



CIRCULAR 088-21

May 18, 2021

REQUEST FOR COMMENTS

AMENDMENTS TO APPENDIX 6E4.1 OF THE RULES OF BOURSE DE MONTRÉAL INC. TO MODIFY THE MINIMUM THRESHOLDS APPLICABLE TO THE THREE-MONTH CANADIAN BANKERS' ACCEPTANCE FUTURES CONTRACT DAILY SETTLEMENT PRICE PROCEDURE

On May 11, 2021, the Rules and Policies Committee of Bourse de Montréal Inc. (the “**Bourse**”) approved amendments to Appendix 6E4.1 of the Rules of the Bourse in order to modify the minimum thresholds defined in the daily settlement price procedure of the Three-Month Canadian Bankers’ Acceptance futures contract (“**BAX**”).

Comments on the proposed amendments must be submitted at the latest on **June 18, 2021**. 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
2640 Laurier boulevard, suite 400
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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 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).



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THE MINIMUM THRESHOLDS APPLICABLE TO THE THREE-MONTH CANADIAN BANKERS'
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I. DESCRIPTION

Bourse de Montréal Inc. (the “Bourse”) hereby proposes to amend its rules to update the minimum thresholds (“Minimum Thresholds”) defined in the daily settlement price procedure of the Three-Month Canadian Bankers’ Acceptance futures contract (“BAX”) applicable in order to better reflect market conditions during the trading day and at settlement time. The BAX daily settlement price Minimum Thresholds were reduced by half in May 2020, following negative market impacts resulting from the COVID-19 pandemic environment. In the last few months, the Bourse observed that liquidity conditions in the BAX contract have significantly and sufficiently improved to justify a Minimum Threshold increase. Therefore, the Bourse is revisiting the BAX daily settlement price Minimum Thresholds with the objective of determining more optimal levels that are in line with the observed market dynamics. Specifically, the Bourse proposes to increase the minimum thresholds by 25 contracts each, resulting in 100, 75 and 50 contracts for the BAX Whites, Reds and Greens respectively. The Bourse believes that the proposed amendments will enhance market efficiency by making the daily settlement prices more reliable and robust, to the benefit of the entire marketplace.

II. PROPOSED AMENDMENTS

The Bourse proposes to amend the minimum thresholds for the BAX daily settlement price procedure within Appendix 6E4.1 of the rules in light of the sustained liquidity observed in the last several months. The Bourse aims to increase the minimum thresholds from:

- 75 contracts to 100 contracts for the first four quarterly contract months (“whites”);
- 50 contracts to 75 contracts for quarterly contract months 5 to 8 (“reds”);
- 25 contracts to 50 contracts for quarterly contract months 9 to 12 (“greens”).

It should be noted that the amendments proposed by the Bourse will not change the methodology set forth in the procedure and the automated pricing algorithm will not be modified except for the minimum number of contracts required for each BAX contract year.

In order to determine the appropriate minimum thresholds for different BAX expiries, the Bourse analyzed internal market data and surveyed market participants. The Bourse believes that the proposed amendments remain consistent with its objective of providing market participants with an efficient price discovery mechanism and hedging utility.

III. ANALYSIS

a. Background

The Bourse determines the BAX daily settlement price by means of an automated pricing algorithm. The daily settlement price is then used by the Canadian Derivatives Clearing Corporation (“CDCC”) to establish end-of-day margins. As settlement prices influence end-of-day margins, they have a significant impact on market participants holding open positions.

The algorithm includes a minimum number of contracts traded during the last three minutes or, as the case may be, during the last 30 minutes of the trading session that is required when determining the settlement prices for all BAX contract months (“the minimum threshold”).

In February 2016, the Bourse introduced three distinct minimum thresholds to be used by the pricing algorithm when calculating the BAX settlement price, as opposed to a single minimum threshold of 50 contracts previously used.

