IIAC ACCVM
INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

1 Place Ville-Marie | Bureau 2901
Montréal (Québec) | H3B 0E9

514.843.8950 | www.accvm.ca

www.accvm.ca

January 30, 2018

Delivered Via Email: legal@tmx.com; consultation-en-cours@lautorite.qc.ca

M^e Martin Jannelle
Legal Counsel, Montreal Exchange and CDCC
Office of the General Counsel
Bourse de Montréal Inc.
Tour de la Bourse
P.O. Box 61, 800 Victoria Square
Montréal, Québec H4Z 1A9

M^e Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
Tour de la Bourse, P.O. Box 246
800 Victoria Square, 22nd floor
Montréal, Québec H4Z 1G3

Dear M^e Jannelle and M^e Beaudoin,

Re: Bourse de Montréal Inc. – Requests for Comments:
Amendments to the Rules and Procedures of Bourse de Montreal Inc. to accommodate the extension of its trading hours (Circular 165-17);
Amendments to the Rules and Procedures of Bourse de Montreal Inc. to expand the definition of approved persons (Circular 166-17).

The Investment Industry Association of Canada (the "IIAC") and its members would like to take this opportunity to express their views on the proposed amendments to the Rules and Procedures of Bourse de Montreal Inc. to accommodate the extension of its trading hours as per Circular 165-17 published on November 14, 2017 and on the proposed amendments to the Rules and Procedures of Bourse de Montreal Inc. to expand the definition of approved persons as per Circular 166-17 published on November 14, 2017.

The IIAC is the national association representing the position of 129 IIROC-regulated Dealer Member firms on securities regulation, public policy and industry issues. We work to foster a vibrant, prosperous investment industry driven by strong and efficient capital markets.

We remind Bourse de Montreal that this comment letter, in its entirety, can be published on the Bourse's website.

Industry Position – Low Support for Extended Trading Hours

With respect to the Bourse's project to extend its trading hours, it should be noted that our members have had extensive conversations with the Bourse regarding this topic over the years.

The industry's view remains: The IIAC and its members are not in favor of this initiative. Our industry, to this day, has major concerns regarding market liquidity, market integrity and market reputation.

Furthermore, the initiative implies additional cost and potential regulatory burden for our members with what we expect to be minimal offset from incremental revenue. We also believe that the liquidity issues, mentioned above, will greatly impact risk levels as well as market integrity. Our industry concerns are summarized below.

Market Liquidity - Risk to Aid Liquidity

Our Canadian members have been the largest supporters of the Canadian futures market, both from a sales perspective and from a market making perspective. Liquidity on the futures market in Montreal is a direct result of the capital and support that those members have devoted to each product.

Despite the Bourse's confidence in the eventual development of liquidity during the extended hours, the basis for this level of confidence is unclear to the industry members. While support for these products is currently supported by Canadian-based and/or foreign-based market makers during regular hours, there is no basis to believe these same participants will be willing to provide liquidity in non-traditional hours when liquidity in the underlying instruments is not available.

After surveying our members active in the Canadian futures market, we feel that support would not extend to an overnight session in which the largest of those end-user clients – the UK and European hedge fund community – would want to have access to liquidity in that early session (liquidity that they would normally have in the regular session).

The financial, operational, and reputational risks involved to aid liquidity in that early session are not risks that our members are currently willing to take.

Furthermore, we note that despite the Bourse's support, material market liquidity has failed to develop for other products introduced by the Bourse including carbon futures, 2 year, 5 year and 30 year Interest rate futures. The failure to have supportive liquidity materialize in the extended hours session could have knock-on impacts to the overall integrity and reputation of the market for products which are currently successful.

If the Bourse wishes to implement the extended hours despite low industry support, the industry advocates that the Bourse have concrete plans in place to ensure liquidity support for products trading in the extended hours session prior to operationalizing this approach. As articulated below, failure to ensure appropriate liquidity may have material impacts on market integrity and participants' risk.

Market Integrity - Market Quality and Manipulation:

Members doubt there will be sufficient market depth and liquidity in derivatives markets without:

i) the support of the Canadian dealers, and
ii) the availability of the underlying securities during the extended trading hours.

