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

CIRCULAR 118-15
September 23, 2015

REQUEST FOR COMMENTS

EXCHANGE FOR PHYSICAL (EFP), EXCHANGE FOR RISK (EFR) AND SUBSTITUTION OF OTC DERIVATIVE INSTRUMENTS FOR FUTURES CONTRACTS

AMENDMENTS TO ARTICLES 6815 AND 6815A

AMENDMENTS TO 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 Rules and Policies Committee of Bourse de Montréal Inc. (the "**Bourse**") has approved amendments to articles 6815 and 6815A of Rule Six of the Bourse (the "**Articles**"), and to the 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 "**Procedures**"), in order to clarify the delay to report such transactions to the Bourse and the types of instruments to be used in the calculation of the correlation coefficient of the legs of the transaction.

Comments on the proposed amendments must be submitted within thirty (30) days following the date of publication of this notice, at the latest on October 23, 2015. Please submit your comments to:

M[e] Jean-Philippe Joyal
Legal Counsel, Legal Affairs, Derivatives
Bourse de Montréal Inc.
Tour de la Bourse
P.O. Box 61, 800 Victoria Square
Montréal, Québec H4Z 1A9
E-mail: **legal@m-x.ca**

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

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800 Victoria Square, 22nd Floor
P.O. Box 246, Tour de la Bourse
Montréal (Québec) H4Z 1G3
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.

Appendices

For your information, you will find in the appendices an analysis of the proposed amendments as well as the amendments proposed to the Articles and the Procedures. 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).

Exchange for Physical (EFP), Exchange for Risk (EFR) and Substitution of OTC derivative instruments for futures contracts

Amendments to article 6815 & 6815A

Amendments to 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

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I. SUMMARY

Bourse de Montréal Inc. (the “Bourse”) hereby proposes to amend article 6815 and 6815A of the Rules of the Bourse and the 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 “Procedures”).

The proposed amendments seek to clarify certain aspects of EFP, EFR and Substitution transactions.

Specifically, the proposed amendments deal with:

- The timeframe to report EFPs, EFRs and Substitutions to the Bourse;
- The determination whereupon the interval begins;
- The wording and syntax in Bourse article 6815, 6815A and its accompanying Procedures. This will touch upon the types of instruments with regards to a cash component for an EFP or the risk component for an EFR correlated in terms of pricing.

II. ANALYSIS

A) Background

Approved participants of the Bourse have indicated their concern with the assumption of regulatory risk with regards to EFP/EFR reporting. The current Rules and Procedures are open to interpretation with regards to the reporting delays for these transactions, particularly given the requirement in the Rules of “immediate” reporting and the historical acceptance of a 15 minute delay. This interpretation has created regulatory issues for approved participants and the Bourse seeks to clarify its Rules and Procedures to provide for a clear timeframe to report transactions.

Market participants who report EFR and EFP transactions have been very vocal in requesting that a longer reporting delay be specified clearly in the Rules, providing sufficient time for reporting the transaction and avoiding any ambiguity or regulatory uncertainty. These active firms have indicated that the current delay is unduly restrictive as they work to conclude a basis trade (an extensive exercise in negotiation itself), compile all necessary information and subsequently transmit that information to the Bourse for reporting.

The participants referenced above have expressed their frustration with the Rule to both the Regulatory Division and the Financial Markets group of the Bourse. The Bourse decided to review the timeframe to report such transactions. In addition the Bourse wishes to clarify and define when the time period commences for reporting.

Furthermore, amendments to the wording and syntax in Bourse article 6815, 6815A and its accompanying Procedures are proposed to provide more clarity and certainty. The selected passages are highlighted in the Attached Documents.

B) Description and Analysis of Market Impact

Delay for reporting an EFR, EFP or Substitution transaction

If we consider a recent timeframe (July 15th to July 17th, 2015 activity profiled below) of EFP & EFR activity on the Bourse, one can appreciate the frequency, size, numerical significance and scope of importance of these transactions.

July 17, 2015						
Time	Transaction	Instrument	Series	Strategy	Volume	Price
8:46 a.m.	EFP	CGB	CGBU15		115	141.500
10:24 a.m.	EFP	CGB	CGBU15		109	141.500
10:44 a.m.	EFP	CGB	CGBU15		76	141.340
2:17 p.m.	EFP	CGB	CGBU15		400	141.410
2:57 p.m.	EFP	CGF	CGFU15		82	125.380
3:12 p.m.	EFP	CGF	CGFU15		206	125.380

July 16, 2015						
Time	Transaction	Instrument	Series	Strategy	Volume	Price
10:06 a.m.	EFP	CGB	CGBU15		573	141.000
10:16 a.m.	EFP	BAX	VSN	A19	600	0.500
10:23 a.m.	EFP	CGB	CGBU15		612	141.160
10:31 a.m.	EFP	CGB	CGBU15		300	141.160
10:36 a.m.	EFP	CGF	CGFU15		206	125.320
11:20 a.m.	EFP	CGB	CGBU15		76	141.230
11:30 a.m.	EFP	CGB	CGBU15		563	141.170
11:33 a.m.	EFP	CGB	CGBU15		563	141.170
12:15 p.m.	EFP	CGB	CGBU15		100	141.330
3:01 p.m.	EFP	CGB	CGBU15		153	141.340
3:05 p.m.	EFP	CGB	CGBU15		714	141.340

July 15, 2015						
Time	**Transaction**	**Instrument**	**Series**	**Strategy**	**Volume**	**Price**
9:30 a.m.	EFP	CGB	CGBU15		200	140.250
9:30 a.m.	EFP	SXF	SXFU15		13	849.300
9:30 a.m.	EFP	SXF	SXFU15		53	849.400
10:21 a.m.	EFP	CGB	CGBU15		225	141.140
11:40 a.m.	EFP	CGB	CGBU15		443	140.770
11:47 a.m.	EFP	CGB	CGBU15		443	140.650
12:24 p.m.	EFP	CGB	CGBU15		115	140.950
1:02 p.m.	EFP	CGB	CGBU15		1,000	141.200
1:23 p.m.	EFP	CGB	CGBU15		200	141.120
1:30 p.m.	EFP	CGB	CGBU15		1,000	141.100
2:13 p.m.	EFP	CGB	CGBU15		1,222	141.150
3:54 p.m.	EFP	CGB	CGBU15		382	

**Source – Bourse De Montreal website http://www.m-x.ca/dailycrosses_en.php

Both informal observations provided by market operations staff of the Bourse and the analysis of market data provided below demonstrate that futures prices are generally not influenced by the publication of EFP/EFR transactions. Two factors explain the lack of correlation between EFP/EFR prices and futures prices. First, market operations staff ensure that futures components of EFP's and EFR's are priced in a fair and reasonable context encompassing a number of factors. This is outlined firsthand in the EFP-EFR Procedures of the Bourse:

