units, or exchange-traded funds comprised of the underlying securities of the related index futures contracts that constitute the

APPENDIX B

riskless basis cross. For the purpose of this type of operation, these instruments are accumulated in the approved participant's account.

- The cash portion of the riskless basis cross must be comprised of at least 80 percent of the components constituting the underlying index (e.g. for the S&P/TSX 60™ Index, at least 48 constituents must be part of the transaction)
- It is generally expected that, for the purpose of the riskless basis cross, approved participants will use all of the index components when taking position in the cash market. However, there are circumstances which may prevent an approved participant from acquiring certain index components, and the approved participant may therefore exclude these index components from the cash position. Examples of such circumstances include: an index component is on the approved participant's or client's internal restricted list (due to a corporate action involving the issuer of the given component), a specific index component is halted from trading during the day of the operation, market conditions of a specific index component are inadequate (e.g. if liquidity is insufficient to execute the transaction) or any other justifiable situation of a similar nature.
- The cash portion of the riskless basis cross must be reasonably correlated to the underlying index with a correlation coefficient (R) of 90% or more.
- At the time agreed with its client the approved participant executes a riskless basis cross transaction for a predetermined quantity of index futures contracts. One side of this riskless basis cross transaction offsets the approved participant's position in the underlying cash market and the other side of the trade represents the total market exposure requested by the client. The resulting "unhedged" index futures contracts position is then allocated into the client's account.
- A riskless basis cross transaction may only be executed during the regular trading hours of the underlying instrument until the end of the extended session at the Toronto Stock Exchange (TSX). The transaction has to be executed the same day as and after the completion of the cash portion of the operation. In the event that the riskless basis cross operation has to be executed over a several day period, the futures portion of the operation has to be proportionate to the underlying portion at any given execution day.
- To execute the riskless basis cross transaction, the approved participant must provide the details of the concluded transaction to the Market Operations Department of the Bourse by filling out and submitting through the Bourse's Web page http://www.m-x.ca/efp_formulaire_en.php the prescribed "Contingent Trade Special Terms Transaction Reporting Form". Once submitted, the riskless basis cross transaction will be registered by the Market Operations Department in the trading system. The transaction will then be specially marked and displayed in the systems (trading platform and data vendors) at the post trade recap level.
- Once concluded and registered, the riskless basis cross transaction will appear in the "Transaction Report" maintained on the Bourse's Web page http://www.m-x.ca/dailycrosses_en.php.

APPENDIX B

- There is no minimum time required to display (by the approved participant) the riskless basis cross transaction prior to execution. As soon as it is reported to the Market Operations Department at the Bourse, the transaction will be registered and displayed without delay.
- There is no minimum size restriction for a riskless basis cross transaction.
- There is no requirement for a riskless basis cross transaction to be executed within either the bid and ask or the daily high and low prices.
- The riskless basis cross transaction is excluded from the daily settlement price procedures, but is included in the daily volume figures.
- Approved participants involved in a basis cross transaction may be required to demonstrate to the Bourse:
 - that the transaction is comprised of at least 80% of the components constituting the underlying index; and
 - that the futures portion of the transaction replicates the underlying index and that components of the underlying index that are not included in the riskless basis cross were justifiably excluded (as described above) from the transaction; and
 - that the cash portion of the riskless basis cross has a minimum correlation of 90% to the underlying index; and
 - whether the transaction's pre-negotiated basis was fixed and established prior to the execution of the transaction or resulted from a guaranteed closing or executed price of the cash component; and
 - that the cash position and the futures contracts position (resulting from the riskless basis cross transaction) are properly recorded in both the approved participant's and client's accounts.
- While the approved participant must acquire the cash market position before executing the futures contract leg, the Bourse does not impose any time limit for the retention or liquidation by the approved participant of the cash market position. Once the riskless basis cross has been completed, the approved participant may manage the positions on its books as it sees fit.

