CANADIAN
FIXED-INCOME
FORUM

SUMMARY OF THE DISCUSSION

Vancouver, October 3, 2024, 1:00 p.m. to 3:00 p.m.

1. Recent bond market developments

CFIF member, TJ Sutter, Portfolio Manager, Co-Head of Fixed Income, and Carolyn Kwan, Portfolio Manager, Product Specialist, Fixed Income, Connor, Clark and Lunn Investment Management, shared their team's macroeconomic outlook and thoughts on factors driving market pricing with CFIF members.

Mr. Sutter noted that inflation is no longer the primary concern as both investors and central banks have become more comfortable with the progress made on inflation and are more confident that inflation will return to central bank targets. Meanwhile, concerns on growth have yet to materialize, despite seeing negative leading economic indicators for 30 consecutive months. Growth has remained resilient in the US and Canada, in the face of higher interest rates.

The reduction in central bank interest rates is providing much-needed relief for some weaker parts of the economy, such as small business and commercial real estate and has reduced the tail risk of a hard landing. However, as US economic growth remains firm, and with lower oil prices, easing financial conditions, and lower exchange rates helping US exporters, he thought the risks of upward surprises to inflation in the US have increased. On the other hand, upside surprise to growth in Canada seems less probable because of elevated household debt and higher interest rate sensitivity in the Canadian economy.

Mr. Sutter noted that risk assets continue to price in a goldilocks scenario where inflation continues its path towards central bank targets while economic growth remains healthy, an observation agreed by other members.

He thinks that the labour market remains the primary concern going forward. Several labour market indicators, such as the Sahm Rule and the Beveridge curve, have reached a fragile point and further weakness typically will result in a material uptick in unemployment rate in the US and Canada. Although, he noted that the uptick was due to a rise in people looking for work and not due to layoffs, so while unemployment rate has been rising, initial jobless claims has remained benign. He is also monitoring housing in the US as he thinks it will be a key signal for determining the level of monetary policy restrictiveness to the US economy.

2. Securitization market in Canada

Potential further development of the Canadian securitization market has been part of the CFIF workplan for a number of years. To facilitate the discussion at this meeting, the CFIF Secretariat put together a high-level comparison of securitization markets across a number of similar jurisdictions.

The presenters noted that Canada's term asset-backed securities (ABS) market is comparable in size with other countries, especially when considering the size of Canada's economy. However, in contrast to other jurisdictions, Canada lacks the development of either a robust private label residential mortgage-backed securities market (RMBS) or a commercial mortgage-backed securities market (CMBS). They also noted that the Canadian RMBS market is dominated by government guaranteed NHA MBS and that this type of securitization together with covered bonds fund a much higher portion of mortgage assets than in other equivalent countries. They observed that while securitization provides an alternative source of funding, more cost-effective unsecured funding options are available to large Canadian banks.

While members generally agreed that there is nothing specific for CFIF to action on at the moment, several commented that some investors continue to be averse to buying asset-backed commercial paper (ABCP) and that educational effort, such as the CFIF BATVN educational primer on ABCP, can be beneficial to the development of the market. One member pointed out that the growth of new products, such as various private credit instruments, have taken a more important role in institutional fixed income investors' portfolio. This potentially offsets the need and demand for new securitized investment products. . Another member noted that private-label bullet bond issuance, securitized with conventional mortgages similar to the structure of the Canada Mortgage Bond, could be well received by investors, although others noted that it would require substantial collaboration across all the major mortgage lenders to put in place. Some members also noted that it may not currently be economically viable against other forms of unsecured issuance.

CFIF co-chairs encouraged members to bring securitization ideas to the committee should they have specific suggestions actionable by CFIF.

3. CORRA sunset review

Representatives from the Bank of Canada (BoC) began the discussion by sharing their analysis on the factors leading to recent higher CORRA settings.

On May 27, 2024, the settlement period for trading GoC bonds in the secondary market in Canada moved from two days to one day. This shortened time for settling secondary cash bond trades caused CORRA eligible overnight repo volumes to rise significantly, and they have remained elevated since, as tomorrow-next repo trades moved to be funded in the overnight repo market. Most of these new overnight trades were hedge fund long positions funded at a higher rates resulting in a slightly higher CORRA setting. The distribution of eligible CORRA trades by repo rate has also become more bimodal as a result.

The BoC, as the CORRA administrator, conducts a review of the CORRA methodology every five years to ensure CORRA remains representative of the market it measures, and the data source and the data providers remain optimal for the calculation of the benchmark. The next review is scheduled in 2025.