> *"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. "*

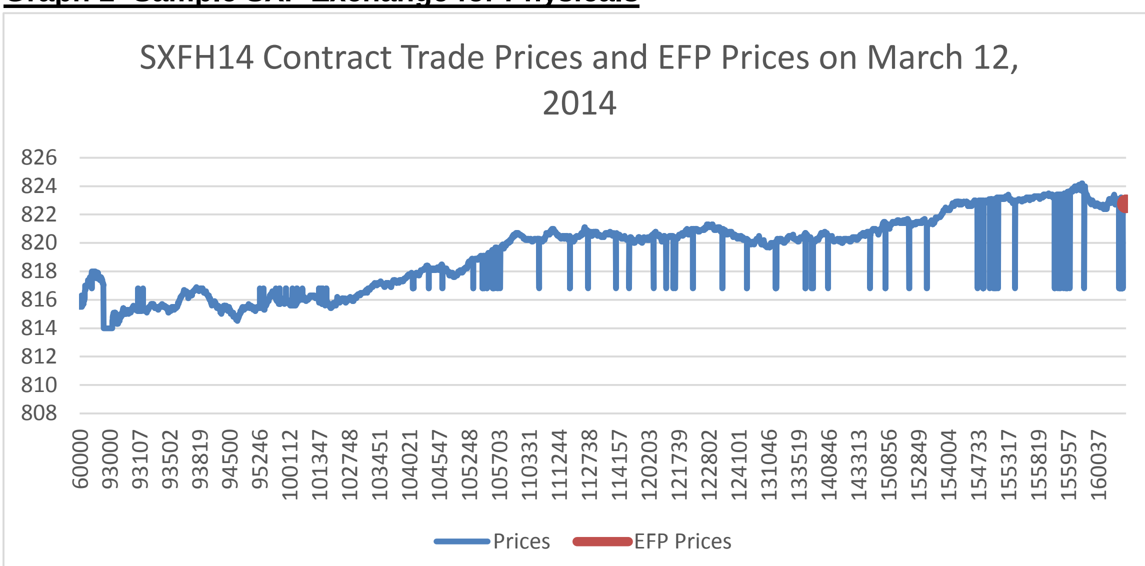
Second, and more importantly, EFPs and EFRs are contingent trades premised on a correlation with another financial instrument, and the subsequent dissemination of the trade and its accompanying details (which can be anywhere from instant to significant time lapses) therefore do not impact futures prices.

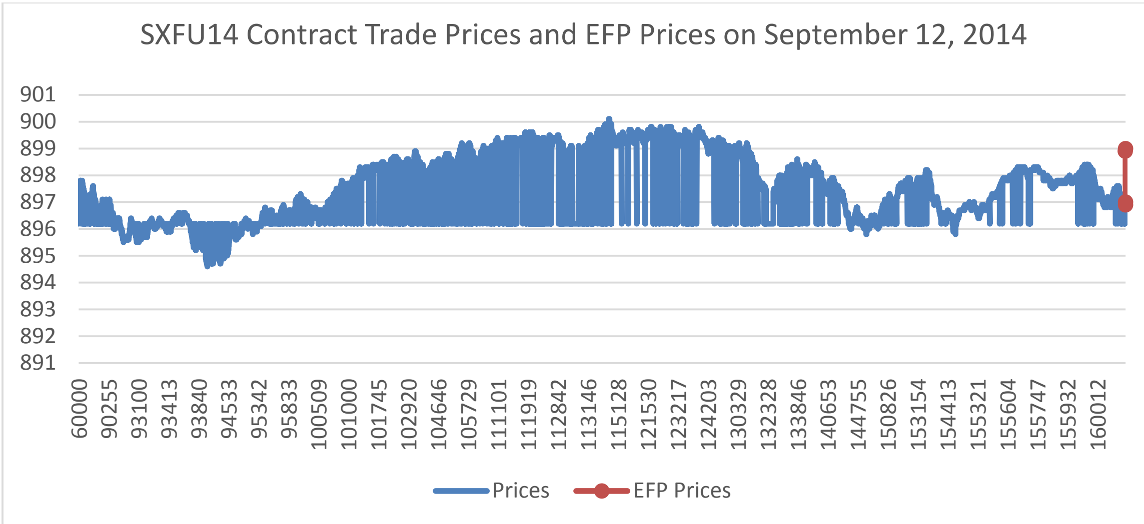
This hypothesis was tested by analyzing trade data from Bourse trading logs before, during and after the publication of EFP/EFR trades on the Bourse website. The analysis of this empirical evidence demonstrated that futures prices are not significantly influenced by the reporting of EFP/EFR trades. Additionally, it can be argued that futures prices in a special terms transaction are supplemented by multi-tier scrutiny. As already mentioned, Market Operations staff is ensuring that futures pricing is conducted in accordance with procedures. Another layer, of course, lies within the Regulatory Division particularly through its Market Analysis and Inspections teams, where verification is conducted to ensure full compliance.

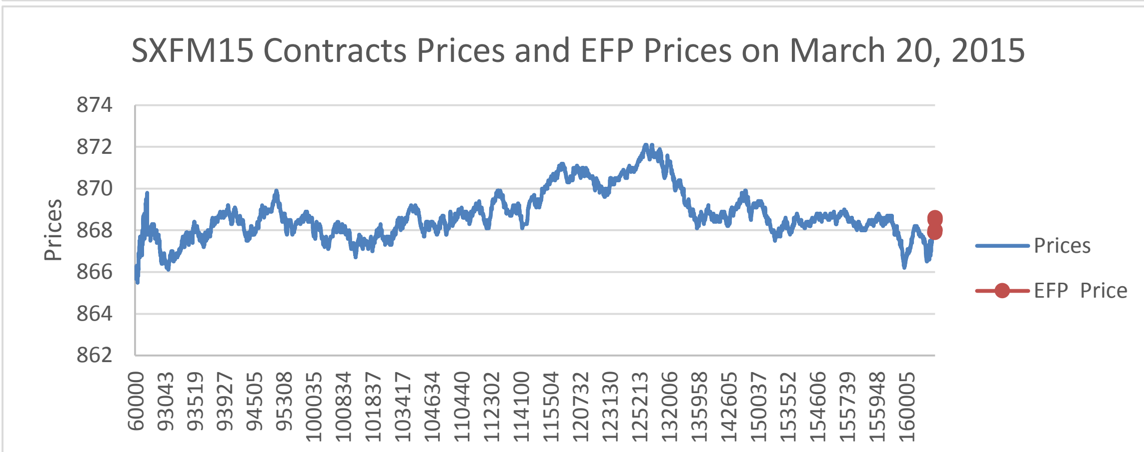
An analysis of EFP and EFR trades that were reported by the Market Operations Department (MOD) for select dates in the latter part of 2014 and the former part of 2015 and the market trade data from trading logs reveals that none of the sampled trades had a significant impact on the price of the futures contracts. The futures market trade prices that were registered in the moments following the dissemination of the reported EFP/EFR transactions by the MOD did not appear to duly impact the futures prices depicted in Graphs 1 and 2. This in turn supports the Bourse's position that a longer reporting delay would not have an impact on the integrity of posted markets.

