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CIRCULAR 130-15
November 4, 2015

REQUEST FOR COMMENTS

AMENDMENTS TO ARTICLE 15608 OF THE RULES OF BOURSE DE MONTRÉAL INC.

MODIFICATION OF BOND FUTURES POSITION LIMIT CALCULATION METHODOLOGY FOR THE FIRST CONTRACT MONTH

The Rules and Policies Committee of Bourse de Montréal Inc. (the "**Bourse"**) has approved amendments to article 15608 of the Rules of the Bourse in order to amend the methodology used for establishing the first contract month position limit for each designated Government of Canada bond futures contacts.

Comments on the proposed amendments must be submitted at the latest on **December 7, 2015**. Please submit your comments to:

M^e^ Sabia Chicoine
Legal Counsel, Legal Affairs, Derivatives
Bourse de Montréal Inc.
Tour de la Bourse
P.O. Box 61, 800 Victoria Square
Montréal, Québec H4Z 1A9
E-mail: legal@m-x.ca

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

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

Please note that comments received by one of these recipients will be transferred to the other recipient and that the Bourse may publish a summary of such comments as part of the self-certification process concerning this file.

Appendices

For your information, you will find in the appendices an analysis of the proposed amendments as well as the 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 determined 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 (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* (CQLR, chapter I-14.01).

AMENDMENTS TO ARTICLE 15608 OF THE RULES OF BOURSE DE MONTREAL INC.

MODIFICATION OF BOND FUTURES POSITION LIMIT CALCULATION METHODOLOGY FOR THE FIRST CONTRACT MONTH

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I. SUMMARY

Bourse de Montréal Inc. (the "Bourse") proposes to amend the methodology used for establishing the first contract month position limit for each designated Government of Canada bond futures contacts (the "First-Month Limit"), described in article 15608 of the Rules of the Bourse.

The current methodology provides that the First-Month Limit must be the lesser of 20% of the open interest for that contract month at the start of trading the first business day prior to the first delivery notice day of the first contract month ("Open Interest Calculation"), or the futures contract equivalent of 5% of the total outstanding amount of Government of Canada bonds eligible for delivery for the designated Government of Canada bond futures contracts at the start of trading on the first business day prior to the first delivery notice day of the first contract month ("Deliverable Bonds Calculation").

It is proposed to eliminate the Open Interest Calculation, so that the methodology used to compute the First-Month Limit will only include the Deliverable Bond Calculation.

It is therefore proposed that the methodology used to compute the First-Month Limit for Government of Canada Bond futures contracts only reflects the futures contract equivalent of 5% of the total outstanding amount of Government of Canada bonds eligible for delivery for the designated Government of Canada bond futures contracts at the start of trading on the first business day prior to the first delivery notice day of the first contract month.

II. ANALYSIS

a. Background

The Bourse's Regulatory Division, (hereinafter the "Division"), publishes position limits on futures and options on futures contracts (hereinafter "futures") on a monthly basis. The purpose of establishing position limits is to prevent an excessive position concentration that could potentially result in disorderly pricing or market manipulation. This is particularly true in the case of futures contracts that require physical delivery of the underlying interest, since position limits serve as a mechanism to prevent the potential cornering of the underlying market by ensuring that the notional value of the futures positions (long or short) that can be held by a single participant is not excessively large relative to the available supply of the underlying interest. This in turn ensures that no one single participant can disrupt the futures markets.

This proposed solution follows a series of initiatives on position limits undertaken since the beginning of 2015. The First-Month Limit was last modified on February 12, 2015 (Circular 014-15[1]). This modification eliminated the dynamic daily recalculation of the Front-Month Limit. As described in the Circular 014-15, the daily recalculation effectively forced investors to liquidate partially or in full their position until the contract expiry.

The Bourse monitored the effect of this amendment after implementation. Although moving from dynamic daily calculation to fixed limits on the front month contract addressed one of the issues

[1] See https://www.m-x.ca/f_circulaires_en/014-15_en.pdf

with the former calculation methodology, it was subsequently noted that the Open Interest Calculation posed a serious impediment to the ability of clients to hold reasonable positions on less-liquid futures contracts. After thorough analysis, and feedback from approved participants, the Bourse now proposes to eliminate the Open interest Calculation and rely solely on the Deliverable Bonds Calculation, as described above in Section I.

At the current time, pursuant to section b) of Article 15608 of the Rules of the Bourse, the position limits on the Bourse's first contract month on bond futures are calculated as follows:

"The lesser of 20% of the open interest of that contract month at the start of trading on the first business day prior to the first delivery notice day of the first contract month or the futures contract equivalent of 5% of the total outstanding amount of Government of Canada bonds eligible for delivery for the designated Government of Canada bond futures contracts at the start of trading on the first business day prior to the first delivery notice day of the first contract month."

