CIRCULAR 113-20
June 25, 2020

REQUEST FOR COMMENTS

AMENDMENTS TO ARTICLE 12.5 OF THE RULES OF BOURSE DE MONTREAL INC. TO MODIFY THE MINIMUM PRICE FLUCTUATION OF THE THREE-MONTH CANADIAN BANKERS' ACCEPTANCE FUTURES

On March 17, 2020, the Rules and Policies Committee of Bourse de Montréal Inc. (the "**Bourse"**) approved amendments to article 12.5 of the Rules of the Bourse to amend the minimum price fluctuation (tick size) of the Three-Month Canadian Bankers' Acceptance Futures (the "BAX contract") such that the minimum price fluctuation for the ninth, tenth, eleventh and twelfth quarterly BAX contract months be reduced by half, from 0.01 index points (a full tick) to 0.005 index points (a half tick).

Comments on the proposed amendments must be submitted at the latest on **July 27, 2020**. 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:

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Executive Director, Legal Affairs
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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).

AMENDMENTS TO ARTICLE 12.5 OF THE RULES OF BOURSE DE MONTREAL INC. TO MODIFY THE MINIMUM PRICE FLUCTUATION OF THE THREE-MONTH CANADIAN BANKERS' ACCEPTANCE FUTURES

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I. DESCRIPTION

Bourse de Montréal Inc. (the "Bourse") hereby proposes to amend the minimum price fluctuation (tick size) of the contract specifications for the Three-Month Canadian Bankers' Acceptance Futures (BAX), such that the minimum price fluctuation for the ninth, tenth, eleventh and twelfth quarterly BAX contract months (the "Greens") be reduced by half, from 0.01 (a full tick) index points to 0.005 index points (a half tick).

After successfully implementing this tick size reduction for the BAX's ten nearest listed contract months (quarterly and serial contracts included), the Bourse is proposing to extend the application of the half tick minimum increment to all of its BAX contract offering.

II. PROPOSED AMENDMENTS

The Bourse proposes to amend the minimum price fluctuation (tick size) of the BAX contract within article 12.5 of its Rules such that the minimum price fluctuation for the ninth, tenth, eleventh and twelfth quarterly BAX contract months be reduced by half, from 0.01 index points (a full tick) to 0.005 index points (a half tick). Therefore, the minimum price fluctuation for all the listed contract months (including serials) would be 0.005, representing $12.50 per contract.

Table 1: Proposed modifications to BAX minimum price fluctuation specification

Current Minimum price fluctuation specification	**Proposed** Minimum price fluctuation specification
0.005 = C$12.50 per contract for the ten (10) nearest listed contract months, including serials 0.01 = C$25.00 per contract for all other contract months	0.005 = C$12.50 per contract for all contract months

III. ANALYSIS

a. Background

Over the years, many market participants (end-users) have requested that the BAX minimum fluctuation price be reduced to a half tick increment for multiple reasons, and the same arguments are still valid to support the implementation in the BAX greens:

1) Reduction in trading costs: Full tick is deemed too costly given the market environment, notably that the bid/ask spread is lower for comparable products in OTC markets[1]. A tick size too wide makes a contract inefficient from a hedging cost point of view. A smaller tick size reduces slippage (the difference between the expected price of a trade and the executed price of the trade), providing greater price precision for all market participants. The Bourse operates in a highly competitive environment (vs OTC markets) and the tick size of futures contracts is a key determinant to its success. There is currently little incentive to use the BAX Greens trading in full tick given that competing products have

[1] Forward rate agreements (FRA's) in the OTC market and on alternative trading platforms offer smaller minimum price fluctuations than the BAX.

much tighter bid-ask spreads. Therefore, reducing the tick size would provide better execution and cost efficiency to market participants.

2) Increase in number of market participants: Having a half tick minimum price fluctuation unit would potentially increase the diversity of market participants. It is expected that reducing the minimum tick size in the BAX Greens would bring in new participants, redirecting them from OTC markets. Multi-product and multi-currency strategy asset managers, who are active in other futures contracts, typically avoid the BAX Greens due to the perceived high trading cost. Many of these asset managers trade other STIR futures rather than Canadian STIR futures, for cost reasons. By reducing the tick size, hedgers will be encouraged to be more active in the market as the cost of hedging a position will be lower and speculators will have a larger pool of clients to trade against. Both hedgers and speculators are essential to the health of the BAX, and it is crucial to ensure that each group makes up a sustainable proportion of the overall market. A healthy futures market needs a diversified mix of client types.

3) Optimize BAX structure: From an economic perspective, the Canadian short term interest rate (STIR) market has been enduring low interest rates and volatility for some time[2]. The Bank of Canada's October 2019 monetary policy report[3] suggests there might be an easing coming up in 2020 but the BAX curve has arguably never been so flat (as illustrated by Figure 1 below), suggesting an extended period of stagnation. Given this context, the importance of having competitive bid-ask spreads is essential.