Concerns with market depth and liquidity greatly increase the probability of market manipulation or disruption. The reputation of the Bourse and of the Canadian markets are at stake.

Furthermore, the lack of underlying benchmarks may greatly increase the difficulty in assessing fair and reasonable pricing of the derivative instruments (re: price discovery degradation). For instance, how will the Bourse assess EFP, EFR and Block trades for fair and reasonable pricing? What measures will the Bourse implement to preserve market quality during unconventional trading hours? What benchmarks will Market operations use during extended hours to adjudicate no-cancel range for off-market trades? Industry members have received answers from the Bourse for some of these questions. The concerns remain.

Opening Time

Our members believe that 2:00 am EST is not a reasonable opening time for the Montreal Exchange.

For example, the Gilt futures open on the ICE/LIFFE at 2:30 am EST. The Montreal Exchange opening at 2:00 am, before major global bond contracts can be traded, suggests to the global investment community that the Bourse may have a misconception on the reliance global investors place on the bourse's products vis-a-vis those of other global exchanges. Global market participants have indicated that they do not need CGBs more than they need Gilts.

To justify extending its trading hours, the Bourse references that Sydney has a practically 24-hour futures market. However, this is a poor comparison given that Sydney is in a time zone almost on its own, where a very small portion of the investment world exists. It is in Sydney's best interest to be open during European and North American trading hours, hence the need for a round-the-clock market.

The First In First Out ("FIFO") Algorithm – Issues

The FIFO fill algorithm on the Bourse's futures exchange means that Good 'Til Canceled ("GTC") orders will be pointless if a client does not want the overnight risk of being filled on a significant event that causes market movement.

The increased risk that an event moves the market will mean people will not work GTC orders, so the only advantage many clients have (GTC in a FIFO market) will effectively be removed.

It should be noted that removing orders in a FIFO market means that the orders go to the back of the queue when they are re-entered. We believe this to be unfair to investors. As previously mentioned, the only fill algorithm that we believe is appropriate in a market that trades for more than regular business hours is a pro-rata algorithm, such that participants can take their order out when they leave and enter the market again later in the morning without putting them at a disadvantage.

As mentioned above, the Bourse's clients may not want to cancel their orders in the book as it would impact the order's priority.

We are asking the Bourse, if the initiative goes forward despite low support from the industry, to introduce a functionality that would allow clients to "hide" their orders in the book during extended hours without losing priority in the book once reactivated. Another acceptable solution would be to move to a pro-rata algorithm as explained above. In any case, the current algorithm does not properly support the Bourse's project.

Licensing and Registration

If the extended trading hours are implemented and our members would wish to participate in the early trading session, they would face licensing and registration issues.

Our members would potentially require their European branches to undergo the same licensing and registration as the Canadian firms to be able to assist Canadian clients if/when they need to trade overnight.

Foreign 24-hour desk staff would therefore need to be “dual-hatted” employees. They would need to be licensed for the Canadian and Foreign jurisdiction, which would effectively mean that members would need a “Canadian branch” of some sort in the Foreign jurisdiction so that employees could be licensed and registered to deal with Canadian clients in regards to Canadian products. That is a costly and large administrative exercise that many firms may refuse to undertake.

Members are also concerned that local regulatory considerations may inhibit the ability to license individuals to perform supervisory functions from non-domestic locations. There is also concern that the act of supervising this activity may bring additional scrutiny from foreign regulatory agencies.

To avoid the dual licensing of foreign staff, Canadian members would need to hire trading staff to work the overnight session from Canada – a minimum of two employees would be required per firm – another costly undertaking.

The issue is that our members do not believe that the incremental revenues they could potentially derive from the Bourse’s initiative would be anywhere close to covering their additional costs.

The addition of domestic personnel to cover the extended session comes with logistical and practical challenges. Because of the unattractiveness of the working hours, extended hours sessions are likely to be staffed by junior personnel who are less equipped to deal with exceptional circumstances. This adds to the potential occurrence of disruptive market events.

Furthermore, the proposal to expand the definition of approved persons (circular 166-17 issued by the Bourse in November 2017) does not help our members comply with other regulatory requirements. The IIAC is currently working with the Investment Industry Regulatory Organization of Canada (IIROC) as well as with the Financial Conduct Authority (FCA) in the United Kingdom in order to fully understand the impact of the Bourse’s proposal on its members. However, the ultimate outcome of these discussions is as yet uncertain.

