



CIRCULAR 043-24

April 29, 2024

REQUEST FOR COMMENTS

**AMENDMENTS TO THE RULES OF THE BOURSE DE MONTRÉAL
TO DEFINE RISKLESS TRANSACTIONS ON OPTIONS**

On **APRIL 22, 2024**, the Rules and Policies Committee of Bourse de Montréal Inc. (the “**Bourse**”) approved amendments to the Rules of the Bourse De Montréal to define Riskless Transactions on Options.

Comments on the proposed amendments must be submitted at the latest on **MAY 29, 2024**. 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:

M^e Philippe Lebel
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 Regulatory Division of the Bourse (the “Division”) is responsible for the regulatory functions of the Bourse and carries on its activities as an independent unit separate from the other activities of the Bourse. The Division’s activities are performed under the oversight of the Self-Regulatory Oversight Committee appointed by the Board of Directors of the Bourse. 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 of the Bourse. Responsibility for new rule proposals or amendments to rules pertaining to market integrity is vested with the Division. The proposals and amendments are thereafter submitted to the Autorité in accordance with the self-certification process as determined by the *Derivatives Act* (CQLR, chapter I-14.01).

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PROPOSED AMENDMENTS TO THE RULES OF THE BOURSE DE MONTRÉAL TO DEFINE RISKLESS TRANSACTIONS ON OPTIONS

Description

The Bourse de Montréal Inc. (the “Bourse”) is hereby proposing to amend its rules (the “Rules”) in order to introduce a new article that defines riskless Transactions on options (the “Amendments”). Similar to a Riskless Basis Cross (Article 6.207 in the Rules), riskless Transactions on options (“Riskless Transactions on Options” or “RTO”) represent a certain type of contingent option trades, or option to stock strategies, in which the Approved Participant has already agreed with the customer that the Approved Participant must first acquire positions (long or short exposure) for their own account in stocks or exchange-traded funds (ETFs) prior to executing the pre-arranged transaction on option.

Additionally, the Bourse is proposing to allow RTOs to trade in a special trading session from 4:00pm to 4:20pm ET (“Special Trading Session”). By doing so, an additional trading window will be available for Approved Participants to execute RTOs and leverage the use of the Market on Close facility (MOC) on the Toronto Stock Exchange (TSX). This will enable participants to benefit from the additional liquidity provided by the MOC to complete the cash position with reduced market impact.

In order to implement these changes, the Bourse hereby proposes the following amendments:

Outline of the Amendments

The Bourse proposes to introduce a new article to define Riskless Transactions on Options in Part 6 - *Trading Rules*, Chapter C - *Prearranged Transactions and Trade Cancellation* of the Rules. The proposed Amendments are attached.

Background

Riskless Transactions on Options represent a type of contingent option trades, or option to stock strategies, in which, similar to a Riskless Basis Cross, the Approved Participant has already agreed with the customer that the Approved Participant must first acquire positions (long or short exposure) for their own account in stocks or exchange-traded funds (ETFs) prior to executing the pre-arranged transaction on option. For the end client, this is a regular option trade. The Approved Participant will have already engaged in a stock position which, once completed, will enable it to take the related option position. The parameters of the trade will have already been agreed to and prearranged between the two parties prior to executing the

stock position and the option strategy. While Riskless Basis Cross is a prearranged transaction involving futures and stocks/ETFs, RTO involves options and stocks/ETFs. In a prearranged transaction such as RTO, allowing both parties to enter in negotiation of the trade details ahead of its completion, allows the overall execution risk to be mitigated.

In some instances, in order to achieve the risk mitigation objective and reduce the market impact, it is required for Participants to spread the execution of the underlying stock or ETF position until the close (including the use of the MOC). Indeed, over the years, the Market on Close Facility of the TSX has proven to be a reliable source of liquidity for the underlying securities.

The objectives of the proposed Amendments are twofold. First, these modifications aim to introduce a new Article in the Rules to define Riskless Transactions on Options. Second, these changes aim to allow the trading of the RTOs in the Special Trading Session.

