CIRCULAR 144-21
August 3, 2021

REQUEST FOR COMMENTS

AMENDMENTS TO THE RULES OF BOURSE DE MONTRÉAL INC. TO MODIFY THE DELIVERY STANDARDS AND THE MINIMUM VOLUME THRESHOLD FOR BLOCK TRANSACTIONS ON THE 30-YEAR GOVERNMENT OF CANADA BOND FUTURES (LGB)

On May 11, 2021, the Rules and Policies Committee of Bourse de Montréal Inc. (the "**Bourse"**) approved amendments to the Rules of the Bourse to modify the delivery standards and the minimum volume threshold for block transactions on the 30-Year Government of Canada bond futures (LGB) in order to better reflect market conditions.

Comments on the proposed amendments must be submitted at the latest on **September 3, 2021**. Please submit your comments to:

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A copy of these comments shall also be forwarded to the *Autorité des marchés financiers* (the "**Autorité**") to:

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Corporate Secretary and
Executive Director, Legal Affairs
Autorité des marchés financiers
Place de la Cité, tour Cominar
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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 THE RULES OF BOURSE DE MONTRÉAL INC. TO MODIFY THE DELIVERY STANDARDS AND THE MINIMUM VOLUME THRESHOLD FOR BLOCK TRANSACTIONS ON THE 30-YEAR GOVERNMENT OF CANADA BOND FUTURES (LGB)

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I. DESCRIPTION

Bourse de Montréal Inc. (the "Bourse") hereby proposes to update its rules pertaining to delivery standards on the 30-Year Government of Canada ("GoC") bond futures ("LGB") to better reflect market conditions and stimulate more activity in the contract. The Bourse considers that a well-functioning LGB market is desirable for the growth of its listed yield curve offering and strives to ensure that its contract design is in line with the needs of its market participants. Therefore, the Bourse proposes to change the lower bound of the remaining time to maturity criteria of deliverable bonds, in order for an eligible bond to exit the deliverable basket quicker. This would allow the cheapest-to-deliver ("CTD") bond to be the 30-year GoC benchmark bond more often. Specifically, the Bourse proposes to change the remaining time to maturity criteria of the delivery standards from 25+ years to 28.5+ years. Additionally, the Bourse proposes to increase the block threshold during the regular trading hours[1] from 100 contracts to 250 contracts. The Bourse believes that these proposed amendments will enhance market efficiency.

II. PROPOSED AMENDMENTS

The Bourse proposes to modify article 12.412 of its rules to change the maturity range criteria of the delivery standards from 25+ years to 28.5+ years, and to change the minimum volume threshold for block transactions during the regular trading hours for the LGB contract. Table 1 below summarizes the modifications contemplated.

Table 1: Maturity range requirement for deliverable bonds and minimum volume threshold for block transaction for the LGB contract

LGB specification	Current	Proposed
Remaining time to maturity requirement for deliverable bonds	Government of Canada bonds which have a remaining time to maturity of not less than 25 years as of the first day of the delivery month, calculated by rounding down to the nearest entire three-month period	Government of Canada bonds which have a remaining time to maturity of not less than 28.5 years as of the first day of the delivery month, calculated by rounding down to the nearest entire three-month period
Minimum volume threshold for block transactions (6:00 am to 4:30 pm ET)	100 contracts	250 contracts

The proposed modifications are based on consultations with dealers and end-user clients, and are meant to increase the contract's effectiveness as a trading and hedging instrument. The feedback the Bourse has received from the industry is that a better alignment between the LGB and the underlying cash bond market will help initiate growth in the futures contract.

[1] From 6:00 am to 4:30 pm ET.

III. ANALYSIS

a. Background

Benchmark bonds are usually the most liquid instruments in the over-the-counter ("OTC") bond market. Because of this liquidity pool concentration, they represent the primary tool for participants wishing to manage and adjust their fixed income portfolios on any given day. Following these transactions in benchmark bonds, a number of clients and dealers manage or transfer this exposure using efficient futures contracts via the Exchange for Physical ("EFP") facility of the Bourse. Therefore, an efficient interaction between the benchmark bonds and their associated GoC bond futures contracts is desirable to help market participants in their portfolio and balance sheet management activities. These EFP transactions (often referred to as "basis trade" or "cash and carry trade") are predominantly quoted against the cheapest-to-deliver ("CTD") bond, since it is the bond most likely to be delivered during the delivery month. Having a new futures contract with the benchmark bond as the CTD would also make the futures pricing exercise more straightforward and clear for users. Thus, the longer the benchmark bond remains the CTD bond, the easier it is for participants to interact with the Bourse's LGB contract to manage fixed income portfolios.

