CITADEL

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Via e-mail delivery to: mxrlegal@tmx.com

Ms. Charlotte Larose
Chief Legal Officer, Regulatory Division
Regulatory Division of Bourse de Montreal Inc.
1800-1190 av des Canadiens-de-Montreal
P.O. Box 37 Montreal, Quebec H3B 0G7

Re: Amendments to the Rules of the Bourse Regarding Position Limits on Government of Canada Bond Listed Products (Circular 148-23)

Dear Ms. Larose:

Citadel appreciates the opportunity to provide comments to the Bourse de Montreal Inc. (the "Exchange") on its proposal to modify the rules for establishing spot month position limits on Government of Canada bond futures and options (the "Proposal").[1] While we support the Exchange's objectives of increasing transparency and refining its methodology for calculating position limits, we urge the Exchange to address certain issues before finalizing the Proposal to ensure it does not inadvertently undermine these goals. Specifically, by basing the new methodology on the outstanding amount of the Cheapest-to-Deliver ("CTD") bond rather than the total outstanding amount of bonds eligible for delivery, we are concerned that the Proposal may make position limits more difficult to predict and could exacerbate volatility during times of stress. Before finalizing the Proposal, we encourage the Exchange to engage with market participants on these issues, and to develop procedures for (i) ensuring CTD changes do not cause material fluctuations in spot month position limits; and (ii) determining the CTD bond.

The Proposal would make two changes to the establishment of spot month position limits on Government of Canada bond futures and options on the Exchange:

- *First*, the Proposal would calculate spot month position limits based on the CTD rather than total outstanding amount of bonds eligible for delivery. Instead of calculating position limits for the futures contract based on 5% of the total outstanding amount of bonds eligible for delivery, the Exchange proposes to calculate position limits based on 15% of the total outstanding amount of the CTD bond.

- *Second*, the Exchange intends to establish and publish position limits at an earlier date than it does currently. Today, Exchange rules specify that it will establish and publish position limits "at market close on the fourth business day prior to the first business day of the first delivery month." The Proposal would remove the 4-business day requirement, and instead require the Exchange to publish position limits "in the month preceding the Delivery Month" and become effective at the market close of the first business day of the first

[1] Amendments to the Rules of the Bourse Regarding Position Limits on Government of Canada Bond Listed Products, TMX (Dec. 14, 2023) available at https://www.m-x.ca/f_circulaires_en/148-23_en.pdf.

delivery month. The Exchange states that this change is intended to allow it to publish spot month position limits at an earlier date and eliminate frictions that may arise from late publications. The Exchange states its preliminary intent to publish spot month position limits "ten business days prior to the effective date."

I. The Amendments Should Establish Clear Procedures for CTD Changes, Ensure Position Limits are Predictable, and Limit the Risk of Material Fluctuations to Calculated Position Limits

Calculating position limits based on the outstanding amount of CTD bonds rather than the total outstanding amount of bonds eligible for delivery introduces a new risk related to the CTD changing, which could have significant implications for calculating position limits. While the Exchange acknowledges this risk, and notes that it "does not expect such changes to be a challenge," it does not specify how a change in the CTD would be handled under the Proposal. Moreover, while we agree that switches to the CTD bond are uncommon, the Exchange itself has recognized that current macro-economic conditions make "switch risk [] higher today in CGB contracts than it has been for a very long time."[2]

Market participants carefully manage their portfolios in accordance with exchange position limits. The Exchange's current methodology for establishing position limits is transparent and predictable, enabling market participants to accurately anticipate and plan for position limits well in advance of the Exchange publishing spot month position limits. Moreover, because the current methodology is based on the total outstanding amount of bonds eligible for delivery, position limits are not subject to rapid or extreme fluctuations.

In contrast, a change in the CTD is difficult to predict. A change to the CTD could cause a sudden reduction in position limits, which could result in significant harm to overall market quality by forcing market participants to sell-off positions in a short period of time. Changes to the CTD are also more likely to occur during periods of heightened volatility, exacerbating this concern. If a change to the CTD resulted in reduced position limits, the Proposal could increase volatility and undermine market resiliency. Given this risk, at minimum the Exchange should make it clear that once position limits are published, it will not reduce established limits in the event of a change to the CTD.

Even in the weeks prior to publishing position limits, however, a change to the CTD could result in a significant change to the forthcoming spot month position limit, leaving a market participant with insufficient time to reasonably reduce its position before the delivery month (for example, if the outstanding amount of the new CTD is materially less than the prior CTD).[3] If the Exchange proceeds with the Proposal, it should develop clear and consistent policies for ensuring positions limits are predictable and not subject to material fluctuations. It is critical that the Exchange's methodology for establishing position limits enables market participants to reasonably plan and manage portfolios according to transparent and consistent limits. Absent these changes,

[2] Kevin Dribnenki, "Switch Risk Update: Canada Bond Futures," (Oct. 2023) available at https://www.m-x.ca/f_publications_en/futures_flash_article17_en.pdf.

[3] Conversely, if the CTD changes and the new CTD issue has a much larger amount of total bonds outstanding, it may be necessary and appropriate to raise position limits.

changes to the CTD could result in unexpected reductions in position limits, resulting in market disruptions and harm to market participants.

II. The Proposal Should Establish a Methodology for Determining the CTD Bond

The Proposal would change the methodology for calculating position limits to include a subjective, value-based measure. Currently, position limits are calculated based on the total outstanding amount of bonds eligible for delivery, and data regarding outstanding bonds is readily available from government sources. The Proposal would instead calculate position limits based on the total outstanding amount of the CTD bond, which requires the Exchange to first determine the bond that is the cheapest to deliver.

The Exchange should establish a transparent methodology and/or data source for determining the CTD bond. In recent years, market participants have at times disagreed over which bond is the CTD in other government security futures markets. For example, in 2022 there was "significant uncertainty" in the German sovereign bond market over which bond would be the CTD for the September 10-year future.[4] During the same period, we understand that there was also uncertainty regarding which bond would be the CTD for September and December expiries of British Gilt futures.[5] The Exchange's rules should provide market participants with certainty and confidence regarding the basis for calculating position limits, including how the Exchange will determine the CTD bond.

III. Conclusion

While we support the Exchange's goals of increasing transparency and refining the methodology for calculating position limits, we are concerned that without first addressing the points we outline above, the Proposal could undermine these objectives. Without transparent and predictable position limits, the Proposal could undermine market participants' ability to prepare for spot month position limits, and potentially harm market quality and exacerbate volatility during periods of stress. Before finalizing the Proposal, we encourage the Exchange to engage with market participants on these issues, and to develop procedures for (i) ensuring CTD changes do not cause material fluctuations in spot month position limits; and (ii) determining the CTD bond.

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[4] Ben St. Clair, Why the search for cheapest-to-deliver bonds just got harder, Risk (Nov. 22, 2022) available at https://www.risk.net/derivatives/7955181/why-the-search-for-cheapest-to-deliver-bonds-just-got-harder?check_logged_in=1.

[5] *Id.*

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Please feel free to contact the undersigned with any questions regarding these comments.

Respectfully,

/s/ Stephen John Berger
Managing Director
Global Head of Government & Regulatory Policy

CC: Me Philippe Lebel, Corporate Secretary and Executive Director, Legal Affairs
Autorité des marchés financiers