During the Special Trading Session, only Riskless Transactions on Options will be eligible, subject to the following conditions:

- The Riskless Transaction on Options must respect the minimum volume threshold set forth in Article 6.205 of the Rules;
- The Riskless Transaction on Options must have a minimum of 10% of its stocks' or ETFs' position that has been executed using the MOC facility.

The latter requirement entails that for Transactions to be accepted during a Special Trading Session, a substantial portion of its stocks' or ETFs' position must be traded at MOC. Moreover, after considering feedback received from participants, it was concluded that a 10% threshold strikes a balance, allowing for increased liquidity through MOC usage without disrupting the MOC equilibrium.

Rationale for the Amendments and Approach

The Amendments recognize the necessity for a more flexible framework within the Canadian derivatives landscape, particularly concerning specific contingent option trades, to mitigate execution risk effectively. The Amendments will support this framework by introducing a new Article in the Rules to define Riskless Transactions on Options

The establishment of a Special Trading Session for these Riskless Transactions on Options is tailored to accommodate RTOs that are hindered by liquidity constraints during standard market hours. Indeed, the Special Trading Session aims to provide Approved Participants with access to the liquidity pool offered by the Market on Close facility, facilitating the completion of the underlying stocks or ETFs position.

These Amendments reflect a forward-thinking perspective on market development. They acknowledge that one size does not fit all and that liquidity, or the lack of, is a constant challenge in the Canadian equity market. By fostering an environment that addresses these challenges, the Canadian derivatives ecosystem becomes more responsive and aligned with participants' needs.

COMPARATIVE ANALYSIS

a) Riskless Transaction on Options

US & International exchanges

Benchmark has been conducted looking at US exchanges, such as CBOE, CME Group or NASDAQ, as well as international exchanges, such as London Stock Exchange, Hong Kong Exchange, Euronext and the Australian Securities Exchange revealing that these exchanges do not offer similar Transactions.

Montreal Exchange

Riskless Transactions on Options are similar to the Riskless Basis Cross Transactions, defined in Article 6.207, currently taking place at the Bourse with the difference being that option contracts are part of the strategy instead of futures contracts. Indeed, a riskless basis cross Transaction is a trade where an approved participant and a client engage in pre negotiation discussions to agree upon the terms of a transaction on index futures contracts or on share futures and their corresponding underlying on the cash market. The trade must include the purchase or sale of a cash market position by the approved participant. The terms agreed upon also include the required amount of index (in the case of index futures) or underlying cash instrument (in the case of share futures) exposure and the basis spread between the average price of the cash exposure acquired by the approved participant and the index or share futures contracts that will be crossed to the client.

Approved participants receiving requests from clients who cannot or do not want to hold cash securities in their accounts but who wish to acquire market exposure in the most efficient way possible (either on the cash or exchange-traded fund markets) are authorized to do a riskless basis cross.

b) Special Trading Session

While some US exchanges such as CBOE¹ or NASDAQ Options Market² and a few international exchanges like EUREX³ and the Australian Securities Exchange (ASX)⁴ extend their trading hours for options, none of them specifically offer a trading session solely dedicated to pre-arranged transactions (crosses) on options.

Analysis of Impacts

(i) *Impact on Market*

¹ Cboe Options Exchange has extended global trading hours for S&P 500 Index (SPX) options, Cboe Volatility Index® (VIX) options and Mini-SPX Index (XSP) options to nearly 24 hours a day, five days a week. [Source](#)

² At NASDAQ Options Market, the regular trading hours which usually end at 4:00pm ET are extended until 4:15pm ET for specific options symbols. [Source](#)

³ The post-late 2 phase is a trading phase after regular hours and it applies for American-style equity options on every exchange day, for equity and equity index options with European-style as well as for interest rate options on the last trading day only. [Source](#)

⁴ ASX offers extended trading hours for their equity options and index options. [Source](#)

The proposed changes only impact pre-arranged transactions of specific contingent option trades. Indeed, the introduction of Riskless Transactions on Options will enable participants to mitigate the overall execution risk and reduce the market impact while executing the underlying stocks' or ETFs' position of these prearranged transactions. Moreover, the addition of a Special Trading Session will benefit participants by giving them access to the liquidity pool offered by the MOC to complete their Riskless Transactions on Options more efficiently. The Special Trading Session will only impact Riskless Transactions on Options above the minimum volume threshold. The retail investor is not affected by these changes as, similar to current Rules in place, he does not interact with pre-arranged contingent options trades transactions.