The historical results of the current methodology are illustrated in the table below.

Table 1: Position limits for first contract month on bond futures August 2014 – August 2015

	CGZ	CGF	CGB	LGB
August 2014	38	1,310	14,000	0
November 2014	11	1,374	18,000	0
February 2015	33	732	19,300	0
May 2015	49	815	20,550	0
August 2015	0	678	13,450	0

As is evident from the table above, all futures contracts First-Month Limit, except CGBs, were derived using 20% of the open interest as opposed to the equivalent of 5% of the total outstanding amount of Government of Canada bonds eligible for delivery.

Table 2: Position limits for first contract month on bond futures August 2014 – August 2015 by only accounting the 5% of delivery supply

	CGZ	CGF	CGB	LGB
August 2014	8,800	10,200	14,000	16,100
November 2014	9,600	10,200	18,000	16,047
February 2015	8,850	8,500	19,300	17,797
May 2015	8,900	10,200	20,550	18,347
August 2015	9,400	10,000	13,450	19,047

Table 2 represents the First-Month Limit by only accounting the 5% of deliverable supply. As shown above, the new calculation would provide much healthier position limits for the CGZ, CGF and LGB.

b. Description and Analysis of Market Impacts

The proposed amendment regarding the First-Month Limit component of Article 15608 aims at addressing practical issues posed by the current computation methodology. It is important to note that the purpose of this provision is to prevent excessive position concentration and potential disorderly pricing in the market for the contract that is going to delivery. In the United States, these limits are often specifically referred to as speculative position limits. According to the CFTC the purpose of these limits - both first contract month (spot month) and non-spot month position limits are to "prevent excessive speculation and manipulation while ensuring sufficient market liquidity for bona fide hedgers and protecting the price discovery process."[2]

The Deliverable Bond Limit is already judged sufficient for the calculation of the First-Month Limit by virtue of its inclusion as a ceiling in the First-Month Limit calculation methodology. That is, where the Open Interest Limit exceeds the Deliverable Bond Limit, the Deliverable Bond Limit will govern. In fact, the primary purpose of a First-Month Limit is to prevent the manipulation of the finite underlying interest of a physically-settled futures contract during the delivery period, often described as preventing a corner of the underlying. This limit is therefore more properly based on the futures-contract equivalent of a percentage of the deliverable, rather than a percentage of the remaining and substantially diminished open interest just before the first notice date.

Including the Open Interest Limit in the current Bourse methodology for setting First-Month Limits creates unfavourable trading environments for less active products such as CGZ and LGB. As demonstrated in table 1, First-Month Limits were on average, for the period of August 2014 to August 2015, 26.2 CGZ contracts and 0 LGB contracts. In other words, any beneficial owner wishing to keep or accumulate a position on CGZ or LGB on the first notice day to expiry would not be able to exceed these limits. While this methodology can prevent excessive concentration, it presents serious challenges for market participants and can lead to a reduction in market liquidity.

Typically, the open interest of the first contract month decreases dramatically as the first delivery notice day approaches since the great majority of positions for that contract month are typically rolled over to the next contract month. This is because holding a position on physically delivered Government bond contracts after the first notice day would incur a significant risk of delivery. Therefore, legal entities with no intention of receiving the underlying would effectively roll their positions to the next expiry before the first notice day. The roll period drastically reduces the total open interest prior to the first notice day. This is why the Open Interest Calculation produces unrealistic First-Month Limits especially for less active contracts.

This daily reduction in open interest of the first contract month may cause market participants who wish to legitimately take their positions to delivery to inadvertently exceed the limit prescribed by the Open Interest Calculation. Market participants needing to reduce their positions on the first contract month following the first delivery notice day may find themselves in contravention of the prescribed limit without being able to efficiently remedy the situation since they may be unable to find counterparties in order to reduce the position.

