Changes to the Bank of Canada's Framework for Financial Market Operations

A consultation paper by the Bank of Canada
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All comments should be received by 4 July 2015.

Background and Context

As Canada's central bank, the Bank of Canada conducts monetary policy and promotes the stability of Canada's financial system, two of its main areas of responsibility. The Bank undertakes a range of financial market operations through its regular operating framework in support of its policy objectives in these areas. The purpose of this paper is to provide interested parties with an opportunity to comment on a range of possible changes to this framework. No inferences should be drawn from these proposals about the current or future stance of monetary policy.

The Bank's framework for financial market operations includes transactions to: (i) reinforce the target for the overnight rate; (ii) provide liquidity to financial system participants; (iii) acquire and manage assets on the Bank's balance sheet; and (iv) make a portion of the Bank's government securities holdings available for securities lending when they are in high demand. In doing so, the Bank interacts with market participants using regular, or standing, facilities. The Bank also has a number of additional market-wide facilities at its disposal to provide liquidity to the financial system in exceptional circumstances.

The Bank's financial market operations are facilitated by and, in turn, influence the size and structure of the Bank's balance sheet. Some of the changes proposed in this consultation paper therefore relate to the composition of the assets the Bank holds and the way it acquires them.

The Bank has been reviewing its framework for market operations, for both routine and exceptional circumstances, to take account of lessons from the global financial crisis and the way the market environment is evolving. Factors being considered include changes in the ways financial institutions manage their liquidity needs; changing dynamics in core funding and government debt markets; the likely future growth in the stock of bank notes in circulation and hence in the size of the Bank's balance sheet; and a range of factors contributing to the persistent and widespread incidence of Government of Canada securities trading at repo rates well below the general collateral rate. In conducting the review, the Bank has looked at experience both in Canada and in other jurisdictions and at evolving operational practices at other major central banks.

Overall, the Bank believes that its framework for financial market operations has generally been effective in achieving its objectives, but that it would be prudent to make some enhancements in several areas. In some cases, changes are being proposed to routine operations. In others, the proposals relate to introducing new tools to help manage any future episodes of exceptional liquidity stress. A summary of the Bank's current framework for market operations and the proposed enhancements is provided in the Appendix to this paper. The underlying objective of the enhancements is to increase the effectiveness of the overall framework in response to the ongoing and expected changes in the external environment, while managing the Bank's market presence in an appropriate manner. Comments should be provided to Operations-consultation@bank-banque-canada.ca by 4 July 2015. Individual responses received by the Bank will be treated as confidential and

will not be published. However, the Bank may choose to issue a summary of the responses received after the consultation period has ended.

Refinements to the Operating Framework to Reinforce the Target for the Overnight Rate

The Bank's monetary policy objective is to preserve the value of money by keeping inflation low, stable and predictable. The Bank implements monetary policy by targeting the overnight rate, often referred to as the policy or target rate. The overnight rate is the interest rate at which major financial institutions borrow and lend one-day (or overnight) funds among themselves. The Bank uses the overnight repo rate on general collateral as a guide for conditions in the broader overnight market.

Key features of the Bank of Canada's framework for the implementation of monetary policy used to reinforce the target rate are[1]

- a 50-basis-point (bps) operating band around the target rate reinforced by standing deposit and liquidity facilities available to participants in Canada's Large Value Transfer System (LVTS) to deposit excess funds with the Bank (at the target overnight rate minus 25 bps) or borrow overnight funds from the Bank (at target plus 25 bps)
- the ability to set and adjust the aggregate level of settlement balances available in the system on a daily basis, and
- the discretion to conduct overnight special purchase and resale agreements (SPRAs) or sale and repurchase agreements (SRAs) if and as needed to reinforce the target overnight rate

In practice, the Bank has consistently achieved its objectives for the overnight rate, with deviations from the target being very small. Hence, the overall structure of the Bank's operating framework for the implementation of monetary policy has been working well and does not need to be changed significantly. However, some fine-tuning of the operational parameters is being proposed to further increase the effectiveness of the existing tools.