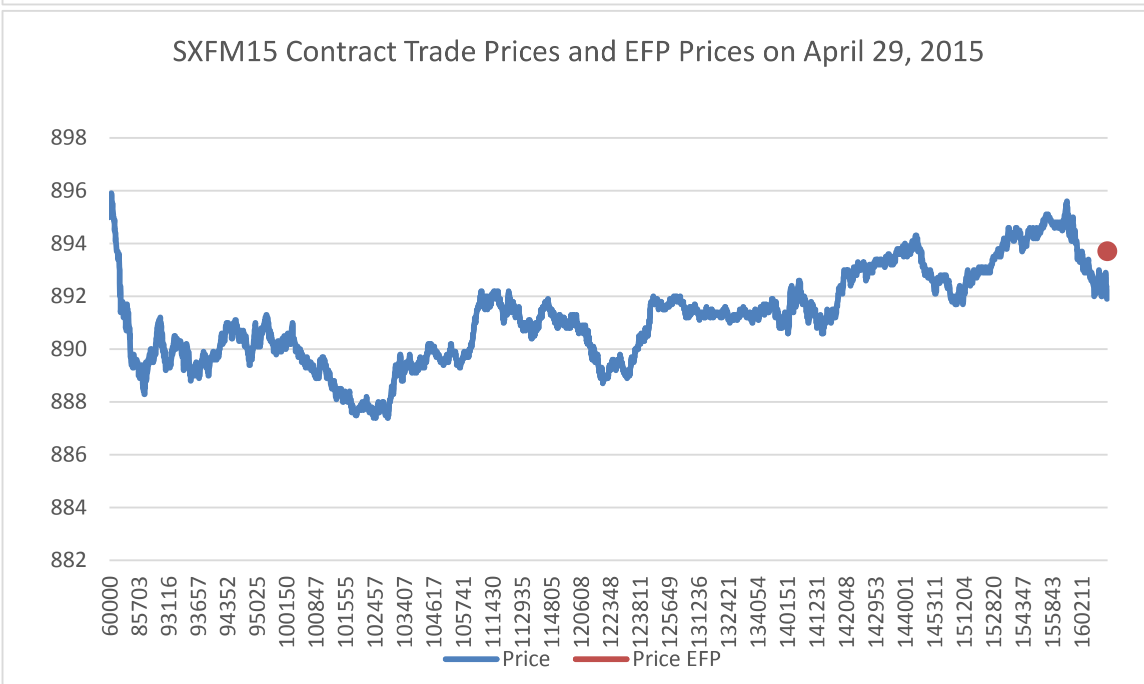
Furthermore, it should be noted that EFP and EFR transactions can be reported several hours after they have been agreed to by the counterparties. For instance, trades that take place after hours can be posted online several hours after they have been agreed to and in some cases they can be reported on the next business day. Examples such as these suggest that the prices of EFP and EFR trades that are reported online are not considered a relevant source of market information and do not contribute to the price formation process.

