☒ Trading – Interest Rate Derivatives	☒ Back-office - Options
☒ Trading – Equity and Index Derivatives	☒ Technology
☒ Back-office – Futures	☒ Regulation

CIRCULAR 175-17
December 12, 2017

SELF-CERTIFICATION

AMENDMENTS TO ARTICLE 6651 OF BOURSE DE MONTREAL INC. REGARDING POSITION LIMITS FOR OPTIONS ON EQUITY-HOLDING EXCHANGE-TRADED FUNDS

The Rules and Policies Committee of Bourse de Montréal Inc. (the "**Bourse**") Bourse and the Special Committee of the Regulatory Division of the Bourse have approved amendments to article 6651 of the Rules of the Bourse changing the position limits for physically-settled options on equity-holding exchange-traded funds. These amendments were self-certified in accordance with the self-certification process as established in the *Derivatives Act* (CQLR, Chapter I-14.01).

These amendments, as attached, will become effective on **December 13, 2017**, before market opening. Please note that the revised articles will also be available on the Bourse's website (www.m-x.ca).

The amendments described in the present circular were published for public comment by the Bourse on March 21, 2017 (see Circular 037-17). Further to the publication of this circular, the Bourse has received comments. A summary of the comments received as well as responses from the Bourse to these comments is attached hereto.

For additional information, please contact Martin Jannelle, Legal Counsel, at 514-787-6578 or by email at martin.jannelle@tmx.com.

Martin Jannelle
Legal Counsel, Montréal Exchange & CDCC

6651 Position Limits for Options and Share Futures Contracts
(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, 25.06.12, 12.04.13, 04.06.15, 23.11.16, 00.00.00)

A) Except for those limits specified in article 6651, no Approved Participant shall make, for any account in which it has an interest or for the account of any client, a transaction in a Listed Product if the Approved Participant has reason to believe that as a result of such transaction the Approved Participant or its client would, acting alone or in concert with others, directly or indirectly, hold or control a position in excess of the position limit established by the Bourse.

B) Except otherwise indicated, the applicable position limits for options, share futures contracts or aggregated options and share futures contracts positions (as defined under paragraph C) 4)) are as follows:

1. Share futures contracts, aggregated options and share futures contracts positions as well as options on stocks, exchange-traded funds or income trust units

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

   b) 50,000 contracts, where either the most recent interlisted six-month trading volume of transactions on the underlying stock, exchange-traded fund or income trust unit totals at least 20 million shares or units, or the most recent interlisted six-month trading volume of transactions totals at least 15 million shares or units of the underlying interest and at least 40 million shares or units of this underlying interest are currently outstanding;

   c) 75,000 contracts, where either the most recent interlisted six-month trading volume of transactions on the underlying stock, exchange-traded fund or income trust unit totals at least 40 million shares or units, or the most recent interlisted six-month trading volume on the underlying interest totals at least 30 million shares or units of the underlying interest and at least 120 million shares or units of this underlying interest are currently outstanding;

   d) 200,000 contracts, where either the most recent interlisted six-month trading volume of transactions on the underlying stock, exchange-traded fund or income trust unit totals at least 80 million shares or units, or the most recent interlisted six-month trading volume on the underlying interest totals at least 60 million shares or units of the underlying interest and at least 240 million shares or units of this underlying interest are currently outstanding;

   e) 250,000 contracts, where either the most recent interlisted six-month trading volume of transactions on the underlying stock, exchange-traded fund or income trust unit totals at least 100 million shares or units of the underlying interest or the most recent interlisted six-month trading volume on the underlying interest totals at least 75 million shares or units of the underlying interest and at least 300 million shares or units of this underlying interest are currently outstanding;

f) 600,000 contracts for options on the following exchange-traded funds:

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

g) except for the specific limits provided for under paragraph f) above, for options where the underlying security is an equity holding exchange-traded fund, defined as an exchange-traded fund for which all of the components are exchange-traded stocks, the position limits shall be equal to twice the limit levels provided for under paragraphs a) to e) above.

2. Debt options

8,000 contracts.

3. Index options

500,000 contracts.

4. Sector index options

40,000 contracts.

5. 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.

6. 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.

7. 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, a net short share futures position, and short underlying interest are on the same side of the market and puts written, calls held, a net long share futures position, and long underlying interest are on the same side of the market;

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

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

4. the "aggregated options and share futures contracts position" is obtained by first netting share futures contracts positions relating to the same underlying share interest and subsequently adding the net futures contracts position (net long or net short) to options positions relating to the same underlying share interest on a per side basis (whether long or short) to determine the aggregate per side quantity held; one option contract being equal to one share futures contract for purposes of this calculation.

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 position limits set out in paragraph B), any one account may hold an amount of options 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.

