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☒	Back-office – Futures	☒	Regulation

CIRCULAR
May 21, 2013

REQUEST FOR COMMENTS

ELIMINATING THE POSITION LIMITS ON THE S&P/TSX 60 STANDARD INDEX FUTURES CONTRACT (SXF) AND THE S&P/TSX 60 MINI FUTURES CONTRACT (SXM)

AMENDMENTS TO ARTICLE 15708 OF THE RULES OF BOURSE DE MONTRÉAL INC.

The Rules and Policies Committee of Bourse de Montréal Inc. (the **Bourse**) has approved amendments to Article 15708 of Rule Fifteen of the Bourse in order to eliminate position limits on the S&P/TSX 60 Standard Index Futures contract (SXF) and the S&P/TSX 60 Mini Futures contract (SXM).

Comments on the proposed amendments must be submitted within 30 days following the date of publication of this notice, at the latest on **June 21, 2013**. Please submit your comments to:

M[e] Pauline Ascoli
Vice-President, Legal Affairs, Derivatives
Bourse de Montréal Inc.
Tour de la Bourse
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Montréal, Québec H4Z 1A9
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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
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Circular no.: 096-2013

Appendices

For your information, you will find in the appendices an analysis of the proposed amendments and amended Rule Fifteen 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).

ELIMINATING THE POSITION LIMITS ON THE S&P/TSX 60 STANDARD INDEX FUTURES CONTRACT (SXF) AND THE S&P/TSX 60 MINI FUTURES CONTRACT (SXM)

AMENDMENTS TO ARTICLE 15708 OF THE RULES OF BOURSE DE MONTRÉAL INC.

I. OVERVIEW

Bourse de Montréal Inc. (the Bourse) hereby proposes to modify Article 15708 of the Rules of the Bourse in regard to the S&P/TSX 60 Standard Index Futures contract (SXF) and the S&P/TSX 60 Mini Futures contract (SXM), with respect to their respective position limits.

The contract specifications currently stipulate that the position limit for the SXF contract is 30,000 contracts and that the position limit for the SXM contract is one-quarter of that. The Bourse proposes that, henceforth, there be no position limit for either the SXF or SXM contracts.

II. ANALYSIS

Description and Analysis of Impacts

Compared to index futures contracts listed on major international derivatives exchanges, the Bourse's SXF contract has the lowest position limit in respect of notional value. In fact, the majority of its peer index futures contracts, including the S&P/ASX 200 Index Futures, the FTSE 100 Index Futures, the EURO STOXX 50 Index Futures, the FTSE JSE Top 40 Index Future, the RTS Index Futures and the NIKKEI 225 Index Futures, do not have position limits.

Consequently, the position limit on the SXF contract is restrictive and it encourages participants who seek to establish a sizeable position on the S&P/TSX 60 Index to bring this activity to the Over-the-Counter (OTC) market, where there are no position limits. This takes transparency away from the market, hampering price discovery and taking valuable information away from the trading public.

Furthermore, this places the Bourse at a competitive disadvantage with regards to large international institutional investors looking to establish positions in the futures market as a means of access to foreign markets.

In theory, position limits exist to prevent market manipulation by a single market participant or by a group of market participants. In the case of listed and cash-settled index futures, however, position limits do not serve as a preventative measure against market manipulation; in fact it can be argued that they hurt the very markets which they are intended to protect.[1]

1 Sanford J. Grossman "The Case for Eliminating Position Limits on Financial Futures – The Journal of Financial Engineering – Volume 2 – Number 1

Excerpts from "The Effectiveness of position limits: Evidence from the foreign exchange futures markets"[2]

> …Gastineau (1992), Tesler (1993) and Grossman (1993) posit that position limits are ineffective controls for market manipulation, and Gastineau and Jarrow (1991) argue that arbitrary position limits even reduce market liquidity and induce nonsynchronous pricing in related markets. According to Grossman (1993), with position limits, speculators shift to foreign or substitute markets. Dutt and Harris (2005) document controversies about the use of position limits.
>
> Overall then, empirical evidence of the effectiveness of either hedging or speculative position limits remains scarce.