Proposed refinements to SPRAs and SRAs

To reinforce the target for the overnight rate when market rates deviate from it, the Bank can conduct repurchase (or repo) transactions at the target rate. When the collateralized overnight rate is generally trading above target, the Bank can intervene with SPRAs, whereby it purchases Government of Canada securities from primary dealers with an agreement to resell those securities the next business day.

[1] For more information, see "The Implementation of Monetary Policy in Canada" (July 2008), available at http://www.bankofcanada.ca/2008/07/discussion-paper-2008-9/; "A Primer on Canada's Large Value Transfer System" (March 2006), available at http://www.bankofcanada.ca/wp-content/uploads/2010/05/lvts_neville.pdf; and "A Primer on the Implementation of Monetary Policy in the LVTS Environment" (June 2010), available at http://www.bankofcanada.ca/wp-content/uploads/2010/07/lvts_primer_2010.pdf.

Conversely, if the collateralized overnight rate is generally trading below target, the Bank can intervene with SRAs, selling Government of Canada securities from its balance sheet with an agreement to repurchase them the next business day. In both cases, the transactions are currently conducted at the target for the overnight rate on a non-competitive basis, with each primary dealer having a fixed nominal amount of transactions that they can undertake in any given round.

The Bank typically intervenes in the overnight market if it judges that general collateral rates are deviating from the Bank's target because of generalized pressures on liquidity in the overnight market. The Bank will not intervene, however, if it observes higher market rates on transactions between some counterparties where it is believed that an additional spread is being charged to reflect the management of specific counterparty credit risk, or if the volume of transactions taking place at rates below or above target at a given point during the day is limited.

While repurchase and repo operations are only occasionally required to reinforce the target for the overnight rate, their effectiveness seems to have declined somewhat in recent years. This appears, at least in part, to be because the market's capacity to channel funds to entities that are in need of liquidity has become less effective, since direct counterparties of the Bank seem to have become less willing to borrow extra liquidity and redistribute it to other counterparties. Rather, decisions by institutions on whether or not to participate in these transactions when the Bank offers them seem to be mostly based on whether they themselves need the liquidity. The Bank is therefore proposing to change some of the parameters of its SPRA and SRA operations with the intent to increase the effectiveness of these operations when they are required, while still limiting the Bank's role in the intermediation of the overnight funding market.

The proposal is to change the allocation format of SPRAs and SRAs from operations where each counterparty can participate for a predetermined fixed amount at a fixed rate, regardless of the amount of participation by the other counterparties, to an auction format at competitive rates, with individual institutions being able to bid for a larger portion of the total operation, up to a given limit, than is currently the case. This change is expected to lead to larger amounts being typically taken up by some participants when SPRAs or SRAs are offered, thereby increasing the effectiveness and allocation efficiency of the operation by channelling more funds to the entities that need them most. An important feature of the proposed auction format is that SPRA and SRA transactions would take place at rates determined by competitive bidding, rather than always occurring at the target rate, as is currently the case. While auction clearing rates may thus be different from the target rate in some cases, the purpose of the intervention will still be achieved by changing the amount of liquidity provided in the overnight funding market and doing so in a more effective way. In practice, it is anticipated that the auction's average rate would typically be fairly close to the target rate, but it might deviate from it from time to time, depending on market conditions.

The Bank believes that interventions structured as proposed above are likely to have more influence on general market rates than the current structure of SPRAs and SRAs. At the same time, the Bank is

considering whether to allow for somewhat larger deviations in market pricing before it intervenes. Without Bank intervention through SPRAs or SRAs, the market should be confident that sufficient liquidity will typically be available in the system, since the Bank will usually be able to adjust the size of the afternoon Receiver General auction in order to meet the published target level of settlement balances. This would permit, for example, more scope for the market to clear itself without official intervention in situations where general collateral rates are deviating from the Bank's target rate, but not as a result of generalized pressures on liquidity in the overnight market.