6651 Position Limits for Options and Share Futures Contracts
(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, 25.06.12, 12.04.13, 04.06.15, 23.11.16, 00.00.00)

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Circular 037-17: Summarised comments and responses

No.	Date comment received	Commenting participant category	Comment summaries	Summary of response
1.	April 18, 2017	Broker Dealer	The Commenter believes that the proposed limit increases, as stated in circular 037-17, are welcomed but are still too conservative considering international standards and market needs, and that the limits should further be increased by the Bourse.	The Bourse thanks the Commenter for this comment and understands that the proposed limits might be perceived as conservative by market participants, but the Bourse believes that a conservative approach was necessary to ensure market integrity.
			The Commenter mentions that the industry has seen a substantial increase in fund sizes and assets under management in the recent past and that the Bourse's current position limits, despite the proposed increases, have yet to adapt to the industry's business reality, giving the example of fund managers who need to efficiently hedge and protect their holdings. In the Commenter's view, Position limits on ETF options are therefore still too low in comparison to the importance of the funds under management and for this reason, the proposed position limits should greatly be increased. The Commenter notes that market participants have mentioned that the current methodology for calculating position limits should be changed to properly address market needs and feels that this change should be made as soon as possible. The Commenter also notes that the Bourse has decided to double the limit until a better methodology can be implemented, understanding that the Bourse is proposing a temporary solution to the position limit issue, but the Commenter points out that the methodology for such temporary relief (doubling the current position limit) is overly simplistic and does not meet market needs. The Commenter points out that the current solution of doubling the limits shows a disconnect to the underlying option market: as an example, market	As mentioned in the Analysis portion of circular 037-17, doubling the position limits for Equity ETF options is a temporary solution to reduce the impacts of the current limits on market liquidity. The Bourse will consider the Commenter's comment to the effect that the temporary solution proposed by the Bourse does not meet market needs. It is important to note that in determining the temporary limits, the Bourse has considered recent position limit exemption requests from market participants and determined that in practice, most market participants do no request more than twice the current limits, hence the decision to double the current limits as a temporary solution. The Bourse understands that a new methodology needs to be developed for the calculation of position limits on ETF options to better align position limits with market needs, and the Bourse is currently reviewing its approach to these limits.

			participants have mentioned that the Bourse's position limit for the XIU could easily be in the millions without impacting the derivatives and cash markets. The Commenter mentions that market participants do not understand the rationale used by the Bourse in establishing its position limits on options related to synthetically created products such as ETFs, and that clarification is needed.	
			The Commenter mentions that market participants have noted that despite the proposed increases in ETF position limits, an arbitrage situation would still exist: the ETF basket can be replicated by using options on the ETF individual components without ever exceeding the position limits on each of the individual components (while exceeding the position limits on the ETF options for the same exposure). The Commenter confirms that although this approach would provide a much greater coverage than the Bourse's position limits on ETF options, it is a much more cumbersome exercise than simply transacting the Index option. The Commenter advises the Bourse to the effect that from a supervision and surveillance perspective, it would be beneficial for market participants to have simple and clear trading requirements on the derivatives market rather than have their traders create complicated trading and booking models to generate the exact same exposure through other products. The Commenter mentions that market participants are of the view that this type of arbitrage should not exist and should be nullified by having equally appropriate position limits on ETF options.	The Bourse understands that an arbitrage situation would still exist while temporary position limits are used. As mentioned above, the Bourse is currently working on a comprehensive approach to position limits on ETF options, which would eliminate the need for market participants to create complicated trading and booking models to generate the exact same exposure as through ETF options.

			The Commenter points out that because the position limits are too low for market needs, market participants must either rely on the Bourse's Exemption process or trade over-the-counter and that market participants need certainty when conducting legitimate hedging transactions to protect their holdings or to provide liquidity. The Commenter believes the Bourse's current position limit exemption policy is not an appropriate vehicle to overcome existing position limits shortcomings as the exemption process is burdensome for market participants and lacks approval certainty. Because of this, the Commenter believes that the proposed position limits should further be increased so that market participants do not need to rely on the exemption policy or do not need to trade over-the-counter. The Commenter suggests that the position limit exemption policy be amended to include pre-emptive exemption approvals in certain situations.	The Bourse is aware that certain market participants consider the exemption process to be burdensome and takes note of the Commenter's suggestion to amend its position limit exemption policy to include pre-emptive exemption approvals in certain situations, before a comprehensive calculation methodology is developed.
			In its conclusions, the Commenter agrees that increasing position limits is a step in the right direction, but it urges the Bourse to adopt a more appropriate methodology for determining positions limits on ETF options going forward, as soon as possible. The Commenter confirms that it is important that the methodology for establishing position limits on ETF options be responsive to market needs without compromising market integrity and that the rationale for methodology must consider the structure of the ETFs and align itself to international position limit standards on ETF options. The Commenter suggests that the Bourse considers the nature of the products (for example, narrow based ETFs vs. broad based ETFs) and the objective it wishes to achieve when establishing position limits. The Commenter wishes that the Bourse's upcoming methodology for calculating ETF option position limits be "effectively adapted to market needs" and in line with the Regulatory Division's mission as stated in Circular 023-17 issued by the Bourse on February 17, 2017: "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".	The Bourse thanks the Commenter for its support for the Bourse's efforts to increase position limits on ETF options and for its suggestion to consider the nature of the products in establishing position limits. The Bourse fully understands the need to have a comprehensive methodology for determining the position limits and agrees with the Commenter's point to the effect that such upcoming methodology for calculating position limits should be in line with the Regulatory Division's mission.