TMX MONTRÉAL EXCHANGE

Canadian Annual Derivatives Conference 2024

MAY 22–23

Table of Contents

The Canadian Annual Derivatives Conference showcased the TMX Group's 150 years of innovation and its future prospects. It featured discussions on industry trends and fireside chats with leaders, all emphasizing the commitment of the Montréal Exchange to advancing Canadian derivatives globally.

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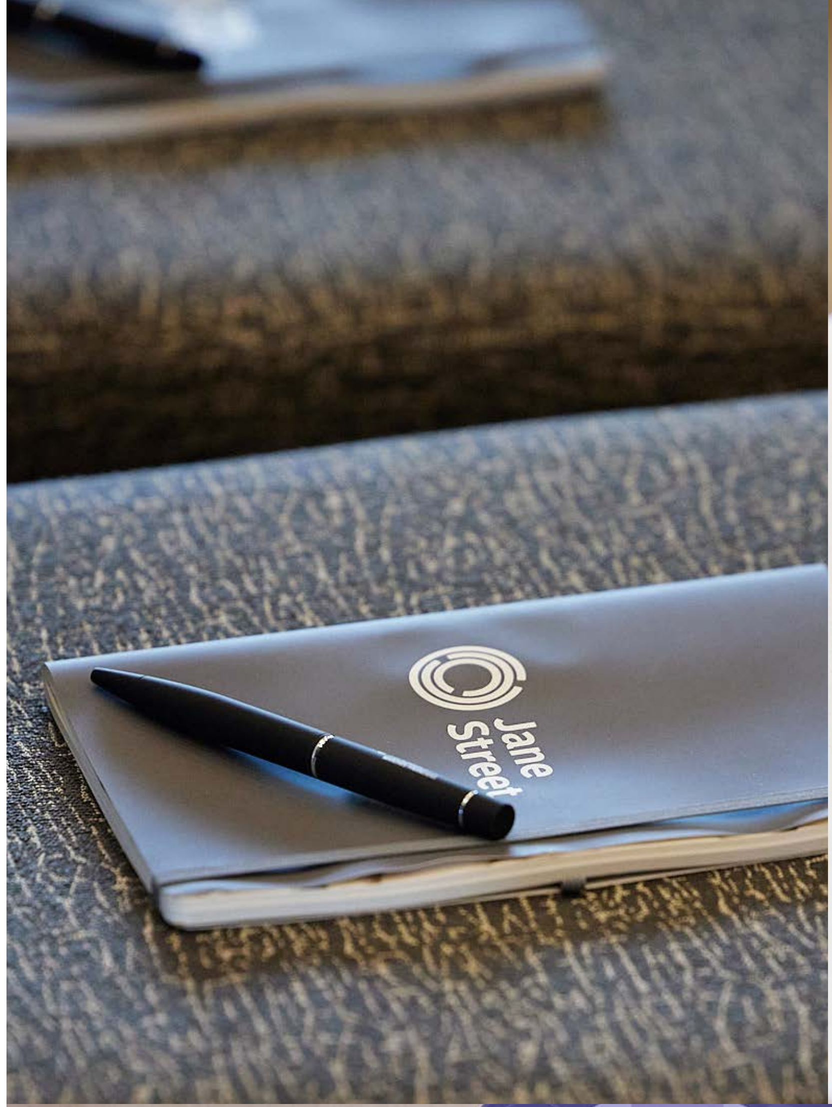


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1

Looking Back, Looking Ahead

SPEAKERS

Luc Bertrand
Chair of the Board, TMX Group

Luc Fortin
Montréal Exchange, TMX Group

Montréal Exchange (MX) has a storied history closely linked with the evolution of Canada's financial industry. Over the years, MX has transformed from a regional exchange to a global player, driven by strategic milestones and a forward-thinking approach. To kick off the conference, Luc Fortin and Luc Bertrand discussed 150 years of innovation and growth at the exchange and what the future holds. Here are the highlights.

Strategic Milestones and Growth

The history of MX is deeply intertwined with the evolution of the financial industry in Montréal and the broader Canadian capital markets. Over the past decades, MX has transitioned from a regional marketplace to a global competitor, seeking to attract international investors and expand its reach beyond Canada's borders. Several key milestones have shaped its modern history.