The proposed new auction format for SPRAs and SRAs would have the following features:

Proposed Refinements

Special purchase and resale agreements/Sale and repurchase agreements	
Eligible participants	Primary dealers in Government of Canada securities—*No change.*
Eligible securities	Government of Canada securities—*No change.*
Size	The total amount offered per operation would be around $1.25–1.5 billion, somewhat larger than the current maximum aggregate limit. Operations would be conducted on a cash-value basis rather than on a nominal-amount basis, as they are currently structured.
Pricing	Competitive and discriminatory rate auction format with a minimum (maximum) bid rate set at the target for the overnight rate for SPRA (SRA) operations.
Term	One business day—*No change.*
Frequency	As required.
Limits	Individual counterparty limits set to some fixed percentage of the aggregate amount (e.g., 30 per cent). Limits for individual participants may be tiered, based on their market share in the primary, secondary and repo markets for Government of Canada securities.
Auction results	Auction results (total amount transacted and average winning bid rate) would be publicly disclosed on the Bank's website.

Questions for Consultation

SPRA/SRA Parameters

1. What are the potential effects of changing the pricing format of SPRA/SRA operations to a competitive and discriminatory rate auction format?

2. What implications, if any, of the proposed structural interventions in the SPRA/SRA overnight markets do you foresee for the behaviour of your firm or of other firms and for the overnight funding market more generally?

Potential tiered remuneration of LVTS settlement balances

The Bank seeks to achieve the desired level of settlement balances in the LVTS at the end of the day by transferring Receiver General deposits from its account at the Bank to financial institutions through twice-daily auctions of overnight and term deposits. However, in some instances, the system can end up with a larger-than-intended aggregate surplus position that cannot be fully offset by adjusting

settlement balances at the end of the day. This is often the case, for example, when the Bank intervenes in the overnight market to reinforce the target rate through one large round or multiple rounds of SPRAs. So, while the SPRA and SRA interventions are intended to be intraday interventions only, in practice, full neutralization of their effect on the level of settlement balances is not always feasible. Therefore, there is some uncertainty regarding how far the liquidity impact of these operations will be offset and, thus, whether the targeted level of settlement balances will be achieved. In such circumstances, some LVTS participants are left with excess funds that are deposited overnight at the Bank of Canada and compensated at the deposit rate (target less 25 bps), which can introduce late-day downward pressure on the overnight rate.

The Bank is considering whether compensating a portion of excess LVTS settlement balances at the target rate could help to alleviate some of the potential late-day downward pressure on the overnight rate. If the Bank were to implement this scheme, it would determine the aggregate amount of LVTS settlement balances eligible for compensation at the target rate, as well as each LVTS participant's share of this amount, or quota. Settlement balances beyond each LVTS participant's quota would be compensated at the deposit rate, as they are today. The Bank would reserve the right to adjust the method to determine the allocation parameters of the tiered remuneration, as required, to improve its effectiveness in maintaining the overnight rate close to the target.

It is expected that such a tiered remuneration of settlement balances for LVTS participants would help maintain the overnight rate close to target in situations where there are unintended, large, system-wide excess balances. However, it is expected that the scheme would be activated relatively infrequently, given that the system is not typically in a large surplus position at the end of the day. As happens now, the Receiver General afternoon auction would be the main tool to achieve the targeted level of settlement balances on a daily basis.

Questions for Consultation

Tiered Remuneration of LVTS Settlement Balances

1. Do you have any comments on the possible design and usefulness of tiered remuneration of LVTS settlement balances?

2. Would this change the way your firm or other participants manage their cash balances and, if so, how?

3. Given that the compensation of balances would depend on whether the system was in a larger-than-intended surplus position at the end of the day, would uncertainty about the compensation of balances affect your cash-management practices and, if so, how?

Proposed Changes in Support of Well-Functioning Markets

This section discusses the following issues: regular longer-term repurchase transactions (hereafter, term repos); secondary market purchases of Government of Canada bonds to reduce the Bank's primary market purchases of benchmark bonds; refinements to the Bank's existing securities-lending

program; and a Contingent Term Repo Facility as an additional tool for addressing any episodes of exceptional market-wide stress.

Term repos

Many central banks undertake some of their routine operations for liquidity provision at maturities beyond overnight and, in some cases since the crisis, they have chosen to expand their use of such operations. For reasons of prudent liquidity management, sometimes reinforced by regulatory requirements, banks and other market participants are tending to lengthen the term of their repo and other money market transactions. As described above, the Bank's framework for implementing monetary policy will continue to be based on influencing the overnight interest rate. However, this does not preclude conducting money market operations at longer maturities, provided such operations do not detract from the desired degree of influence on overnight rates.