Graph 1- Sample SXF Exchange for Physicals

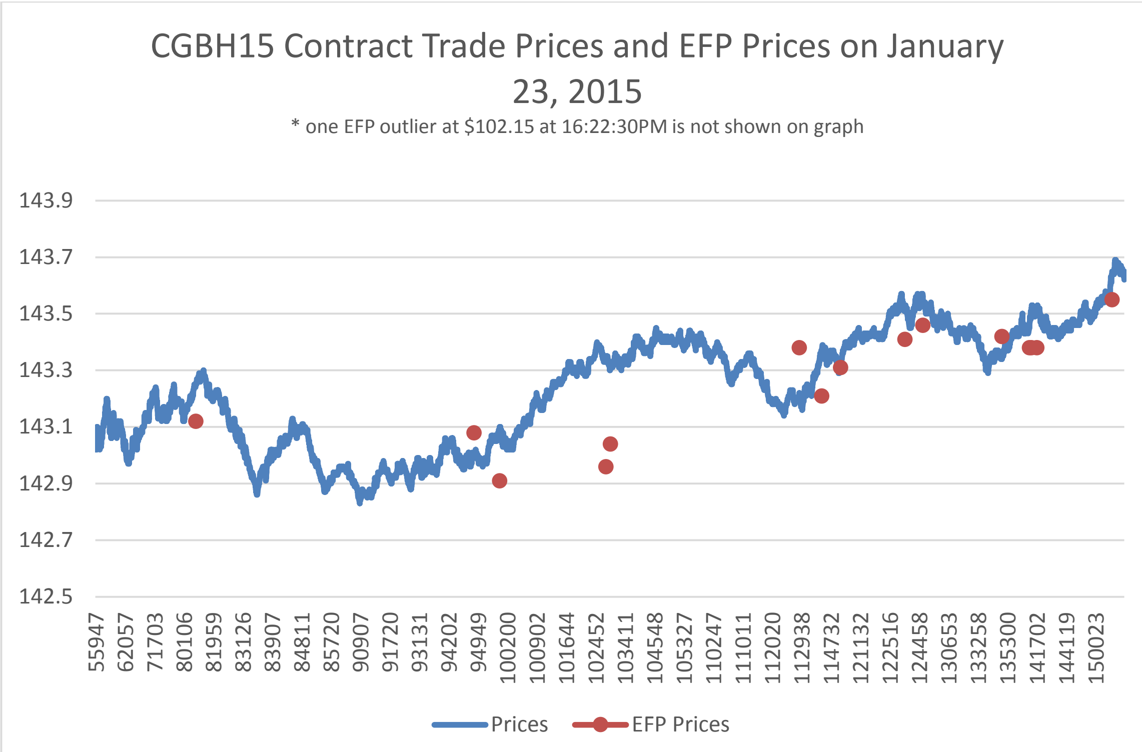


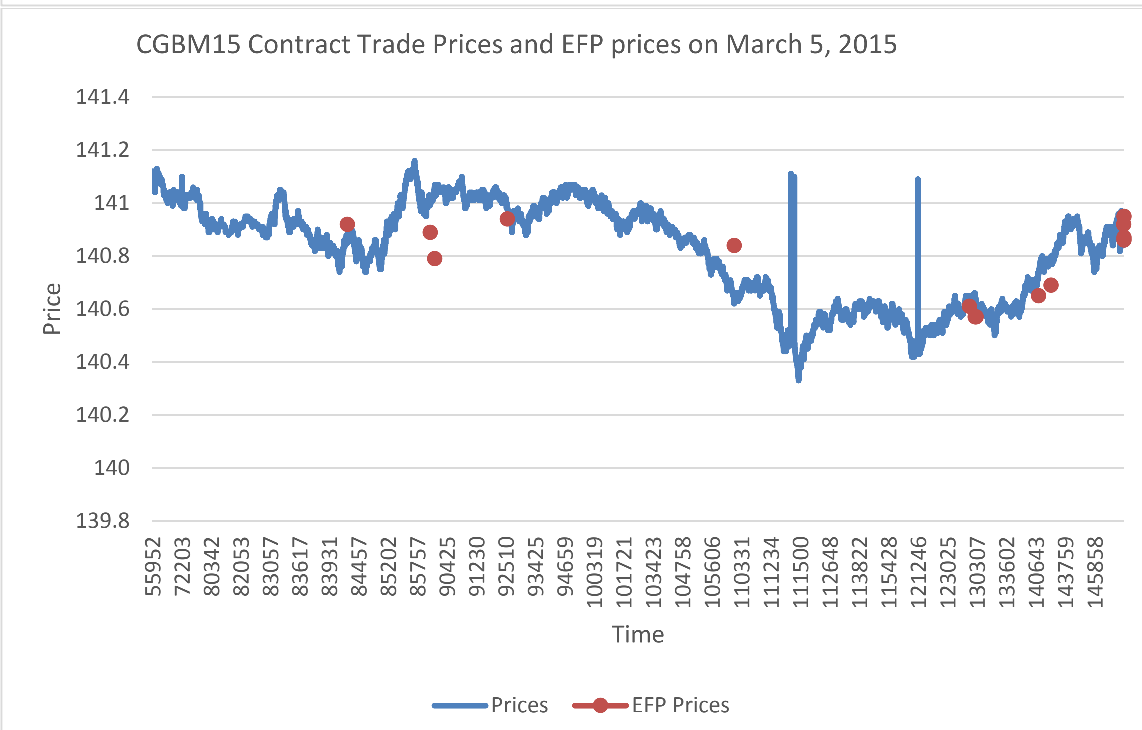

SXFU14 Contract Trade Prices and EFP Prices on September 12, 2014
901
900
899
898
897
896
895
894
893
892
891
60000
90255
93100
93413
93840
94533
95342
95833
100509
101000
101745
102920
104646
105729
111101
111919
112842
113146
115128
121530
123217
124203
130329
132328
133846
140653
144755
150826
153154
154413
155321
155604
155747
155932
160012
Prices
EFP Prices

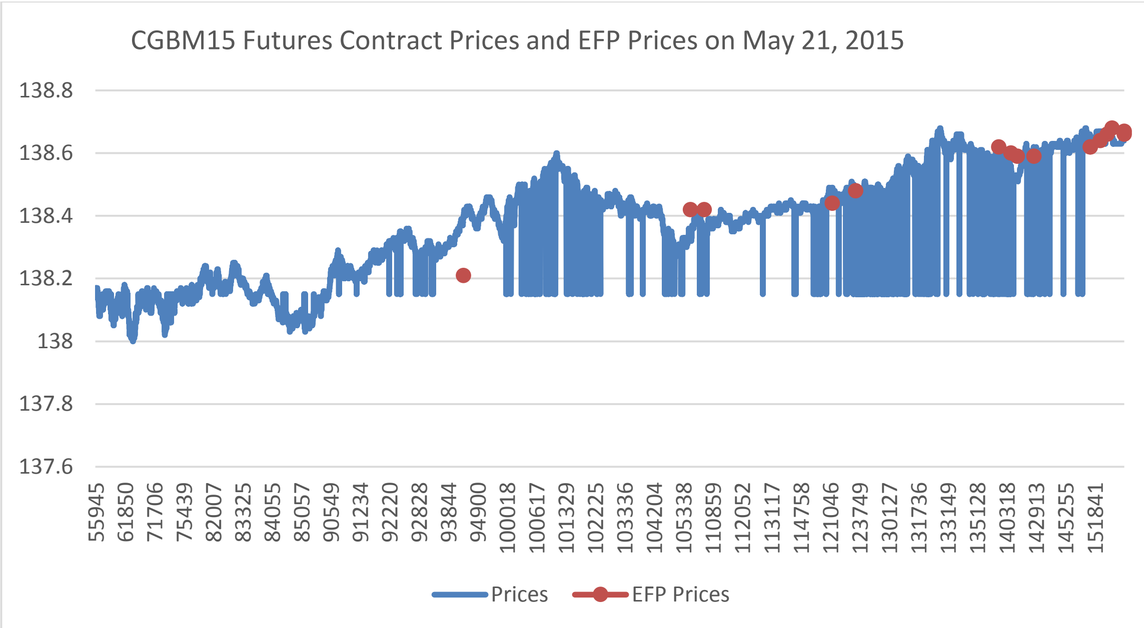

SXFM15 Contracts Prices and EFP Prices on March 20, 2015
Prices
874
872
870
868
866
864
862
60000
93043
93519
93927
94505
95308
100035
100834
101837
103417
104634
110440
112302
114100
115504
120732
123130
125213
132006
135958
142605
150037
153552
154606
155739
155948
160005
Prices
EFP Price


SXFM15 Contract Trade Prices and EFP Prices on April 29, 2015
898
896
894
892
890
888
886
884
882
60000
85703
93116
93657
94352
95025
100150
100847
101555
102457
103407
104617
105741
111430
112935
114805
120608
122348
123811
125649
131236
132421
134054
140151
141231
142048
142953
144001
145311
151204
152820
154347
155843
160211
Price
Price EFP

Graph 2-Sample CGB Exchange for Physicals







Wording and syntax amendments

Amendments with regards to wording and syntax in Bourse article 6815, 6815A and its accompanying Procedures are proposed as certain passages have long been the source of ambiguity. The proposed amendments deal with the clarification of the type of instrument to which the cash or OTC component of an EFP, EFR or Substitution transaction can be compared for the purpose of establishing whether there is a reasonable price correlation.

Such amendment will have no impact on the market as it will enhance clarity to the process of establishing a reasonable price correlation among instruments subject to an EFP, EFR or Substitution transaction.

C) Comparative Analysis

Extending and clearly defining the reporting requirement from ”immediately” to one hour will provide a clear understanding to all approved participants of the regulatory requirements related to EFP/EFR transactions. Furthermore, the Bourse will harmonize its regulatory requirements with those of other global futures exchanges such as the CME, CBOT, NYMEX and COMEX. In addition to CME Group, Eurex and Australian Securities Exchange (ASX) are also included in this benchmark analysis.