In the 1970s, it launched equity options, becoming the first Canadian exchange to do so. This initiative laid the groundwork for the Exchange's future focus on derivatives. By the 1980s, it introduced financial futures under new leadership, marking a significant shift towards developing a robust derivatives market. Despite initial skepticism about derivatives, the Exchange's commitment to this area positioned it as a leader. The late 1990s brought a significant restructuring of Canada's exchange landscape. MX decided to specialize in derivatives, while other exchanges focused on different areas. This controversial move ultimately paved the way for the Exchange's future success.

Technology has been a cornerstone of the exchange's strategy. In the early 2000s, MX developed SOLA®, a fully electronic trading platform, one of the first in North America. This technological advancement enabled significant growth, positioned MX as a technical operator in the US equity options market and underscored the importance of investing in innovative technologies to support expanding trading volumes and market demands.

Global Expansion and Strategic Partnerships

In recent years, the Exchange has focused on globalizing its business. Recognizing the need to align with global peers, MX expanded its product offerings and formed strategic partnerships to cater to a worldwide audience. A vital aspect of this strategy has been listening to clients and delivering products that meet their needs rather than adopting a "build it and they will come" approach.

The launch of extended trading hours to align with Asian markets and the establishment of partnerships in Europe are examples of this global outreach. Additionally, the Exchange has developed new products and services, contributing significantly to its revenue growth. Over the past five years, 25% of its top-line revenue has come from these new initiatives.

Maintaining Canadian Ownership and Enhancing Market Competitiveness

MX's commitment to maintaining Canadian ownership has been critical to its strategy. In 2011, a consortium of financial institutions known as the Maple Group successfully countered a bid by the London Stock Exchange Group to acquire Toronto Stock Exchange and MX. This move ensured the exchanges and financial infrastructure remained under Canadian control, preserving its unique market ecosystem.

This Canadian ownership has allowed TMX Group to support and develop critical market segments, such as TSX Venture Exchange (TSXV), which is vital for nurturing entrepreneurs, small and medium enterprises, and fostering economic growth. This commitment to supporting TSXV through different market cycles has helped maintain its strength and resilience.

Looking Forward: Future Growth and Innovation

MX continues to innovate and explore new growth opportunities. With a focus on two primary asset classes, equities and fixed-income products, it is now looking to expand into other areas. It also leverages its successful technology platforms to build scalable solutions supporting further expansion.

Partnerships remain key to its growth strategy, as it collaborates with market participants to drive innovation and meet client needs. The Exchange's vision for the future includes further global expansion, particularly in the US, Europe and Asia, leveraging its expertise to compete globally.

Montréal Exchange's journey from a regional marketplace to a global competitor is a testament to its strategic vision, technological innovation, and commitment to serving its clients.




2

Developing Repo Central Clearing Opportunities

MODERATOR

Adrian Walton
Bank of Canada

PANELISTS

Ciaran Dayal
Scotiabank

Josh Galper
Finadium

The evolution of repo central clearing has been a significant journey marked by collaboration between industry and central banks, driven by the need to mitigate counterparty credit risks that became evident during the financial crisis. Central clearing has since evolved to address dealer capacity, with the ability to offset repos and reverse repos through central counterparties, using minimal balance sheet resources.

This panel examined trends in central clearing, related benefits and areas for development, including the role of buy-side in the evolution of repo central clearing. These are the highlights from their discussion.

Trends in Canadian and Global Repo Markets

All sell-side fixed-income participants in Canada are members of the Canadian Derivatives Clearing Corporation (CDCC), facilitating efficient trading among dealers. However, buy-side participation remains limited, with only a small share of Canada's repo volume being centrally cleared through the Limited Clearing Model (LCM), a unique model created in 2018 for buy-side participants. New clearing models will be essential to accommodate the growing demand and unlock the full potential of central clearing in Canada.

Comparing Canada to international peers, particularly the US, highlights differences in how balance sheet constraints are managed. In the US, the Securities and Exchange Commission (SEC) has mandated repo central clearing for specific segments of the Treasury market. The regulation aims to make markets more resilient to shocks but poses challenges, such as increased margin costs potentially driving some market participants away.

In the US, various repo clearing models, including sponsored repo and agency clearing, offer alternatives to mandatory central clearing. These models provide flexibility and meet regulatory requirements while maintaining market efficiency. With its single central counterparty for derivatives and fixed-income products, the Canadian market has unique opportunities for streamlined clearing processes. However, challenges remain in achieving critical mass in buy-side participation.