Against this background, the Bank is proposing to conduct term repos as part of its regular market operations. It is envisaged that such operations would help the Bank's monitoring of liquidity conditions in term funding markets and encourage the further development of and liquidity in the longer-term repo market in Canada.

In addition, conducting longer-term repos would help reduce the need for the Bank to acquire Government of Canada securities outright for balance-sheet-management purposes. Currently, the Bank's assets consist almost entirely of Government of Canada nominal bonds and treasury bills acquired on a regular basis through purchases, on a non-competitive basis, at the government securities auctions conducted by the Bank as fiscal agent for the Government of Canada. The distribution of the Bank's portfolio broadly reflects the composition of the federal government's stock of domestic marketable nominal debt in terms of maturity distribution and the split between treasury bills and bonds.

Looking ahead, it is assumed that the size of the Bank's balance sheet will continue to grow in line with the value of bank notes in circulation, which has historically increased at a rate roughly equivalent to the growth in nominal GDP. Under the Bank's current Statement of Policy Governing the Acquisition and Management of Financial Assets for the Bank of Canada's Balance Sheet,[2] this would further increase the Bank's presence in the Government of Canada securities market over time. The Bank currently purchases a fixed 20 per cent share of each nominal bond auction for its balance sheet and, in some scenarios, that share would have to be raised further if no changes were made to the Bank's asset-acquisition policy. An increase in the Bank's participation at each auction would in turn further reduce the tradable float of Government of Canada securities in an environment of increasing investor demand for such securities, in part reflecting regulatory changes. Such a reduction would be expected to have some impact on the liquidity of Government of Canada securities.

[2] Available at http://www.bankofcanada.ca/wp-content/uploads/2010/07/statement_policy.pdf.

At present, the Bank is proposing to commence these term repo operations in the autumn of 2015 and to use a six-month phase-in strategy for reaching the currently envisaged steady-state portfolio of $7 billion to $10 billion in term repos.

Proposed Terms

Term repos[a]	
Outstanding amount	Total outstanding amount of $7 billion–$10 billion, to be accumulated over a six-month phase-in period beginning in autumn 2015.
Eligible participants	Primary dealers in Government of Canada securities.
Counterparty limits	Individual counterparty limits would be set based on the institution's share in the primary, secondary and repo markets for Government of Canada securities, up to a maximum percentage of the auctioned amount, and subject to the institution maintaining sufficiently high credit quality. It is currently envisioned that individual counterparty limits would be set at either 25 per cent or 15 per cent of the outstanding amount.
Eligible securities	Canadian-dollar-denominated securities issued or explicitly guaranteed by the Government of Canada and by provincial governments, including stripped coupons and residuals, subject to appropriate margin requirements under the Bank's existing policy on assets eligible as collateral under its Standing Liquidity Facility (available at http://www.bankofcanada.ca/wp-content/uploads/2014/03/SLF-Policy.pdf). Securities substitution would be allowed at fixed intervals, to be determined at a later date. Outstanding securities would be subject to margin calls under the Bank's existing margin-call practice (available at http://www.bankofcanada.ca/wp-content/uploads/2012/12/margin_call_practice_domestic_operations.pdf).
Pricing and type of auction	The interest rate on term repos would be set by means of competitive auction at market rates, subject to a minimum bid rate based on overnight index swap rates for equivalent maturities, as determined by the Bank. Operations would be conducted on a cash-value basis.
Term	Typically 1- and 3-month terms, but could be varied at the Bank's discretion, depending on market circumstances and the Bank's needs, such as dealing with temporary seasonal increases in the demand for bank notes.
Frequency	Regularly, on a biweekly basis, but could be varied at the Bank's discretion, depending on market circumstances and the Bank's needs, such as dealing with temporary seasonal increases in the demand for bank notes.
Communication	Upcoming operation dates to be announced in advance. Results to be published on the Bank's website will include minimum, maximum and average rates, as well as the total amount of term repos transacted.