In 2019, the Bourse implemented a similar modification to the CGF delivery standards, reducing the remaining maturity range of deliverable bonds from 4.25-5.25 years to a maturity of 4.5-5.5 years. This change improved the attractiveness of the CGF contract by increasing the duration of the CTD bond and reducing the tracking error relative to the on-the-run five-year GoC bond.

Regarding the minimum volume for block transactions during the regular trading hours, the Bourse proposes to increase the minimum threshold ahead of the projected product relaunch, in an attempt to provide a healthy balance between providing market transparency and fairness, while protecting clients from excess volatility and price disruption. The last time the Bourse made modifications to the LGB block threshold during the regular trading hours was in 2018, when the product was not being traded by participants. At that time, the minimum volume threshold for block transactions was reduced from 500 contracts to 100 contracts, in an effort to encourage participation and build open interest in the contract in the absence of sustained liquidity provided in the electronic market[2]. After a reassessment of optimal launch conditions and based on the recent successful launch of its 2-year ("CGZ") and 5-year ("CGF") GoC bond futures contracts, the Bourse believes that the updated threshold strikes a better balance of interests while still accommodating early participation in the product.

b. Objectives

The objective of the proposed amendment is to ensure that the 30-year benchmark bond in the cash market is the CTD bond for the LGB contract as often as possible. The Bourse believes that the proposed modifications will increase the utility and the effectiveness of the LGB contract for hedgers and speculators. The Bourse aims to provide the market with an attractive 30-year contract offering that meets the needs of its initial supporters, in an effort to grow the volume

[2] https://www.m-x.ca/f_circulaires_en/133-18_en.pdf

and open interest until it reaches a critical mass of activity. The Bourse proposes to modify the LGB delivery standards and minimum volume threshold for block transactions following a product specifications review exercise and after conducting a survey with market participants that expressed interest in transacting the LGB contract

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

- increase the effectiveness of the LGB contract for hedgers and speculators involved in the Canadian bond futures market.
- help build initial liquidity in the LGB contract by reducing uncertainty related to the CTD bond
- facilitate the management of the Canadian 30-year sector exposure

The Bourse believes that these amendments remain consistent with its objective to: 1) provide market participants with an efficient price discovery mechanism as well as hedging tool 2) strengthen the functioning of the Canadian derivatives market and 3) better serve the interests of market participants.

c. Comparative Analysis

The replacement of the remaining time to maturity criteria from 25+ years to 28.5+ years will result in a bond exiting the deliverable basket sooner (the one with the shortest time to maturity), thus increasing the modified duration and the DV01[3] of the LGB contract. This increase is desirable for some participants who would like to see the longest duration possible, while it is not perceived as a significant change for others. The Bourse believes the proposed modifications still align the LGB contract with comparable international product specifications, as illustrated by the table 3 below.

Table 3: Remaining maturity range requirement for 30-year bond futures

Exchange	MX - proposal	CME	Eurex	ICE
Futures contract	LGB	Ultra 30Y US T-Note	Euro-Buxl	Ultra Long Gilt
Remaining maturity criteria (range)	28.5+ years	25+ years	24 to 35 years	28 to 37 years
Modified duration (june 2021 contract)	22.7 years	18.4 years	20.4 years	19.5 years

Source: Contract specification on exchanges websites, Bloomberg

With regards to the minimum volume threshold for block transactions, the increase proposed by the Bourse is slightly more restrictive than that implemented by Eurex and ICE, which favors more price transparency. For the reasons mentioned above, the Bourse believes that the 250 contracts level is relevant for the projected product relaunch.

[3] Dollar value of a basis point.

