CANADIAN FIXED-INCOME FORUM

SUMMARY OF THE DISCUSSION

Toronto, 7 October 2015, 4 p.m. to 6 p.m.

1. Objectives of the Canadian Fixed-Income Forum

Members were welcomed to the inaugural meeting of the Canadian Fixed-Income Forum (CFIF), and the objectives, structure and organization of the group were introduced. CFIF will function similarly to the European Central Bank's Bond Market Contact Group and the Federal Reserve's Treasury Market Practices Group. Public disclosure of the Forum's membership, agendas, presentations and meeting summaries will be posted on the CFIF web page on the Bank of Canada's website.

The four main goals proposed were: i) enhance the efficiency and resilience of the Canadian fixed-income market; ii) improve the quality, clarity and market-wide understanding of Canadian fixed-income trading practices; iii) evaluate and propose changes to market infrastructure; and iv) communicate any recommendations and analysis to oversight authorities, regulators, industry groups and other market participants as needed. The objectives and organizational structure will be approved and finalized based on feedback from members.

2. Future Discussion Topics

Topics for future meetings suggested by the members were presented to prioritize work for 2016. The primary focus of the discussion was liquidity, including analyzing the impact on liquidity of the interlinkages in the fixed-income market and measuring the impact of regulatory changes on market functioning. There was broad agreement on using member surveys to better analyze these types of issues. Topics for 2016 will be finalized at the next meeting.

3. Liquidity in the Canadian Fixed-Income Market

i) Results of the market liquidity survey

The secretariat presented the results of the informal CFIF member survey on market liquidity. According to members: i) most Canadian fixed-income instruments have experienced a reduction in liquidity over the past two years, with the most prominent declines occurring in corporate bonds; ii) the most significant drivers of declining liquidity were regulation and reduced dealer market-making capacity, although a broad range of factors was cited; iii) liquidity has become more fragile or volatile; and iv) the reduction in Canadian fixed-income liquidity appears to be linked to a general global trend of a reduction in liquidity across all financial markets. According to the responses, most members were very concerned about the amount of liquidity that would be available during periods of market stress and the impact that would have on market confidence.

Some concerns that liquidity would continue to decline were shared. It was noted that there had been a move away from principal-based trading toward agency-based trading, largely driven by changes in the regulatory framework. According to some participants these changes have led to a decline in the profitability for principal-based dealer intermediation.

The survey showed the perceived level of liquidity in benchmark government bonds to be greater than in the associated futures. Some members attributed this finding to the difference in the width of bid-offer spreads. This is because the wider bid-offer spread associated with benchmark cash bonds better absorbs the impact from large transactions than the narrower spread quoted on the futures exchange.

There was no consensus among the members as to how to define an appropriate level of liquidity. However, several members agreed that liquidity may have been underpriced in the 2006–07 period.

ii) Liquidity in the Government of Canada bond market

Various potential liquidity metrics for the GoC bond market were presented by the Bank of Canada. The presentation focused on two main areas: i) trading of GoC securities, including issuance and volumes; and ii) foreign flows into the Canadian market.

There was skepticism among members regarding the liquidity of GoC instruments depicted in the data. In contrast to some of the analysis, which showed there had only been a recent deterioration in liquidity, some members believed that liquidity in GoC bonds had been deteriorating over a longer time frame and was now at its lowest level since the crisis. Some of this skepticism was attributed to the failure of the trading data to distinguish GoC trading driven as a consequence of other activities (e.g. to facilitate corporate trading) or to account for the adjustments that market participants have had to make to the way they trade. As a result, members felt that the data overstated the actual level of GoC liquidity, but overall agreed that the measurement of liquidity was difficult to evaluate. Members suggested analyzing interdealer broker and CanDeal data to better illustrate liquidity in the market.

4. Impact of Declining Liquidity and Regulatory Changes

The buy-side described having to adjust their trading strategies in the current economic environment. Trading strategies were increasingly described as macro-based rather than tactical. Members were especially concerned with the level of liquidity in the corporate bond market in light of the large increase in net corporate issuance, with some members saying that they were purchasing corporate bonds assuming that they might have to hold them to maturity. Members also noted that the global consolidation of the buy-side had resulted in trades becoming "chunkier" at the same time as the risk appetite of intermediaries had declined.

Sell-side members noted an increased focus on balance-sheet efficiency as a result of various regulatory changes. Members acknowledged that regulations were reducing the systemic risks in the financial system, but that they were also redistributing liquidity risk from traditional market-makers to investors. After the meeting, the following documents related to this topic were circulated electronically to members:

- [IMF Global Financial Stability Report Chapter 2: Market Liquidity – Resilient or Fleeting?]
- [CSA Request for Comment 21-315 on Next Steps in Regulation and Transparency of the Fixed Income Market]
- [US Joint Staff Report on the US Treasury Market on October 15, 2014]
- [BIS CGFS paper on market-making and proprietary trading]

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

Following the liquidity discussion, changes announced on 30 September 2015 to the Bank of Canada's framework for financial market operations were presented. The changes were designed to take into account the lessons learned from the global financial crisis and the changing market environment. For more information on the changes, please click here.

6. Other Items

The co-chairs welcomed the creation of the Forum and provided concluding remarks. They emphasized that the CFIF would provide a valuable opportunity to address issues related to the functioning of the Canadian fixed-income market and to improve the dialogue between market participants and policy-makers.

The next meeting will be held in Toronto on 25 January 2016.

List of Attendees

Market Representatives
Jean-François Pépin, Addenda Capital
John McArthur, Bank of America Merrill Lynch
Michael Taylor, BlueCrest Capital Management
Chris Beauchemin, British Columbia Investment Management Corporation
Marc Cormier, Caisse de dépôt et placement du Québec
Roger Casgrain, Casgrain & Company
Chris Kalbfleisch, Connor, Clark & Lunn Investment Management
Martin Bellefeuille, Desjardins Securities
Daniel Bergen, Great West Life Assurance Company
Murray Shackleton, Manufacturers Life Insurance Company
Daniel Duggan, National Bank Financial
Jason Chang, Ontario Teachers' Pension Plan
Jim Byrd, RBC Capital Markets
Andrew Branion, Scotiabank
Mike Donnelly, TD Securities

Bank of Canada
Lynn Patterson (Co-chair)
Toni Gravelle (Co-chair)
Harri Vikstedt

Paul Chilcott
Grahame Johnson
Eric Tuer
Maksym Padalko
Samantha Sohal