CME, NYMEX, COMEX & CBOT Products

For EFRPs executed between 6:00 a.m. and 6:00 p.m. **Central Time**, firms **must submit the trade within one hour**. For EFRPs executed between 6:00 p.m. and 6:00 a.m., **Central Time**, firms must submit the trade no later than 7:00 a.m. **Central Time. ***

NYMEX and COMEX Products

For EFRPs executed between 7:00 a.m. and 5:45 p.m. **Eastern Time**, the **trades must be submitted within one hour**. For EFRPs executed between 5:45 p.m. and 7:00 a.m., **Eastern Time**, the trades must be submitted prior to 8:00 a.m. **Eastern Time**.*

***http://www.cmegroup.com/rulebook/files/RA1006-5.pdf**

Reference: Rule 538

EUREX

Each Off-Book Trade has to be entered into the Eurex System by the Participant initiating the Off-Book Trade **within 15 minutes** (trade entry period) after its conclusion. The trade entry period starts after a) the Eurex System is available and b) all trade details to be entered are available. If the Participant accepting the Off-Book Trade is the same as the initiator, the entry and acceptance of the Off-Book Trade must be made within the trade entry period. A period of up to 15 minutes (period of ratification) is available starting with the entry of an Off-Book Trade into the Eurex System by the Participant initiating the transaction or by the Third Party Information Provider, as the case may be, and ending with the acceptance of such Off-Book Trade by another Participant.

Reference: Conditions for Utilization of the Eurex Trade Entry Services, (3) Clearing of Off-Book Trades (section 3, 4) (see http://www.eurexclearing.com/clearing-en/resources/rules-and-regulations/136788/

AUSTRALIAN SECURITIES EXCHANGE

EFPs agreed between 7:00am and 4:30pm
Seller: Registered **within 30 minutes** of the Agreement Time.
Buyer: Registered **within 60 minutes** of the Seller completing the registration process. The registration process must be completed by 5:30pm
EFPs agreed between 4:30pm and 7:00am
Seller: Registered by 9:00am
Buyer: Registered by 9:30am

REFERENCE:

Rules 4800-4804 and Rule 3500 http://www.asx.com.au/documents/rules/asx_24_section_04.pdf **and** **http://www.asx.com.au/documents/rules/Draft_ASX_Operating_Rules_procedures.pdf** EFP guidelines , rules and forms (http://www.asx.com.au/products/interest-rate-derivatives/efp-guidelines-rules-forms.htm)

In analyzing the three marketplaces profiled and their respective models, the Bourse feels that the Eurex model would not be appropriate as this is virtually similar to what the Bourse currently has in place. By contrast, The Australian Securities Exchange and CME Group possess time delays that are much longer. This would enable for a more conducive platform to facilitate the complexity of these transactions especially EFR's. The CME standard, in particular, has been repeatedly referenced by trading and compliance personnel from the actual approved participants who actively trade EFP's and EFR's on the Bourse

The one hour interval at CME therefore would be the most compatible and effective option from both a regulatory and operational standpoint.

D) Proposed amendments

Delay for reporting the EFR, EFP or Substitution

The reference to "immediately" has long been accepted as unrealistic and impractical, and a reporting delay of approximately fifteen (15) minutes has been tolerated by the Bourse. The proposed amendments call for a precise and definitive reporting delay of one hour. The one hour reporting requirement, while appropriate for both EFR and EFP transactions, is particularly appropriate for the relatively complex requirements of executing EFR transactions.

At present, Bourse EFP Procedures merely make reference to "immediately". In the "**Reporting an EFP, EFR or Substitution transaction to the Bourse"** segment of the Procedures it reads:

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 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 Special Terms

Transaction Reporting Form must be submitted no later than 10:00 a.m. (Montréal time) on the next trading day.

The Procedures also make reference to "immediately upon execution". The Bourse proposes to amend this segment of the Procedures to refer to "within one hour upon determination of all the relevant terms of the trade". This is a critical difference in that with the former, there has been some ambiguity around what is meant by "execution". The terms and conditions of a transaction may have been negotiated well before the execution. Clearly defining the moment at which the 60 minute delay begins to run will provide more clarity and guidance to participants. It is important to note that the CME provides this guidance in a Market Regulation Advisory Notice (Advisory Number RA1311-5RR) published on June 27, 2014 http://www.cmegroup.com/rulebook/files/ra1311-5rr-rule538.pdf, questions 22 and 23).

The proposed amendments will clarify the EFP/EFR Rules and Procedures and align the Bourse with other futures exchanges with respect to these transactions. The proposed longer reporting delay is consistent with the delays imposed by other exchanges and, as demonstrated in the accompanying analysis of trade data, will not impair or compromise market integrity. Market integrity will only be enhanced through clear rules and procedures that are consistently applied.

Wording and syntax amendments

In most cases, the section of article 6815 and 6815A that deals with the price correlation can be applied by the Bourse's Market Supervisors in the Market Operations Department to determine whether a given cash, or OTC instrument is appropriate for the purposes of an EFP or EFR transaction. However, in certain circumstances, this is not applicable as certain of the Bourses' futures contracts do not have underlying interests that trade in the secondary market and that can be evaluated for correlation with an OTC instrument.

One such example is the Bourse's Three Month Canadian Bankers' Acceptance futures contracts (BAX), for which the underlying interest is C$1 000 000.00 nominal value of Canadian Bankers' Acceptances (BA) with a three-month maturity. BA's are essentially short promissory notes issued by corporations and accepted by financial institutions with maturities ranging from 1 month to 12 months. BA's are typically priced as discount to face value whereby the borrower receives the discounted value and promises to pay face value at maturity.

Given the characteristics of the BA's described above and the lack of availability of these instruments in the secondary market, the Bourse's BAX futures are priced using 3, 6, and 12 month CDOR rates plus a credit risk premium (typically 25 basis points).

Based on what has been described above when an Approved participant of the Bourse executes an EFP, EFR, or Substitution transaction on a BAX future, it is impossible to compare the correlation of the cash or OTC leg of the transaction to the underlying interest of the contract. In order for market supervisors to determine whether the OTC or cash leg instrument is adequate for the purpose of an EFP, EFR, or Substitution transaction, the cash or OTC instrument is compared to the BAX futures contract to determine suitability.

Therefore, the Bourse wishes to add wording in articles 6815, 6815A as well as the Procedures to allow the use of the futures for calculation, where applicable.

III. AMENDMENT PROCESS

The drafting process was initiated to address the concerns raised by compliance and trading personnel from the approved participants of the Bourse regarding the need for greater clarity of the Rules and Procedures relating to the EFP/EFR facility, and to make these Rules and Procedures more consistent with those on other global futures exchanges.

IV. 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.

V. OBJECTIVES OF THE PROPOSED AMENDMENTS TO THE PROCEDURES & RULES OF THE BOURSE

The objective of the proposed amendments is to enhance clarity and transparency of the Rules and Procedures pertaining EFP, EFR and Substitutions

VI. PUBLIC INTEREST

The Bourse considers that these amendments are in the public interest.
The proposed changes will contribute to market integrity through the promulgation of clear and precise requirements that are adapted to the needs of the market. The reporting of EFP/EFR transactions has been demonstrated to have no effect on posted markets or trade prices, and the establishment of a sixty (60) minute reporting delay will therefore not impair market integrity.

VI. EFFICIENCY

The proposed amendments will have no impact on market efficiency.

VIII. PROCESS

The proposed amendment will be presented for approval to the Rules and Policies Committee of the Bourse, and will then be submitted to the Autorité des marchés financiers (AMF) for self-certification purposes. These modifications will also be transmitted to the Ontario Securities Commission (OSC) for information.