FUTURES CONTRACTS ON CANADIAN SHARES:

Bourse de Montréal Inc. (the Bourse) authorizes riskless basis cross transactions on listed Share Futures contracts. The Bourse provides approved participants with a facility that permits the purchase/sale of Share Futures contracts against the underlying cash instrument for an average cash market price plus a pre-negotiated basis. A riskless

APPENDIX B

basis cross has no impact on the existing cash market as the initiated operation results in a riskless transaction in the books of the approved participant.

Approved participants receiving requests from clients who cannot or do not want to hold cash securities in their accounts but who wish to acquire market exposure in the most efficient way possible on the cash market are authorized to do a riskless basis cross. The sole intent and purpose of the riskless basis cross is to allow market participants to use the attributes of the underlying cash market to take on the market position requested by the client and then to replicate it through the use of futures contracts thus leaving the approved participant with no resulting market position and the client with a final position in the futures contract.

Once the terms of the riskless basis cross have been agreed to with the client, the approved participant begins the transaction by taking a position in the cash instruments in its own account on behalf of the client. The approved participant then has to execute the riskless basis cross transaction (by contacting the Market Operations Department of the Bourse) and allocate the futures contract position, functionally equivalent to the cash market exposure, (as initially requested by the client) into the client's account.

Approved participants must apply the following procedures when executing riskless basis crosses:

- The approved participant accepts the order to execute a transaction on behalf of its client (who wishes to acquire a cash market exposure with a resulting futures position) for an average cash market price plus a pre-negotiated basis (spread).
- The terms of the transaction should either be a fixed pre-negotiated basis established prior to execution of the transaction or a guaranteed (by the approved participant to the client) closing or executed price of the cash component in which circumstance the basis will be adjusted accordingly.
- The approved participant begins the transaction by acquiring exposure (long or short) in the cash market on its client's behalf, using the underlying security of the related Share Futures contract that constitute the riskless basis cross. For the purpose of this type of operation, these instruments are accumulated in the approved participant's account.
- The cash portion of the riskless basis cross must be comprised of the underlying stock of the Share Futures contract.
- At the time agreed with its client the approved participant executes a riskless basis cross transaction for a predetermined quantity of Share Futures contracts. One side of this riskless basis cross transaction offsets the approved participant's position in the underlying cash market and the other side of the trade represents the total market exposure requested by the client. The resulting "unhedged" Share Futures contracts position is then allocated into the client's account.
- A riskless basis cross transaction may only be executed during the regular trading hours of the underlying instrument until the end of the extended session at the Toronto Stock Exchange (TSX). The transaction has to be executed the same day as and after the completion of the cash portion of the operation. In the

APPENDIX B

event that the riskless basis cross operation has to be executed over a several day period, the futures portion of the operation has to be proportionate to the underlying portion at any given execution day.

- To execute the riskless basis cross transaction, the approved participant must provide the details of the concluded transaction to the Market Operations Department of the Bourse by filling out and submitting through the Bourse's Web page http://www.m-x.ca/efp_formulaire_en.php the prescribed "Contingent Trade Special Terms Transaction Reporting Form". Once submitted, the riskless basis cross transaction will be registered by the Market Operations Department in the trading system. The transaction will then be specially marked and displayed in the systems (trading platform and data vendors) at the post trade recap level.
- Once concluded and registered, the riskless basis cross transaction will appear in the "Transaction Report" maintained on the Bourse's Web page http://www.m-x.ca/dailycrosses_en.php.
- There is no minimum time required to display (by the approved participant) the riskless basis cross transaction prior to execution. As soon as it is reported to the Market Operations Department at the Bourse, the transaction will be registered and displayed without delay.
- There is no minimum size restriction for a riskless basis cross transaction.
- There is no requirement for a riskless basis cross transaction to be executed within either the bid and ask or the daily high and low prices.
- The riskless basis cross transaction is excluded from the daily settlement price procedures, but is included in the daily volume figures.
- Approved participants involved in a basis cross transaction may be required to demonstrate to the Bourse:
 - whether the transaction's pre-negotiated basis was fixed and established prior to the execution of the transaction or resulted from a guaranteed closing or executed price of the cash component; and
 - that the cash position and the futures contracts position (resulting from the riskless basis cross transaction) are properly recorded in both the approved participant's and client's accounts.
- While the approved participant must acquire the cash market position before executing the futures contract leg, the Bourse does not impose any time limit for the retention or liquidation by the approved participant of the cash market position. Once the riskless basis cross has been completed, the approved participant may manage the positions on its books as it sees fit.



