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CIRCULAR
December 20, 2011

REQUEST FOR COMMENTS

AMENDMENTS TO POSITION LIMITS FOR EQUITY OPTIONS AND OPTIONS ON EXCHANGE TRADED FUNDS

AMENDMENTS TO ARTICLE 6651 OF RULE SIX

The Rules and Policies Committee of Bourse de Montréal Inc. (the "**Bourse**") has approved the amendments to article 6651 of Rule Six ("**Rule Six**") of the Bourse in order to increase the position limits for equity options and options on exchange-traded funds.

Comments on the proposed amendments must be submitted within 30 days following the date of publication of this notice, at the latest on **January 20, 2012**. Please submit your comments to:

Mr. François Gilbert
Vice-President, Legal Affairs, Derivatives
Bourse de Montréal Inc.
Tour de la Bourse
P.O. Box 61, 800 Victoria Square
Montréal, Quebec H4Z 1A9
E-mail: legal@m-x.ca

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

Ms. Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800 Victoria Square, 22nd Floor
P.O. Box 246, Tour de la Bourse
Montréal (Quebec) H4Z 1G3
E-mail: consultation-en-cours@lautorite.qc.ca

Circular no.:186-2011

Appendices

For your information, you will find in appendices an analysis of the proposed amendments as well as the amended article of Rule Six. 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).

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AMENDMENTS TO POSITION LIMITS FOR EQUITY OPTIONS AND OPTIONS ON EXCHANGE TRADED FUNDS

I. Introduction

Bourse de Montreal Inc. (the "Bourse") intends to increase its position limits for equity options and options on exchange-traded funds.

II. Detailed Analysis

A. Rationale

The Bourse's position limits are significantly lower than comparable position limits at American exchanges. Position limits were identical across the border prior to 2005, when the Securities and Exchange Commission (SEC) approved a pilot program establishing a new position limit structure for all American derivatives exchanges.

An excerpt from the Securities and Exchange Commission (SEC) release explaining their rationale for increasing position limits on equity options and options on exchange traded funds:

> "Since the last position limit increase, there has been an exponential increase in the overall volume in options trading. Part of this volume is attributable to a corresponding increase in the number of overall market participants. This growth in market participants has in turn brought about additional depth and increased liquidity in options trading. FINRA has no reason to believe that the current trading volume in equity options will not continue. Rather, FINRA expects continued options volume growth as opportunities for investors to participate in the options markets increase and evolve. FINRA believes that the non-pilot position and exercise limits might constrain liquidity in the options markets. FINRA has not encountered any significant regulatory issues regarding the applicable position limits. Moreover, FINRA believes that there is a lack of evidence of market manipulation schemes, which justifies the proposed permanent approval of the pilot program. To date, FINRA is unaware of any adverse affects on the markets as a result of past increases in the limits for equity option contracts." *Securities and Exchange Commission Release No 34-57413* *http://www.sec.gov/rules/sro/finra/2008/34-57413.pdf*

The existence of divergent position limits between Canadian and American derivative exchanges poses a significant risk of regulatory arbitrage in the realm of interlisted options. The Bourse is in perpetual competition with American derivatives exchanges, especially in the realm of interlisted options. With the high correlation of Canadian and American options markets, barriers such as excessively restrictive position limits serve to divert volume from the Bourse.

The vast majority of North American options transactions take place Over the Counter (OTC), where no position limits exist. In contrast to the exchange-traded derivatives market, the OTC market is subject to little to no regulation, and furthermore, transactional information is not disclosed to the market. This greatly hampers the price discovery process. The proposed position limit increase would encourage institutional investors to trade on exchange, rather than

OTC, facilitating greater transparency and providing the market with information crucial to the gauging of fair prices.

Large institutions have repeatedly informed the Bourse that position limits are too low, prohibiting them from executing transactions that could have any significant impact on their portfolios, and because of that, they have no choice but to execute their trades OTC.

In conjunction with proper surveillance functions, position limits serve as a valuable tool in the maintenance of fair and stable markets for underlying equities. This entails preventing attempts to corner the market and concentrated, leveraged positions with unacceptable risk of disorderly liquidations.

While addressing these concerns, position limits should not be so restrictive as to inhibit appropriate conduct. The Bourse’s existing positions limits put strict constraints on legitimate entities that pose no threat to the market. With higher position limits, such entities may generate larger transactions which further market liquidity. Swap dealers and other intermediaries are also constrained from providing optimal liquidity due to these restrictive position limits, begetting increased costs and discouraging investment in the market.