IX. ATTACHED DOCUMENTS

- Proposed amendments to articles 6815 and 6815A
- Proposed amendments to the 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.

6815 Exchanges for Physicals (EFP) and Exchanges for Risk Transactions (EFR)
(08.09.89, 17.10.91, 05.01.94, 19.01.95, 01.05.95, 07.09.99, 31.01.01, 03.05.04, 21.04.08,17.04.09, 00.00.00)

Exchanges for physicals (EFP) or exchanges for risk (EFR) transactions involving futures contracts listed and traded on the Bourse are permitted if such transactions are executed in accordance with the requirements of this article and of the procedures established by the Bourse.

1) Exchanges for physicals (EFP)

a) An EFP may be concluded between two parties if one of the parties is the buyer of a physical or cash component that is acceptable to the Bourse for the purpose of the EFP transaction and the seller of the futures contract, and the other party is the seller of such physical or cash component and the buyer of the futures contract.

b) The purchase and sale of the futures contract must be simultaneous with the sale and purchase of a corresponding quantity of the physical or cash component acceptable to the Bourse for the purpose of the EFP transaction.

c) The physical or cash component of the EFP transaction must involve a physical or cash instrument that is related to and that has a reasonable price correlation with the underlying interest of the futures contract being exchanged or the futures contract itself where the use of the underlying interest is not practical. The quantity or value covered by the physical or cash component of the EFP transaction must be approximately equivalent to the quantity or value covered by the futures contract.

2) Exchange for Risk Transactions

An exchange of a futures contract for an over-the-counter (OTC) derivative instrument and/or swap agreement (an Exchange for Risk (EFR) transaction) consists of two discrete, but related simultaneous transactions: a risk transaction and a futures contract transaction. At the time such transaction is effected, the parties to the futures contract transaction must be the same parties to the risk transaction and the buyer and the seller of the futures contract must be, respectively, the seller and the buyer of the OTC derivative instrument and/or swap agreement. The risk component of the EFR transaction must involve an OTC derivative instrument and/or swap agreement that is related to and that has a reasonable price correlation with the underlying interest of the futures contract being exchanged or the futures contract itself where the use of the underlying interest is not practical. The quantity or value covered by the risk component of the EFR transaction must be approximately equivalent to the quantity or value covered by the futures contract.

3) General Provision

a) EFP and EFR transactions must at all times be executed in accordance with such other procedures, terms and conditions that the Bourse may prescribe from time to time.

b) The futures contracts that are eligible to EFP or EFR transactions, and the last day and time for executing such transactions shall be determined by the Bourse.

c) The cash components acceptable for the purpose of an EFP transaction and the over the counter derivative instruments acceptable for the purpose of an EFR transaction are those specified in the procedures set by the Bourse.

d) Each party to an EFP or EFR transaction must satisfy the Bourse, upon request, that the transaction is a bona fide EFP or EFR transaction. To this effect, parties to such a transaction must maintain and must provide to the Bourse upon request complete records and documentary evidence relating to such transaction including all records relating to the purchase or sale of securities, physical underlyings, sub-instruments of these physical underlyings, instruments related thereto or over the counter derivative instruments and to any transfer of funds or ownership made in connection with such transaction.

e) It is prohibited for any party to an EFP or an EFR transaction to effect a transaction which is contrary to the requirements and practices prescribed by the rules, policies and procedures of the Bourse or to effect such a transaction for the sole purpose of reporting, registering or recording a price that is not a bona fide price or of making a transaction which is a "wash sale", an accommodation trade or a fictitious sale.

f) An EFP or an EFR transaction may be made at such prices that are mutually agreed upon by the two parties to this transaction. However, the price at which the futures contract leg of the transaction is arranged must be fair and reasonable in light of factors such as, but not limited to, the size of the 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 as well as the general market conditions.

g) Each EFP or EFR transaction must be reported to the Bourse in accordance with the procedures set by the Bourse. Such report must be in the form prescribed by the Bourse and must contain all the information required on such prescribed form.

h) Each EFP or EFR transaction executed during the ~~usual~~ trading hours of the futures contract to which the transaction applies must be ~~immediately~~ reported to the Bourse within one hour upon determination of all the relevant terms of the trade. Each EFP or EFR transaction executed after the ~~usual~~ trading hours of the futures contract to which the transaction applies must be reported to the Bourse no later than 10:00 a.m. (Montréal time) on the next trading day following the execution of the transaction.

i) The accounts involved on each side of an EFP or EFR transaction must satisfy at least one of the following conditions:

   i) they have different beneficial ownership;

   ii) they have the same beneficial ownership, but are under separate control;

   iii) the accounts are commonly controlled, but involve separate legal entities which may or may not have the same beneficial ownership.

   In cases where the parties to an EFP or EFR transaction involve the same legal entity, same beneficial ownership, or separate legal entities under common control, the parties must be able to demonstrate that the exchange transaction was a legitimate arms-length transaction.

j) It is strictly prohibited for any party, for both the buyer and the seller, to enter into an EFP or EFR transaction to circumvent the contract month roll in the corresponding security or derivative instrument.

6815A Substitution of over-the-counter derivative instruments for futures contracts
(30.05.08, 00.00.00)

a) Transactions allowing to substitute an over-the-counter derivative instrument and/or a swap agreement for futures contracts listed and traded on the Bourse are permitted if such transactions are executed in accordance with the requirements of this article and of the procedures established by the Bourse.

b) A substitution of an over-the-counter (OTC) derivative instrument and/or swap agreement for futures contracts consists of two discrete transactions: a risk transaction and a futures contract transaction. At the time such transaction is effected, the parties to the futures contract transaction must be the same parties to the risk transaction and the buyer and the seller of the futures contract must be, respectively, the buyer and the seller of the OTC derivative instrument and/or swap agreement. The risk component of the substitution transaction must involve the interest underlying the futures contracts (or a derivative, by-product or related product of such underlying interest) and must have a reasonable price correlation with the underlying interest of the futures contract involved in the substitution transaction or the futures contract itself where the use of the underlying interest is not practical. The quantity or value covered by the risk component of the substitution of over-the-counter derivative instruments for futures contracts must be approximately equivalent to the quantity or value covered by the futures contract transaction.

c) Substitution transactions involving over-the-counter derivative instruments must at all times be executed in accordance with such other procedures, terms and conditions that the Bourse may prescribe from time to time.

d) The futures contracts that are eligible to substitution transactions, and the last day and time for executing such transactions shall be determined by the Bourse.

e) The risk components acceptable for the purpose of a substitution transaction are those specified in the procedures set by the Bourse.