Regardless of the outcome of the registration issues, firms believe that relying on employees in foreign offices to manage customer relationships for Canadian derivatives products is sub-optimal. Representatives in foreign offices are typically already fully engaged, have less familiarity with the particulars of the Canadian marketplace and, consequently, may not be well positioned to provide optimal customer service or execution for Canadian derivatives products. For some smaller dealers, the option to leverage foreign operations to accommodate the overnight demands may not be available. This would create an unlevel competitive environment among participants.

Overall Increased Payroll

To support this costly initiative, our members would need to increase staffing in the following departments:

- Trading, as mentioned above
- Compliance and Surveillance
- Risk management
- Administration
- Information Technology

Furthermore, we believe certain legislation may require that night staff be paid a premium on their salary. The IIAC is still analyzing the legal impact of the proposal.

CDCC – Clearing Impacts:

We wonder if the clearing impacts have been properly assessed by the Bourse.

The industry has many questions and concerns. For example, will transactions be novated on a live basis? If this is not the case, our members would be taking on the complete counterparty risk of a transaction until this transaction gets novated by the CDCC. Concerns remain despite answers received from the Bourse regarding clearing.

Due to the increased counterparty risk (and associated increased financial and regulatory risk), our members may not want to participate in the extended trading hours. We believe this is yet another key issue for our members.

Regardless whether members participate in the extended trading hours, they would have credit exposure resulting from market stress events during the extended session. Without adequate means to remediate credit exposure from customers and counterparties, member firms financial position could be negatively impacted.

The industry would also like additional clarity related to the structure of the proposed 7:15 margin call. It is not currently clear whether the margin call will reflect price movements on contracts during the extended session. If this is the case, it represents a risk to firms whether they decide to participate in the early session or not, since the firms' open positions will be subject to variation margins based on the prices of the early session.

This is a material exposure to overnight market or political events which is compounded by the fact that this 7:15 margin call occurs when Dealers' back offices will be lightly staffed, customers and counterparties are not available to provide offsetting margin deposits to the participant and the participant does not have immediate access to secondary sources of liquidity. The implications to firms' liquidity could be significant in the event of significant overnight stress events.

Furthermore, we highly doubt that the current CDCC systems will be able to support the initiative. It is necessary that the CDCC systems be updated to support the proposed changes if the Bourse goes ahead with the initiative despite low industry support.

MX support:

Our members also have concerns regarding the support provided by the Bourse, the Regulatory Division and the CDCC if the proposal is implemented. The industry participants have many questions:

- Will the Market Operations Department offer proper support during the extended trading hours?
- Will the Technical Help Desk offer proper support during the extended trading hours?
- Will the Bourse's IT Department offer proper support during the extended trading hours?
- Will the Regulatory Division offer proper support during the extended trading hours?
- Will CDCC offer proper support during the extended trading hours?
- Did the Bourse evaluate the cost of providing extended support to market participants?

We believe proper support should be made available to our members during the extended trading hours if the project is adopted. Concerns remain despite answers provided to industry members.

Live Orders – Increased Risk:

Our members feel it would be unreasonable to expect the Bourse's Approved Participants to monitor their orders in the book from 2:00 am to 4:15pm. Members believe it would also be unreasonable to expect that Approved Participants should assume market risk during the unconventional trading hours.

Technology Impacts:

Another impact that may not have been properly assessed by the Bourse is whether the existing IT and Surveillance applications provided by third-party vendors will be able to support the extended trading hours. Once again, members have questions:

- Did the Bourse discuss its project with third-party vendors?
- Has the Bourse enquired about third-party vendors' batch processing time?
- Did the Bourse assess the impact of its project on our members' surveillance tools?

Concerns remain despite answers provided to our members.

The Bourse's Revenues – How Are the Revenues Generated?

The Bourse suggests that a very large portion of its trading activity comes from London, UK. The IIAC agrees. However, the support base that has requested this earlier trading session also consists largely of trading entities that trade large volumes often for no loss or gain.

These entities also pay the exchange minuscule fees relative to the Canadian banks and dealers that have supported the Canadian market for so long.

