



NOTICE TO MEMBERS

No. 2010 – 084

September 22, 2010

REQUEST FOR COMMENTS

MODIFICATIONS TO THE SPECIFICATIONS

FIVE-YEAR GOVERNMENT OF CANADA BOND FUTURES CONTRACT (CGF)

AMENDMENTS TO ARTICLE C-1402 OF RULE C-14 OF CDCC'S RULES

Summary

The Board of Directors of the Canadian Derivatives Clearing Corporation (CDCC) approved the amendments to article C-1402 of Rule C-14 to exclude 10-year Government of Canada bonds from the basket of deliverable bonds for the 5-year Government of Canada bond futures contract (CGF).

You will find enclosed the analysis document of the proposed rule amendments as well as the proposed regulatory amendments.

Process for Changes to the Rules

CDCC is a recognized self-regulatory organization (SRO) by the Autorité des marchés financiers (the Autorité) and as such, carries on activities as a clearing house and as an SRO in Québec.

The Board of Directors of CDCC has the power to approve the adoption or amendment of Rules of CDCC. The amendments will be transmitted to the Autorité in accordance with the self-certification process as established in the *Derivatives Act* (R.S.Q., chapter I-14.01).

Comments on the proposed amendments to Rule C-14 of CDCC's Rules must be submitted within 30 days following the date of publication of the present notice. Please submit your comments to:

François Gilbert
Assistant Secretary
Canadian Derivatives Clearing Corporation
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 to:

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
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MODIFICATIONS TO THE SPECIFICATIONS

FIVE-YEAR GOVERNMENT OF CANADA BOND FUTURES CONTRACT (CGF)

AMENDMENTS TO ARTICLE C-1402 OF RULE C-14

INTRODUCTION

Following a consultative process with market participants, Bourse de Montréal Inc. (the “Bourse”) proposes to exclude 10-year Government of Canada bonds from the basket of deliverable bonds for the 5-year Government of Canada bond futures contract (the “CGF contract”).

The Canadian Derivatives Clearing Corporation Inc. (“CDCC”) must amend its current Rules to accommodate the Bourse’s proposed change.

The Bourse’s analysis document “Modification to the specifications of the 5-year Government of Canada bond futures contract (CGF)”, is herein attached to provide the background information required to understand the proposed amendment.

I. PROPOSED REGULATORY AMENDMENTS

CDCC must amend article C-1402 of Rule C-14 to accommodate the clearing of the CGF contract with the exclusion of 10-year Government of Canada bond from the basket of deliverable bonds. Article C-1402 defines the notional coupon and the delivery standards which are specific to the CGF contract.

The amendments will be effective starting with the December 2010 CGZ futures contract month as well as for all subsequent contract months.

II. OBJECTIVE OF THE PROPOSED AMENDMENTS TO THE RULES OF CDCC

The objective of the proposed amendments to article C-1402 of Rule C-14 of CDCC is to exclude from the basket of deliverable bonds for the CGF contract those bonds that were originally issued at 10-year Government of Canada bond auctions since, for the purpose of this contract, these bonds, although being the cheapest to deliver, are difficult to get a hold of in the cash market. These amendments respond to demand received from the Bourse’s participants.

III. PUBLIC INTEREST

The amendments to the Rules of CDCC are proposed in order to exclude 10-year Government of Canada bonds from the basket of deliverable bonds for the clearing of the CGF contract.

IV. PROCESS

The proposed regulatory amendments are submitted for approval by the CDCC Board. Once the approval has been obtained, they will then be transmitted to the Autorité des marchés financiers in accordance with the self-certification process and to the Ontario Securities Commission for information. They will also be published by CDCC for a request for comments period of 30 days.

V. ATTACHED DOCUMENTS

- Rule C-14 of CDCC: amendment to Article C-1402
- Bourse's analysis document "Modifications to the specifications of the 5-year government of Canada bond futures contract (CGF)"
- For information: Amended CGF Specifications



MODIFICATION TO THE DELIVERY STANDARDS
FIVE-YEAR GOVERNMENT OF CANADA BOND FUTURES CONTRACT (CGF)
AMENDMENT TO ARTICLE 15613 OF RULE FIFTEEN
OF BOURSE DE MONTRÉAL INC.

Bourse de Montréal Inc. (the Bourse) re-launched the CGF on April 17, 2009, as part of the Bourse's 2009 initiatives. The CGF was an effort to capitalize on extending the Bourse's product coverage of the Government of Canada (GoC) yield curve, thereby providing participants with increased spread trading opportunities.