[a.] As with all Bank facilities, the operating parameters of this term repo program (counterparties, terms, limits and collateral) would be subject to change at the discretion of the Bank.

Questions for Consultation

Term Repos

1. Do you have any comments or suggestions on the specific design parameters proposed for the new operations (e.g., size, security eligibility and substitution, term, frequency, minimum bid rate, or disclosure of results)?

2. What would be the likely impact of the Bank conducting regular longer-term repos on activity in the overnight and longer-term repo markets in Canada?

3. What considerations would be important to your firm if National Housing Act Mortgage-Backed Securities were to be treated differently from other securities eligible for regular repo operations to account for the interest and principal repayment flows (e.g., return interest and principal repayment flows rather than retain them)?

Secondary market purchases of Government of Canada securities to reduce primary market purchases

The introduction of regular term repos, as proposed above, would reduce somewhat the amount of government bonds that would be held outright on the Bank's balance sheet. However, the Bank judges that further steps to reduce the Bank's holdings of benchmark bonds would also be desirable, given the important role these securities play in pricing and hedging a variety of other cash and derivatives instruments.

The Bank is therefore proposing to shift some of its purchases of Government of Canada bonds from the acquisition of benchmark issues in the primary market to secondary market purchases of what would generally be non-benchmark Government of Canada securities, which would help increase the tradable float of benchmark Government of Canada securities. These purchases would be conducted through a reverse auction mechanism similar to the bond buyback operations the Bank already conducts as fiscal agent for the Government of Canada. The purchases would be structured in a way that limits adverse impacts on the functioning of the Government of Canada securities market, consistent with the operational guidelines of neutrality, prudence and transparency that are currently applied under the current Statement of Policy Governing the Acquisition and Management of Financial Assets for the Bank of Canada's Balance Sheet. The Bank's holdings of Government of Canada securities would continue to be made available through securities-lending operations in accordance with the methods under the existing program, subject to the proposals in the section on securities lending, below.

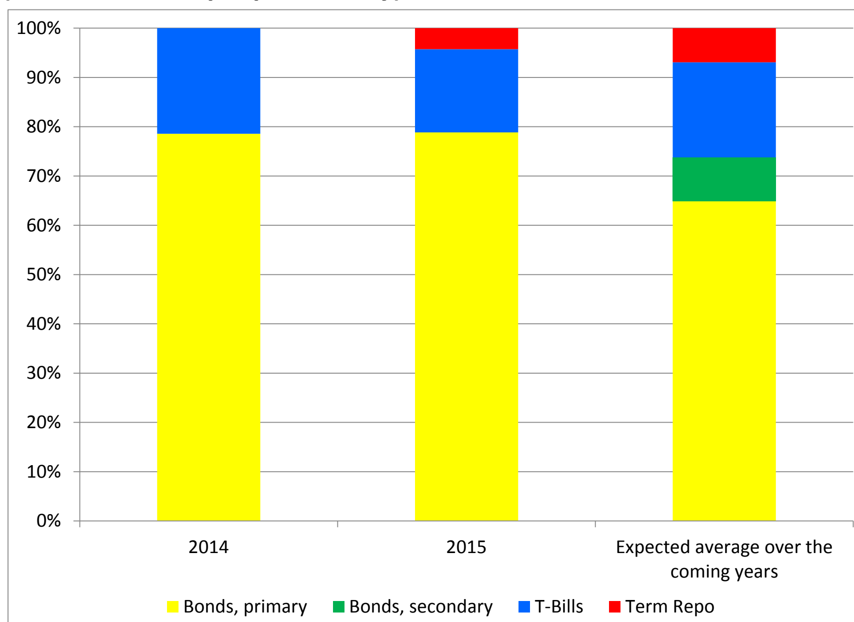
The intent is for the combination of secondary market purchases and regular term repos to reduce the Bank's purchases of benchmark bonds at primary auctions from 20 per cent of the amount being issued to around 10 per cent.