The BoC has been working with industry through the Canadian Alternative Reference Rate working group (CARR), which led the original work on enhancing CORRA in 2019, and the CORRA Advisory Group (CAG) to help determine the scope of the upcoming sunset review. CARR and CAG have determined that CORRA remains largely representative of the general collateral (GC) Government of Canada (GoC) repo rate, which it is meant to represent and that it currently does not require any major definitional changes. The groups also recommend that the timing of the 2025 review be pushed to Q4-2025. This shift in timing was proposed, because they felt that more time is required to collect sufficient data on repo market dynamics that have resulted from the various recent changes to repo market structure. They also recommend that the scope of the 2025 review should include an analysis of and potential recommended changes to, where applicable, the trim rate, the inclusion of Bank of Canada trades, and the minimum fallback volume threshold. CARR and CAG also noted that the BoC will need to monitor the development of the Canadian Collateral Management Service (CCMS), which will potentially result in substantiative changes to the functioning of the Canadian repo market. For instance, the introduction of GoC GC collateral baskets may eventually require changes to the CORRA calculation methodology down the road as these types of repo trades would not be required to be trimmed as they represent the GoC GC rate that CORRA is meant to measure. CARR and CAG also noted that enhanced transparency proposed by the BoC around the CORRA data distribution would be beneficial to market participants and should be implemented as soon as possible. CFIF members were also informed that CARR members agreed at the October CARR meeting that the group will be wound up as a result of having completed the successful transition from CDOR to CORRA and that the October meeting was the last meeting for the group. The CARR co-chairs also noted that CAG should take over the sole responsibility for advisory work on CORRA going forward.

CFIF members agreed on CARR's and CAG's recommendations on the timing and scope of the CORRA sunset review. The CFIF co-chairs also thanked CARR and its members for leading a very successful CDOR transition.

4. BA Transition Virtual Network (BATVN) update

BATVN's co-chair provided an update on how the market has adjusted to the cessation of BA issuance since June. The co-chair noted that the transition away from BA has gone smoothly, and attributed the success to the group's work on clear communication and education of stakeholders, and an orderly wind down of BA issuance, aided by CFIF's proposed plan for winding down BA issuance. She also noted that the overall size of short-term market has remained relatively constant[1] leading up to BA cessation, which was helpful for the transition.

CFIF thanked the co-chair and the BATVN's work on facilitating a smooth transition away from BAs.

5. CFIF credit beta project update

CFIF's Credit Beta Steering Committee chair updated members on the progress of the project. As mentioned in the last meeting, the group has decided to create a bank-only securities-based futures contract instead of basing it on a broad basket of corporate bonds to ensure more robust liquidity at the onset. Although the securities coverage is narrower, the correlation with the FTSE Canada All Corporate Bond Index of such a product is very high and if proven successful, may allow for creation of a more comprehensive corporate bond basket in the future. A tentative launch date has been set for early 2025 and the speaker noted that the success of the product will largely depend on strong participation by all market participants at the launch.

The Credit Beta Steering Committee will continue to work with TMX and relevant partners to develop and finalise the product.

[1] Other money market products, such ABCP and Government of Canada treasury bills, have increased in size during the period.

6. CIMPA update

The Collateral Infrastructure and Market Practices Advisory Group (CIMPA) was officially launched in April and has had two meeting since its creation. Three subgroups have been formed to help fully operationalise CCMS, the new Canadian tri-party repo service launched by TMX and Clearstream, and to ensure maximum operational effectiveness for the Canadian repo market. The Custodian Model subgroup aims to develop working models for custodians to ensure a seamless integration of custodians into the system, which will facilitate buy-side involvement in CCMS. The Standardized Basket subgroup will focus on developing standardized GC repo baskets. The objective is to create standardized baskets that can be easily traded and financed, improving access to the Canadian repo market. The Valuation, Pricing and Haircuts subgroup aims to develop standardized valuation methodologies for market participants, including pricing and haircuts.

The CIMPA co-chairs noted that transacting through CCMS should commence by end-of-the year with many of the largest Canadian buy-side participants expected to join the service in Q1-2025.

CIMPA will continue to work with industry stakeholders to provide guidance and support changes to Canadian financing and collateral infrastructure and develop market practices that support the safe and efficient movement of securities in the cash, collateral, and securities financing markets.

Meeting participants:

CFIF members:
Jim Byrd, RBC Capital Markets, Co-Chair
Nick Chan, BMO Capital Markets
Roger Casgrain, Casgrain & Company Limited
Karl Wildi, CIBC World Markets
TJ Sutter, Connor, Clark & Lunn Investment Management
Bronwyn Ward, CPP Investment Board
Philippe Ouellette, Fiera Capital
Rob Goobie, Health Care of Ontario Pension Plan
Chris Miller, National Bank Financial
Vinayak Seshasayee, PIMCO
Jason Lewis, Ministry of Finance, Province of British Columbia
Elaine Lindhorst, TD Asset Management
Eugene Lundrigan, SLC Management

External participants:
Item 1
Carolyn Kwan, Portfolio Manager, Product Specialist, Fixed Income, Clark & Lunn Investment Management

Bank of Canada:
Toni Gravelle, Co-Chair
Wendy Chan, Secretariat
Sheryl King
Stéphane Lavoie
Harri Vikstedt