Table 4: International benchmarking of government bond futures 2020 average daily volume ("ADV") and minimum block thresholds

Government Bond Futures	MX proposal (GoC Bond Futures)	CME* (US Bond Futures)	Eurex (German Bond Futures)	ICE (UK Bond Futures)
30Y ADV (Block threshold)	0 (250 regular*, 100 extended)	134k (5,000 (RTH), 2,500 (ETH), 1,250 (ATH))	56k (100)	30 (50 Standard publication, 250 Delayed publication)

*RTH = Regular Trading Hours, ETH = European Trading Hours, ATH = Asian Trading Hours
Sources: Contract specifications and exchange websites

Based on this international benchmarking, the Bourse considers that the proposed modifications are justified as the LGB delivery standards and block threshold will be comparable with products of other exchanges while taking into account local market needs.

d. Analysis of Impacts

i. Impacts on Market

GoC 30-year issuance pattern

Here are the projected 30-year bond issuances for 2021, a pattern that experienced some changes due to the effect of the global pandemic on the central bank's debt management strategies[4]. The impacts of the proposed modifications discussed thereafter are based on these conditions:

- Ten auctions per year (at one or two month intervals)
- December maturity for any new 30-year bond issued
- Target size for each 30-year bond is C$46-C$58B.

In addition, a 30-year bond's benchmark period is usually when its remaining time to maturity is between 28.5 years and 32 years. Thus, a 30-year benchmark switch happens usually every 3.5 - 4 years.

Impacts of the proposed change to the remaining maturity range on the delivery basket

Generally speaking, the impacts of changing the remaining time to maturity criteria of the deliverable standards from 25+ years to 28.5+ will be as follows:

- One (or two) less deliverable bond(s) in the delivery basket, reducing the deliverable amount outstanding (of about 25%)
- A reduction of position limit for the aggregate contract months and for the first contract month (of about 25%)
- The 30-year GoC benchmark bond would be the CTD bond for most (if not all) of its 3.5 - 4 years benchmark period.

[4] https://www.budget.gc.ca/2021/report-rapport/anx2-en.html

Tables 5 and 6 below summarize the impacts of the proposed modifications on the deliverable basket and on the CTD bond for upcoming LGB contracts. We can see that currently, the 2048 GoC bond, which is the CTD bond, remains in the basket until the December 2023 expiry. When it exits, the CTD will shift to the 2051 GoC bond, which is expected to have just ended its benchmark period. That illustrates that the CTD[5] would never be the benchmark bond on a constant basis should the delivery standards remain unchanged. Removing that bond from the basket quicker will allow the 2051 bond to be the CTD until the end of its projected benchmark period, and so on.

Table 5 : Current LGB delivery basket for the 2021 contract expiries (and upcoming contracts)

30Y GoC bond in the delivery basket	Amount outstanding	Status	Benchmark period	Last expiry in the basket
CAN 2.75 12/01/2048	C$14.9B	CTD	November 2016 - April 2020	December 2023
CAN 2 12/01/2051	C$45.8B	30Y benchmark (since April 2020)	April 2020 - Q3 2023*	December 2026
New 30Y GoC bond projected to be issued in Q2 2021	Not issued yet, but will be included in the basket when it reaches the minimum amount outstanding requirement			

* projected

Table 6: **Proposed** LGB delivery basket for the 2021 contract expiries (and upcoming contracts)

30Y GoC bond in the delivery basket	Amount outstanding	Status	Benchmark period	Last expiry in the basket
CAN 2 12/01/2051	C$45.8B	CTD and 30Y benchmark (since April 2020)	April 2020 - Q3 2023*	June 2023
New 30Y GoC bond projected to be issued in Q2 2021	Not issued yet, but will be included in the basket when it reaches the minimum amount outstanding requirement			

* projected

Regarding the minimum volume threshold for block transactions, the Bourse believes the impact on market participants will be minimal as there is currently no volume or open interest in the LGB contract and block transactions are not expected to account for a large proportion of the volume when the product is relaunched.

Impacts of the proposed modifications on position limits

The position limits for the Bourse's GoC bond futures are based on the amount outstanding of the deliverable baskets. Removing one matured bond from the basket will reduce the position limits (aggregate contract months and first contract month limits). Market participants surveyed are aware of this impact and have not identified that as an impediment for them to trade the contract

[5] CTD math favorises bonds with shorter maturity and high coupon in a low yield environment, which we are in since over ten years. An LGB CTD switch is very unlikely in all realistic scenarios in the coming years.

or hold the positions desired for different strategies. Both position limits still represent a large amount of exposure for the 30-year sector and should be sufficient to cover client needs based on feedback from key market participants. The impact on the first contract month is also limited as only a small fraction of the LGB is expected to go into delivery, similar to what is observed for the other bond futures listed by the Bourse.