Proposed Terms

Secondary market purchases of Government of Canada securities	
Operation size	$500 million or lower per operation.
Operation type	Buyback operation based on multiple-price competitive auction.
Frequency	Weekly or biweekly; currently expected to commence toward the second half of 2016. More precise timing to be confirmed at a later date.
Maturities	Individual operations will typically focus on bonds within a given maturity range.
Eligible participants	Primary dealers and government securities distributors in Government of Canada securities, and clients (via a dealer) that have been approved to participate in Government of Canada securities auctions.
Eligible securities	Canadian-dollar-denominated Government of Canada nominal bonds, with a focus on non-benchmark securities. The Bank may limit its total holdings of individual securities to some percentage of the amount outstanding (e.g., 25 per cent). The Bank would abstain from purchasing individual securities if such purchases are believed to be detrimental to market functioning. For example, the Bank might choose not to purchase current, upcoming or recent benchmark bonds and securities that are trading deeply "on special" in the repo market or have been experiencing a high level of settlement fails.

The anticipated impact on the Bank's balance sheet from the proposals in this section is illustrated in **Chart 1**, below.

Chart 1: Estimated composition of the Bank of Canada's assets (for illustrative purposes only)



Questions for Consultation

Secondary Market Purchases of Government of Canada Securities

1. What would be the impact on the benchmark and non-benchmark segments of the Government of Canada securities market of the proposed reduction in the Bank's participation at nominal bond auctions and proposed secondary market purchases?

2. What measures or parameters should be included to minimize any potential negative effects of the secondary market purchases on market functioning?

Securities-lending program

Since 2002, the Bank has operated a securities-lending program, under which it can lend to primary dealers a portion of its holdings of Government of Canada securities when a specific bond or treasury bill is in high demand and is unavailable, or is trading below a certain threshold in the repo market. This program is intended to provide a secondary source of securities to support a well-functioning market for Government of Canada securities and is designed to support efficient clearing and price discovery in the market under normal conditions without interventions from the Bank.

Since 2013, a growing number of Government of Canada bonds have been trading persistently "on special," at repo rates well below the overnight general collateral rate. As a result, given the current parameters, the use of the Bank's securities-lending program has increased considerably. Repo tightness typically reflects an imbalance between the demand for and availability of certain securities in the repo market. Protracted repo tightness can affect the cash prices of these bonds and contribute to a reduction in market liquidity. It can also lead to an increase in settlement fails.

Several structural and cyclical factors have been at play in causing this more widespread and persistent repo tightness, including increased foreign ownership of Government of Canada bonds; greater demand for high-quality assets (partly to meet regulatory requirements); changes in the activities of financial institutions in the repo and securities-lending markets; and lower financial incentives to lend out bonds, given low interest rates. More frequent instances of repo tightness are not exclusive to Canada, and the reasons for this suggest that the situation is not likely to change significantly in the foreseeable future. The Bank is limited in its capacity to offset the combined impact of the various factors affecting the repo market, not least because the size of the Bank's portfolio available for lending is not necessarily sufficient to meet demand. In addition, the Bank's general preference is to allow the market to clear through the operation of market forces, with the Bank acting as a secondary source of securities only. However, the Bank is proposing to take some steps that, at the margin, are expected to help improve market functioning.

As discussed above, the Bank is proposing to reduce its purchases of Government of Canada securities at auction, which should lead to an increased supply of benchmark securities in the market. The Bank is also proposing changes to the terms of its securities-lending program that would help support

market liquidity while respecting the intended temporary and secondary nature of the program. One modification being proposed is to change the effective intervention threshold from the current 50 per cent of the Bank's target rate to the following formula:

- a constant spread of 50 bps below the target for the overnight rate when the target is 1 per cent or lower
- a threshold of half the level of the target for the overnight rate when the latter is above 1 per cent and below 4 per cent
- a constant spread of 200 bps when the target rate is 4 per cent or higher

This change could provide holders of Government of Canada securities with a greater financial incentive to lend out their securities before the Bank's securities-lending program is triggered. At the moment, it appears that the Bank's intervention threshold is setting the de facto floor for market repo rates. In some circumstances, however, that rate does not seem to be low enough to induce sufficient lending from private sector bondholders to meet demand. Therefore, a lower intervention threshold could help the market to clear, while the Bank's program would remain available to primary dealers as a backstop.[3]

The Bank could also change certain other operational parameters, such as the time and frequency of the operations (e.g., moving the operation to the afternoon or introducing the possibility of a second round toward the end of the day), or it could investigate the possibility of lending securities for terms longer than overnight.