f) Each party to a substitution transaction must satisfy the Bourse, upon request, that the transaction is a bona fide substitution transaction. To this effect, parties to such a transaction must maintain and must provide to the Bourse upon request complete records and documentary evidence relating to such transaction including all records relating to the purchase or sale of securities, physical underlyings, sub-instruments of these physical underlyings, instruments related thereto or over the counter derivative instruments and to any transfer of funds or ownership made in connection with such transaction.

g) It is prohibited for any party to a substitution transaction to effect a transaction which is contrary to the requirements and practices prescribed by the rules, policies and procedures of the Bourse or to effect such a transaction for the sole purpose of reporting, registering or recording a price that is not a bona fide price or of making a transaction which is a "wash sale", an accommodation trade or a fictitious sale.

h) A substitution transaction may be made at such prices that are mutually agreed upon by the two parties to this transaction. However, the price at which the futures contract leg of the transaction is arranged must be fair and reasonable in light of factors such as, but not limited to, the size of the 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 as well as the general market conditions.

i) Each substitution transaction must be reported to the Bourse in accordance with the procedures set by the Bourse. Such report must be in the form prescribed by the Bourse and must contain all the information required on such prescribed form.

j) Each substitution transaction executed during the usual trading hours of the futures contract to which the transaction applies must be immediately reported to the Bourse. Each substitution transaction executed after the usual trading hours of the futures contract to which the transaction applies must be reported to the Bourse no later than 10:00 a.m. (Montréal time) on the next trading day following the execution of the transaction.

k) The accounts involved on each side of a substitution transaction must satisfy at least one of the following conditions:

   i) they have different beneficial ownership;

   ii) they have the same beneficial ownership, but are under separate control;

   iii) the accounts are commonly controlled, but involve separate legal entities which may or may not have the same beneficial ownership.

   In cases where the parties to a substitution transaction involve the same legal entity, same beneficial ownership, or separate legal entities under common control, the parties must be able to demonstrate that the transaction was a legitimate arms-length transaction.

l) It is strictly prohibited for any party, for both the buyer and the seller, to enter into a substitution transaction to circumvent the contract month roll in the corresponding security or derivative instrument.

6815 Exchanges for Physicals (EFP) and Exchanges for Risk Transactions (EFR)
(08.09.89, 17.10.91, 05.01.94, 19.01.95, 01.05.95, 07.09.99, 31.01.01, 03.05.04, 21.04.08,17.04.09, 00.00.00)

Exchanges for physicals (EFP) or exchanges for risk (EFR) transactions involving futures contracts listed and traded on the Bourse are permitted if such transactions are executed in accordance with the requirements of this article and of the procedures established by the Bourse.

1) Exchanges for physicals (EFP)

a) An EFP may be concluded between two parties if one of the parties is the buyer of a physical or cash component that is acceptable to the Bourse for the purpose of the EFP transaction and the seller of the futures contract, and the other party is the seller of such physical or cash component and the buyer of the futures contract.

b) The purchase and sale of the futures contract must be simultaneous with the sale and purchase of a corresponding quantity of the physical or cash component acceptable to the Bourse for the purpose of the EFP transaction.

c) The physical or cash component of the EFP transaction must involve a physical or cash instrument that is related to and that has a reasonable price correlation with the underlying interest of the futures contract being exchanged or the futures contract itself where the use of the underlying interest is not practical. The quantity or value covered by the physical or cash component of the EFP transaction must be approximately equivalent to the quantity or value covered by the futures contract.

2) Exchange for Risk Transactions

An exchange of a futures contract for an over-the-counter (OTC) derivative instrument and/or swap agreement (an Exchange for Risk (EFR) transaction) consists of two discrete, but related simultaneous transactions: a risk transaction and a futures contract transaction. At the time such transaction is effected, the parties to the futures contract transaction must be the same parties to the risk transaction and the buyer and the seller of the futures contract must be, respectively, the seller and the buyer of the OTC derivative instrument and/or swap agreement. The risk component of the EFR transaction must involve an OTC derivative instrument and/or swap agreement that is related to and that has a reasonable price correlation with the underlying interest of the futures contract being exchanged or the futures contract itself where the use of the underlying interest is not practical. The quantity or value covered by the risk component of the EFR transaction must be approximately equivalent to the quantity or value covered by the futures contract.

3) General Provision

a) EFP and EFR transactions must at all times be executed in accordance with such other procedures, terms and conditions that the Bourse may prescribe from time to time.

b) The futures contracts that are eligible to EFP or EFR transactions, and the last day and time for executing such transactions shall be determined by the Bourse.

c) The cash components acceptable for the purpose of an EFP transaction and the over the counter derivative instruments acceptable for the purpose of an EFR transaction are those specified in the procedures set by the Bourse.

d) Each party to an EFP or EFR transaction must satisfy the Bourse, upon request, that the transaction is a bona fide EFP or EFR transaction. To this effect, parties to such a transaction must maintain and must provide to the Bourse upon request complete records and documentary evidence relating to such transaction including all records relating to the purchase or sale of securities, physical underlyings, sub-instruments of these physical underlyings, instruments related thereto or over the counter derivative instruments and to any transfer of funds or ownership made in connection with such transaction.

e) It is prohibited for any party to an EFP or an EFR transaction to effect a transaction which is contrary to the requirements and practices prescribed by the rules, policies and procedures of the Bourse or to effect such a transaction for the sole purpose of reporting, registering or recording a price that is not a bona fide price or of making a transaction which is a "wash sale", an accommodation trade or a fictitious sale.

f) An EFP or an EFR transaction may be made at such prices that are mutually agreed upon by the two parties to this transaction. However, the price at which the futures contract leg of the transaction is arranged must be fair and reasonable in light of factors such as, but not limited to, the size of the 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 as well as the general market conditions.

g) Each EFP or EFR transaction must be reported to the Bourse in accordance with the procedures set by the Bourse. Such report must be in the form prescribed by the Bourse and must contain all the information required on such prescribed form.

h) Each EFP or EFR transaction executed during the trading hours of the futures contract to which the transaction applies must be reported to the Bourse within one hour upon determination of all the relevant terms of the trade. Each EFP or EFR transaction executed after the trading hours of the futures contract to which the transaction applies must be reported to the Bourse no later than 10:00 a.m. (Montréal time) on the next trading day following the execution of the transaction.

i) The accounts involved on each side of an EFP or EFR transaction must satisfy at least one of the following conditions:

ii) they have different beneficial ownership;

ii) they have the same beneficial ownership, but are under separate control;

iii) the accounts are commonly controlled, but involve separate legal entities which may or may not have the same beneficial ownership.

In cases where the parties to an EFP or EFR transaction involve the same legal entity, same beneficial ownership, or separate legal entities under common control, the parties must be able to demonstrate that the exchange transaction was a legitimate arms-length transaction.

j) It is strictly prohibited for any party, for both the buyer and the seller, to enter into an EFP or EFR transaction to circumvent the contract month roll in the corresponding security or derivative instrument.