(ii) Impacts on technology

The Bourse will need to complete technological developments that will be released in a new protocol to ensure a fully automated process. In the meantime, Approved Participants will be able to send their RTOs through the Special Terms Transaction Portal via an updated Special Term Transaction Reporting Form (STTRF) that will include RTO as an allowed transaction. Once submitted via STTRF, the trades will then be entered into the trading system by a Market Supervisor of the Market Operation Department. The STTRF will be used to send RTO to the Bourse while the automated process is completed and will remain available for participants afterwards as an additional way to send their RTOs to the Bourse.

(iii) Impacts on regulatory functions

The proposal to introduce a new Article in the Rules to define Riskless Transactions on Options will not impact the Regulatory Division's surveillance and market analysis functions of pre-arranged transactions on options. The surveillance system feed, database, and parameters will have to be updated or reconfigured to account for the establishment of a Special Trading Session. The corresponding procedures will have to be revised as well, to accommodate the proposed Amendments to the Rules.

(iv) Impacts on clearing functions

The proposed modification to the MX trading window will have limited impact on CDCC's clearing functions. No amendments to CDCC's manuals or rules are required.

(v) Public interest

The Bourse is of the view that the proposed Amendments are not contrary to the public interest. In fact, the Bourse believes that the proposed changes help benefit both parties, the Approved Participant and the customer, of a prearranged transaction while reducing the impact of price fluctuations in the underlying equities market.

Timing

Following receipt of regulatory approval, the Bourse intends to implement the Amendments in July 2024.

APPENDIX A

BLACKLINED VERSION OF THE AMENDMENTS

Article 3.105 Notification to the Regulatory Division of Non-Compliance

[...]

(b) An Approved Participant must diligently conduct a review in accordance with its internal supervision policies and procedures upon becoming aware that, such Approved Participant, an employee, an Approved Person, or a client authorized pursuant to Article 3.5 possibly violated the Rules pertaining to:

- (i) Article 7.6 respecting front running;
- (ii) Article 7.5 respecting manipulative or deceptive methods of trading;
- (iii) Article 7.3 respecting best execution;
- (iv) Articles 3.4 and 3.5 respecting access to electronic trading;
- (v) Articles 6.114 and 6.116 respecting management of priorities;
- (vi) Articles 6.203, 6.204, 6.205, 6.206, ~~and 6.207~~ and 6.207A respecting Transactions required on Bourse facilities;
- (vii) Article 6.200 respecting Off-Exchange Transfers of Existing Positions on a Listed Product;
- (viii) Article 6.208 respecting Exchange of Futures for Related Products.

[...]

Article 3.112 Market Makers – Options and Futures

[...]

- (g) Conditions specific to clients of an Approved Participant:
 - (i) Under the terms of the mandatory Market Making Agreement referred to under paragraph (f) above, a client of an Approved Participant notably agrees to the following with respect to its trading activities and conduct as a Market Maker and must (i) be subject to the jurisdiction of the Bourse, acting as a self-regulatory organization, including its Regulatory Division and any of its Committee, during the term of the Market Making Assignment and thereafter in

accordance with Article 4.2 to the same extent and as if it was itself an Approved Participant and (ii) comply with all the Regulations of the Bourse as if it was itself an Approved Participant, with the necessary adaptations, including with Part 4 of the Rules (except with respect to examinations), Articles 3.100, 3.110, 4.101, 6.3, 6.10, 6.11, 6.114, 6.115, 6.118, 6.118(j)(k), 6.119, 6.120, 6.202, 6.203, 6.204, 6.205, 6.206, 6.207, **6.207A**, 6.209, 6.210, 6.309 and following regarding position limits, 7.5, 7.6, 7.7 and 12.7 and following regarding position limits, as these may be amended and/or replaced from time to time.