Technology integration in repo markets, particularly moving from manual settlement to straight-through processing, has improved efficiency and reduced operational complexities. While the electronification of repo transactions has gained momentum, the Canadian market lags behind its European counterparts in adopting electronic trading platforms. Continued technological integration is expected to drive further improvements in market operations.

Balancing Capacity and Growth

One of the central themes discussed is the delicate balance of dealer capacity. While the current state does not indicate an immediate need for relief, normalization in liquidity and recent developments in bilateral netting have provided some alleviation. The ability to offset repos and reverse repos bilaterally has enhanced dealers' capacity to conduct repo business efficiently. However, this method is less flexible than central clearing, especially during market stress.

The growth trajectory of bond and repo markets suggests that increased central clearing will be essential. Central clearing offers benefits such as reducing counterparty risk, enhancing market resiliency, and increasing transparency. However, achieving these benefits requires broader buy-side participation and possibly new clearing models, such as a sponsored model, to ensure balance sheet availability for buy-side entities.

Central clearing will likely remain a best practice, supported by technological advancements and regulatory developments. The future of repo markets may also see the introduction of innovative financing products, such as cleared total return swaps or futurized financing mechanisms, driven by the need for efficiency and market stability.

As the market continues to grow, ongoing efforts to enhance clearing models, incentivize buy-side participation and integrate technology will be crucial in shaping a resilient and efficient repo market landscape for the future.

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3

Macro Panel - Navigating the Year of Divergence

MODERATOR

Todd Hargarten
TMX Group

PANELISTS

Candice Bangsund
Fiera Capital Corporation

Earl Davis
BMO Global Asset Management

Jason Daw
RBC Capital Markets

Douglas Porter
BMO Financial Group

In the wake of the COVID-19 pandemic, the global economy has been on a tumultuous journey, marked by unprecedented stimulus measures, inflationary pressures, and varying recovery trajectories among nations. One of the most noticeable impacts is the divergence between the Canadian and US economies. Traditionally closely linked, they now show distinct paths in monetary policies and growth.

The macro panel explored several topics, ranging from macro and policy divergence, yield curve dynamics, and politics to what all this means for fixed-income asset class performance. The discussion references current economic developments at the time of the event (May 2024).

Macro-economic Trends

Historically, the economic fortunes of Canada and the US have been closely intertwined, with movements in the US economy often serving as a predictor for Canada. However, recent trends highlight a significant divergence. While the US economy has shown robust growth, with a 3% increase in real terms over the past year, Canada's growth has barely reached 1%. This gap is primarily attributed to differences in productivity growth, where the US has outpaced Canada.

A critical factor contributing to Canada's slower growth is the impact of higher interest rates on the housing market. Unlike the US, where residential investment has not significantly dragged on GDP, Canada has seen a substantial adverse effect from its housing market. The sensitivity of Canadian consumers to borrowing costs, coupled with elevated household debt levels, has amplified this impact, slowing economic growth and inflation.

Similarly, both countries experienced inflationary pressures throughout the pandemic, but since early 2024, their inflation paths have markedly diverged. In the US, core inflation (excluding food and energy) has risen at an annual rate exceeding 4%, a substantial increase from pre-pandemic levels. In contrast, Canada's core inflation has remained below 2%, aligning more closely with pre-pandemic figures. This disparity is influenced by various factors, including labor market dynamics and consumer sensitivity to borrowing costs.

Monetary and Fiscal Policies

The differing economic conditions have implications for monetary policy in both countries. In the US, despite the Federal Reserve's intention to cut rates, persistent inflation has limited its ability to do so. The expectation is for the Fed to hold off on rate cuts until at least the end of the year. Conversely, the Bank of Canada is positioned to begin cutting rates sooner. This anticipated divergence in monetary policy highlights the contrasting economic landscapes.

The divergence in monetary policy also raises questions about currency and fiscal policy implications. Historically, a significant divergence in interest rates between Canada and the US has led to currency fluctuations. However, the current economic context suggests that the Canadian dollar might not depreciate drastically unless there is a significant further divergence in monetary policy or external shocks, such as changes in commodity prices.