A statement from a University of Houston professor on the impact of restrictive position limits:

> “One of the most important functions of the markets is to discover prices, to provide a mechanism whereby information about supply and demand dispersed among millions can be aggregated. The price of an underlying is not dictated by any single entity; if so there would be no need for the markets. Restrictive position limits prohibit the market from working as intended, and constrain many legitimate market participants who pose no danger of market manipulation. Indeed, by limiting liquidity, the rule structure threatens to exacerbate large price moves in response to triggers. Prices have to move more in less liquid, less flexible markets in order to accommodate large shocks. Restrictive position limits drive business into physical markets, thereby distorting the prices producers receive and consumers pay. This is counterproductive, given that the ostensible purpose of the position limits is to prevent and diminish such distortions.” Dr. Craig Pirrong – University of Houston http://www.cato.org/pubs/regulation/regv33n2/regv33n2-8.pdf

While the SEC did originally implement a one year pilot program for the increase of position limits, the Bourse does not propose to implement such a strategy here. Over the six years since position limits were increased in the United States, there has been no evidence of any negative impact through the increase of position limits. Conversely, the introduction of such a pilot program could cause uncertainty in the market and discourage participants from trading.

B. Benchmarking

Canadian and American equity option position limits are based on identical five-tiered systems, through which options on actively traded equities are granted higher limits. The only real difference between the position limit structures are the actual limits themselves.

Equity Option and Option on Exchange Traded Fund Position Limits

Criteria	The Bourse	American Exchanges
Up to 20 Million 6 month Volume or Up to 15 Million 6 month Volume & 40 Million Shares Outstanding	13,500	25,000
Up to 40 Million 6 month Volume or Up to 30 Million 6 month Volume & 120 Million Shares Outstanding	22,500	50,000

Up to 80 Million 6 month Volume or Up to 60 Million 6 month Volume & 240 Million Shares Outstanding	31,500	75,000
Up to 100 Million 6 month Volume or Up to 75 Million 6 month Volume & 300 Million Shares Outstanding	60,000	200,000
At least 100 Million 6 month Volume or At least 75 Million 6 month Volume & 300 Million Shares Outstanding	75,000	250,000

Source: Boston Options Exchange (BOX)

Disparity of Canadian and American Position Limits on Interlisted Equity Options
(As of April 26, 2011)