At the time, it was decided to re-launch the contract in its original form, keeping the contract specifications identical to those that were established in 2000 given the high dollar amount outstanding of deliverable GoC bonds in the underlying cash market.

However, it has been reported by both potential market makers and buy side clients that the cheapest to deliver bond in the CGF basket of deliverables is an illiquid bond that is difficult to get a hold of. Removing from the CGF basket of deliverables bonds that were originally issued as 10-year GoC bonds would make the CGF more efficient for market participants to use.

I. OVERVIEW

a) Proposed Amendment

In order to exclude Government of Canada 10-year bonds from the basket of deliverable bonds of the CGF futures contract, the Bourse proposes to amend article 15613 of Rule Fifteen of the Bourse for the CGF contract. The implementation of the proposed amendment will exclude from the basket of deliverable bonds for the CGF futures contract, bonds that were originally issued at 10-year GoC bond auctions in reason of the fact that, for the purpose of this contract, these bonds, aside from being the cheapest-to-deliver bond, are difficult to get a hold of in the cash market. Moreover, the modification would facilitate effective pricing of the futures contracts and make it easier to execute basis trades between the cheapest-to-deliver 5-year bond and the CGF futures contract.

The Bourse intends to make the proposed change effective starting with the December 2010 CGF futures contract month as well as for all subsequent contract months. There is currently no volume or open interest in the December 2010 CGF futures contract or in the subsequent contract months that are currently listed. The Bourse proposes this amendment in order to encourage an increase in the utilization of the CGF and make its market more efficient.

II. RATIONALE

Following a consultative process with market participants, they recommended to the Bourse that the delivery standards of the CGF be changed by removing from the basket of deliverable bonds those bonds that were originally issued at 10-year Government of Canada bond auctions.

Several factors justify modifying the delivery standards for the CGF contract:

a) There are liquidity issues with bonds in the CGF basket of deliverables that were originally issued at 10-year GoC bond auctions

The CGF basket of deliverable bonds includes bonds that were originally issued at 10-year GoC bond auctions. Despite a large amount outstanding, old 10-year GoC bonds that are part of the CGF basket of deliverable bonds are not actively traded in the cash market as they have been accumulated by institutional investors for the purpose of holding them until maturity. Consequently, a large part of these issues is not readily available in the market and it becomes difficult for participants to obtain these bonds for the purpose of executing basis trades or cash and carry trades using the CGF contract.

For illustrative purposes, the following table lists the basket of deliverable bonds for the CGF bond futures contract comprised of only 5-year GoC bonds that meets the new delivery standards:

Table I: CGF Basket of deliverables with only 5-year GoC bonds – Proposed

Government of Canada Bonds			5-year GoC Futures Contract Month - CGF			
Coupon	Maturity	Issue Type	dec 2010	march 2011	june 2011	sept 2011
3,00%	june 2014	5-year	16,000	16,000	16,000	16,000
2,00%	dec 2014	5-year	15,000	15,000	15,000	15,000
2,50%	june 2015	5-year	9,000	9,000	9,000	9,000
3,00%	dec 2015	5-year	10,500	10,500	10,500	10,500
Total Outstanding (C\$ billion)			50,50	50,50	50,50	50,50

denotes cheapest-to-deliver bond issue

Source: Montréal Exchange Research Department

b) The cheapest-to-deliver bond is always an old 10-year GoC bond that suffers from liquidity issues

Given current market conditions where yields of 5-year GoC bonds - currently at 2.25% as at September 13, 2010 - are considerably below the notional coupon of 6%, shorter duration bonds are favoured as the cheapest-to-deliver bond for the CGF contract.

Consequently, the cheapest-to-deliver bond is always an old 10-year GoC bond that does not actively trade in the cash market – reducing the efficiency of the CGF, as illustrated in Table II.

