**AMENDMENTS TO RULE C-18 OF THE CANADIAN DERIVATIVES CLEARING CORPORATION TO MODIFY THE DELIVERY STANDARDS OF THE 30-YEAR GOVERNMENT OF CANADA BOND FUTURE CONTRACTS (LGB)**

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## I. DESCRIPTION

Bourse de Montréal Inc. (the "Bourse") proposes to modify the delivery standards of the 30-Year Government of Canada Bond Futures ("LGB") to change the remaining maturity range of deliverable bonds from 25+ years to 28.5+ years. Therefore, the rules of the Canadian Derivatives Clearing Corporation ("CDCC"), which also contain the delivery standards of the LGB, need to be modified in order to reflect these proposed changes.

## II. PROPOSED AMENDMENTS

The proposed amendments to Rule C-18 of CDCC's Rules are attached. More specifically, CDCC proposes to replace the current remaining maturity of not less than 25 years of the LGB contract with a remaining maturity of not less than 28.5 years.

## III. ANALYSIS

### a. Background

The Bourse proposes to update its rules pertaining to LGB delivery standards as it considers that a well-functioning LGB market is desirable for the growth of its products and wants to ensure that its contract design is in line with the needs of market participants. CDCC refers to the following extracts of the Bourse's detailed analysis pertaining to this modification to the LGB delivery standards for additional background information on the proposed amendments:

> *"Benchmark bonds are usually the most liquid instruments in the over-the-counter ("OTC") bond market. Because of this liquidity pool concentration, they represent the primary tool for participants wishing to manage and adjust their fixed income portfolios on any given day. Following these transactions in benchmark bonds, a number of clients and dealers manage or transfer this exposure using efficient futures contracts via the Exchange for Physical ("EFP") facility of the Bourse. Therefore, an efficient interaction between the benchmark bonds and their associated GoC bond futures contracts is desirable to help market participants in their portfolio and balance sheet management activities. These EFP transactions (often referred to as "basis trade" or "cash and carry trade") are predominantly quoted against the cheapest-to-deliver ("CTD") bond, since it is the bond most likely to be delivered during the delivery month. Having a new futures contract with the benchmark bond as the CTD would also make the futures pricing exercise more straightforward and clear for users. Thus, the longer the benchmark bond remains the CTD bond, the easier it is for participants to interact with the Bourse's LGB contract to manage fixed income portfolios.*
>
> *In 2019, the Bourse implemented a similar modification to the CGF delivery standards, reducing the remaining maturity range of deliverable bonds from 4.25-5.25 years to a maturity of 4.5-5.5 years. This change improved the attractiveness of the CGF contract by increasing the duration of the CTD bond and reducing the tracking error relative to the on-the-run five-year GoC bond."*

### b. Objectives

CDCC's Rules need to be aligned with the changes proposed by the Bourse. The objective set by the Bourse is to ensure that the 30-year benchmark bond in the cash market is the cheapest-to-deliver ("CTD") bond of the LGB contract as often as possible. The Bourse believes that the proposed modifications will increase the utility and the effectiveness of the LGB contract for hedgers and speculators. The Bourse aims to provide the market with an attractive 30-year contract offering that meets the needs of its initial supporters, in an effort to grow the volume and open interest until it reaches a critical mass of activity.

### c. Comparative Analysis

Given the nature of the proposed amendments, CDCC is of the view that a comparative analysis is not required.

### d. Analysis of Impacts

#### i. Impacts on Market

The proposed modifications are based on consultations conducted by the Bourse with dealers and end-user clients, and are meant to increase the contract's effectiveness as a trading and hedging instrument. The feedback the Bourse has received from the industry is that a better alignment between the LGB and the underlying cash bond market will help initiate growth in the futures contract.

The objective of the proposed amendment is to ensure that the 30-year benchmark bond in the cash market is the cheapest-to-deliver ("CTD") bond for the LGB contract as often as possible. Following this change on the LGB delivery standards, the remaining time to maturity will now usually be between 28.5 years and 32 years, compared to the interval of 24.5 years and 29.5 years under the current LGB delivery standards. Hence, this will result in a slight increase in the implied volatility of the LGB contract prices as well as in an increase in the Margin Interval (MI); these increases are respectively estimated at 2.8% and 11.7% on average over the period from 2010-01-01 to 2021-06-15[1]. Consequently, a slight increase in the Base Initial Margin required level is also expected for this contract at the launch (the increase in the Base Initial Margin is estimated at 19.9% on the period from 2010-01-01 to 2021-06-15). No other significant financial risk impact is expected.

In order to capture the new historical risk dynamics caused by the reduction in the size of the basket of deliverables, CDCC has recalculated the historical LGB prices with this new constraint. To this end, the historical prices for the past ten years will be updated at the launch based on a full theoretical revaluation to ensure that the LGB prices used will reflect the appropriate risk level of the new LGB contract characteristics throughout the Base IM model's ten-year lookback period. Thereafter, the new daily settlement prices will be established by the Bourse, according

[1] Please note that this MI variation is calculated according to the current MI model. The impact on the MI on the same period of time is 7.0% while taking into consideration the new Initial Margin Model Change for Bond Derivatives (for more information, see notice to members 082-21). Please note that the amendments proposed under notice to members 082-21 are not yet in force.

to their standard daily settlement price procedure for futures contracts, and will be added to CDCC's historical prices on a daily basis (as it is the case in production today).

### ii. Impacts on Technology

The proposed changes should have no impact on the technological systems of CDCC, Clearing Members or other market participants.

### iii. Impacts on trading functions

Not applicable.

### iv. Public Interest

CDCC is of the view that the proposed amendments are not contrary to the public interest.

## IV. PROCESS

The proposed amendments, including this analysis, must be approved by CDCC’s board of directors and submitted to the Autorité des marchés financiers, in accordance with the regulatory self-certification process, and to the Ontario Securities Commission in accordance with the rules stated in Appendix “A” of Schedule “C” of CDCC Recognition Order dated April 8, 2014 (as amended from time to time). The proposed amendments and analysis will also be submitted to the Bank of Canada in accordance with the Regulatory Oversight Agreement. Subject to public comments, the proposed amendments will take effect during Q4 2021.

## V. ATTACHED DOCUMENTS

Proposed amendments to Rule C-18 of CDCC’s Rules

**Proposed amendments to the Rules of CDCC**

## Section C-1802 Delivery Standards

(1) For all 30-year Canada Bond Futures

(a) The delivery unit for 30-Year Canada Bond Futures shall be Government of Canada Bonds which do not mature and are not callable for a minimum of 28~~5~~ ½ years 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 are originally issued at 30-year auctions.

All bonds in a delivery unit must be of the same issue.

[...]