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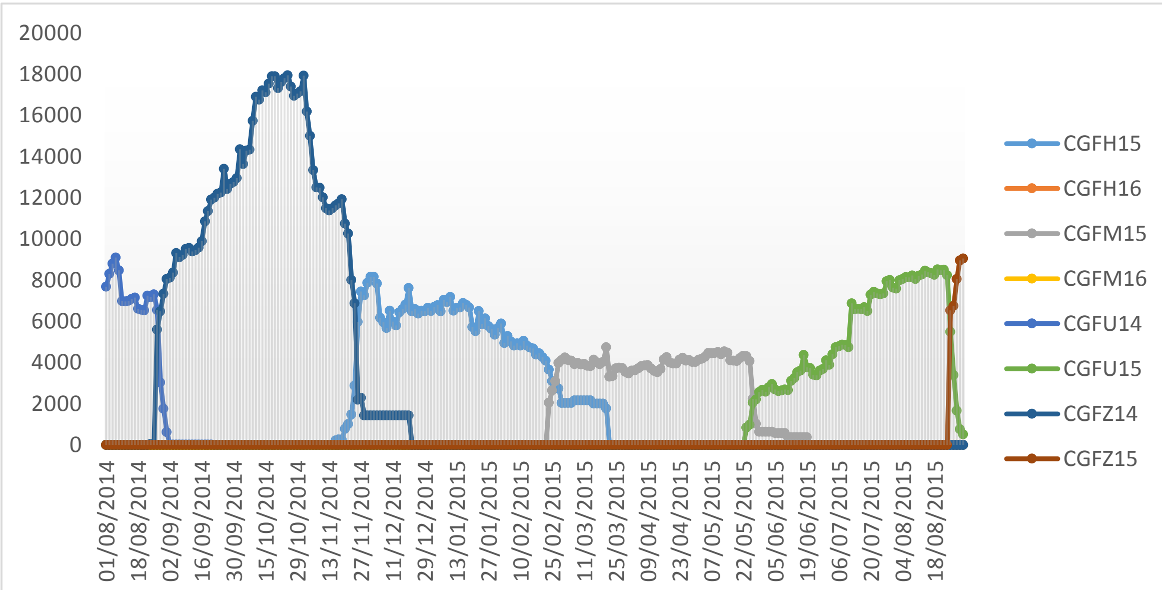
[2] See CFTC Q & A – Position Limits for Futures and Swaps at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/pl_qa_final.pdf.

The reliance on the Deliverable Bonds Limit and the elimination of the Open Interest Limit is therefore consistent with both the purpose of First-Month Limits and the practical requirements of the futures market.

Chart 1 – Open Interest on the CGF Contract for the Period of August 2014 to August 2015.



c. Comparative Analysis

Exchange / Regulator	Instrument Type Used for Benchmarking	Is a First Contract Month Position Limit Applied?	How are These Position Limits Calculated?
Montreal Exchange	Government of Canada Bond Futures Contract	Yes	Lesser of 20% of Open Interest or 5% of Deliverable Supply
CFTC	Physical Commodity Futures Contract	Yes	25% of Deliverable Supply[3]
ASX	3 & 10 Year Treasury Bond Futures	Yes	Fixed Number of Contracts. (Reviewed on 2005, 2009 and 2014)[4]
CBOT	US Treasury Bond Futures & US Treasury Notes Futures	Yes	Fixed Number of Contracts[5]

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[3] Ibid.
[4] See ASX 24 Notice no. 008/14 at http://www.sfe.com.au/content/notices/2014/notice2014_008.pdf.
[5] See CME Group Market Surveillance Notice # MSN08-12-15 regarding Position Limits in Treasury Futures During Last 10 Trading Days at http://www.cmegroup.com/tools-information/lookups/advisories/market-regulation/market-

As indicated previously, the Open Interest Calculation of the First-Month Limit highly reduces the possibility for firms to retain positions after the first notice day. As noticed in the benchmarking, none of the exchanges and Regulator reviewed are calculating the first month limit on a percentage of open interest.

Table 3: Position limits for front months Government Bond Futures from the ASX and CBOT.

ASX

ASX Contracts	Maximum number of spot month net open positions to be held at close of trading on T-1 and the remaining life of the contract at a corporate 'group' level
ASX Treasury Bond 3 Years	37,500 contracts
ASX Treasury Bond 10 Years	28,500 contracts

CBOT

September 2015 Contract	Position Limit During Last 10 Trading Days	Effective Date (by close of business on)
Ultra U.S. Treasury Bonds	80,000 contracts	September 4, 2015
30-Year U.S. Treasury Bonds	25,000 contracts	September 4, 2015
10-Year U.S. Treasury Notes	70,000 contracts	September 4, 2015
5-Year U.S. Treasury Notes	85,000 contracts	September 16, 2015
3-Year U.S. Treasury Notes	20,000 contracts	September 16, 2015
2-Year U.S. Treasury Notes	35,000 contracts	September 16, 2015

d. Proposed Amendments

The Bourse proposes to amend paragraph b) of article 15608 in order to remove the Open Interest Calculation and base the First-Month Limit solely on the Deliverable Supply Calculation. Therefore, it is proposed that the first part of this paragraph reads as follows: "For the first contract month, the maximum net Long Position or net Short Position in each designated Government of Canada bond futures contract which a person may own or control in accordance with article 14157 is the futures contract equivalent of 5% of the total outstanding amount of Government of Canada bonds eligible for delivery for the designated Government of Canada bond futures contracts at the start of trading on the first business day prior to the first delivery notice day of the first contract month." The Bourse also proposes consequential amendments to the second part of that paragraph, the details of which are attached hereto.

surveillance/files/Position-Limits-in-Treasury-Futures-During-Last-10-Trading-Days.pdf. See also relevant CME Group Rules at and http://www.cmegroup.com/rulebook/CBOT/I/5/5.pdf.