Table II: CGF Basket of deliverables cheapest-to-deliver bond – Current situation

Government of Canada Bonds			5-year GoC Futures Contract Month - CGF			
Coupon	Maturity	Issue Type	dec 2010	march 2011	june 2011	sept 2011
5,00%	june 2014	10-year	9,753	9,753	9,753	9,753
3,00%	june 2014	5-year	16,000	16,000	16,000	16,000
2,00%	dec 2014	5-year	15,000	15,000	15,000	15,000
2,50%	june 2015	5-year	9,000	9,000	9,000	9,000
4,50%	june 2015	10-year	10,143	10,143	10,143	10,143
3,00%	dec 2015	5-year	10,500	10,500	10,500	10,500
4,00%	june 2016	10-year	10,157	10,157	10,157	10,157
Total Outstanding (C\$ billion)			80,553	80,553	80,553	80,553

denotes cheapest-to-deliver bond issue

Source: Montréal Exchange Research Department

c) The supply of 5-year GoC bonds is sufficiently large to support a basket of deliverables without the inclusion of old 10-year GoC bonds

In light of the Government of Canada's substantial increase in bond issuances as part of its debt program for 2009/10 to finance the forecasted financial requirement of over C\$100 billion, there has been a considerable increase in the supply of GoC bonds targeted at each segment of the curve.

With the benchmark target size of 5-year GoC bonds established by the GoC (at between C\$9-12 billion) largely exceeded, the CGF basket of deliverable bonds is sufficiently large if it was designed to include only GoC bonds that were originally issued at 5-year GoC bond auctions – thereby, excluding old 10-year GoC bonds from the basket of deliverable bonds.

For example, the amount outstanding of the benchmark 5-year GoC issue is currently C\$16 billion and the amount outstanding of all eligible bonds in the CGF basket of deliverable bonds under the new proposal will be at least C\$50 billion – which does not take into consideration the supply of soon to be auctioned 5-year GoC bonds.

Moreover, there has been an increase in the number of issuances of 5-year GoC bonds relative to previous years. In fact, the number of issuances of 5-year GoC bonds has increased from six (6) – for a total amount issued of C\$18 billion - in 2008, to nine (9) – for a total amount issued of C\$31 billion - in 2009. In 2010, five (5) issuances of 5-year GoC bonds have occurred – for a total amount issued of C\$16.5 billion through September 3, 2010.

III. SUMMARY OF THE PROPOSED AMENDMENT

Article 15613 of Rule Fifteen

The Bourse proposes to amend article 15613 subparagraph b) iii) of Rule Fifteen to allow the Bourse to exclude from the basket of deliverable bonds, bonds that were originally issued at auctions for 10-year Government of Canada bonds.

IV. OBJECTIVE OF THE PROPOSED AMENDMENT

The objectives of the proposed amendment to article 15613 of Rule Fifteen of the Bourse are to allow the Bourse to be able to remove from the CGF basket of deliverable bonds illiquid bonds that were originally issued at 10-year Government of Canada bond auctions to make the CGF more efficient for market participants to use.

V. PUBLIC INTEREST

This amendment to the Rules of the Bourse is proposed in order to make the use of the CGF contract more efficient for market participants who have expressed their support to remove from the basket of deliverable bonds those bonds that were originally issued at 10-year Government of Canada bond auctions for the purpose of improving their trading and/or risk management strategies. Furthermore, it is in the public's interest that the Bourse be granted the flexibility to adapt quickly to changing market conditions in the underlying GoC bond.

VI. PROCESS

The proposed amendment is submitted to the Rules and Policies Committee of the Bourse for approval. Once the approval has been obtained, it will then be transmitted to the Autorité des marchés financiers (AMF) in accordance with the self-certification process and to the Ontario Securities Commission (OSC) for information. The proposed amendment will also be published for a 30-day comment period.

VII. ATTACHED DOCUMENTS

- Rule Fifteen of Bourse de Montreal Inc.: amendment to subparagraph b) iii) of article 15613
- For information: CGF specifications

RULE C-14 5-YEAR CANADA BOND FUTURES

The sections of this Rule C-14 are applicable only to Futures where the Underlying Interest is Government of Canada bonds as defined in Section C-1402, herein referred to as "5-year Canada Bond Futures".

Section C-1401 Definitions

Notwithstanding Section A-102 for the purposes of 5-year Canada Bond Futures the following terms are as defined:

"Assignment File" means the computer file constructed to enable Tenders to be assigned on a first-in-first-out basis pursuant to Section C-1405.

"Underlying Interest" means Government of Canada Bonds which meet the criteria established in Section C-1402 of this rule.

