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With a copy to:

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RE: MONTRÉAL EXCHANGE MARKET MAKING PROGRAMS REFORM

The Investment Industry Association of Canada (“IIAC”) welcomes this opportunity to provide comments on the Montreal Exchange’s (“MX” or “Bourse”) proposed reform to its Market Making Programs outlined in MX Circular 056-16 (the “Proposal”). The Proposal is of particular relevance to the IIAC as many of the Bourse’s approved participants are IIAC members.

The IIAC appreciates the attention the Bourse has devoted to liquidity and price discovery on its facility as these are essential for markets to function efficiently. The IIAC has generally been supportive of measures that foster improved market liquidity provided, however, that those measures do not detract from the integrity of the marketplace and the confidence of investors transacting in that market. In this respect, the IIAC has identified some areas of concern with the Proposal which we outline in our following submission.

The Bourse has identified a need to improve liquidity on its facility and thereby proposes to expand market maker eligibility to include clients of approved participants which have direct market access. While not specifically stated in the Proposal it is assumed that the Bourse intends on expanding market maker eligibility across all its listed equity and fixed income products, for both options and futures contracts.

Our members have noted, however, that open interest and trading volumes on several of the Bourse's products such as BAX, CGB and SXF are at historically high levels. In fact, statistics published by the MX for the period covering 2012 to 2015 show that total futures and options volumes have jumped nearly 20% and Open Interest up over 30% - driven largely by several of the Bourse's most popular instruments. The Proposal, therefore, would appear to be more directly connected with the Bourse's experience with some of its newer, less established products which the marketplace has been slow to embrace. It is uncertain to us whether the slow take-up of these products by investors is directly the result of the absence of market makers or whether the products themselves lack investor relevance or purpose in which case the Proposal would likely not contribute much to the Bourse's objectives.

Oversight of market making clients is an area we believe requires added clarity. Currently, the regulatory division of the Bourse does not have any jurisdiction over clients and therefore must rely on its approved participant to ensure their clients comply with the rules of the MX. This has placed a significant responsibility on approved participants. It is unclear whether this responsibility will increase further under the Proposal.

While the Proposal states that the MX will extend the jurisdiction of its Regulatory Division over market making clients *"to ensure that practices of all market makers are subject to the surveillance, monitoring and disciplinary function of the Bourse"* it further goes on to say that the Bourse *"shall be solely responsible for overseeing the performance of the market makers and their compliance with the market making agreement but that performance of specific market making obligations and compliance with the terms and conditions of the market making agreement shall not be subject to their disciplinary jurisdictions."* We interpret this to mean that the Bourse will not have full direct oversight of clients serving as market makers. Furthermore, it is unclear from the Proposal what role, if any, approved participants will have to fulfill should their clients choose to become market makers. Any added monitoring or surveillance obligations stemming from the Proposal introduces additional risks and costs to approved participants. The Bourse's expectations surrounding the obligations of approved participants with clients acting as market makers should be more clearly articulated so that informed decisions can be made including whether or not approved participants wish to carry out that client relationship.

We are also concerned that the Proposal could jeopardize the integrity of the market which the Bourse serves. Investors have comfort that IIROC member market makers are registered representatives that have met prescribed proficiency requirements, are generally experienced in trading in the Canadian market, and are directly accountable to IIROC for their business conduct. IIROC Members must also maintain sufficient capital for the business activities they undertake. Allowing clients who are not bound by the same requirements of an IIROC member may not provide the same level of safeguards to investors. It is also uncertain whether all clients would demonstrate the same level of commitment to

their market making responsibilities as have IIROC members. Increasing the number of market makers may in itself not achieve the Bourse's objectives if new market makers cannot be depended on for providing on-screen liquidity during all market cycles including periods of market stress. We have seen no evidence that clients would make consistent two-way markets. This situation currently exists in other jurisdictions and has caused liquidity to dry up when needed most, as non-committed market makers cease quoting during volatile periods.

Members have also raised questions surrounding the existing margining framework and its ability to support the Proposal. While the MX sets the margining requirements for certain listed instruments, it is IIROC who fulfils that function for other MX instruments. We do not see how a non-IIROC registered entity or non-exchange member can provide adequate liquidity without having access to SPAN margining. At best, these clients would be able to quote only a few selected classes or even limit themselves to specific strikes or expiries. That would do little to foster healthier markets.

Furthermore, if issues arise with client market making activities, we are not certain the Proposal would provide the Bourse the level of visibility necessary to appropriately identify the cause of the issue and the authority to carry out remedial action.

Lastly, we are also concerned that the Proposal creates an unlevelled playing field amongst the two categories of market makers. While we recognize that the Bourse proposes to impose the same obligations and standards on all market makers this does not address the fact that some clients will not have to bear comparable registration requirements to that of an IIROC Dealer.

We would be pleased to arrange for you a meeting with our members to discuss the concerns raised in our submission.

Sincerely,



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Cc: IIAC Debt Markets Committee
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