☒	**Trading – Interest Rate Derivatives**	☒	**Back-office - Options**
☒	**Trading – Equity and Index Derivatives**	☒	**Technology**
☒	**Back-office – Futures**	☒	**Regulation**

CIRCULAR
June 23, 2005

REQUEST FOR COMMENTS

IDENTIFICATION AND ENTRY OF ORDERS

AMENDMENTS TO ARTICLE 6379

Summary

The Rules and Policies Committee of Bourse de Montréal Inc. (the Bourse) has approved amendments to article 6379of the Rules of the Bourse, which deal with the elimination of the requirement to identify the account type at the time of order entry for futures contracts and options on futures contracts. However, these amendments maintain the requirement that this identification, if not done at the time of order entry, be done when the transaction is allocated.

Process for Changes to the Rules

Bourse de Montréal Inc. is recognized as a self-regulatory organization (SRO) by the Autorité des marchés financiers (the Autorité). In accordance with this recognition, the Bourse carries on activities as an exchange and as a SRO in Québec. 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.

Circular no.: 099-2005

The Board of Directors of the Bourse has the power to approve the adoption or amendment of various Rules and Policies of the Bourse. The Board of Directors has delegated to the Rules and Policies Committee of the Bourse its powers to approve or amend its Rules and Policies. These changes are submitted to the Autorité for approval.

Comments on the proposed amendments to article 6379 of the Rules of the Bourse must be submitted within 30 days following the date of publication of the present notice in the bulletin of the Autorité. Please submit your comments to:

Ms. Joëlle Saint-Arnault
Vice-President, Legal Affairs and Secretary
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

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

Ms. Anne-Marie Beaudoin
Director – Secretariat of L'Autorité
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 rule amendments as well as the proposed regulatory text. The implementation date of the proposed amendments will be determined, if applicable, with the other Canadian self-regulatory organizations following approval by the "Autorité des marchés financiers”.

Bourse de Montréal Inc.

IDENTIFICATION AND ENTRY OF ORDERS

– AMENDMENTS TO ARTICLE 6379

I SUMMARY

A – Current Rule

The current Rules of Bourse de Montréal Inc. (the Bourse) contain certain requirements regarding the identification of orders at the entry. Thus, article 6379 requires that orders be identified as to their origin, either as being orders for the account of a firm, of a customer or of a professional.

Before a transaction is executed, a trader must manually enter the account type (Firm, Client, Pro) into the appropriate field of the trading system. This entry creates the trade identifier required for each transaction.

For regulatory purposes, having the correct trade identifier for each transaction creates an audit trail which allows for an effective supervision of unacceptable practices such as front running.

Background of Article 6379

Prior to year 2000, the Bourse's futures contract products were negotiated in an open outcry market. Once a trade was executed in the trading pit, it was allocated into the proper account via a back office system called "DTM". On this system, one had to identify the account type (Firm, Client, Pro) according to its account allocation.

In 2000, the Bourse converted from an open outcry trading market to an electronic trading platform thus eliminating the need to use DTM. The new electronic trading platform allowed for both execution of transactions and their allocation to accounts through a system called Mind Trade Management (MTM). MTM allows approved participants to identify the account type at the time of execution and when the transaction is allocated to an account. The account type identifier is therefore found twice for every transaction in MTM.

The account type trade identifier can serve, for regulatory purposes, as an indicator for front running. However, it is unnecessary to have it both at execution time and at allocation time. Having the correct identifier at allocation would be sufficient.

With MTM, the equity option contracts do not currently benefit from an account type trade identifier at the time of allocation as it is the case for futures contracts since the Bourse's options trading system does not permit allocations, and these must be done through the approved participants' back office systems. Therefore, in the case of equity option contracts, it is important that the account type identifier be correctly entered at execution time since it is the only one available. Furthermore, because the options market does not have the same dynamics as the futures contracts market, the speed needed to enter an order is not as important a factor as it is for futures contracts trading, making the identification of the account type at order entry an easier task. The requirement to record the account type identification at the time of order entry must therefore remain for equity option contracts.

C – The Issue

As mentioned previously, the information required by article 6379 can be found twice on the MTM system (at execution and when the transaction is allocated). However, it was brought to the attention of the Market Surveillance Department of the Bourse that the account type information found at execution is often wrong because the traders executing the transaction do not have the time in a very dynamic and competitive futures contracts market to properly identify each order in the system before executing the trade. Consequently, many of them use a default trade identifier to identify the greater majority of their orders. This means that every order entered always has the same identifier, therefore making the account type identifier at execution unreliable. However, the identifier is always correct at allocation, since every account has a correct account type designation.