New Rule 6/89, 9/94, 9/95

Section C-1402 Delivery Standards

- (1) The delivery unit for 5-year Canada Bond Futures shall be Government of Canada Bonds which do not mature and are not callable for at least 3 years six months and no more than 5 years three months from the first calendar day of the Delivery Month, having a coupon rate of 6%, an aggregate face value at maturity of \$100,000, an outstanding face value, net of all potential purchases by the Government of Canada up until the end of the delivery period of the corresponding Delivery Month, of at least \$3.5 billion, are issued and delivered on or before the 15th calendar day preceding the first tender date corresponding to the Delivery Month of the contract, ~~and which have been originally issued at 5-year Government of Canada bond auctions, and which have an original maturity of not more than 5 years nine months. A bond issue which was deliverable in the 10 year Canada Bond Futures and which would otherwise meet the standards of this Rule C-14, is also deemed eligible for delivery.~~ All bonds in a delivery unit must be of the same issue.
- (2) Substitution - at the option of the Clearing Member holding the Short Position, bonds with coupon rates other than 6% are deliverable, at a discount for bonds with coupons less than 6%, and at a premium for bonds with coupons more than 6%. The amount of premium or discount for each different deliverable issue shall be determined on the basis of yield equivalency with a 6% bond selling at par. The price at which a bond having a particular maturity and coupon rate will yield 6% shall be determined according to bond tables prepared by the Exchange on which the Future trades. The Settlement Amount of such delivery unit shall be \$1,000 multiplied by the product of such price and the Settlement Price of that series of 5-year Canada Bond Futures. Interest accrued on the bonds shall be charged to the Clearing Member taking delivery.
- (3) The Exchange on which the Future trades shall publish a list of deliverable issues prior to each Delivery Month. The time to maturity of a given issue is calculated in complete one month increments (rounded down to the entire one month period) from the first calendar day of the Delivery Month. New issues of Government of Canada bonds which satisfy the standards of this section shall be added to the deliverable list as they are issued by the Government of Canada. In the event that, at any regular issue or auction, the Government of Canada reopens an existing issue which has an original maturity of more than 5 years nine months but would otherwise meet the standards of this Rule, thus rendering the existing issue indistinguishable

from the newly issued one, then the older issue is deemed to meet the standards of this Rule and would be deliverable if the reopening of such an existing issue has a total minimum face value amount of \$3.5 billion during the last 12 month period preceding the first tender date of the contract month. The Exchange shall have the right to exclude any new issue from deliverable status or to further limit outstanding issues from deliverable status, whether or not they otherwise satisfy the standards of this section.

- (4) In the event the Corporation determines that there exists a shortage of deliverable Government of Canada Bond issues it may designate as deliverable on a 5-year Canada Bond Futures such other Government of Canada issues as it deems suitable, and may specify any adjustments in the settlement amount that it considers appropriate and equitable.

| Amended 9/94, 12/95, 7/97, 12/08, ~~12/08~~

Section C-1403 Submission of Tender Notices

- (1) A Clearing Member who holds a Short Position in the currently deliverable series and who wishes to make delivery must submit a Tender Notice to the Corporation no later than the time established by the Corporation on a Business Day from three Business Days prior to the first Business Day of the Delivery Month up to and including the third last Business Day preceding the last Business Day of the Delivery Month indicating the maturity of the Government of Canada bonds being delivered.
- (2) A Clearing Member who, at the time that trading has ceased, holds a Short Position of the currently deliverable series shall submit a Tender Notice to the Corporation indicating the maturity of the Government of Canada Bonds being delivered. Such Notice must be tendered no later than the third Business Day preceding the last Business Day of the Delivery Month.
- (3) The Clearing Member to whom a delivery has been assigned must confirm to the Corporation that delivery has been completed.

This Section C-1403 supplements Section C-502.

Amended 9/95

Section C-1404 Delivery Through the Clearing Corporation

- (1) Day of Delivery - Delivery of Government of Canada bonds as required by this Rule shall be made by the Clearing Member on the third Business Day following submission of a Tender Notice, or on a day as otherwise determined by the Corporation. Delivery must be made no later than the last Business Day of the Delivery Month.
- (2) Time of Delivery - Each Clearing Member who is to make or take delivery of Government of Canada bonds shall do so against or by payment of certified funds by no later than 2:45 p.m. on the Day of Delivery.
- (3) If delivery of the Underlying Interest by the delivering Clearing Member, or payment therefor by the assigned Clearing Member, is not effected by the time provided in Section C-1404(2), such Clearing Member becomes a Non-Conforming Member and must inform the Corporation of such failure of the Non-Conforming Member no later than 3:00 p.m. on the Day of Delivery. The Clearing Member shall notify the Corporation of the default of the Non-Conforming Member by telephone, with written notification, sent by facsimile transmission, to be provided as soon as possible.