PROCEDURES FOR THE EXECUTION AND REPORTING OF EXCHANGE FOR PHYSICAL (EFP), EXCHANGE FOR RISK (EFR) AND SUBSTITUTION OF OTC DERIVATIVE INSTRUMENTS FOR FUTURES CONTRACTS TRANSACTIONS

The purpose of the following procedures is to explain as fully as possible: a) the requirements of article 6815 of the Rules of Bourse de Montréal Inc. (the Bourse) relating to the execution of transactions involving the exchange of futures contracts for a corresponding cash position (Exchange for Physical (EFP)) and of transactions involving the exchange of futures contracts for a corresponding over-the-counter derivative instrument (Exchange for Risk (EFR)); and b) of article 6815A of the Rules of the Bourse relating to the execution of transactions involving the substitution of an over-the-counter derivative instrument for futures contracts. Approved participants must ensure that all of their employees who are involved in the execution of this type of transactions are fully aware of these procedures. Any violation of the requirements set forth in articles 6815 and 6815A of the Rules of the Bourse and in these procedures could result in disciplinary action being taken by the Bourse.

Exchanges for Physicals (EFP)

An EFP is a transaction whereby two parties enter into an agreement in which one party purchases a cash market position and simultaneously sells a corresponding futures contract position and the other party sells the cash market position and simultaneously purchases the corresponding futures contract position.

The Bourse permits EFP transactions on the following instruments:

- Interest rate futures contracts**
- Futures contracts on S&P/TSX indices**
- Futures contracts on carbon dioxide equivalent (CO₂e) units (MCX)**
- Futures contracts on Canadian crude oil**
- Canadian Share Futures Contracts**

Exchange for Risk (EFR)

An EFR is a transaction whereby two parties enter into an agreement in which one party purchases an over-the-counter derivative instrument and simultaneously sells a corresponding futures contract and the other party sells the over-the-counter derivative instrument and simultaneously purchases the corresponding futures contract.

The Bourse permits EFR transactions on the following instruments:

- Interest rate futures contracts**
- Futures contracts on S&P/TSX indices**
- Futures contracts on carbon dioxide equivalent (CO₂e) units (MCX)**
- Futures contracts on Canadian crude oil**
- Canadian Share Futures Contracts**

Substitution of an OTC derivative instrument for futures contracts (Substitution)

A Substitution is a transaction whereby two parties enter into an agreement to substitute an over-the-counter derivatives position for a corresponding futures contract position. The party who is the buyer of the over-the-counter derivative instrument substitutes this position and buys the corresponding futures contract and the other party who is the seller of the over-the-counter derivative instrument substitutes this position and sells the corresponding futures contract.

The Bourse currently permits Substitution transactions on futures contracts on carbon dioxide equivalent (CO₂e) units.

Pricing the Cash component of an EFP or the Risk component of an EFR or of a Substitution

The cash component of an EFP or the risk component of an EFR or of a Substitution is priced at such level that is mutually agreed upon by the two parties to the transaction.

The futures contract leg of an EFP, an EFR or a Substitution must be priced at a fair and reasonable level in light of factors such as, but not limited to, the size of such an EFP, EFR or Substitution transaction, the currently traded prices and bid and ask prices in the same contract at the relevant time, the volatility and liquidity of the relevant market and the general market conditions prevailing at the time the EFP, EFR or Substitution transaction is executed.

The cash component of an EFP or the risk component of an EFR or of a Substitution transaction must be the futures contract underlying interest, a by-product of this underlying interest or a similar product that is reasonably correlated to the futures contract being exchanged.