- The first threshold applied from the 1st to the 4th BAX quarterly contract month (“whites”) and was set at 150 contracts.
- The second threshold, for the 5th to the 8th quarterly contract month (“reds”), was set at 100 contracts.
- The third threshold, involving less liquid contracts from the 9th to the 12th quarterly contract month (“greens”), remained at 50 contracts.

The objective of raising the threshold for near-term contracts (from the 1st to the 8th quarterly contract month, “whites” and “reds”) was to make it more difficult and costly to influence the settlement price. As a result, a market participant who was tempted to influence the BAX settlement price would have to incur additional trading costs and greater risk.

In May 2020, the Bourse amended the daily settlement price procedures of the BAX contract within its rules in response to the market context which resulted in substantially diminished BAX Futures contracts liquidity. The minimum thresholds were adjusted to 75, 50 and 25 contracts for the BAX whites, reds and greens respectively¹. These adjustments were required in order to generate settlement prices that were aligned with market conditions at the time of settlement price calculation.

Since then, the Bourse continued to monitor the market conditions of the BAX Futures contract, with the intention of raising the minimum thresholds if an improvement of liquidity was observed over a sustained period of time. This was effectively observed in Q1 2021 for all twelve contract expiries, as shown in Table 1 below. The activity increase during the settlement period (and throughout the overall trading day) is a sign that the market has stabilized and the Bourse is confident that this activity level will continue going forward. Determination of the Minimum Thresholds also takes into account that the figures in Table 1 represent averages that can be influenced by market conditions on specific days. The levels were determined to maximize the likelihood that transactions are favored by the daily pricing algorithm.

¹ Which represented 50% of the minimum thresholds in place at that time.

Table 1: Average daily volume observed during the daily settlement period for each BAX contract.

BAX contract	Q2 2020	Q3 2020	Q4 2020	Q1 2021
White 1	822	93	309	258
White 2	91	264	104	206
White 3	123	197	86	201
White 4	150	147	104	75
Red 1	113	91	126	162
Red 2	103	76	162	139
Red 3	71	49	130	267
Red 4	56	35	47	104
Green 1	5	26	41	111
Green 2	65	3	5	92
Green 3	5	0	13	122
Green 4	0	5	9	113

b. Objectives

The objective of the proposed amendments is to revise the procedure used to determine the BAX settlement price, in particular the minimum thresholds, and bring it in line with the new environment of the BAX market in order to make it more robust and efficient. The Bourse wants to provide the market with an efficient mechanism of price discovery.

More specifically, the Bourse believes that the proposed modifications will:

- increase the robustness and effectiveness of the daily settlement price for hedgers and speculators involved in the BAX market
- make the daily settlement price more reflective of market conditions and increase transparency

The Bourse believes that these amendments will strengthen the functioning of the Canadian derivatives market and better serve the interests of market participants.

c. Comparative Analysis

Certain specifications of the procedure used by the Bourse to determine daily BAX settlement prices are similar to those of other exchanges on which short term interest rate futures are traded, such as CME and ICE. The threshold and the time required are different for their comparable futures contracts. Table 1 below shows the minimum quantity thresholds required by other exchanges, if applicable. Disclosing the minimum thresholds used in determining daily settlement price is a frequent practice in the industry as it gives the market more transparency and clarity surrounding settlement price establishments.

Table 2: International benchmarking of the minimum thresholds required to determine the daily settlement price of STIRs futures contracts.