Amended 9/95, 9/98

Section C-1405 Assignment of Tender Notice

- (1) Tender Notices accepted by the Corporation shall be assigned, at the end of each Business Day on which the Contract Specifications permits Tender Notices to be tendered, to Clearing Members with open Long Positions as of the close of trading on the day on which the Tender Notice is submitted. Tenders Notices will be assigned in accordance with the Corporation's procedures of assigning Tender Notices to the oldest open contract (First In, First Out).
- (2) A Tender Notice shall not be assigned to any Non-Conforming Member which has been suspended for default or insolvency. A Tender Notice assigned to a Clearing Member which is subsequently so suspended shall be withdrawn and thereupon assigned to another Clearing Member in accordance with this Section.

This section C-1405 replaces Section C-505.

New 12/89, amended 5/95, 9/98

C-1406 Assignment File Procedures

The following rule shall apply to the compilation of the Assignment File.

- (1) On the sixth Business Day prior to the first Business Day of the Delivery Month each Clearing Member holding Long Positions in the relevant Series of Futures must enter into the Assignment File in the Corporation's computer system all the Clearing Member's Long Positions in that Series of Futures in chronological order.
- (2) Prior to the Close of Business on each subsequent Business Day up to and including the next to last Business Day on which Tender Notices may be submitted, each Clearing Member shall access the Assignment File and either make changes to reflect the current chronological order of all Long Positions in the relevant Series of Futures or confirm that the existing Assignment File records are correct.
- (3) Every Clearing Member shall ensure that an Authorized Representative is available by telephone to the Corporation until the Close of Business on every day on which an amendment to the Assignment File can be made.
- (4) It shall be the duty of each Clearing Member to review daily the relevant reports available on the Corporation's computer system.
- (5) Failure to access the Assignment File and maintain the current chronological order of all the Clearing Member's Long Positions in the relevant Series of Futures on a daily basis or to have an Authorized Representative available by telephone shall be deemed a violation of the procedures of the Corporation and shall be subject to disciplinary action pursuant to the Rules.

New Rule 9/94, amended 9/95; 9/98, 3/99

Specifications

CGF - Five-Year Government of Canada Bond Futures Contract

Trading Unit	C\$100,000 nominal value Government of Canada Bond with 6% notional coupon
Contract Months	March, June, September and December.
Price Quotation	Par is on the basis of 100 points, with one point equal to C\$1,000.
Last Trading Day	Trading ceases at 1:00 p.m. (ET) on the seventh business day preceding the last business day of the delivery month.
Contract Type	Physical delivery of eligible Government of Canada Bonds.
Delivery Notices	Delivery notices should be submitted before 5:30 p.m. or before such time set by the clearing corporation on any business day, between the third business day preceding the first business day of the delivery month, and the third business day preceding the last business day of the delivery month inclusively.
Delivery Date	Delivery shall be made on the third business day following the submission of the delivery notice by the member holding a seller's position or on any other day as determined by the clearing corporation. Delivery shall be completed no later than the last business day of the delivery month.
Minimum Price Fluctuation	0.01 = C\$ 10 per contract.
Reporting Level	250 contracts.
Position Limits	Information on position limits can be obtained from Bourse de Montréal Inc. as they are subject to periodic changes.
Minimum Margin Requirements	Information on Minimum Margin Requirements can be obtained from the Bourse as they are subject to periodic changes.
Delivery Standards	Government of Canada Bonds which: <ul style="list-style-type: none"> i) have a remaining time to maturity of between 3 years 6 months and 5 years 3 months as of the first day of the delivery month, calculated by rounding down to the nearest whole month period; ii) have an outstanding amount of at least C\$3.5 billion nominal value; iii) are originally issued at five-year or ten-year Government of Canada bond auctions; iv) are issued and delivered on or before the 15th day preceding the first delivery notice day month of the contract.
Daily Price Limit	None
Trading Hours	<ul style="list-style-type: none"> • Early session: 6:00 a.m. to 8:05 a.m. (ET) • Regular session: 8:20 a.m. to 3:00 p.m. (ET) • Extended session* : 3:06 p.m. to 4:00 p.m. (ET) <p>* There is no extended session on the last trading day of the expiring contract month.</p> <p>Note: During early closing days, the regular session closes at 1:00 p.m., time at which the daily settlement price is established. In those circumstances, the extended session is from 1:06 to 1:30 p.m.</p>
Clearing Corporation	Canadian Derivatives Clearing Corporation (CDCC).
Ticker Symbol	CGF

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