Also, the number of futures contracts exchanged must be approximately equivalent to the quantity or value of the cash market position being exchanged in an EFP transaction or of the risk component being exchanged in the case of an EFR or substituted in the case of a Substitution. Approved participants that are parties to an EFP, EFR or Substitution transaction may be required to demonstrate such equivalency.

Acceptable EFP, EFR and Substitution Transactions

In order to have an EFP, EFR or Substitution transaction accepted by the Bourse, the transaction must satisfy the following conditions:

- There must be separate but integrally related futures contracts and cash (in the case of an EFP) or risk component (in the case of an EFR or Substitution) transactions.
- The exchange or substitution transaction must be done between two separate accounts that must satisfy at least one of the following criteria:
 - accounts have different beneficial ownership;
 - accounts have the same beneficial ownership but are under separate control; or
 - accounts are under a common control but involve separate legal entities which may or may not have the same beneficial ownership.

If the parties to an EFP, EFR or Substitution transaction involve the same legal entity, same beneficial owner or separate legal entities under common control, the

APPENDIX B

approved participant (or the parties themselves) must be able to demonstrate that the EFP, EFR or Substitution transaction is a legitimate arm's length transaction.

- The cash market instrument leg of the EFP or the risk component leg of an EFR transaction must provide for a transfer of ownership of the cash market instrument of an EFP or of the over-the-counter derivative instrument of the EFR to the buyer of this instrument and the delivery of this instrument must take place within a reasonable period of time (in accordance with cash market or over-the-counter practice).
- The relation between the prices of the futures contract and of the cash instrument leg of the EFP or the risk component leg of the EFR or Substitution transaction and the relevant prices in either market must be established.
- If he does not have actual possession of the cash instrument, in the case of an EFP transaction, or of the over-the-counter derivative instrument, in the case of an EFR transaction, before the execution of the transaction, the seller of this cash instrument or over-the-counter derivative instrument must be able to demonstrate his ability to satisfy his delivery obligation.
- The Bourse may request that approved participants involved in an EFP, EFR or a Substitution transaction demonstrate that the related cash position and futures position is reasonably correlated.

Acceptable Cash Components for the purpose of an EFP Transaction

In order to have an EFP transaction accepted by the Bourse, the cash component of the transaction must satisfy the following conditions:

- **For interest rate futures contracts:** fixed income instruments that have a reasonable price correlation, maturities as well as risk characteristics that parallel the instrument underlying the futures contract being exchanged. Such instruments include, but are not necessarily limited to, money market instruments including asset backed commercial paper, Government of Canada and Federal Crown Corporation fixed income instruments, provincials fixed income instruments, investment grade corporates including Maple Bonds and mortgage instruments including collateralized mortgage obligations (CMOs). Fixed income instruments denominated in the currency of a G7 member country that satisfy these conditions are also acceptable.
- **For futures contracts on S&P/TSX indices:** stock baskets must be reasonably correlated to the underlying index with a correlation coefficient (R) of 0.90 or more. Furthermore, these stock baskets must represent a weight of at least 50% of the underlying index or must include at least 50% of the securities of the underlying index. The notional value of the basket must be fairly equal to the value of the futures contract component of the exchange transaction. Exchange-traded funds (iShares™) are also acceptable, provided they mirror the index futures contract against which the EFP transaction is made.
- **For futures contracts on carbon dioxide equivalent (CO₂e) units:** The eligible Canadian CO₂e units are regulated emitters' credits, and / or offset credits

APPENDIX B

- **For futures contracts on Canadian crude oil:**
 - For Canadian heavy crude oil: specific domestic crude oil streams with not less than 2.5% nor more than 3.5% sulfur by weight, not less than 19° API gravity nor more than 22° API gravity. Domestic crude oil streams include, but are not limited to: Western Canadian Select, Western Canadian Blend, Lloyd Blend, Bow River, Cold Lake Blend and Wabasca.
- **For Canadian share futures contracts:** The underlying stock of the futures contract being exchanged.