Bond and Fixed-Income Yields

For investors, understanding these divergences is crucial for making informed decisions. The divergence in monetary policies suggests different strategies for investing in bonds and equities in the two countries. Rate cut expectations by the Bank of Canada suggest that bond yields may remain lower. Moreover, there could be opportunities for a steepening yield curve if the Bank of Canada proceeds with multiple rate cuts.. On the other hand, the US might see higher bond yields driven by sustained inflation and a more gradual approach to rate cuts by the Federal Reserve. This creates a complex environment for fixed-income investors, who must consider the potential for higher yields in the US versus a more favorable bond market in Canada driven by anticipated rate cuts.

The post-pandemic period has highlighted the importance of tailored economic policies that respond to domestic conditions. For Canada, this means leveraging its current inflation dynamics to support growth through potential rate cuts. For the US, it involves managing inflationary pressures while balancing the need for economic stability. As both countries adapt to the evolving economic environment, their divergent paths will offer valuable insights into the complexities of post-pandemic recovery.

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4

EQD: Global Trends in Equity Options

MODERATOR

Etienne Ménard
TMX Group

PANELISTS

Jean Fouquet
Mako Trading

Eshank Shah
TMX Group

Sean Truett
BOX Options

The landscape of global options trading is characterized by distinct trends and dynamics across different regions. Equity/ETF and index options are seeing a global uptick, driven by increased participation from retail investors, widened access to trading platforms, and a growing interest in derivatives for portfolio hedging and speculation. Technological advancements have also played a significant role in making options more accessible and their trading more efficient, bolstering their popularity as a financial instrument.

The equity derivatives panel examined regional variations in market structure, regulation, and investor behavior shaping equity options trading in Canada, the US, Europe and India. These are the highlights of their discussion.

Regional Trading Patterns

Institutional trading in Canada has consistently risen over the past few years, contrasting with a gradual decline in retail trading, which is returning to pre-pandemic levels. Institutional investors primarily use strategies like covered calls and Delta One transactions, driving record highs in open interest for long-dated ETF options. Institutional trading accounts for about 65% of the total market volume, a significant shift from a decade ago when retail trading was predominant.

The US options market has seen substantial growth, particularly in retail trading. Daily volumes have increased from 19 million contracts in 2019 to nearly 50 million in recent quarters. Factors driving this growth include zero-commission trading offered by discount brokers, easy account setups, and sophisticated trading platforms. These platforms allow retail investors to engage in more complex strategies, such as iron condors and iron butterflies. Despite the rise in retail participation, institutional trading remains significant, often facilitated through trading floors and electronic mechanisms that ensure regulatory compliance and market integrity.

Europe presents a complex picture, with each country's market operating under different rules and practices. For instance, Amsterdam sees about 75% of trading volume conducted on-screen by retail investors, while Germany, France and the UK primarily handle trades as off-screen blocks. European markets rely heavily on broker-dealer interactions, with large volumes managed by inter-dealer brokers and market makers. Strict regulatory requirements, including financial literacy and risk disclosures, might deter retail participation.

India is experiencing a retail trading boom in its options market. With a young population and widespread internet and smartphone usage, more individuals are entering the market. Initiatives to improve financial literacy and the rise of discount brokers have significantly contributed to this trend. India's market features smaller contract sizes to attract retail investors, and regulatory changes such as the introduction of GIFT City (a tax haven jurisdiction) and cash-settled European-style options have further facilitated market growth.