III. AMENDMENT PROCESS

This amendment is necessary to address practical issues posed by the current methodology which yields inappropriate limits especially for less active contracts. This amendment will align the Bourse's methodology for calculating First-Month Limits with other exchanges' and Regulator's approach to such limits.

IV. IMPACTS ON TECHNOLOGICAL SYSTEMS

The proposed changes will have no impact on the technological systems of the Bourse, of the Bourse's approved participants, or of any other market participants.

V. OBJECTIVES OF THE PROPOSED ADMENDMENTS

This amendment is being proposed to reflect the practical realities of the Government of Canada bond futures contracts and to ensure that the liquidity and price discovery processes of Government of Canada bond futures contracts are not threatened, while still ensuring that position limits play the relevant role they are meant to with regards to excessive position concentration prevention.

VI. PUBLIC INTEREST

The proposed amendments are in the public interest since the proposed amendment will ensure that the principal objective of the First-Month Limit - the prevention of excessive concentration and disorderly pricing - is maintained while ensuring that the liquidity and price discovery processes of Government of Canada bond futures are not impaired.

VII. EFFICIENCY

This change will result in a more efficient and equitable market as it will yield healthy position limits for both active and less active contracts, without unnecessarily constraining market activity.

VIII. PROCESS

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.

IX. ATTACHED DOCUMENTS

Proposed amendments to article 15608 of the Rules.

15608 Position Limits for Bonds Futures Contracts
(08.09.89, 30.12.93, 07.04.94, 26.08.94, 19.01.95, 03.05.04, 17.04.09, 13.02.15, 21.05.15, 00.00.00)

For all expiration months combined

a) For all expiration months combined for each designated Government of Canada bond futures contract, the maximum net Long Position or net Short Position which a person may own or control in accordance with article 14157 is equal to half the sum of:

i) 20% of the total outstanding deliverable bonds of the front contract month; and
ii) the greater of:
    a) 4,000 contracts or
    b) 20% of the average daily open interest for all contract months during the preceding three calendar months.

If deemed necessary, the Bourse may apply a different position limit to an approved participant or its client. This position limit may not exceed the position limit determined in accordance with this paragraph a) unless an exemption is granted under article 14157.

For the first contract month

b) For the first contract month, the maximum net Long Position or net Short Position in each designated Government of Canada bond futures contract which a person may own or control in accordance with article 14157 is ~~the lesser of:~~

~~i) 20% of the open interest of that contract month at the start of trading on the first business day prior to the first delivery notice day of the first contract month; or~~
~~ii)~~ the futures contract equivalent of 5% of the total outstanding amount of Government of Canada bonds eligible for delivery for the designated Government of Canada bond futures contracts at the start of trading on the first business day prior to the first delivery notice day of the first contract month.

The position limit for the first contract month becomes effective on the first business day prior to the first delivery notice day of the first contract month.

If deemed necessary, the Bourse may apply a different position limit to an approved participant or its client. This position limit may not exceed the position limit determined in accordance with this paragraph b)~~amount set forth in i) or ii),~~ unless ~~:~~

an exemption is granted under article 14157. ~~or,~~

~~the approved participant is a market maker as defined in article 6820. In this case, this position limit may not exceed the amount set forth in ii) or,~~

~~the approved participant commits to taking the futures contracts to delivery. In this case, this position limit may not exceed the amount set forth in ii).~~

15608 Position Limits for Bonds Futures Contracts
(08.09.89, 30.12.93, 07.04.94, 26.08.94, 19.01.95, 03.05.04, 17.04.09, 13.02.15, 21.05.15, 00.00.00)

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   ii) the greater of:
      a) 4,000 contracts or
      b) 20% of the average daily open interest for all contract months during the preceding three calendar months.

   If deemed necessary, the Bourse may apply a different position limit to an approved participant or its client. This position limit may not exceed the position limit determined in accordance with this paragraph a) unless an exemption is granted under article 14157.

For the first contract month

b) For the first contract month, the maximum net Long Position or net Short Position in each designated Government of Canada bond futures contract which a person may own or control in accordance with article 14157 is the futures contract equivalent of 5% of the total outstanding amount of Government of Canada bonds eligible for delivery for the designated Government of Canada bond futures contracts at the start of trading on the first business day prior to the first delivery notice day of the first contract month.

   The position limit for the first contract month becomes effective on the first business day prior to the first delivery notice day of the first contract month.

   If deemed necessary, the Bourse may apply a different position limit to an approved participant or its client. This position limit may not exceed the position limit determined in accordance with this paragraph b) unless an exemption is granted under article 14157.