Fall 2024 Debt Distribution Framework Review Consultation Summary

The Government of Canada (GoC) and the Bank of Canada (the Bank) seek to regularly conduct reviews of Canada's domestic Debt Distribution Framework (DDF) to ensure its continued suitability to meet Canada's debt management objectives in ever evolving financial markets. The previous DDF review was conducted in 2018.

The preliminary findings of the current DDF review process led to a series of recommendations. These proposals were the basis of consultations which were conducted through September and October of 2024, both online and in person, with Government Securities Distributors (GSDs) and customers at GoC securities auctions. The views expressed below reflect those provided by market participants and will be taken into consideration when finalizing any recommendations to change Canada's DDF.

Overall Comments

All respondents agreed that the DDF, as currently designed, is effective and aligns with Canada's twin debt management objectives of achieving stable low-cost funding and supporting a well-functioning GoC securities market. Canada's DDF aims to meet these objectives via four principles:

1. Facilitating continuous access to funding markets;
2. Supporting a well-functioning government securities market;
3. Fostering a competitive primary market for government securities; and
4. Mitigating execution, settlement and operational risks.

Structural trends raised by respondents that impact Canada's DDF included the increased role of customers at GoC securities auctions, the decline in the number of primary dealers (PDs), the ability of primary dealers to take risk and manage it in an environment of rising debt issuances, and the increased use of interest rate futures contracts over trades of GoC securities in the secondary market.

A common view was that the current framework works efficiently and that any changes should be well considered and be proposals that authorities strongly believe will be permanent.

Reform to non-Primary Dealer Government Securities Distributors

Customer feedback generally expressed a forward-looking concern with regards to the steadily declining number of PDs in Canada. Participants did highlight that Canada is a particularly difficult jurisdiction for new dealers to enter, given its high concentrations of talent, expertise and capacity. As such, the proposals looking to encourage new GSD applications were broadly welcomed. An expanded set of GSDs should provide increased optionality in services available to existing customers and expand the investor base for GoC securities by bringing in new international GSDs' clients.

Several participants observed that while some large international financial institutions may have very active GoC swap desks, there would still be a need for investment to develop GoC cash desks and a presence in other Canadian debt markets, both of which are required to be successful as a Canadian securities dealer. Respondents agreed that if CIRO membership is not required for foreign non-PD GSDs, these entities should be held firmly to equivalent standards by foreign regulators and there should be no decline in the level of oversight for those potential new entrants.

Primary dealers' feedback was mixed, with some dealers questioning the benefits of the proposals, others being more agnostic and neutral, and some describing the potential changes as healthy. Concerned dealers raised the risk that foreign non-PD GSDs could be disruptive by becoming GSDs and then shortly afterwards changing their minds and exiting. Any new entrants should be supportive of maintaining and enhancing the well-functioning of the GoC's market. Dealers also questioned what would be gained for Canada if one or two larger international firms became non-PD GSDs. Further, some dealers observed that prospective firms which could become GSDs were existing clients who would now become competitors (although it was pointed out that there could also be new collaboration opportunities as well).

Several respondents made suggestions for other potential changes to the non-PD GSD category. These included considering whether non-PD GSDs should be required to bid for a certain level of duration or dollar amount (in addition to the current obligation regarding the frequency of their bids). The idea of asking new GSDs to formally commit to remaining in this role for a minimum number of years was also raised, as well as the notion of splitting non-PD GSDs into two types, Canadian and international, with slightly different requirements and benefits. In terms of benefits, there was a suggestion to make non-PD GSDs eligible for more Bank of Canada facilities, including the overnight repo, in order to put the smaller dealers at less of a disadvantage in the Canadian repo market.

Finally, several respondents noted that a common method for attracting more dealers could be the introduction of more regular use of syndications for the issuance of nominal GoC securities.

Changes to Auction Rules for Government of Canada Securities

Most dealers agreed that the current Calculated Value system for determining minimum bidding requirements and bidding limits at bond auctions are little understood and do not drive their business decisions. Therefore, respondents had few concerns for the idea of all primary dealers being subject to the same auction rules, in the form of uniform bidding limits and minimum bidding obligations.

Some dealers did note that a move to uniform bidding rules would remove an incentive for firms to outperform, which in turn could reduce competition. Another risk could be that dealers with smaller balance sheet capacity or client orders could occasionally struggle to meet increased minimum bidding requirements.

Changes to Bidding Limits

Dealers expressed that the current competitive bidding limit of 25% remains appropriate for their needs the vast majority of the time, while a small number expressed that they would not refuse higher limits if they were offered. Likewise, customers were nearly uniformly of the opinion that 25% is sufficient. Most large dealers did, however, advocate for an increase to the 40% aggregate bidding limit that applies to the combined amount of a PD's own bids and that of its customers. Not only do dealers occasionally reach this combined limit and have to turn away customer orders, which is damaging from a relationship point of view, but having a larger aggregate limit was advocated as a measure which would ease operational concerns regarding an evolution to the terms and conditions for GoC auctions whereby dealer staff inputting the dealer's bids and customers' bid would be segregated with no exchange of information possible.

On the subject of non-competitive bidding limits, market participants were largely of the view that these have a role and should be maintained, but that they would need to be increased from the current limit size of $3-5 Mn. However, these bids should not be allowed to constitute a material amount of the auctions. There were mixed views around the level such higher non-competitive limits should be set at, and whether they should remain dollar-size limits or become percentage limits. Most respondents did, however, state that these limits should be scaled by duration (e.g., smaller limits for ISINs with longer maturities).

Tactical Re-Openings of Off-the-Run GoC Securities

Most market participants were in support of the proposal to re-open off-the-run GoC securities that are exhibiting signs of being perpetually on special or “squeezed.” Respondents noted that such a facility could help resolve the issues surrounding the GoC securities of which the Bank of Canada currently owns a large proportion of, and that such operations could reduce the risk of potential liquidity issues developing in the future as well. Several respondents gave suggestions of criteria the Bank and the Government could consider when designing such a facility (e.g., the number of fails, how long an ISIN has been problematic, how far does the security trade in the repo market below the rate for general collateral). Many emphasized that the criteria for such operations should be clear to deter market participants from lobbying for tactical re-openings, and that the introduction and communications for this facility should be carefully managed to limit volatility. The Bank and GoC should also be aware of the scale of any problematic GoC securities and maintain a high bar for any re-opening.

Some firms did push back on this proposal. Objections included how the GoC and Bank should only intervene during crises and otherwise leave the market to function as is and that special GoC securities could be addressed by the Bank making more of its holdings of these bonds available via its repo or securities-lending facilities. Some wondered to what extent small re-openings would be able to meaningfully correct any problematic securities.

Other comments

Institutional respondents were in support of removing individuals from being eligible to request bidder identification numbers (BINs) to participate at GoC auctions. However, some participants and individuals noted that the ability for retail investors to access GoC securities (and not doing this via an Exchange Traded Fund or mutual fund) is both expensive and inefficient. Some suggested that Canada consider the potential of a system resembling the Treasury Direct program in the United States to provide a pathway for retail investors to purchase GoC securities at auction prices.

Several respondents suggested that Canada consider adopting single-price auctions, citing how these can promote participation from international investors with less expertise in the Canadian market. Given its smaller issuance sizes compared to some G7 peers, others advised against the idea to protect Canada from very large flows.