There needs to be proper consideration for the revenue that the exchange is generating from the participants that have requested the change versus the revenue from the members that are opposed to the change. The Bourse must assess the revenues rather than simply look at the volumes that those foreign participants are trading.

Where Is the Profit?

The Bourse has given guidance to our members on the profits expected from this proposed initiative.

The Bourse also estimates that approximately 10% to 15% of the daily volume would trade in the early session.

The issue is that we do not expect our members' overall volume to increase by 10% to 15% from the extended trading hours. Furthermore, even if a 10% volume would be realistic from the extended trading hours, the decreased volume in the "regular" trading session and the additional costs to our members for making staffing, administrative and infrastructure changes would not create increased profits for our members.

The Chicago Mercantile Exchange Group ("CME") Example

On April 12, 2017, the CME, one of the world's biggest exchanges, issued the following newswire:

"The CME Group is closing two operations in London by year end after they ran up losses of more than $100 million…

*"**While Europe continues to be a critically important and expanding market for CME Group ... our customers have shown that they prefer to access our global products, deep liquidity and greater capital efficiencies through our U.S. infrastructure**," William Knottenbelt, CME Group senior managing director, international, said in a statement".*

We foresee a similar outcome if the Bourse extends its trading hours as proposed.

Market Reputation - Reputational risk

We believe the Bourse needs to be careful in assessing this new initiative and its impact on the industry.

The industry in not confident that the Bourse has sufficient mechanisms available to mitigate potential price dislocation in the marketplace during periods of stress. The impact to markets as result of extraneous market moving events during the extended hours session will be severely impacted by minimal liquidity. The ability to mitigate disruptive or 'fat finger' events under these circumstances will be circumscribed. This is compounded by a lack of clarity around the sources that the Bourse will leverage to determine trades that are excessive (outside the no-cancel range) given the limited transparency that may be available on the underlying instruments during the early hours session.

The participants requesting the extended trading session will be fickle if they are not generating profits from it. If the Bourse goes to this early session and the "liquidity providers" do not participate, the reputation of the Canadian derivatives market is at stake.

We do not believe the reputational risk is worth the minimal gain in revenue that could potentially be garnered from this exercise.

The Bourse's Analysis

In talking with the Bourse's Financial Markets department, the IIAC Derivatives Committee members learned that this initiative was a 2017 objective ("it will happen", "the extended trading hours will be implemented") to be implemented in 2018. At the time where we first learned about the extended trading hours, the analysis of the project's impact had not yet been completed by the Bourse.

We felt that the documentation provided to members by the Bourse in 2017 in order to justify the initiative was overlooking certain major impacts (which are included in this letter).

Furthermore, when first asking the Bourse's Regulatory Division for its analysis of regulatory impacts, we were told that the analysis had just begun and was yet to be completed. When the official proposal was published in November 2017, we once again asked the Regulatory Division for its analysis of the project as the circular stated that "…the Regulatory Division independently reviews and analyzes such proposals to assess the impacts on its activities as well as those of the approved participants…" [emphasis added]. The Regulatory Division did not provide us with its analysis. Instead, we were told that the Bourse's commercial unit could answer any questions we may have. Concerns remain.

In 2017, we were also told that the Bourse was still in discussion with the CDCC to find solutions to certain clearing problems.

Once again, our members had major concerns. How can a project receive the "go ahead" in early 2017 without a completed commercial, regulatory and clearing analysis?

We feel that the commercial, regulatory and clearing analysis should have been completed before the Bourse made the decision to implement the extended trading hours. As previously mentioned, our members were told in early 2017 that the initiative was "going to happen".

We must also note that Circular 023-17 issued by the Bourse in regards to the Bourse's Regulatory Division mission states that the Division "*is responsible for market regulation for the Bourse de Montréal Inc. The Division's mission is to promote the integrity of exchange-traded derivatives markets at the Bourse or in Canada through the development and consistent application of clear, fair rules and policies that are effectively adapted to market needs*". We believe, despite an independent analysis (which we did not see and were not given access to), that the Regulatory Division may be overlooking negative market impacts if it ultimately agrees with the extended trading session project.