Permissible Over-the-Counter Derivative Instruments for the purpose of an EFR Transaction

A list of permissible over-the-counter derivative instruments for the purpose of effecting an EFR transaction is included in Appendix I.

Permissible Over-the-Counter Derivative Instruments for the purpose of a Substitution Transaction

- **For futures contracts on carbon dioxide equivalent (CO₂e) units:** Over-the-counter derivative instruments on carbon dioxide equivalent units that are reasonably correlated (with a correlation coefficient (R) of 0.80 or more) to the futures contract being substituted.

As a guideline, the time period used to calculate the correlation coefficient must be based on daily price data for a period of at least six (6) months or, if weekly price data are used, for a period of at least one (1) year.

Reporting an EFP, EFR or Substitution transaction to the Bourse

EFP, EFR and Substitution transactions must be reported to the Bourse's Market Monitoring Operations Department for approval and subsequent input into the Montréal Automated System (SAM). Approved participants for both the seller and buyer must complete and submit to the Market Monitoring Operations Department the Special Terms Transaction EFP / EFR / Substitution Reporting Form prescribed by the Bourse. This form is available on the Web sites of the Bourse at http://www.m-x.ca/efp_formulaire_en.php and at http://www.mcx.ca/trading_transactionReportForm in the case of futures contracts on carbon dioxide equivalent (CO₂e) units. If the EFP, EFR or Substitution transaction is executed before the closing of the trading session of the futures contract involved in the transaction, the EFP / EFR / Substitution Special Terms Transaction Reporting Form must be submitted immediately upon the execution of the transaction. If the EFP, EFR or Substitution transaction is made after the closing of the trading session, the EFP / EFR / Substitution Special Terms Transaction Reporting Form must be submitted no later than 10:00 a.m. (Montréal time) on the next trading day.

If the EFP / EFR / Substitution Special Terms Transaction Reporting Form is not accurately filled out with all the relevant information required by the Market Monitoring Operations Department of the Bourse, the transaction will not be approved neither recorded in SAM and the

APPENDIX B

approved participant will have to resubmit a new EFP / EFR / Substitution Special Terms Transaction #Reporting Form correctly completed.

Once correctly completed EFP / EFR / Substitution Special Terms Transaction #Reporting Forms have been received, the Market Monitoring-Operations Department will validate the transaction. The Bourse has the discretion to refuse an EFP, EFR or Substitution transaction if it deems that it is not in compliance with the requirements, as the case may be, of articles 6815 or 6815A of the Rules of the Bourse or of these procedures. In case of refusal, the Market Monitoring-Operations Department will ensure that the approved participant(s) involved in the EFP, EFR or Substitution transaction are promptly informed of such refusal and of the reasons for it.

Once an EFP, an EFR or Substitution transaction has been validated and has been entered into SAM by the Market Monitoring-Operations Department, the following information with respect to this transaction will be disseminated by the Bourse on its Web sites at http://www.m-x.ca/dailycrosses_en.php or at http://www.mcx.ca/trading_transactionReport in the case of case of futures contracts on carbon dioxide equivalent (CO₂e) units:

- Date and time of transaction
- product description (code);
- Contract month(s);
- Volume of the transaction; and
- Transaction price

Trade validation and market dissemination by the Bourse of an EFP, EFR or Substitution transaction will not preclude the Bourse from initiating any investigation and, as the case may be, disciplinary procedures in the event that the transaction is subsequently found to have been made other than in accordance with the requirements of articles 6815 and 6815A of the Rules of the Bourse or of these procedures.