ii. Impacts on Technology

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

iii. Impacts on regulatory functions

The proposal has no impact on the compliance, supervision and reporting rules on the Bourse. Participants engaged in block transactions (regardless of the size of the trade and the reporting time delay applicable) should comply with the Rules of the Bourse and are subject to the oversight of the Regulatory Division of the Bourse. As a reminder, participants must at all times adhere to the principles of good business practice in the conduct of their affairs. Specifically for block transactions, the Bourse would like to remind participants that practices such as front running (article 7.6) are prohibited.

iv. Impacts on clearing functions

CDCC's Rules need to be aligned with the changes proposed by the Bourse with respect to the delivery standards of the LGB. The proposed changes should have no impact on the clearing functions of CDCC, on CDCC's Operations Manual, nor on CDCC's Clearing Members, or other Industry participants dealing with CDCC.

v. Public Interest

The Bourse considers these amendments to be in the interest of the public as they will allow for better trading and hedging practices for market participants, while keeping as much activity as possible "on-screen". A contract that is better tailored to participants needs will be more liquid and will attract more activity to the transparent and centrally-cleared futures market. The Bourse believes the new delivery standards and block threshold are in line with market expectations, will encourage more transactions on the electronic market and will provide a healthier balance of interests for participants.

IV. PROCESS

The drafting process was initiated by the desire of the Bourse to review the relevance of LGB product specifications ahead of the expected product relaunch. The Bourse believes that more appropriate delivery standards and minimum volume threshold for block transactions should be set to help generate interest in using the LGB and foster activity in this contract during its liquidity development phase.

The proposed amendments, including this analysis, must be approved by the Bourse's Rules and Policies Committee and submitted to the Autorité des marchés financiers, in accordance with the self-certification process, and to the Ontario Securities Commission for information purposes

V. ATTACHED DOCUMENTS

Proposed amendments to the Rules of the Bourse.

Article 6.206 Block Trades

Eligible derivatives instruments	Prescribed time delay (from 6AM until the end of the Trading Day) (As soon as practicable and in any event within the following time delay)	Block - Minimum volume threshold (from 6AM until the end of the Trading Day)	Prescribed time delay (from 2AM until 5h59m59s) (As soon as practicable and in any event within the following time delay)	Block - Minimum volume threshold (from 2AM until 5h59m59s)
[…]	[…]	[…]	[…]	[…]
30-Year Government of Canada Bond Futures Contracts (LGB)	15 minutes	~~100~~ 250 contracts	1 hour	100 contracts
[…]	[…]	[…]	[…]	[…]

[…]

Article 12.412 Delivery Standards

(a) For Thirty-year Government of Canada Bond Futures, shall be deliverable only those Government of Canada Bond issues which:

(i) have a remaining maturity of not less than ~~twenty-five (25)~~ 28 1/2 years, as of the first day of the Delivery Month (for the purpose of determining the maturity of a Bond eligible for Delivery and for settlement, the time to maturity of a given issue shall be calculated in complete periods of three months, by rounding down to the nearest entire three-month period, e.g. 30 years and seven months shall be considered 30 1⁄2 years from the first day of the Delivery Month);

[…]

Article 6.206 Block Trades

Eligible derivatives instruments	Prescribed time delay (from 6AM until the end of the Trading Day) (As soon as practicable and in any event within the following time delay)	Block - Minimum volume threshold (from 6AM until the end of the Trading Day)	Prescribed time delay (from 2AM until 5h59m59s) (As soon as practicable and in any event within the following time delay)	Block - Minimum volume threshold (from 2AM until 5h59m59s)
[...]	[...]	[...]	[...]	[...]
30-Year Government of Canada Bond Futures Contracts (LGB)	15 minutes	250 contracts	1 hour	100 contracts
[...]	[...]	[...]	[...]	[...]

[...]

Article 12.412 Delivery Standards

(a) For Thirty-year Government of Canada Bond Futures, shall be deliverable only those Government of Canada Bond issues which:

(i) have a remaining maturity of not less than 28 1/2 years, as of the first day of the Delivery Month (for the purpose of determining the maturity of a Bond eligible for Delivery and for settlement, the time to maturity of a given issue shall be calculated in complete periods of three months, by rounding down to the nearest entire three-month period, e.g. 30 years and seven months shall be considered 30 1⁄2 years from the first day of the Delivery Month);

[...]