The industry is also concerned with the involvement of the Regulatory Division in the Bourse's commercial project throughout 2017. Members have more questions:

- How could the Bourse give the "go ahead" to this initiative in early 2017 before the regulatory analysis was completed?
- Did the Regulatory Division have a say in the project?
- Could the Regulatory Division stop the project, or any project, if the regulatory risks are deemed too great for the Canadian market?
- Why weren't the industry members given a copy of the Regulatory Division's independent analysis of the project since the impacts on approved participants were analyzed?
- Why, when asking for the Regulatory Division's analysis of the project, were we told that the commercial unit of the Bourse could answer any questions we may have? Shouldn't the Regulatory Division be independent from the commercial unit of the Bourse?

It should be noted that the industry firmly believes that the Autorité des Marchés Financiers should be involved in assessing this project. The risks involved are too important for the Canadian market. A false assessment of the initiative's impacts is not an option.

<u>Conclusion:</u>

As previously mentioned, there is no industry-wide support for this project. There is low support from our IIAC members. Clients of our members ("locals") are also concerned about the negative impact the initiative will have on market integrity.

Major concerns exist in the industry. Our members foresee major issues impacting:

- Market liquidity
- Cash market liquidity
- Market integrity
- Canadian market reputation

Our members also foresee:

- Price gaps which may increase the risk of market manipulation
- Increased financial and regulatory risk

As a for-profit enterprise, the Bourse should not abrogate its responsibility as the custodian of the primary derivatives market in Canada for the purpose of incremental revenue gains at the cost of market participants and the potential detrimental impact to market integrity.

We firmly believe the Autorité des Marchés Financiers should be involved in assessing the risks and impacts of this project to ensure that the potential impacts to market integrity have been appropriately addressed. The IIAC and its members are seriously concerned. Concerns increased when our members were recently told that the initiative would involve a 90-day advisory period. Such a period is significantly too short as serious logistical issues exist for our members.

Furthermore, we also have major concerns regarding our members' and the Bourse's readiness for this initiative on the following fronts:

- Internal technology
- External technology
- Operations
- Regulation
- Compliance
- Risk management

Without commitment from our members to participate and to be properly equipped to support these extended trading hours, the Bourse may well be heading towards failure. Lack of market readiness may also create an uneven playing field.

Overall, we strongly believe that this initiative is not a sensible use of exchange or participants resources.

Please note that the IIAC and its members, as always, remain available for further consultations.

Yours sincerely,

A. Sinigagliese

Annie Sinigagliese
Managing Director
Investment Industry Association of Canada
asinigagliese@iiac.ca

BY EMAIL ONLY
asinigagliese@iiac.ca

April 13, 2018

Annie Sinigagliese Managing Director
Investment Industry Association of Canada 1 Place Ville-Marie
Suite 2901
Montréal, Québec H3B 0E9 Mrs. Sinigagliese,

Subject: Bourse de Montréal's Extended Trading Hours Project (the "Project")

We refer to your letter dated January 30, 2018 (the "**Comment Letter**") sent on behalf of the Investment Industry Association of Canada ("**IIAC**") with respect to Circular 165-17 (Request for Comments – Amendments to the Rules and Procedures of Bourse de Montréal Inc. to accommodate the extension of its trading hours) (the "**Circular 165-17**") and Circular 166-17 (Request for Comments – Amendments to the Rules and Procedures of Bourse de Montréal Inc. to expand the definition of Approved Person) (the "**Circular 166-17**") published by the Bourse de Montréal Inc. (the "**Bourse**") on November 14, 2017.

We also refer to IIAC's letter dated May 19, 2017 (the "**Initial Letter**") regarding the Project as well as the Bourse's response dated July 31, 2017 (the "**Bourse July Letter**").

The Bourse reiterates its sincere appreciation for IIAC's comments and questions expressed both in the Comment Letter and the Initial Letter. It is of the utmost importance for the Bourse to engage with all stakeholders, including IIAC, as it embarks on this strategic initiative. As you know, the intent of the Project is to bring the Canadian derivatives market to the next stage of its development and benefit all market participants. The Bourse values IIAC's willingness to contribute to the realization of this endeavour by way of its response to the Bourse's various requests for comments.