Finally, the Bank is also seeking feedback on whether a broadly adopted trade settlement fail fee for Government of Canada securities would help encourage securities holders to lend their securities. Such a fee was introduced in the U.S. Treasury market in 2009, and the Bank currently imposes such a fee in its own securities-lending contracts. At the moment, however, such fees do not exist in relation to private sector repo contracts and cash trades in Canada. The main objective for adopting a market-wide fail fee would be to help reduce the risk of significant settlement fails and provide investors with additional financial incentives to lend securities that are in short supply.

While settlement fails are currently not a persistent problem in Canada, experience in other countries suggests that, under certain market conditions, a spike in settlement fails could impede the functioning of the government bond market. Currently, a typical market convention for trades that do not settle is to postpone settlement to the next business day at an unchanged transaction price. Assuming that the trade settles on the next business day, the opportunity cost incurred from postponing settlement in this manner is one day's interest. However, this convention may not always provide enough financial incentives for a seller to deliver a security to a buyer. The option of failing to deliver a security without incurring a significant financial penalty becomes more attractive when rates are comparatively low, but

[3] The revised proposal would also make the threshold identical for both treasury bills and bonds.

a fail fee could, in principle, be an effective way to increase the financial incentives to lend bonds, regardless of the level of interest rates.

Questions for Consultation

Securities-Lending Program

1. What would be the impact of the proposed change to the intervention threshold for the securities-lending program?

2. What additional changes to specific terms of the securities-lending program would help the program achieve its objective?

3. What are the main factors behind tightness in the repo market for Government of Canada securities?

4. Would a market-wide settlement fail fee for Government of Canada securities be effective in providing greater incentives to lend scarce securities and avoid settlement fails?

Contingent Term Repo Facility

In response to severe market-wide liquidity stress, the Bank retains the ability to launch any of the facilities used during the financial crisis or to introduce new ones to deal with the situation at hand. [4] The regular program of term repos proposed in the section above could also be expanded along various dimensions to provide liquidity if system-wide conditions warranted.

In addition to the facilities already at its disposal, the Bank is proposing to create a Contingent Term Repo Facility (CTRF) to enhance its ability to respond to any future episodes of intense market-wide stress. Activation and deactivation of the CTRF would be at the Bank's sole discretion, as conditions warrant, and would be intended to be used only to deal with severe market-wide liquidity stress. This facility would not be used to address idiosyncratic liquidity shocks at individual institutions.

If activated, the CTRF would offer liquidity for customized variable terms of up to one month to a range of counterparties against a broad set of eligible securities at a fixed price. The specific parameters of the facility would be confirmed upon activation. It is anticipated that, if the CTRF were activated, the counterparties eligible for the facility would be primary dealers and their affiliates. However, the range of eligible counterparties for this facility could be extended, at the Bank's discretion, to include other institutions should the Bank deem it necessary to support the stability of the Canadian financial system. These other institutions would need to demonstrate significant activity in the Canadian money and/or bond markets, be subject to federal or provincial regulation and meet any other conditions the Bank believed to be warranted.

[4] A list of the Bank's liquidity facilities is available at http://credit.bankofcanada.ca/facilities/liquidityfacilities.

If the CTRF were activated, liquidity would be offered against a broad range of the securities eligible under the Bank's Standing Liquidity Facility, such as securities issued or guaranteed by the Government of Canada and provincial governments; municipal securities; and certain private sector securities, including corporate bonds, bankers' acceptances and asset-backed securities.[5] Once activated, the CTRF would function as a bilateral standing facility that, subject to the availability of eligible collateral, counterparties would be able to access, as needed, at an appropriate spread over the target for the overnight rate or the relevant reference rate based on the term of the transaction, as determined by the Bank. The CTRF would remain active until the Bank judged that it was no longer necessary to support market-wide financial stability.