[...]

Article 6.204 Exceptions to Prohibition on Prearranged Transactions

The prohibition in Article 6.203 shall not apply to prearranged Transactions pursuant to Article 6.205; block Trades pursuant to Article 6.206; riskless basis cross Trades pursuant to Article 6.207; **riskless Transactions on options pursuant to Article 6.207A**; exchange of Futures for risk pursuant to Article 6.208; and off-exchange transfers under Article 6.200; *provided however*, no Transaction under any of the exceptions included in this Article may be executed using a hidden volume functionality.

Article 6.207A Riskless Transactions on Options

a) In general. An Approved Participant and the customer may prearrange a Transaction outside of the Electronic Trading System as mutually agreed between the Approved Participant and the customer, in accordance with the following conditions:

- (i) The parties may agree on the average price traded and quantity (expressed in delta percentage) of the underlying stock or exchange-traded fund (“Underlying Securities”), the option price as well as the quantity of option contracts.
- (ii) To initiate the riskless Transaction on options, the Approved Participant must first acquire positions (long or short exposure) in stocks or exchange-traded funds for its own account.
- (iii) The Transaction shall be executed at the time agreed by the counterparties, with the Underlying Securities’ position being completed during the regular trading hours of the Underlying Securities and the option position being completed either:
 - (1) During the regular trading hours of the options as determined and published by the Bourse, or
 - (2) Before the end of the special trading session, as established by the Bourse, subject to the following conditions:

(A) a minimum of 10% of the Underlying Securities position has been completed using the Market on Close facility of Toronto Stock Exchange;

(B) the quantity of option contracts respects the minimum volume threshold set forth in Article 6.205 of the Rules.

(iv) Approved Participants can submit their Transactions in the format specified by the Exchange.

(v) The minimum size requirement to enter into a riskless Transaction on options is the minimum volume threshold set forth for User Defined Strategies (UDS) in Article 6.205 of the Rules if the Transaction is executed during the special trading session. During the regular trading hours of the options, there is no minimum size requirement to complete a Riskless Transaction on Options and it will follow the prescribed time period as defined in Article 6.205 b).

vi) The trading hours will be determined and published by the Bourse.

(b) Each party to a riskless Transaction on options must keep full and complete records relating to the riskless Transaction on options and must provide to the Bourse upon request complete records and documentary evidence relating to such Transaction demonstrating that the Transaction is a *bona fide* Transaction and that it has been carried out in accordance with the conditions of this Article.

(c) In all circumstances, a riskless Transaction on options can only be arranged by the Approved Participant's Approved Persons.

CLEAN VERSION OF THE AMENDMENTS

Article 3.105 Notification to the Regulatory Division of Non-Compliance

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(b) An Approved Participant must diligently conduct a review in accordance with its internal supervision policies and procedures upon becoming aware that, such Approved Participant, an employee, an Approved Person, or a client authorized pursuant to Article 3.5 possibly violated the Rules pertaining to:

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accordance with Article 4.2 to the same extent and as if it was itself an Approved Participant and (ii) comply with all the Regulations of the Bourse as if it was itself an Approved Participant, with the necessary adaptations, including with Part 4 of the Rules (except with respect to examinations), Articles 3.100, 3.110, 4.101, 6.3, 6.10, 6.11, 6.114, 6.115, 6.118, 6.118(j)(k), 6.119, 6.120, 6.202, 6.203, 6.204, 6.205, 6.206, 6.207, 6.207A, 6.209, 6.210, 6.309 and following regarding position limits, 7.5, 7.6, 7.7 and 12.7 and following regarding position limits, as these may be amended and/or replaced from time to time.

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(ii) To initiate the riskless Transaction on options, the Approved Participant must first acquire positions (long or short exposure) in stocks or exchange-traded funds for its own account.

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