CANADIAN FIXED-INCOME FORUM

SUMMARY OF THE DISCUSSION

Virtual Meeting, October 12, 2021, 4:00 p.m. to 6:00 p.m.

1. Introduction

The co-chairs welcomed Kelsey Gunderson, President and CEO, Head of Capital Markets from Laurentian Bank Financial Group, and Nick Chan, Managing Director and Global Head of Repo and Asset Management for BMO Capital Markets to CFIF.

2. Recent bond market developments

A member recapped the key developments in the credit bond market and fixed income markets in general. Macroeconomic factors and economic growth remain key anchor points for credit conditions, with demand for credit products expected to remain strong in the next 12 months. There is, however, more uncertainty in the medium term and the member expects more periods of volatility as a result. Despite credit spreads being tight by historical standards, their internal analysis indicated a more neutral outlook for credit.

Members also discussed the potential impact of IFRS 17 on credit and longer term yields. It was noted that analysis is still underway, and it will take some time to fully understand the impact on long duration product.

3. Initiatives to enhance GoC Market Functioning

GoC Market Functioning Steering Group (GMF) co-chairs updated CFIF members on the status of the project.

The Complementary Policies Working Group continues its effort on industry best practice recommendations. The low level of fails in GoC securities in Canada introduces challenges to the work, therefore, the co-chairs expect that any recommendations would likely focus on marginal improvements to existing practices. However, the improvements would be beneficial to improve settlement during periods of market stress and increased settlement volumes. The working group will also leverage the experience gained in March 2020 and investigate potential ties to potential future infrastructure work undertaken by the TMX.

The Calibration Working Group (CWG) presented two revised calibration options for a potential GoC fail fee, along with a comprehensive discussion of the respective advantages and drawbacks. Both options reflect the desire to have an effective and operational insurance policy appropriate for the Canadian marketplace, while minimizing potential unintended consequences. Option A is comprised of a time-limited period to test the processes and infrastructure after which a fail fee would be introduced that would apply to all settlement fails that take place through CDS. The fee would escalate if fails rose above a certain threshold. Option B involves an indefinite test period (invoicing without actual payment) but would incorporate a trigger to turn on the payment exchange.

Under the proposal, CDS would build the infrastructure, collect the fail fees, and create a monthly billing and invoicing system with appropriate audit trail.

CFIF members supported Option A with the incorporation of a formal review process, after a set period, to decide whether to continue to keep the fee active. The CWG will continue to develop the governance framework and the decision criteria for the formal review.

The GMF plans to deliver its final blueprint for the GoC settlement framework to CFIF in two-stages, with the fail fee component, including its governance being presented at the November CFIF meeting. The co-chairs expect the best-practices to be tabled in February. The decision on whether to proceed with the framework to a public consultation is expected in early 2022.

4. CARR update

CARR's co-chairs presented the initial findings of CARR's analysis of CDOR. These findings were based on the work done by CARR's Credit Sensitive subgroup, which has formed three workstreams to analyze and review (i) the size and scope of the use of CDOR and bankers' acceptances (BAs), (ii) CDOR submission process and its comparison to other major global credit sensitive rates, and (iii) the efficacy of BAs as a short-term bank funding tool, as a corporate loan product and as a money market investment product.

CDOR is currently the primary interest rate benchmark in Canada. It is referenced in over $20 trillion of gross notional exposures across the Canadian financial system, including in derivatives, bonds, and loans. Derivatives account for 97% of this exposure.

CDOR represents the rate at which panel banks offer their balance sheet to their corporate clients under a BA credit facility and was originally developed in the 1980s as the basis for pricing BA related credit facilities. Like LIBOR, it is a 'credit-sensitive' benchmark that is calculated from voluntary panel bank submissions, however, unlike LIBOR (and other global interbank offered rates), it is a committed lending rate and not a borrowing/funding rate.

CARR's analysis of CDOR has pointed to some structural issues in its architecture that may potentially impact its robustness over the longer term. Given its definition and purpose, it is based predominantly on expert judgement and therefore cannot be directly tied to observable arms-length transactions, which is not consistent with evolving global best practices. The BA lending model, which supports CDOR, is no longer seen as an effective way for banks to provide credit to the corporate borrowers. Similarly to other global credit sensitive benchmarks, the rate is referenced in a very large volume of financial products but based on a small underlying market, particularly so in stress periods. The CDOR panel is also very small, with only 6 panel banks, down from 9 banks in 2012, exposing a key fragility should one or more panel banks decide to leave.

Benchmark reform is a global endeavour seeking to establish a sound foundation for financial products in the future. In Canada, this initiative is being supported by the work of CARR as well and under a new regulatory framework brought in by the Canadian Securities Administrators (CSA) as benchmark regulators. The CSA recently designated CDOR a ‘critical’ interest rate benchmark which aligns with the heightened standards other jurisdictions have begun adopting since 2018.

CARR intends to publish a whitepaper in December 2021 that provides CARR’s detailed analysis of CDOR and its recommendation for the future of the benchmark. Any material changes recommended for CDOR would require a public consultation by Refinitiv Benchmark Solutions Ltd, the administrator of CDOR.

5. Other business

The Secretariat tabled CFIF meeting dates for 2022.

Meeting participants:

CFIF members:
Jim Byrd, RBC Capital Markets, Co-Chair
Sandra Lau, Alberta Investment Management Corporation
Brian D'Costa, Algonquin Capital
John McArthur, Bank of America Securities
Nick Chan, BMO Capital Markets
Daniel Bergen, Canada Life Assurance Company
Karl Wildi, CIBC World Markets
Marlene Puffer, CN Investment Division
Philippe Ouellette, Fiera Capital
Rob Goobie, Healthcare of Ontario Pension Plan
Kelsey Gunderson, Laurentian Bank Financial Group
Graeme Robertson, Phillips, Hager and North Investment Management
Jason Lewis, Provincial Treasury of BC
Paul Scurfield, Scotiabank
Greg Moore, TD Bank

Bank of Canada:
Toni Gravelle, Co-Chair
Wendy Chan, Secretariat
Zahir Antia
Mark De Guzman
Annick Demers
Mark Hardisty
Grahame Johnson
Sheryl King
Stéphane Lavoie
Michael Mueller (Item 3)
Thomas Thorn
Harri Vikstedt
Sabrina Wu (Item 3)