   Additionally, having the same tick size for the entire BAX curve will improve BAX strategy[4] execution and smooth the end-of-day settlement process, by removing potential price jumps (dislocations) between the settlement of the last BAX Red and first BAX Green contract. Applying the minimum tick size reduction to BAX Greens will also align the minimum price fluctuation with that of the upcoming 3M CORRA Futures[5], which will facilitate inter-group strategy trading.

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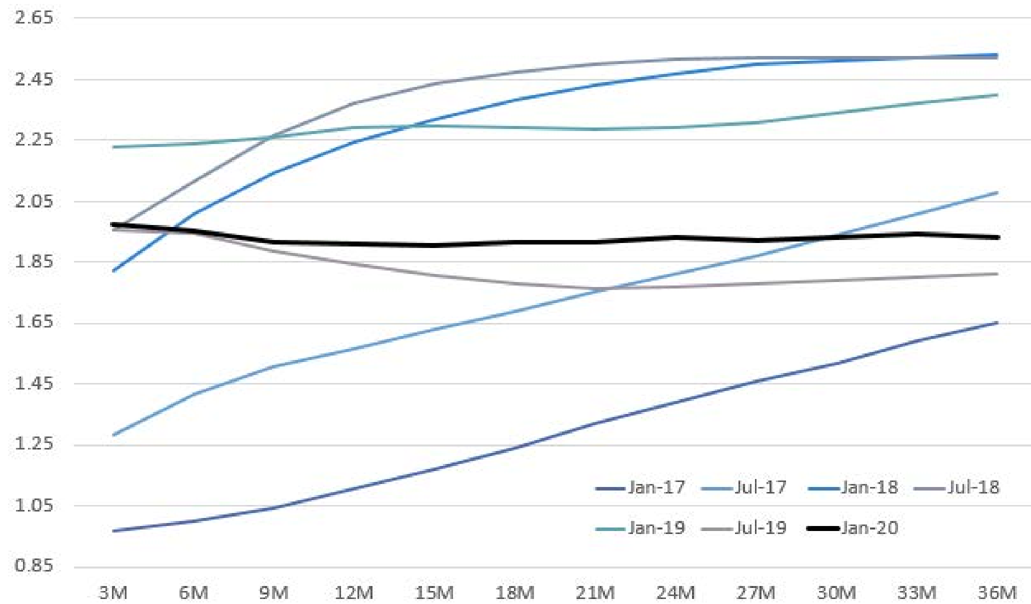
[2] Even with the rate hikes of 2018, Canadian STIRs are still relatively low versus their historical mean.

[3] https://www.bankofcanada.ca/wp-content/uploads/2019/10/mpr-2019-10-30.pdf

[4] Such as calendar spreads, butterflies and condors.

[5] Proposed 3M CORRA Futures tick size structure is 0.0025 for nearest contract and 0.005 for all other contracts.

Figure 1 – Historical implied 3M CDOR for different tenors based on BAX prices.



Source: Montréal Exchange and Bloomberg

The Bourse has conducted extensive consultations with market participants to gauge their interest in a reduced minimum price fluctuation in BAX Greens. The participants' feedback was centered around the three principal benefits summarized above.

When the BAX contract was introduced in April of 1988, the minimum price fluctuation (tick size) for all contract months was established at 0.01 index points (a full tick). In February of 2002, the Bourse reduced the minimum price fluctuation to 0.005 index points (a half tick) for the three nearest listed contract months (the first quarterly BAX contract month and the two serial BAX contract months) as a greater level of granularity was in the best interest of the market.

In September 2014, at the request of market participants, the Bourse extended the minimum tick size reduction to the second, third and fourth BAX quarterly futures contract months (the "Whites") for the reasons cited above. The reduction of the minimum price fluctuation was a success based on the results that were observed over the six month period following the implementation of half tick, mainly a consistent reduction of the bid / offer spread and a decrease in the number of resting orders in the order book (thus, a higher turnover of orders).

Based on these results and on an extensive market participant survey, the Bourse extended again the implementation of halt tick to the fifth, sixth, seventh and eighth BAX quarterly futures contract months (the "Reds") in March 2018. Once again, the Bourse obtained satisfying results as with the implementation of the minimum tick size reduction in BAX Whites contracts. Additionally, the BAX Reds average daily volume increased by 15% during the evaluation period and their weight in the total BAX volume increased by 5%.

The Bourse contends that the reasons cited for the change in 2014 and 2018 (and mentioned above) still apply today for a reduction of the minimum tick size in the BAX Greens. The Bourse decided to adopt a phased-in approach for the implementation of halt tick in the BAX contracts, to: 1) better assess the impacts on its markets and on participants and 2) limit the unintended consequences and allow participants used to trading in minimum tick increments of 0.01 index points to adapt their trading behavior to the new tick size. After analyzing the results of the previous minimum tick size reductions, the Bourse is now comfortable with completing the migration of its entire BAX contract offering to a 0.005 index points increment. The Bourse believes that the proposed amendments will help increase the BAX Greens volume and reduce the bid-ask spread. The latest statistics on these measures are presented in tables 2 and 3.