D – Objective

The objective of the proposed amendment to article 6379 of the Rules is to delete the requirement for a trade identifier at order entry for all futures contracts and options on futures contracts. The identification of orders would therefore only be required at allocation.

E – Effect of Proposed Amendment

The proposed amendments will permit a more efficient way for approved participants to execute orders and eliminate redundancy in requirements of article 6379.

II – DETAILED ANALYSIS

A – Problems Caused by Current Requirements of Article 6379

The mechanics of trading futures contracts is very different from the mechanics of trading equity options. The trading environment for futures contracts traded on the Bourse is characterized by limited market depth, wide bid and ask spreads and frequent statistical releases of economic data. Furthermore, the majority of clients who trade futures contracts are institutional clients who put a very strong emphasis on quality and speed of execution.

Because of these differences, the rules that are applicable to the options market cannot always be replicated in an exact manner for the futures contracts market. In the latter case, because of the frequent very high degree of volatility and minimal client base, approved participants' response time to their clients must be very quick. Below are some of the possible situations and difficulties that can occur in the application of trade identifiers at execution time for futures contracts:

1) entering the client identification can delay the order entry and this can result in the client taking his business elsewhere. In the event of adverse economic releases, an approved participant trader whose trade identifier is set at default will benefit by being able to execute trades faster than the one who has not such a default setting;

2) in many instances, volatility in the futures contract markets can increase significantly shortly after news releases resulting in many clients calling all at once. In such a situation, the trader has to handle almost simultaneously a large number of buy and sell orders for numerous clients. In this case, the task of identifying the clients at execution time becomes virtually impossible if the trader wants to efficiently execute his client orders and provide an adequate service. Increasing the amount of time required between an order being received and its execution does not benefit anyone.

3) Since trades will be identified at the time of allocation, making the trade identification compulsory at order entry time is redundant considering that traders have a duty to concentrate on keeping an eye on the market and to adequately service their clients. By having the proper trade identifier at allocation time, the regulatory needs are met.

B – Current Rules and Proposed Rules

Article 6379 – Input of Orders

Article 6379 currently contains a provision requiring approved participants to indicate at the time of order entry if an order is for the account of a firm, a client or a professional.

It is proposed to amend this requirement so that, for futures contracts and options on futures contracts, it be no longer necessary to enter the trade identifier at the time of order entry. The trade identifier would be required only when making the allocation once the order is executed.

C – Other Alternatives Considered

No other alternative was considered.

D – Effect of proposed amendment

The proposed amendment to article 6379 will have a positive impact on approved participants and the futures contracts and options on futures contracts market in the sense that by no longer requiring a trade identifier at time of order entry, the speed of execution will improve resulting in more efficient servicing for the end customer, without compromising the audit trail since the proper indicator will be found at allocation (see Appendix I).

F – Interests of Capital Markets

The Bourse is of the opinion that the proposed regulatory amendment is in the best interests of the capital markets since it will permit a more efficient trade execution.

G – Public Interest Objective

The proposed amendments are considered to be of public interest because they will not only eliminate the redundancy that currently exists regarding the identification of orders but they will also contribute to a more efficient execution which will in turn benefit the end customer.

III -- COMMENTS

A) Process

The first step of the approval process for the regulatory amendment proposed in the present document consists in having them approved by the Rules and Policies Committee of the Bourse. Once the approval of the Rules and Policies Committee is obtained, the project is published by the Bourse for a 30-day comment period and submitted to the Autorité des marchés financiers for approval and to the Ontario Securities Commission for information.

IV – SOURCES

- Article 6379 of the Rules of Bourse de Montréal Inc.

Appendix I - Impact of removing the trade identifier at execution

Without the proper trade identifier at the entry, will the Bourse and the approved participants be able to perform proper trading activity supervision and detect infractions such as front running or client order priority?

First, the supervision of futures contracts trading activities is mainly done on a T+1 basis, therefore only after execution and allocation of the order.

Secondly, the Bourse offers a system called Mind Trade Management (MTM) for the allocation of futures contract trades which allows approved participants or any user of MTM to see the type of account in which each trade was allocated. This system, mandatory for the allocation of futures transactions, is in place for each approved participant trading futures contracts, usually in the back office. The Market Surveillance Department of the Bourse itself has also access to MTM and uses it as one of its tools to supervise each approved participants' trading activities. The following presents the system as it appears to the approved participant.

As shown in the table below, the trade is first executed ("trade" line) under the type of account (client, firm, pro) which, according to articles 6376 and 6379, must be the account type for the final receiver. Then the transaction will be allocated by the approved participant ("allocation" line) under the appropriate account type which should, normally and when done in accordance with article 6379, be the same account type as the one indicated on the "trade" line.