Exchange	Products (Short-term interest rate futures)	Number of contracts traded or quoted during the daily settlement period								
CME	Eurodollar Futures	Not specified; volume-weighted average price during the last minute of trading. For other non-treasury interest rate futures contracts with low open interest, the minimum quantity is 50 contracts. ²								
ICE	Euribor Futures and Short Sterling Futures	500 contracts. Less liquid STIRs futures contracts have minimum thresholds ranging from 20 to 250 contracts. ³								
ASX	90-day Bank Bill Futures	Not specified. The market operator may from time to time, nominate an order and/or trade volume requirement per product required to be taken into account for the purpose of settlement calculation ⁴ .								
MX	BAX	<table border="0"> <tr> <td>Current</td> <td>Proposed</td> </tr> <tr> <td>Whites: 75 contracts</td> <td>Whites: 100 contracts</td> </tr> <tr> <td>Reds: 50 contracts</td> <td>Reds: 75 contracts</td> </tr> <tr> <td>Greens: 25 contracts</td> <td>Greens: 50 contracts</td> </tr> </table>	Current	Proposed	Whites: 75 contracts	Whites: 100 contracts	Reds: 50 contracts	Reds: 75 contracts	Greens: 25 contracts	Greens: 50 contracts
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Greens: 25 contracts	Greens: 50 contracts									

Based on this international benchmarking exercise, the Bourse considers that the proposed modifications to modify the minimum thresholds for the BAX daily settlement price procedure is aligned with international practices for comparable products, given their liquidity levels.

d. Analysis of Impacts

i. Impacts on Market

The proposed amendments will have minimal impact on daily trading as they apply only to the calculation of the BAX daily settlement price, which is based on the last minutes of daily trading. The volume of the BAX contract may increase during the closing range as the required threshold will be raised. However, the Bourse foresees no major impact on the volume of trading in individual contracts. As stated earlier, the intention of the Bourse is to strengthen the functioning of the Canadian derivatives market. The proposed modifications will be more reflective of liquidity conditions in the BAX market, which should provide more price transparency for participants.

ii. Impacts on Technology

² https://www.cmegroup.com/market-data/files/CME_Group_Settlement_Procedures.pdf

³ https://www.theice.com/publicdocs/futures/Designated_Settlement_Periods_Volume_Thresholds.pdf

⁴ https://www.asx.com.au/documents/rules/asx_24_section_02.pdf

The proposed rule amendments have no impact on the technological systems of the Bourse, its approved participants, independent software vendors, or any other market participants. The Bourse has not identified any impediments, whether technical, operational or other, to the implementation of the proposed amendments.

iii. Impacts on regulatory functions

The proposal has no impact on the compliance, supervision and reporting rules on the Bourse.

iv. Impacts on clearing functions

The proposed changes should have no impact on the clearing functions of CDCC, on CDCC's Rules and Operations Manual, nor on CDCC's Clearing Members, or other Industry participants dealing with CDCC.

v. Public Interest

The proposed amendments should enhance the quality of the closing prices and thus increase the transparency of the BAX contract. The Bourse considers these amendments to be in the interest of the public as they will allow for better trading and hedging practices for market participants. As previously stated, the robustness and effectiveness of the daily settlement price, which is beneficial for market participants.

IV. PROCESS

The amendment process was triggered by the Bourse's desire to update the Minimum Thresholds parameters contained in the BAX daily settlement price algorithm and to bring them in line with the market conditions observed recently. The proposed amendments, including this analysis, must be approved by the Bourse's Rules and Policies Committee and submitted to the Autorité des marchés financiers, in accordance with the self-certification process, and to the Ontario Securities Commission for information purposes.

V. ATTACHED DOCUMENTS

Proposed amendments to the Rules of the Bourse.

Appendix 6E4.1 THREE-MONTH CANADIAN BANKERS' ACCEPTANCE FUTURES CONTRACTS (BAX)

The daily Settlement Price procedure for the Three-Month Canadian Bankers' Acceptance Futures contract (BAX) is executed by a fully automated pricing algorithm which utilizes the parameters described in paragraphs (b), (c) and (d) of Appendix 6D-4.1 to ensure accuracy in the process.

(a) Definitions:

[...]

(iii) "Minimum Threshold" means the applicable threshold for BAX will be:

- (1) ~~75~~ 100 contracts for the first four quarterly contract months ("whites");
- (2) ~~50~~ 75 contracts for quarterly contract months 5 to 8 ("reds"); and
- (3) ~~25~~ 50 contracts for quarterly contract months 9 to 12 ("greens").

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