6815A Substitution of over-the-counter derivative instruments for futures contracts
(30.05.08, 00.00.00)

a) Transactions allowing to substitute an over-the-counter derivative instrument and/or a swap agreement for futures contracts listed and traded on the Bourse are permitted if such transactions are executed in accordance with the requirements of this article and of the procedures established by the Bourse.

b) A substitution of an over-the-counter (OTC) derivative instrument and/or swap agreement for futures contracts consists of two discrete transactions: a risk transaction and a futures contract transaction. At the time such transaction is effected, the parties to the futures contract transaction must be the same parties to the risk transaction and the buyer and the seller of the futures contract must be, respectively, the buyer and the seller of the OTC derivative instrument and/or swap agreement. The risk component of the substitution transaction must involve the interest underlying the futures contracts (or a derivative, by-product or related product of such underlying interest) and must have a reasonable price correlation with the underlying interest of the futures contract involved in the substitution transaction or the futures contract itself where the use of the underlying interest is not practical. The quantity or value covered by the risk component of the substitution of over-the-counter derivative instruments for futures contracts must be approximately equivalent to the quantity or value covered by the futures contract transaction.

c) Substitution transactions involving over-the-counter derivative instruments must at all times be executed in accordance with such other procedures, terms and conditions that the Bourse may prescribe from time to time.

d) The futures contracts that are eligible to substitution transactions, and the last day and time for executing such transactions shall be determined by the Bourse.

e) The risk components acceptable for the purpose of a substitution transaction are those specified in the procedures set by the Bourse.

f) Each party to a substitution transaction must satisfy the Bourse, upon request, that the transaction is a bona fide substitution transaction. To this effect, parties to such a transaction must maintain and must provide to the Bourse upon request complete records and documentary evidence relating to such transaction including all records relating to the purchase or sale of securities, physical underlyings, sub-instruments of these physical underlyings, instruments related thereto or over the counter derivative instruments and to any transfer of funds or ownership made in connection with such transaction.

g) It is prohibited for any party to a substitution transaction to effect a transaction which is contrary to the requirements and practices prescribed by the rules, policies and procedures of the Bourse or to effect such a transaction for the sole purpose of reporting, registering or recording a price that is not a bona fide price or of making a transaction which is a "wash sale", an accommodation trade or a fictitious sale.

h) A substitution transaction may be made at such prices that are mutually agreed upon by the two parties to this transaction. However, the price at which the futures contract leg of the transaction is arranged must be fair and reasonable in light of factors such as, but not limited to, the size of the 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 as well as the general market conditions.

i) Each substitution transaction must be reported to the Bourse in accordance with the procedures set by the Bourse. Such report must be in the form prescribed by the Bourse and must contain all the information required on such prescribed form.

j) Each substitution transaction executed during the usual trading hours of the futures contract to which the transaction applies must be immediately reported to the Bourse. Each substitution transaction executed after the usual trading hours of the futures contract to which the transaction applies must be reported to the Bourse no later than 10:00 a.m. (Montréal time) on the next trading day following the execution of the transaction.

k) The accounts involved on each side of a substitution transaction must satisfy at least one of the following conditions:

    iii) they have different beneficial ownership;

    iv) they have the same beneficial ownership, but are under separate control;

    iii) the accounts are commonly controlled, but involve separate legal entities which may or may not have the same beneficial ownership.

    In cases where the parties to a substitution transaction involve the same legal entity, same beneficial ownership, or separate legal entities under common control, the parties must be able to demonstrate that the transaction was a legitimate arms-length transaction.

l) It is strictly prohibited for any party, for both the buyer and the seller, to enter into a substitution transaction to circumvent the contract month roll in the corresponding security or derivative instrument.

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 & on the FTSE Emerging Markets Index
Futures contracts on carbon dioxide equivalent (CO_2e) 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 & on the FTSE Emerging Markets Index
Futures contracts on carbon dioxide equivalent (CO_2e) 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 (CO_2e) 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 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 and on the FTSE Emerging Markets index:** 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 are also acceptable, provided they mirror the index futures contract against which the EFP transaction is made.

- **For futures contracts on carbon dioxide equivalent (CO_2e) units:** The eligible Canadian CO_2e units are regulated emitters' credits, and / or offset credits

- **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 (CO_2e) 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 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 Operations Department the Special Terms Transaction Reporting Form prescribed by the Bourse. This form is available on the Web sites of the Bourse at http://sttrf-frots.m-x.ca/ and at http://sttrf-frots.m-x.ca/ in the case of futures contracts on carbon dioxide equivalent (CO_2e) 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 Special Terms Transaction Reporting Form must be submitted ~~immediately~~ within one hour upon ~~the execution of the transaction~~determination of all the relevant terms of the trade. If the EFP, EFR or Substitution transaction is made after the closing of the trading session, the Special Terms Transaction Reporting Form must be submitted no later than 10:00 a.m. (Montréal time) on the next trading day.

If the Special Terms Transaction Reporting Form is not accurately filled out with all the relevant information required by the Market Operations Department of the Bourse, the transaction will not be approved neither recorded in SAM and the approved participant will have to resubmit a new Special Terms Transaction Reporting Form correctly completed.

Once correctly completed Special Terms Transaction Reporting Forms have been received, the Market 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 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 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.mcex.ca/trading_transactionReport in the case of case of futures contracts on carbon dioxide equivalent (CO_2e) 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 = 0.70 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

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.

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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 & on the FTSE Emerging Markets Index
Futures contracts on carbon dioxide equivalent (CO_2e) 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 & on the FTSE Emerging Markets Index
Futures contracts on carbon dioxide equivalent (CO_2e) 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 (CO_2e) 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 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 and on the FTSE Emerging Markets index:** 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 are also acceptable, provided they mirror the index futures contract against which the EFP transaction is made.

- **For futures contracts on carbon dioxide equivalent (CO_2e) units:** The eligible Canadian CO_2e units are regulated emitters' credits, and / or offset credits

- **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 (CO_2e) 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 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 Operations Department the Special Terms Transaction Reporting Form prescribed by the Bourse. This form is available on the Web sites of the Bourse at http://sttrf-frots.m-x.ca/ and at http://sttrf-frots.m-x.ca/ in the case of futures contracts on carbon dioxide equivalent (CO_2e) 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 Special Terms Transaction Reporting Form must be submitted within one hour upon determination of all the relevant terms of the trade. If the EFP, EFR or Substitution transaction is made after the closing of the trading session, the Special Terms Transaction Reporting Form must be submitted no later than 10:00 a.m. (Montréal time) on the next trading day.

If the Special Terms Transaction Reporting Form is not accurately filled out with all the relevant information required by the Market Operations Department of the Bourse, the transaction will not be approved neither recorded in SAM and the approved participant will have to resubmit a new Special Terms Transaction Reporting Form correctly completed.

Once correctly completed Special Terms Transaction Reporting Forms have been received, the Market 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 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 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.mcex.ca/trading_transactionReport in the case of case of futures contracts on carbon dioxide equivalent (CO_2e) 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 = 0.70 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

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.

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