Canadian Symbol	Canadian Open Interest	Canadian Position Limit	American Symbol	American Open Interest	American Position Limit	Canadian Symbol	Canadian Open Interest	Canadian Position Limit	American Symbol	American Open Interest	American Position Limit
AAV	1 298	75 000	AAV	19 485	75 000	MFL	1 435	31 500	MFN	32 599	200 000
ABX	54 541	75 000	ABX	628 198	250 000	MG	11 202	75 000	MGA	21 804	250 000
AEM	11 727	75 000	AEM	156 419	250 000	MX	2 418	22 500	MEOH	2 924	75 000
AGU	14 008	75 000	AGU	47 277	250 000	NDM	1 140	22 500	NAK	62 852	250 000
ANV	7 181	31 500	ANV	21 198	250 000	NDN	1 139	22 500	NDZ	72	250 000
ARZ	1 814	60 000	AZK	6 265	200 000	NG	759	60 000	NG	217 782	250 000
ATP	888	22 500	AT	458	50 000	NGD	9 748	75 000	NGD	58 542	250 000
AVL	893	75 000	AVL	43 342	250 000	NSU	2 544	60 000	NSU	5 577	200 000
AXR	791	22 500	AXU	17 700	200 000	NXY	29 481	75 000	NXY	78 191	250 000
BAM.A	2 446	75 000	BAM	2 205	250 000	OTC	2 877	22 500	OTEX	13 160	75 000
BCB	516	22 500	COT	1 289	250 000	PAA	6 417	31 500	PAAS	118 579	250 000
BCE	22 705	75 000	BCE	3 821	250 000	PD	5 810	75 000	PDS	7 538	250 000
BIN	1 084	31 500	BIN	22	75 000	PDL	4 224	75 000	PAL	63 070	250 000
BMO	51 270	75 000	BMO	18 723	500 000	PGF	2 282	75 000	PGH	17 469	250 000
BNS	47 505	75 000	BNS	6 073	75 000	POT	19 925	75 000	POT	656 614	750 000
BPO	29 527	75 000	BPO	3 094	250 000	PVE	180	60 000	PVX	15 297	250 000
BTE	4 512	31 500	BTE	2 849	50 000	PWT	9 720	75 000	PWE	30 876	250 000
CCO	25 964	75 000	CCJ	234 548	250 000	QLT	1 056	22 500	QLTI	2 607	50 000
CDM	1 387	22 500	CDE	169 317	250 000	RBA	85	22 500	RBA	996	75 000
CM	30 047	75 000	CM	4 318	250 000	RCI.B	20 211	75 000	RCI	3 015	75 000
CNQ	38 333	75 000	CNQ	174 432	500 000	RGL	172	22 500	RGLD	64 283	250 000
CNR	8 392	75 000	CNI	13 558	250 000	RIM	47 076	75 000	RIMM	912 846	250 000
COM	36	22 500	CRME	1 973	75 000	RMX	9 986	75 000	RBY	36 084	250 000
CP	7 400	75 000	CP	4 948	75 000	RY	63 387	75 000	RY	20 878	250 000
CVE	16 936	75 000	CVE	27 651	250 000	SEA	275	22 500	SA	41 179	75 000
DWI	1 390	13 500	DRWI	8 876	75 000	SLF	30 806	75 000	SLF	1 697	200 000
ECA	37 086	75 000	ECA	144 148	250 000	SLW	20 976	75 000	SLW	605 097	250 000
EDR	1 183	75 000	EXK	45 915	250 000	SSO	2 802	31 500	SSRI	66 741	250 000
ELD	25 208	75 000	EGO	76 849	250 000	SU	66 513	75 000	SU	385 687	250 000
ENB	12 978	75 000	ENB	3 215	150 000	SVM	7 113	75 000	SVM	79 825	250 000
ERF	1 697	60 000	ERF	15 428	200 000	SW	673	13 500	SWIR	4 812	50 000
G	56 226	75 000	GG	350 861	250 000	SXC	195	22 500	SXCI	3 002	50 000
GIB.A	1 680	75 000	GIB	914	75 000	T	9 607	75 000	TU	552	25 000
GIL	7 432	60 000	GIL	5 520	75 000	TCK.B	59 049	75 000	TCK	120 245	250 000
GSC	1 728	60 000	GSS	41 145	250 000	TCM	7 567	75 000	TC	21 673	250 000
GTE	9 379	75 000	GTE	20 140	250 000	TD	33 002	75 000	TD	27 443	250 000
HW	3 928	31 500	HWD	4 587	50 000	TGL	648	22 500	TGA	10 059	75 000
IMG	7 420	75 000	IAG	99 908	250 000	THI	2 021	60 000	THI	1 792	50 000
IMO	6 981	75 000	IMO	5 701	75 000	TKO	2 797	75 000	TGB	52 074	250 000
IMX	509	13 500	IMAX	44 545	250 000	TLM	17 023	75 000	TLM	20 266	250 000
ITH	46	22 500	THM	2 472	75 000	TRI	12 721	75 000	TRI	762	250 000
IVN	1 555	75 000	IVN	71 708	250 000	TRP	34 669	75 000	TRP	1 832	75 000
JAG	2 241	31 500	JAG	21 328	250 000	UFS	360	13 500	UFS	19 899	200 000
K	60 233	75 000	KGC	460 435	250 000	VRX	2 718	75 000	VRX	165 959	695 000
KGN	90	31 500	KGN	2 092	25 000	WPT	882	13 500	WPRT	24 669	250 000
LLL	1 124	22 500	LULU	100 003	500 000	XRC	591	22 500	XRA	33 175	75 000
MFC	138 579	75 000	MFC	34 711	250 000	YRI	21 419	75 000	AUY	352 629	250 000

Source: Options Clearing Corporation (OCC)
Note: All 24 securities shaded in grey in the above table demonstrate higher open interest on the Canadian side than the American side. Of those, 16 have higher position limits in the US,

III. Proposed Regulatory Amendments

A. Amendments to the Rules

The Bourse proposes to amend article 6651 of Rule Six, modifying the position limits for each tier to match the American position limits for that tier. Below is a table of the proposed position limits for the Bourse de Montréal.