Why is the Bourse Extending its Trading Hours

Globalization is a phenomenon affecting many industries including derivatives markets. Over the years, the Bourse has established itself as Canada's benchmark. While the Bourse is undoubtedly a strong local exchange, the need for Canadian listed derivatives is growing globally and market participants' needs are changing. Just as many Canadian dealers are expanding their offerings beyond Canada, the Bourse has reached a turning point in its development. The Bourse has decided to extend its trading hours in order to remain relevant, continue to grow its markets and address the needs of market participants and end-users of the Bourse's products. Doing so will accommodate trading and risk management needs globally. The Bourse is one of the few of its derivatives exchange peers currently opened for trading during its local business hours only. By extending its trading hours, the Bourse aims at fostering and enhancing even more transparency, price discovery and market participation, which should in turn bring more market depth and liquidity to its listed derivatives, in a long term perspective. This should ultimately benefit the Canadian listed derivatives market and its participants overall. While the Bourse can understand that accommodating extended trading hours may require resources depending on each participant's or clearing member's specific circumstances, the Bourse hopes to partner with all of its stakeholders to offer Canada to the world.

Addressing IIAC's Comments and Questions

The Comment Letter contains many relevant comments and questions. Although some answers to these comments have already been provided in the Bourse July Letter, the Bourse would like to address these comments and questions with additional details as follows:

I) <u>Market Liquidity</u>

Canadian members have undoubtedly been great supporters of the Canadian futures market and the Bourse is and will continue to be grateful for the underlying long lasting and valuable relationships. In the past years, market dynamics have shifted in the futures space. The involvement and support of foreign members and market participants have greatly evolved and have strongly contributed to the Bourse's markets overall growth. The Bourse has decided to extend its trading hours in order to continue to grow its markets and address the needs of market participants and end-users not only domestically but also globally. The Bourse believes the extension of its trading hours will help fulfill trading and risk management needs globally for a greater number of market participants. More specifically, the ability to access listed Canadian derivatives products for an extended period of time will likely result in better portfolio management efficiency, especially given the global nature of financial markets.

As mentioned in the Bourse July Letter, market liquidity is an everyday preoccupation of the Bourse. The Bourse recognizes that market liquidity during non-regular hours may be more challenging, especially when the Project will be launched and in its early stage. The Bourse is committed to doing everything in its power to foster the development of healthy liquidity during extended as well as regular trading hours. The Bourse has a true network of global participants and will leverage it around the globe to enhance market participation. As a result, the Bourse believes the conditions will be in place to build up the initial liquidity.

In fact, the Bourse notes that many derivatives exchanges open for trading during non-local business hours (including North American derivatives exchanges) have successfully developed an acceptable level of liquidity throughout the years in their flagship contracts during their extended hours period, mostly as a result of the internationalization of their client base.

The 6am-7am example

The evolution of liquidity for the Bourse flagship products in the current first hour of trading (6am to 7am) may be used as an indicator of future development of liquidity during the extended trading hours. After a thorough analysis of historical market data, it can be concluded that liquidity in the first hour of trading has improved significantly throughout the years, based on bid-ask spread, size and depth of book metrics. In the first hour of trading in 2017, the cost of crossing the spread was significantly lower than what it was in 2005. This is the result of the average bid-ask spread becoming exponentially tighter, from 52 ticks wide in 2005 to 1.2 ticks in 2017 for CGB, and from 4.7 ticks to 0.53 tick on average for BAX front month. This represents a notional spread value improvement of $508 for CGB (from $520 to $12) and $105 for BAX (from $118 to $13) per contract. Average size at the top of book has also drastically improved for BAX front month (from 230 contracts in 2005 to 1,200 contracts in 2017, on the bid and ask respectively) and has remained similar for CGB (around 20 contracts on the bid and ask respectively). The combination of tighter spreads and larger bid and ask sizes, not only at the top of book, but also across all levels of depth, has contributed to enhancing the overall depth of book and market quality. Market activity has also significantly increased during the current first hour of trading for products in scope: a 42% increase in the last two years alone (vs. a 31% increase of overall volume for the full trading day). Of the 42% volume increase in the first hour of trading between 2015 and 2017, 33% consisted of foreign flow (vs. 9% domestic). This could certainly suggest a trend of increased demand for Bourse products at earlier hours of the day.