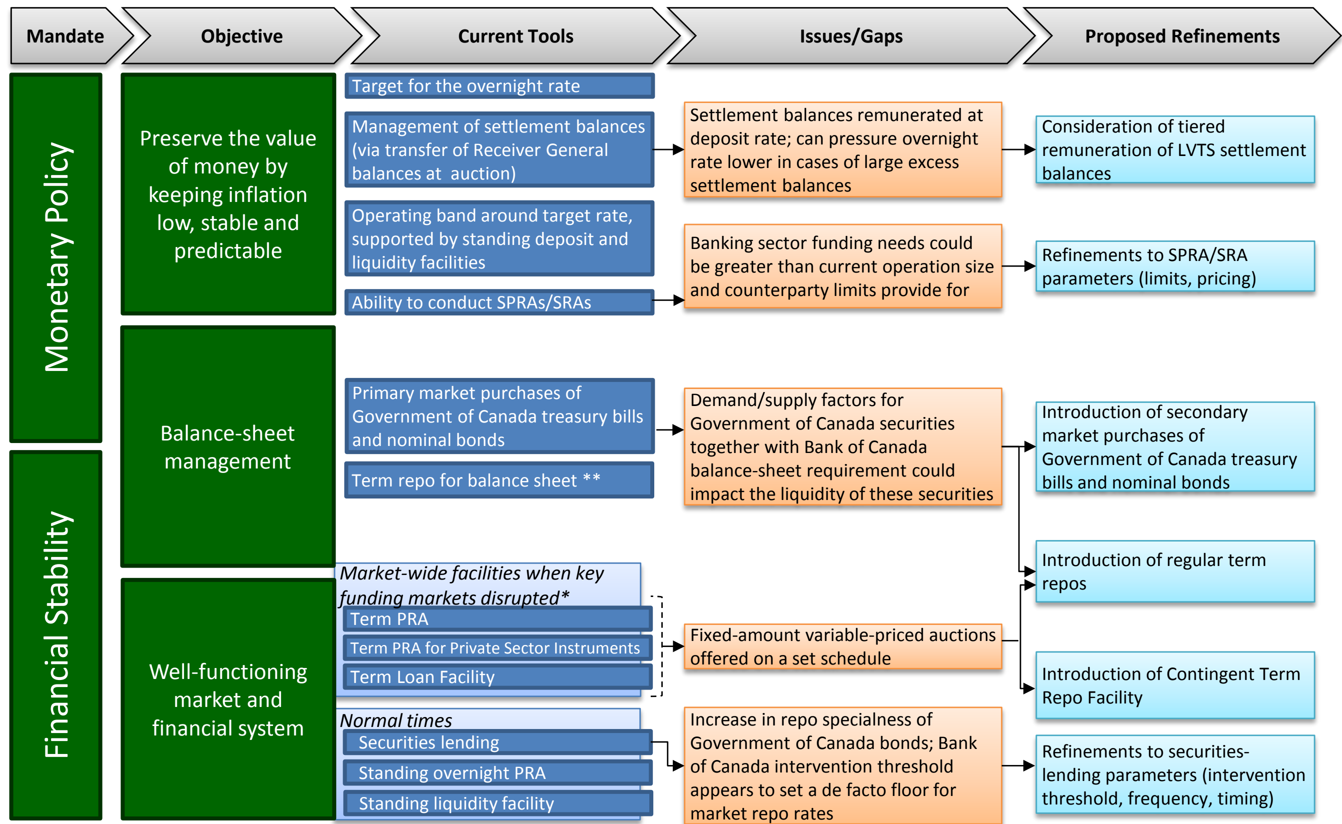
Question for Consultation

Contingent Term Repo Facility

1. How useful would the proposed Contingent Term Repo Facility be as an additional tool for the Bank to have available to deal with severe market-wide liquidity stress?

[5] A list of the assets eligible under the Standing Liquidity Facility is available at http://www.bankofcanada.ca/wp-content/uploads/2014/03/SLF-Policy.pdf. It is envisaged that some assets eligible under the Standing Liquidity Facility, such as non-mortgage loan portfolios, would not be eligible under the CTRF.

Appendix: Simplified Illustration of the Bank of Canada's Framework for Financial Market Operations and Proposed Refinements



* These were temporary facilities activated during the financial crisis.

** This operation has historically been used to meet seasonal fluctuations in bank note demand (e.g., holiday seasons).