Futures markets play an essential role in world markets as they provide critical information about the value of financial instruments. The competitive nature of futures markets lends value to both the futures and cash markets by providing insight into where prices should be, both today and for a period of time into the future. The setting of prices in futures markets necessitates an incredible amount of information, thus transactions in futures markets have a great impact on the perceived value of the asset underlying the futures contract. When such transactions are executed on-exchange, the trading public gains valuable insight into the fair value of that underlying asset, both at that point and in the future. When such transactions are executed through the OTC market, however, this information is lost to the trading public and only benefits the highly sophisticated investors executing these transactions in the OTC market.

Currently, participants who trade forwards on the S&P/TSX 60 index by means of the OTC market are not required to report their positions, no matter what size of position they have. While the Bourse proposes to eliminate position limits on SXF and SXM in order to encourage participants in the OTC market to bring their transactions on-exchange, the Bourse has no intention whatsoever to modify the way positions in the SXF and SXM contracts are monitored.

The Bourse's approved participants are required to file reports with the Regulatory Division of the Bourse on a daily basis stipulating all gross positions held for their own account, and for the accounts of their clients, that are in excess of 1,000 contracts. This is an essential requirement which must be maintained as it facilitates the identification of any situation that could give rise to concentration risk, for example in the case where an account, or a group of related accounts, holds a significant percentage of the open interest, presenting risk of manipulation. This information on the holders of large positions enables the Bourse to take preventative measures as appropriate to ensure that the market continues to operate in a fair and equitable manner.

It is also worth noting that, as is currently the case, these proposed amendments retain the Bourse's ability to impose specific position limits on one or more approved participants, or clients, if deemed necessary or appropriate. With this provision and the requirement to provide position reports as detailed above, the Bourse will maintain complete control of its market and will retain the ability to impose limitations when justified, even in the absence of universal position limits.

The S&P/TSX 60 index is the asset underlying the SXF and SXM contracts and it covers approximately 73% of Canada's equity market capitalisation[3]. Furthermore, the SXF and SXM contracts are cash-settled at maturity, meaning that the holder of the contract will receive cash as opposed to units in the actual S&P/TSX 60 index, thus, position limits truly have no relevance in the case of the SXF and SXM contracts.

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[2] Chang, Y.-K., et al. "The effectiveness of position limits : Evidence from the foreign exchange futures markets", J. Bank Finance (2013)

[3] S&P/TSX 60 http://www.standardandpoors.com/indices/sp-tsx-60/en/us/?indexId=spcadntx--caduf--p-ca-l--

Recent regulatory and risk management reforms set forth in the US *Dodd-Frank Wall Street Reform and Consumer Protection Act*, the *Markets in Financial Instruments Directive* (*MiFID*) and the *Markets in Financial Instruments Directive Regulation* (*MiFIR*) as well as in the *European Market Infrastructure Regulation* (*EMIR*) stem from G-20 commitments to mitigate counterparty risk by utilizing mandatory clearing and to foster trading on trading venues to improve price discovery and transparency. These reforms are prompting participants in the OTC market to shift their business towards listed and centrally cleared derivatives contracts[4], thus the time is opportune to encourage participants in the OTC market to move their business to listed and centrally-cleared derivatives contracts such as SXF by eliminating the associated position limits.

On February 1, 2013 the Bourse launched a market making program for the SXF contract designed to increase liquidity and trading activity on the SXF contract. The elimination of the associated position limit would further encourage enhancements in terms of liquidity and trading activity.

Drafting Process

While the drafting process was driven by the need to remain consistent with competing derivatives exchanges, there has also been substantial market demand to move forward with this proposal.

Impacts on Technological Systems

The proposed changes should have no impact on the technological systems of the Bourse, of the Bourse's approved participants or of any other market participants.

Benchmarking

The table below compares and contrasts the SXF position limit against the position limits of other index futures contracts listed on major international derivatives exchanges.