Market Making

For the extended trading hours, the Bourse is seeking partnerships with domestic and international firms to support such liquidity, more precisely by way of market making programs. On March 1st 2018, the Bourse published a Call for Interest (Circular 032-18) in which interested parties were called upon to provide feedback with regards to the structure of the extended hours market making program, with the ultimate goals to achieve an optimal design that will help develop market liquidity as best possible during these hours. The Bourse has received comments in this regard. A formal request for proposal, which will also be published by the Bourse in the upcoming weeks, will allow interested firms to submit their proposals regarding market making activities. The Bourse has also engaged in several discussions with market participants regarding their willingness to fulfil market maker obligations during the extended hours, such as maintaining a contracted minimum size, maximum spread and minimum rate of presence on key contracts. In short, some current and prospective market makers have shown substantial interest for such a program. In addition, other participants have also stated that even though they might not take part in the market making program, they would be in the market to provide liquidity at those times. The Bourse already offers eligible market participants the option to enroll in a volume rebate program. This incentive program will also be made available during the extended hours of trading and will also motivate the community to provide liquidity during those hours.

Based on the foregoing, the Bourse is confident that liquidity can be fostered and with time, will effectively develop during the extended hours of trading, as it has improved in the past.

II) Market Integrity

The Bourse would like to reassure IIAC that the Market Operations Department ("**MOD**") and the Regulatory Division of the Bourse (the "**Division**") will apply and enforce the same rules and procedures during the extended hours of trading that they currently enforce during regular business hours. In addition, the Regulatory Division will be monitoring the extended hours activities on a regular basis and may adapt its own activities where and if necessary. Like any other commercial projects led by the Bourse, the Division has independently reviewed and analyzed the Project to assess the impacts on its activities.

IIAC has expressed concerns as to how the Bourse will assess EFP, EFR and block trades for fair and reasonable pricing during the extended hours of trading. When determining the appropriateness of an EFP/EFR transaction, the MOD takes into consideration three factors: correlation, hedge ratio and actual basis level.

Correlation means that the Bourse must determine if the cash (bond) or risk (swap) instrument sufficiently correlates to the "cheapest-to-deliver". This is accomplished by performing a regression analysis between the two relevant instruments. For fixed income EFP/EFR transactions, the threshold is a coefficient of 0.70. Anything below this threshold is rejected. Hedge ratio means that the Bourse must determine if the notional values of the cash/risk instruments are approximately similar to the notional values of the futures. Finally, actual basis level means that the Bourse must determine if the basis level is representative of market conditions. The basis is the spread between the futures contract and the cash/risk instrument. It is in the Bourse's experience that under normal conditions, the spread between the two instruments does not vary by much on a daily basis. On trading days when the Bank of Canada modifies its key interest rate, greater variations can be observed compared to trades executed prior to the decision (however, key interest rate announcements are made during normal trading hours). This procedure will be applied by the Bourse without change during the extended trading hours. Based on the foregoing, the Bourse is confident that such assessment can be performed during the extended business hours, as performed during today's current business hours.

In conclusion, the Bourse is of the view that it has the resources in place to protect and enhance market integrity where market depth and liquidity alone may not be enough.

III) <u>Market Reputation</u>

During periods of stress (such as the 2008 financial crisis), liquidity generally dries up regardless of the time of the trading day. This is often the consequence of black swan events and is usually unavoidable. The Bourse believes it is important to make a distinction between the ability of the Bourse to justify a price dislocation as a result of extraneous market events as opposed to entry errors that have nothing to do with extraneous market events.

In the case of extraneous market events, as it is the case today, the Bourse will analyze the data at hand and try to ascertain whether a specific price move is justified. In the case of errors, the Bourse will contact both counterparties and endeavor to get the counterparties to cancel the transaction if there is consent. If there is no consent, the Bourse will force a price adjustment. The price adjustment will be based on calculating a reference price for the instrument and then adding or subtracting the no-cancel range increments to the reference price. The reference price will be calculated by using market data before and after the transaction, amongst any other relevant market information.

In short, nothing prevents the Bourse from performing the exact same measures and tasks during the extended business hours, as it currently does during today's regular trading hours.