Audit Trail Requirements for EFP, EFR and Substitution Transactions

Approved participants who enter into an EFP, EFR or Substitution transaction must maintain all documents relevant to the futures contracts and corresponding cash market or over-the-counter derivative instruments transactions and must be able to promptly provide copies of such documents to the Regulatory Division of the Bourse upon request. Documents that may be requested include, but are not limited to, the following:

- Futures contracts order tickets;
- Futures contracts account statements;
- Documentation customarily generated in accordance with the cash market, over-the-counter or other relevant market practices such as cash account statements, trade confirmation statements, ISDA[®] Master Agreements or other documents of title;
- Third party documentation to support proof of payment or allowing to verify that the ownership title of the related cash market position or, as the case may be, of the related over-the-counter derivative instrument position was transferred from the seller to the buyer. This may include, but is not limited to canceled checks, bank statements; cash account statements and cash instruments clearing corporation documents (e.g.: CDS Depository and Clearing Services Inc.).

All futures contracts order tickets must clearly indicate the time of execution of the EFP, EFR or Substitution transactions.

APPENDIX 1
Exchange for Risk: List of permissible OTC derivative instruments

	Bond Futures Contracts	Short-Term Interest Rate Futures Contracts	Stock Index Futures/ Single Stock Futures	Commodities Futures
Vanilla Interest Rate Swaps	√	√		
Equity and Index Swaps			√	
Commodities Swaps or Forwards				√
Forward Rate Agreements - FRAs		√		
OTC Options and Options Strategies	√	√	√	

The following outlines the characteristics of OTC derivative instruments that would be acceptable for EFR transaction purposes.

Swaps:

Interest rate

- standard plain vanilla OTC swap;
- written under the terms of an ISDA[®] Master Agreement;
- providing for regular fixed rate payments against regular floating rate payments;
- All swap payments must be denominated in the currency of a G7 member country;
- The OTC interest rate swap must be reasonably correlated with an R = 0.90 or greater so that the futures contract is a suitable instrument for hedging the OTC derivative instrument transactions. As a guideline, the time period used to calculate the correlation must be based on daily price data for a period of at least six (6) months or, if weekly price data are used, for a period of at least one (1) year.

Equities and indices

- standard plain vanilla OTC swap;
- written under the terms of an ISDA[®] Master Agreement;
- providing for regular fixed rate payments or regular floating rate payments against the positive or negative performance of a basket of securities or a stock index;
- All swap payments must be denominated in the currency of a G7 member country;
- The OTC equity or index swap must be reasonably correlated with an R = 0.90 or greater so that the futures contract is a suitable instrument for hedging the OTC derivative instrument transaction. As a guideline, the time period used to calculate the correlation must be based on daily price data for a period of at least six (6) months or, if weekly price data are used, for a period of at least one (1) year.

Swaps or Forwards on Commodities:

- written under the terms of an ISDA[®] Master Agreement;
- The OTC commodities swap or forward must be reasonably correlated with an R = 0.80 or greater so that the futures contract is a suitable instrument for hedging the OTC derivative instrument transaction. As a guideline, the time period used to calculate the

APPENDIX B

correlation must be based on daily price data for a period of at least six (6) months or, if weekly price data are used, for a period of at least one (1) year.

Forward Rate Agreements (FRAs):

- conventional FRA;
- written under the terms of an ISDA® Master Agreement;
- predetermined interest rate;
- agreed start/end date;
- have a defined interest (repo) rate.

OTC Options and OTC Option Strategies:

- Any individual or combination of OTC equity or stock index option positions can form the risk transaction component of an EFR transaction against any of the Bourse's stock index or single stock futures contracts.
- Any individual or combination of OTC bond, interest rate swap or FRA options (e.g. caps, floors, collars) can form the risk component of an EFR transaction against any of the Bourse's interest rate futures contracts

Stock baskets used in an EFR transaction must have the following characteristics:

- be reasonably correlated to the index underlying the futures contract with an $R = 0.90$ or greater and the time period used to calculate the correlation must be based on daily price data for a period of at least six (6) months or, if weekly price data is used, for a period of at least one (1) year;
- represent at least 50% of the weight of the index underlying the futures contract or include at least 50% of the stocks comprised in the index underlying the futures contract;
- have a notional value equivalent to the value of the futures contract component of the EFR transaction;
- exchange-traded funds (ETFs) are acceptable provided that they mirror stock index products traded on the Bourse.