Debt Strategy 2005/06 Consultation Document

Overview

The government and the Bank of Canada are seeking views of Government Securities Distributors, institutional investors, and other interested parties on issues relating to the design and operation of the Government of Canada domestic debt programs for fiscal year 2005/06. This document focuses on the strategic direction of the domestic debt programs in light of evolving borrowing requirements and market trends.

These consultations are conducted in conjunction with the review of the Government of Canada debt distribution framework. The parties are invited to refer to the document Review of the Government of Canada Debt Distribution Framework for more background information and questions pertaining to the debt distribution framework.

As in previous years, a summary of the comments received will be released on the Bank of Canada Web site concurrently with the release of the 2005/06 Debt Management Strategy.

Context

The government's fiscal performance since 1995/1996 has resulted in a decline of annual net bond issuance and a reduction in the outstanding stock of government securities. To maintain a liquid market for government securities, the government has focused on maintaining regular issuance in key bond and treasury bill maturity sectors and building benchmark issues to target sizes that are established in consultation with market participants. Another key initiative supporting market liquidity has been the introduction of bond buybacks on a cash and switch basis to maintain the level of gross bond issuance despite lower borrowing requirements.

The 2004/05 Debt Management Strategy, published in March 2004, announced gross bond issuance of roughly $36 billion in the current fiscal year, compared to $39 billion in 2003/04. The outstanding amount of treasury bills is expected to increase from roughly $115 billion to approximately $130 billion in the current fiscal year. The plan reflects the borrowing requirements of the government and the decision to lower the fixed-rate share to 60 per cent over a medium-term horizon.

An important factor in helping to maintain the level of gross issuance in future years is the size of the bond buyback program. About $10 billion of bonds were bought back in 2003/04, while the planned amount of bond buybacks for 2004/05 is in the order of $11 billion. Analysis suggests that the stock of bonds available for repurchase could decline in the coming years as a larger proportion of outstanding bonds are concentrated in large benchmarks and one-time old benchmarks, which, under the current parameters of the program, are not eligible to be bought back. If the bond buyback program becomes smaller, reduced gross bond issuance or other adjustments to the debt programs may be required in future years.

Another important issue for the government and the Bank of Canada is transparency in the secondary market. Transparency pertains to the availability of trading-related information to market participants. Transparency enhances market liquidity and efficiency, and contributes to the well-functioning of the market.

One concern of market participants is the likely trade-off between greater transparency and the liquidity of the market. Given the relatively limited number of active dealers in the trading of fixed-income securities, the real-time posting of large-volume trades could potentially affect the ability of dealers to make active markets.

In previous consultations, market participants indicated that electronic trading systems have contributed positively to transparency, particularly for Government of Canada bonds. They indicated that improved transparency had benefited smaller institutional and retail investors, although it had not improved market depth. Transparency is discussed in more depth in the Review of the Government of Canada Debt Distribution Framework.

The following section consists of two parts: The first covers questions related to strategic issues on debt management and transparency, and the second part relates to operational aspects of debt programs.

Issues for Discussion

Strategic Issues

Bond and Bond Buyback Programs

1. If gross bond issuance continues to fall in the future as a result of changes in the debt structure, a weaker performance of the buyback program or further debt paydown, how should the government adjust its bond program? What are your views on the bond maturity mix? Which of the auction size, the benchmark size, and the time to build a new benchmark is most important to you? Do you have any other suggestions to help manage gross bond issuance?

2. What are the factors driving your participation at buyback operations? How do you see your participation evolving? What can the government do to encourage or broaden participation?

Transparency

3. While transparency requirements for secondary-market trading of corporate debt securities under the Canadian Securities Administrators' ATS Rules have been in force since January 2004, government debt securities have been granted an exemption until 2007. What are your views with respect to the dissemination of pre-trade and/or post-trade information (in terms of price, volumes and, timeliness) for benchmark Government of Canada securities?

4. How would the publication of more real-time information on government securities affect your business activities?

5. What else can be done to improve transparency in the Government of Canada bond market?

Operational Issues

Treasury Bill and Cash Management Bill Programs

6. In the context of a gradual reduction in the fixed-rate share of the debt, how has the market adapted to larger auctions of treasury bills and a larger outstanding amount of treasury bills? How has liquidity evolved as a result of these adjustments?

7. In September 2004, the government and the Bank of Canada announced the removal, on a trial basis, of minimum and maximum bidding limits at auctions of non-fungible cash management bills (CMBs) to allow dealers and customers to participate in CMB auctions to the extent of their interest. What do you think should be the minimum/maximum auction size and maturity for non-fungible CMBs under the new rules?

Bond Programs

8. With respect to the issuance of 30-year nominal bonds, why has the adoption of the 5.75% - 1 June 2033 maturity as the new long-bond benchmark been slower than in other maturity sectors? What steps could be taken to facilitate the adoption of new issues as future benchmarks?

9. Do you have any additional comments regarding the nominal bond or the Real Return Bond programs?

Buyback Programs

10. To help achieve planned levels of bond buybacks, the eligibility criteria for bonds included in the buyback baskets could be reviewed. Several options are under consideration.

    - In previous consultations, a number of market participants indicated that a reduction of the floor for Government of Canada bonds below the current threshold of $6 billion would hurt liquidity, especially for securities with maturities longer than 10 years. What are your views with respect to a reduction of the $6 billion floor for maturities of less than 10 years? For bonds with longer terms to maturity, should the government continue to target only specific previous benchmark bonds once the $6 billion floor is reached, or should the government reduce the floor for all previous benchmark bonds?

- Could the basket of eligible bonds be broadened to include off-the-run (one-time old) benchmark bonds?

- The deadline to submit bids at buyback operations on a cash basis is currently 1 p.m., which is 30 minutes after the deadline for submitting bids at nominal bond auctions. Since auction results are now released on a best-efforts basis, would you support advancing the deadline for submitting bids at cash buyback operations from 1 p.m. to 12:50 p.m.?

Turnaround Time

11. On April 1, 2004, the Bank of Canada began to release results for auctions and buybacks on a “best efforts” basis (i.e., when ready) to reduce the market risk for participants, thereby enhancing the efficiency of the auction and buyback process. This change has resulted in a significant reduction in turnaround time and has been well received by market participants. To what extent would you value further reductions in turnaround time for auctions? For buybacks?