Table I: Notional values and position limits of index futures contracts listed on major international derivatives exchanges as at March 21, 2013

Contracts	Exchanges	Position Limits	Contract Values	Position Limit Notional Values (PLNV)	Ratios of S&P/TSX 60 PLNV to those of the others
S&P/TSX 60	MX	30 000	$146,750	$4,402,500,000	-
E-mini S&P 500	CME	100 000	$77,300	$7,730,000,000	1,76X
E-mini DJIA	CME	100 000	$72,000	$7,200,000,000	1,64X
NIKKEI 225	OSE	NO LIMIT	12 540 000 JPY	NO LIMIT	NO LIMIT
S&P/ASX 200	ASX	NO LIMIT	$123,600	NO LIMIT	NO LIMIT
FTSE 100	LIFFE	NO LIMIT	63,200 £	NO LIMIT	NO LIMIT
EURO STOXX 50	EUREX	NO LIMIT	26,15	NO LIMIT	NO LIMIT
RTS Index	RTS Exchange	NO LIMIT	143,700 RUB	NO LIMIT	NO LIMIT
FTSE JSE Top 40	JSE	NO LIMIT	360,000 ZAR	NO LIMIT	NO LIMIT

Source: Bourse de Montréal Inc. - Research and Development, Bloomberg L.P

III. SUMMARY OF THE PROPOSED AMENDMENTS TO THE RULES OF THE BOURSE

[4] ERNST & YOUNG – Managing change with OTC derivatives reforms
http://www.ey.com/GL/en/Industries/Financial-Services/Banking---Capital-Markets/Global-financial-regulatory-reform--OTC-derivatives

The Bourse proposes to amend Article 15708 of the Rules of the Bourse to stipulate that there is no position limit for the SXF and SXM contracts.

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

The objective of the proposed amendments is further liquidity and trading activity on SXF, encouraging institutions to move their business on-exchange and away from the Over-the-Counter (OTC) market.

V. PUBLIC INTEREST

The Bourse receives frequent comments from institutional market participants stating that they would prefer to trade the SXF as opposed to its counterpart in the OTC market; however they are not able to do so because of the position limit in place on the SXF. They often request that the SXF position limit be eliminated so that they will be free to choose where they wish to execute their transactions.

The proposed elimination of the SXF position limit would also reap benefits for the Canadian derivatives market as a whole by facilitating enhanced transparency and price discovery, and by reducing pricing discrepancies and arbitrage opportunities between the listed and OTC markets. Furthermore, the SXF contract would also see improvements in both liquidity and trading activity.

VI. PROCESS

The proposed amendments, including this Analysis, are to 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. They will also be published by the Bourse for a 30-day request for comment period.

VII. ATTACHED DOCUMENTS

ARTICLE 15708 OF THE RULES OF BOURSE DE MONTRÉAL INC. - REVISED

SECTION 15701 - 15750
Futures Contracts on S&P/TSX 60 Index
(07.09.99, 06.05.11)

Sub-section 15701 - 15720
Specific Trading Provisions

15708 Position Limits
(07.09.99, 15.05.09, 06.05.11, 00.00.00)

There are no position limits for standard futures contracts or equivalent contracts on the S&P/TSX 60 Index.~~The maximum number of net long or net short positions in all contract months combined in index futures contracts which a person may own or control in accordance with article 14157 of the Rules shall be as follows:~~

~~30,000 standard futures contracts, or equivalent contracts, on the S&P/TSX 60 Index~~

Notwithstanding the above paragraph, the Bourse may if it sees fit or deems necessary to ensure the integrity and fairness of the market impose specific position limits on one or more approved participants, or clients.~~or such other position limits as may be determined by the Exchange. For purposes of this calculation, a mini futures contract on the S&P/TSX 60 Index shall be deemed to be equivalent to one-quarter of a standard futures contract on the S&P/TSX 60 Index.~~

If such specific position limits are imposed, an S&P/TSX 60 Index Mini Futures contract shall be deemed to be equivalent to one-quarter of a standard futures contract on the S&P/TSX 60 Index, for the purpose of calculating these position limits.~~In establishing position limits, the Exchange may apply specific limits to one or more rather than all members or clients, if deemed necessary.~~

~~Members may benefit from the exemption for a bona fide hedge in accordance with article 14157 of the Rules.~~