In a situation where the transaction was executed and given up to another firm, this transaction will be composed of a "trade" line and a "give up" line (no "allocation" line), both indicating the account type which should always be "client" in this kind of situation (refer to rows 5 and 6).

Note that more fields than the ones presented in the table below are available. However, for the purpose of this explanation, only the necessary fields have been included.

	Order Date Time	Execution Date	Trade Id	Trader Id	*Opposite* Firm Id	Clearing Type	Acct Type	B/S	Symbol	Trade Volume	Trade Price	Seconds	Client Acct Nb
1	**2004/03/05 10:08:34**	**2004/03/05 10:24:37**	**138711**	**000AAA**	**BDM000**	**Trade**	**Pro**	**Sell**	**BAXU04**	**4**	**97.100**	**963**	**12345**
2	**2004/03/05 10:08:34**	**2004/03/05 10:24:37**	**138711**	**000AAA**	**BDM000**	**Allocation**	**Client**	**Sell**	**BAXU04**	**4**	**97.100**	**963**	**12345**
3	2004/03/05 10:08:39	2004/03/05 10:32:30	**138733**	000LLL	BDM000	**Trade**	**Client**	Sell	BAXU04	2	97.100	1436	98765
4	2004/03/05 10:08:39	2004/03/05 10:32:30	**138733**	000LLL	BDM000	**Allocation**	**Client**	Sell	BAXU04	2	97.100	1436	98765
5	2004/03/05 10:17:34	2004/03/05 10:32:57	**138739**	000LLL	BDM000	**Trade**	**Client**	Sell	BAXU04	7	97.100	1436	55555
6	2004/03/05 10:17:34	2004/03/05 10:32:57	**138739**	000LLL	BDM000	**GiveUp**	**Client**	Sell	BAXU04	7	97.100	1436	55555

It can be seen that the two first lines (row 1 or "trade" line and row 2 or "allocation" line) pertaining to one transaction being transaction number 138711 (column "trade id") indicate that the order was entered under "pro" type and allocated under "client" type. Thus the type of account selected at the entry was erroneous, which would constitute an infraction to article 6379.

Appendix I - Impact of removing the trade identifier at execution (cont'd)

The next transaction, being transaction number 138733 (row 3 or "trade" line and row 4 or "allocation" line) was entered and allocated under the "client" account type. For this transaction, the account type was correctly identified at the entry.

Finally, the last transaction which is composed of row 5 or "trade" line and row 6 or "give-up" line and identified as transaction number 138739 was entered and given up under the "client" account type. So the transaction was entered under the appropriate type of account.

The MTM system offers the opportunity of seeing in which account type the order was allocated (or "given up"). The account type at the allocation is always accurate, the same cannot be said about the account type at execution. Therefore the supervision in order to detect any front running, or to ensure that the priority of order was respected or any other type of infraction is more accurately done using the "allocation" and "give up" lines, thus making the trade identifier at execution time ("trade" line) useless.

Since allocation lines are always accurate (unlike trade lines), the advantage is that the reviewer can rely totally on the account type indicated when looking at "allocation" and "give up" lines.

If, as described in article 6374, client and firm orders are at the same price and have the same time stamp, the firm will be able to look at "allocation" lines and raise a flag by looking at any firm trade coming before a client trade to ensure that the trader did comply with the requirement of article 6374 to give priority to client orders over approved participant's own orders. With the help of order tickets and tape recordings (mandatory as per article 6377), the approved participant should be able to determine if priority was respected or not.

6379 Input of Orders
(25.09.00, 24.09.01, 29.10.01, 01.04.04, 00.00.05)

Except as provided in paragraph b) of article 6375, the market orders and limit orders are entered into the trading system and presented to the market without delay in accordance with the chronology of their receipt. The other orders are presented to the market as soon as their time limit or triggering limit is reached.

Any order which is entered into the trading system must indicate if the order is for the account of a firm, of a client or of a professional, as these terms are defined in article 6376. In addition, if the order is for the account of an insider or of a significant shareholder, as these terms are defined in article 6376, it must be identified as such. When these conditions are fulfilled, the input in the system triggers the recording of the order. However, for futures contracts and options on futures contracts, such identification may be entered after execution of the transaction when making allocation to accounts for clearing purposes. Should the final receiver fail to be identified directly in the system, a time-stamped recording in accordance with article 6377 of the Rules must be completed.

If a chronological ranking of receipt cannot be established between many orders, the client priority rules of article 6374 of the Rules apply.