IV) <u>Opening Time</u>

Opening times, trading stages and trading sessions all vary across different comparable derivatives exchanges and are dependent on each respective business' needs, objectives and market realities. The Bourse believes the proposed 2:00 am ET to be a reasonable and suitable opening time for its trading day given market participants' needs and the business' objectives. The Bourse is confident that extending its trading hours to an opening at 2:00 am ET will contribute to achieving its goals to expand globally and cater to the demand from the international trading community for an earlier opening time. Finally, it is not in the Bourse's intention to comment on the importance, the relevance or the reliance of its products relative to other comparable products.

V) First-in, First-Out

The "first-in, first out" algorithm used at the Bourse since its inception rewards risk taking and efforts. This is a market model that is currently and efficiently used by other international exchanges. A complete transition from one market model to another, or the addition of hidden-order functionalities, may result in drastic and unreasonable alterations of market dynamics, which may not be in the overall market's best interest. At this time, the Bourse remains of the view that its market model is of relevance and properly supports the trading of participants. The extension of the trading hours and the choice of market model should be viewed as two distinct business decisions.

Moreover, it is not the Bourse's intention to favour or penalize any specific subset of market participants. The Bourse's objective is to harmonize the trading experience for market participants doing business during both regular and extended trading hours. The Bourse has not, when submitting the Project for comments, prohibited or limited access to the services it offers, whether by a rule, a fee or otherwise. In fact, the content of Circular 165-17 clearly shows that the amendments to the Bourse's rules are minor in nature. With a very few exceptions highlighted in the circular in question, all current rules and procedures of the Bourse will apply during the extended hours of trading, a principle very important to the Bourse. The few changes proposed by the Bourse aim at fostering liquidity during the extended trading hours, which is to the benefit of all market participants, not just a select few.

VI) Canadian De rivativ es C lea ring Cor po ration ("CDCC")

The great majority of the concerns raised in the Comment Letter have been addressed by CDCC in its Circular 157-017. The circular explains in detail the changes to CDCC's clearing and settlement activities that the Project requires. In summary, CDCC is proposing to adjust its operational processes, Rules and Manuals to ensure the clearing of the transactions executed during the extended trading hours. All proposed changes comply with the relevant regulatory standards, including the *Principles for Financial Market Infrastructures* developed by the Committee on Payments and Market Infrastructure and the International Organization of Securities Commission. All transactions entered into during the extended trading hours will be novated in real time, as it is currently the case during the regular trading hours. As a result, there should be no concerns around counterparty risk as CDCC will be the counterpart to each transaction.

Moreover, CDCC currently performs intra-day margin calls at 10:30am and 12:45pm, in addition to the end-of-day margin call at 5:30pm, to mitigate risks that may arise from the derivative instruments cleared. In the context of the Project, CDCC will add an early morning intra-day margin call at 7:15am (as opposed to a variation margin call). This will minimize any potential risk of uncovered exposure during the overnight trading hours. Please note that all other rules and procedures of CDCC will apply during the extended trading hours, without change.

CDCC fully supports the Bourse's initiative and will be ready in advance of the first trading day opening at 2:00am.

VII) Other considerations

The Comment Letter also raised a few other concerns, some of which have already been addressed in the Bourse July Letter. As part of the self-certification process established pursuant to the *Derivatives Act* (Quebec), the Bourse will summarize and respond to all comments made by IIAC, on an anonymous basis (unless you agree otherwise), as part of its self-certification documentation.

We hope this letter gives IIAC members a better understanding of the Project and assurance that the Bourse is taking all measures to ensure this Project will be a successful endeavour. While this initiative will help the Bourse achieve its strategic goals, it will primarily bring further liquidity, price discovery and transparency to the Canadian listed derivatives marketplace in the long term, which the Bourse believes to be desirable features of a healthy functioning financial market. Although our collective addresses are Canadian, our addressable market is now a global reality.

Yours very truly,

[signature]
Robert Tasca
Director, Interest Rate Derivatives Bourse de Montréal

cc: Luc Fortin, Bourse de Montréal
Glenn Goucher, Canadian Derivatives Clearing Corporation
Julie Rochette, Bourse de Montréal
Sabia Chicoine, Bourse de Montréal, Canadian Derivatives Clearing Corporation