Criteria	Article 6651 Paragraph B)	Existing Position Limits	Proposed Position Limits
Up to 20 Million 6 month Volume or Up to 15 Million 6 month Volume & 40 Million Shares Outstanding	sub -par. 1. a)	13 500	25,000
Up to 40 Million 6 month Volume or Up to 30 Million 6 month Volume & 120 Million Shares Outstanding	sub -par. 1. b)	22 500	50,000
Up to 80 Million 6 month Volume or Up to 60 Million 6 month Volume & 240 Million Shares Outstanding	sub -par. 1. c)	31 500	75,000
Up to 100 Million 6 month Volume or Up to 75 Million 6 month Volume & 300 Million Shares Outstanding	sub -par. 1. d)	60 000	200,000
At least 100 Million 6 month Volume or At least 75 Million 6 month Volume & 300 Million Shares Outstanding	sub -par. 1. e)	75 000	250,000

IV. Objectives and Consequences

The objective of the proposed amendments to the Bourse's Rules as described in this proposal is to increase the Bourse's equity option and option on exchange-traded fund position limits, to encourage more trading on exchange in Canada.

In 2004, the year prior to the pilot program that increased position limits in the United States, the average daily trading volume (ADV) for equity options in the United States was 4.7 million contracts. In 2005, when the pilot program was introduced, the ADV rose to nearly 6 million contracts, an increase approaching 28%. In 2006, once the pilot program ended and the limits became permanent the ADV increased another 35% to 8.1 million contracts per day. The growth has continued steadily each year and is now approximately 18.6 million contracts per day, an increase of 296% since the introduction of the pilot program six years ago. While not all of this increase can be attributed to the increase in position limits, they did play a role in the growth of these trading volumes.

Furthermore, the higher position limits would negate the current state of regulatory arbitrage that exists between the Canadian and American derivatives exchanges in terms of interlisted equity options and ultimately, allow for fair competition.

V. Public Interest

If equitable position limits were established for Canadian and American equity options and options on exchange-traded funds, institutional investors would have greater choice as to where to execute their trades.

This move would bring the Canadian options trading community closer to fully transparent and equitable markets. This would benefit all market participants and lend greater fairness to the derivatives trading community in Canada.

A statement from SEC Commissioner Roel C. Campos on the benefits of transparency which this proposal would offer by encouraging trading on exchange, as opposed to on the OTC market:

> "SEC staff economists as well as several academics are finding that increases in transparency reduce transaction costs for trades of all sizes and do not minimize liquidity. The various studies of trade reporting suggest that spreads tighten after the market becomes transparent. (Bessembinder, Maxwell and Venkataraman (2005); Hotchkiss and Sirri (2005); Edwards, Harris and Piwowar (2005)). In the 2005 Bessembinder, Maxwell and Venkataraman study, for example, the authors found that after the initiation of TRACE reporting, large sophisticated investors found a 50% reduction in trade execution costs. The study also noted that … the reduction in costs, even for institutional trades is tremendous … transparency increases investor confidence and is an essential component of efficient and fair markets. It reduces transaction costs, improves the pricing mechanism, promotes investor confidence, aids in compliance and surveillance, and lowers the cost of accessing capital." *Securities and Exchange Commission: Commissioner Roel C. Campos http://www.sec.gov/news/speech/2006/spch060806.htm*

VI. Process

The proposed modifications, including this Analysis, are to be approved by the Bourse's Rules and Policies Committee and submitted to the Authorité des marchés financiers in accordance with the self-certification process and to the Ontario Securities Commission for information.

VII. References

Boston Options Exchange Group LLC – Trading Rules
http://www.bostonoptions.com/box_regulations/PDF/BOX_RULES.pdf

Interlisted Symbols on the Toronto Stock Exchange
http://www.tmx.com/en/pdf/Interlisted.txt

TMX – Montréal Exchange – Update – Position Limits
http://www.m-x.ca/f_circulaires_en/160-11_en.pdf

VIII. Attached Documents

- Rule Six of Bourse de Montréal Inc.: amendments to article 6651

RULE SIX

TRADING

C. OPTIONS

Section 6651 - 6670
Limits and Restrictions

6651 Position Limits
(06.08.86, 19.05.87, 08.09.89, 06.08.90, 20.03.91,10.11.92, 07.04.94, 08.07.99, 07.09.99, 11.02.00, 28.01.02, 26.09.05, 20.05.10, XX.XX.XX)

A) Except as provided in paragraph D) of this article, no approved participant or restricted permit holder shall make for any account in which it has an interest, or for the account of any client, an opening transaction if the approved participant or the restricted permit holder has reason to believe that as a result of such transaction the approved participant or its client, or the restricted permit holder would, acting alone or in concert with others, directly or indirectly, hold, control or be obligated with respect to a position on the same side of the market relating to the same underlying interest (whether long or short) in excess of the position limits established by the Bourse.