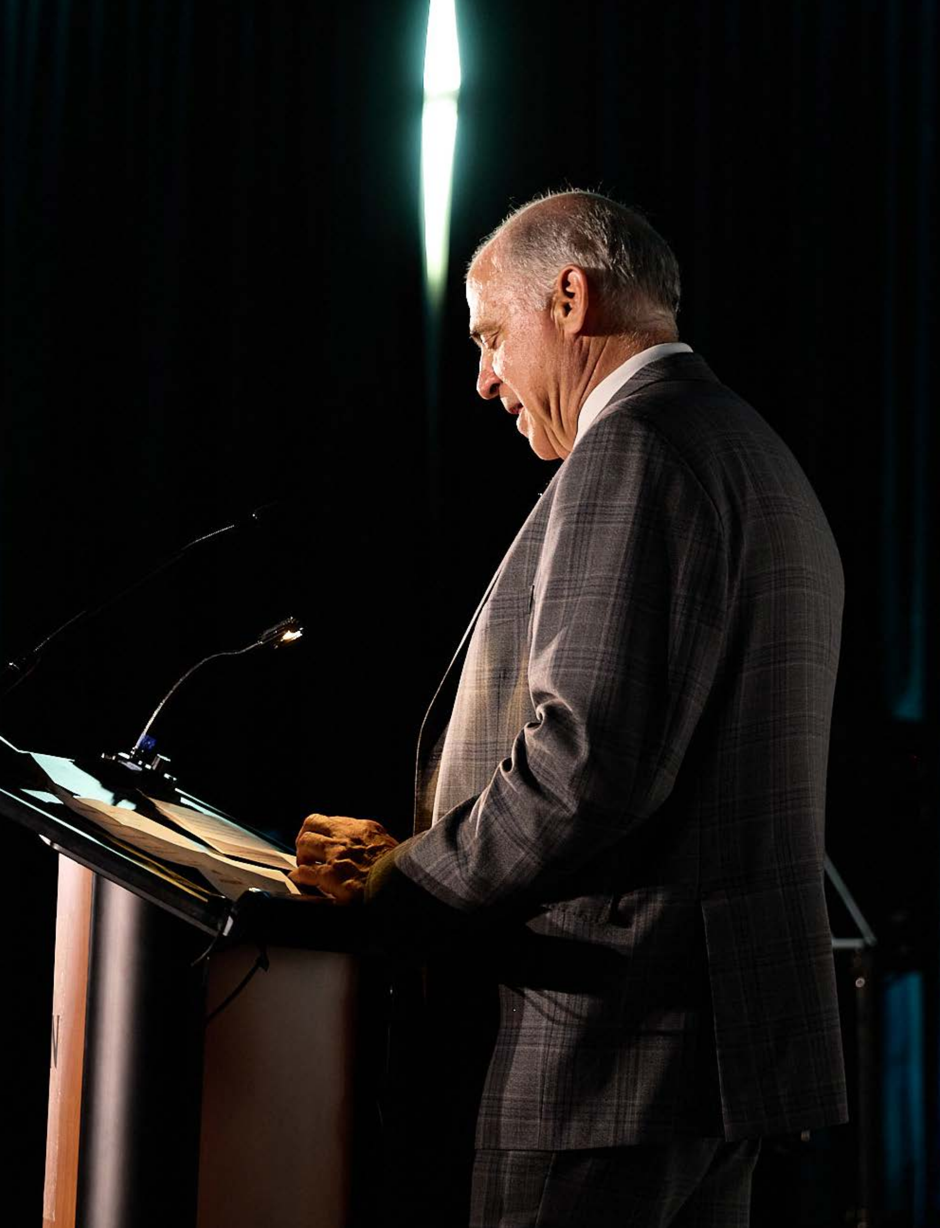
Market Structures and Regulatory Environment

A critical factor in the growth of retail trading in both India and the US is market accessibility and cost structure. In India, retail investors benefit from free access to live market quotes, while in the US, payment-for-order flow (PFOF) mechanisms have enabled zero-commission trading. These structures lower the entry barriers for retail investors, promoting increased participation.

Education is crucial in sustaining market growth. Regulatory measures in European jurisdictions focus on protecting investors, resulting in stringent requirements. Europe's conservative approach, characterized by high savings rates and limited risk appetite, contrasts with the more dynamic and technologically driven markets in India and the US, which emphasize creating awareness and simplifying market access.

Canada could benefit from the experiences of other regions by reducing trading costs and enhancing market accessibility to attract more retail investors. Similarly, Europe's markets might evolve with increased harmonization and relaxed regulatory barriers, potentially spurring greater retail participation. Meanwhile, India's model of smaller contract sizes and targeted financial literacy programs could serve as a blueprint for other emerging markets.

The global equity derivatives markets are shaped by diverse trends and regulatory frameworks. Understanding these dynamics and regional regulatory environments is essential for investors aiming to navigate and succeed in the evolving options trading landscape.




Exchange
WESTIN


MX
Cocktail signature des 150 ans
de la Bourse de Montréal
Notre histoire a commencé il y a près de deux siècles, en 1832, alors que s'effectuaient les premières négociations d'actions au Canada, à l'Exchange Coffee House, dans le Vieux-Montréal.
Aujourd'hui, pour souligner le 150e anniversaire de la constitution officielle de la Bourse de Montréal, en 1874, nous vous proposons notre cocktail signature, l'espresso Martini.
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