Table 2: BAX contract average daily volume ("ADV") by contract year

Year	BAX Whites	BAX Reds	BAX Greens
2017	80 991	33 346	1 977
2018	81 818	32 615	1 639
2019	82 480	34 725	2 065

Source: Montréal Exchange

Table 3: Average Bid / Offer spread for each BAX Green contract[6]

First BAX Green	0.0159
Second BAX Green	0.0197
Third BAX Green	0.0248
Fourth BAX Green	0.0302

Source: Montréal Exchange

b. Objectives

The objective of the proposed amendments is to enhance the execution and cost efficiency of the BAX contract by improving price precision. The expected benefits are a reduction in trading costs for market participants as well as attracting further domestic and international participation to the BAX market. The proposed changes would also optimize the BAX market structure in the current low rate and volatility environment, as well as improve strategy trading and smooth the daily settlement price establishment process.

The Bourse wants to ensure that the remains relevant for market participants, that is, not too large so that traders would find tick size movements and price risk too high. The Bourse believes this change to be beneficial to the Canadian derivatives market as a whole and that the proposed reduction in minimum price fluctuation will yield immediate results in the BAX Greens.

c. Comparative Analysis

[6] Statistics reflect the whole trading day, from 2 a.m. to 4:30 p.m ET.

Reducing the minimum price fluctuation by half for the BAX Greens will harmonize the BAX with STIR futures markets around the world, such as the Eurodollar on CME, the Euribor and the Short Sterling on ICE and the Euroyen on TFX.

Table 4: Minimum price fluctuation for 3M STIR futures

Futures contract	Exchange	Minimum price fluctuation
BAX (current structure)	Bourse de Montréal	0.005 = C$ 12.50 per contract for the ten (10) nearest listed contract months, including serials 0.01 = C$ 25.00 per contract for all other contract months
Eurodollar	CME	0.0025 = $ 6.25 for the nearest expiring contract month 0.005 = $12.50 for all other contract months (up to 10 years)
3M Euribor	ICE	0.005 = EUR 12.50 for all contract months (up to 6 years)
3M Euroyen	TFX	0.005 = JPY 1,250 for all contract months (up to 5 years)
3M Short Sterling	ICE	0.005 = GBP 6.25 for all contract months (up to 6 years)
90-day Bank Bills	SFE (ASX)	0.01 = approx AUD 24 for all contract months (up to 5 years)

Source: Contract specifications on exchange websites

The table 4 above demonstrates that other major and peripheral international STIR contracts have a minimum price fluctuation similar to that what is proposed by the Bourse; most notably, the Eurodollar and Euribor, which are international benchmarks in the STIR futures space.

d. Analysis of Impacts

i. Impacts on Market

Extending the minimum price reduction to the BAX Greens will reduce the profitability per trade for liquidity providers. However, this reduction in profit per trade will be offset by an increase in trading activity. Liquidity providers, in the BAX market, usually place bids and offers in the central limit order book (CLOB) passively waiting for end-user participants to enter the market and instantaneously get filled. End-user participants, unwilling to pay a 0.01 index points for a fill, are simply placing their orders in the book and waiting for a fill to come along, or are looking for fills in competing markets. The result is a CLOB with a large number of resting orders. A reduced minimum price fluctuation would increase the likelihood of end-user participants lifting offers or hitting bids that liquidity providers have placed in the order book. Therefore, while profitability per trade will decrease, the number of profitable trades will increase.

Feedback from market participants suggests that there is demand from hedge funds who are not currently trading the BAX Greens due to the current costly minimum price fluctuation. Some hedge funds have suggested that a reduction in tick size would lead them to redirect some of their OTC volume to the BAX, perhaps even increasing their BAX trading volumes. This uncaptured buy-side volume would offer current BAX liquidity providers new trading opportunities, and would drive new liquidity providers into the BAX market.

ii. Impacts on Technology

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.

iii. Impacts on regulatory functions

The proposed changes should have no impact on the activities of the Regulatory Division of 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

Since the purpose of this amendment is to accommodate requests from market participants to reduce the minimum price fluctuation of the ninth, tenth, eleventh and twelfth quarterly BAX contract months, the Bourse considers these amendments to be in the public interest.

The Bourse is of the view that the present initiative will improve market efficiency as it will enhance the efficiency of the BAX contract by improving price precision, which will thereafter provide better liquidity and price transparency in the BAX market while allowing more participants to efficiently transact in such a market.

IV. PROCESS

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 regulatory self-certification process, and to the Ontario Securities Commission for information purposes. Subject to public comments, the proposed amendments will take effect immediately thereafter.

V. ATTACHED DOCUMENTS

Proposed rule changes.

PROPOSED AMENDMENTS

Blackline version

Article 12.5 Minimum Price Fluctuation

Unless otherwise determined by the Bourse, the minimum price fluctuation ~~is as follow:~~

~~For the ten (10) nearest listed Settlement Months including serials, the minimum price fluctuation~~ is 0.005, representing $12.50 per contract, for all contract months.

~~(a) For all other contract months, the minimum price fluctuation is 0.01, representing $25 per contract.~~

Clean version

Article 12.5 Minimum Price Fluctuation

Unless otherwise determined by the Bourse, the minimum price fluctuation is 0.005, representing $12.50 per contract, for all contract months.