B) Except otherwise indicated, the applicable position limits are as follows:

1. Stock or index participation unit options

   a) 25,000~~13,500~~ contracts where the underlying security does not meet the requirements set out in sub-paragraphs B) 1. b) and B) 1. c) of this article;

   b) 50,000~~22,500~~ contracts, where either the most recent interlisted six-month trading volume of the underlying interest totals at least 20 million shares, or the most recent interlisted six-month trading volume on the underlying interest totals at least 15 million shares and at least 40 million shares are currently outstanding;

   c) 75,000~~31,500~~ contracts, where either the most recent interlisted six-month trading volume in the underlying interest totals at least 40 million shares, or the most recent interlisted six-month trading volume on the underlying interest totals at least 30 million shares and at least 120 million shares are currently outstanding.

   d) 200,000~~60,000~~ contracts, where either the most recent interlisted six-month trading volume in the underlying interest totals at least 80 million shares, or the most recent interlisted six-month trading volume on the underlying interest totals at least 60 million shares and at least 240 million shares are currently outstanding.

   e) 250,000~~75,000~~ contracts, where either the most recent interlisted six-month trading volume in the underlying interest totals at least 100 million shares, or the most recent interlisted six-month trading volume on the underlying interest totals at least 75 million shares and at least 300 million shares are currently outstanding.

f) 300,000 contracts for options on the following index participation units:

- units of the iShares S&P/TSX 60 Index Fund (XIU).

2. Debt options

   8,000 contracts;

3. Index options

   50,000 contracts;

4. Options on futures

   The number of contracts established as the position limits for the underlying futures contract.

   For the purpose of this article, options contract positions are aggregated with the underlying futures contract positions. For aggregation purposes, the futures equivalent of one in-the-money option contract is one futures contract and the futures equivalent of one at-the-money or out-of-the-money option contract is half a futures contract.

5. Sponsored options

   The position limits described above apply to sponsored options. However, these position limits must be adjusted by using an equivalent unit of trading.

   When the underlying interest is traded on a market other than the Bourse, the position limits of this market apply to sponsored options by using an equivalent unit of trading.

6. Currency options

   40,000 contracts when the trading unit is 10,000 units of foreign currency. The limit will be adjusted to obtain the same notional amount if the trading unit is amended or if the Bourse introduces new trading units.

C) For the purpose of this article:

1. calls written, puts held and short underlying interest are on the same side of the market and puts written, calls held and long underlying interest are on the same side of the market;

2. the account of an individual member or of the holder of a restricted trading permit will not be counted with that of his clearing member unless the clearing member has an interest in the account;

3. the Exchange may, by notice, change the position limits. A change in the position limit will be effective on the date set by the Exchange and reasonable notice shall be given of each new position limit.

D) Conversions, reverse conversions, long and short hedges

1. For the purposes of this article the following defined hedges are approved by the Exchange:

    a) conversion: where an opening long put transaction in any option is entirely offset by an opening short call transaction having the same expiry month and strike price in the same option class, either of which option transaction is effectively hedged by a long position in the underlying interest of the option;

    b) reverse conversion: where an opening short put transaction in any option is entirely offset by an opening long call transaction having the same expiry month and strike price in the same option class, either of which option transaction is effectively hedged by a short position in the underlying interest of the option;

    c) short hedge: where an opening long call transaction or an opening short put transaction in any option is entirely offset by a short position in the underlying interest of the option;

    d) long hedge: where an opening short call transaction or an opening long put transaction in any option is entirely offset by a long position in the underlying interest of the option.

2. In addition to the options position limits set out in paragraph B), any one account may hold an amount not exceeding the applicable paragraph B) limit of any combination of the approved hedge positions defined in sub-paragraphs D) 1. a) to D) 1. d), inclusive.

3. For all position limits set out in this article, in the case of conversion and reverse conversion as defined in paragraph D) 1. a) and b), such limits shall apply as if calls written and puts held, or puts written and calls held, as the case may be, were not on the same side of the market.

E) Exemption

As described in Policy C-1, a member may file with the Exchange an application to obtain on behalf of a bona fide hedger an exemption from the position limits prescribed in this article. The application must be filed on the appropriate form, no later than the next business day after the limit has been exceeded. If the application is rejected, the member shall reduce the position below the prescribed limit within the period set by the Exchange. The Exchange may modify any exemption which has been previously granted. A bona fide hedger may also under certain circumstances file directly with the Exchange, in the form prescribed, an application to obtain an exemption from the position limits prescribed by the Exchange.