Update from the GoC Market Functioning Steering Group (GMF)

Sep 15, 2020

Agenda

Background

Update on GMF's recent work

GMF recommendations on next steps

Background

Recap: GMF mandate and background

❖ The GMF mandate:

– Study and design a framework for supporting GoC market functioning in a low-rate environment (**Design Phase**) and present design recommendations to CFIF

   • Framework to include a financial incentive mechanism for timely settlement

– Pending endorsement and further direction from CFIF, take steps to implement the framework (**Implementation Phase**)

❖ Factors precipitating the GMF's work:

– Bank research has demonstrated that the overnight rate caps the special spread

   • diminished financial incentives to deliver GoC securities when interest rates are low may affect market clearing and participation in cash and securities financing markets for GoC bonds

– Industry acknowledged that setting up and calibrating a framework in advance is preferable to rushing measures into place during a time of market stress

– Market participants also see the possibility that the framework could improve market discipline outside of low-rate environments

Analysis of GoC cash bond trade fail rate

Methodology:
- Daily cash fails as a percentage of cash trade settlement volume (from MTRS2)
- All GoC bonds included, pending trades filtered out
- Fails identified as recurring only included on the first fail date

CDSX Cash Fails as a Percentage of MTRS2 Cash Volumes



%Volume Failed — 5DMA Rate
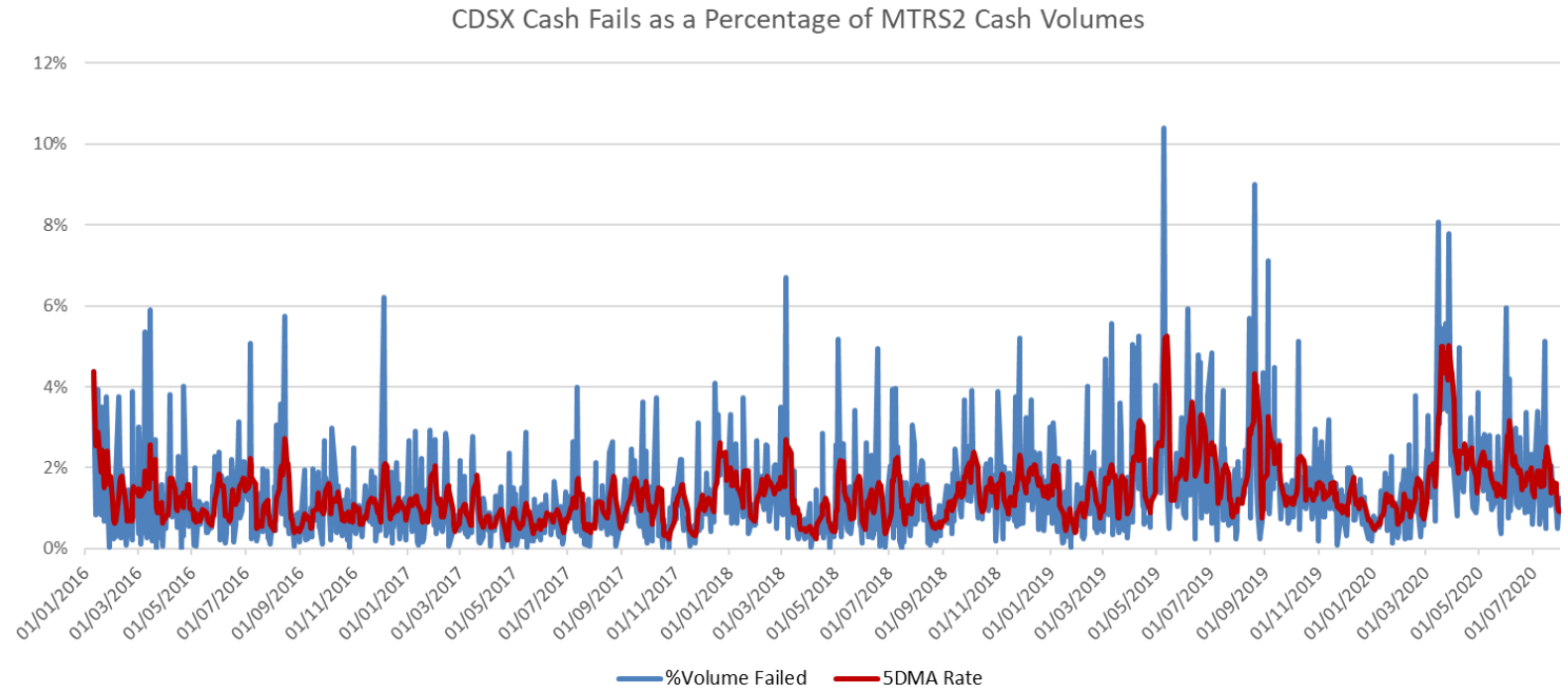
- Average cash fail rate over sample period is 1.4%
- Elevated and persistent fails have not been a problem in Canada to the same extent as in other jurisdictions, but spikes do occur: daily fail rate spikes in the 4-10% range occur with some regularity
- The *total volume* of failed GoC cash bond trades also spiked in March, and constitutes the largest spike in our dataset
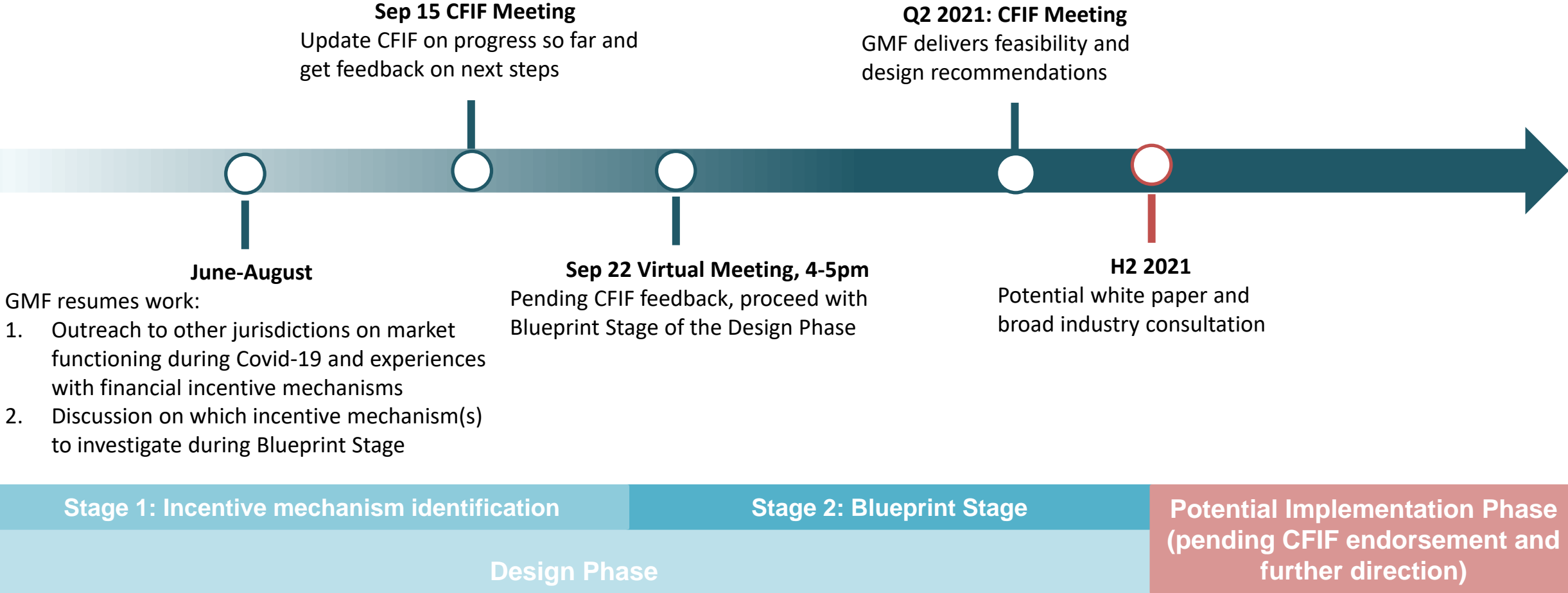
Analysis of GoC repo trade fail rate

Methodology:
- Daily repo fails as a percentage of repo settlement volume (from MTRS2)
- Other filters same as for cash fails analysis

CDSX Repo Fails as a Percentage of MTRS2 Repo Volumes
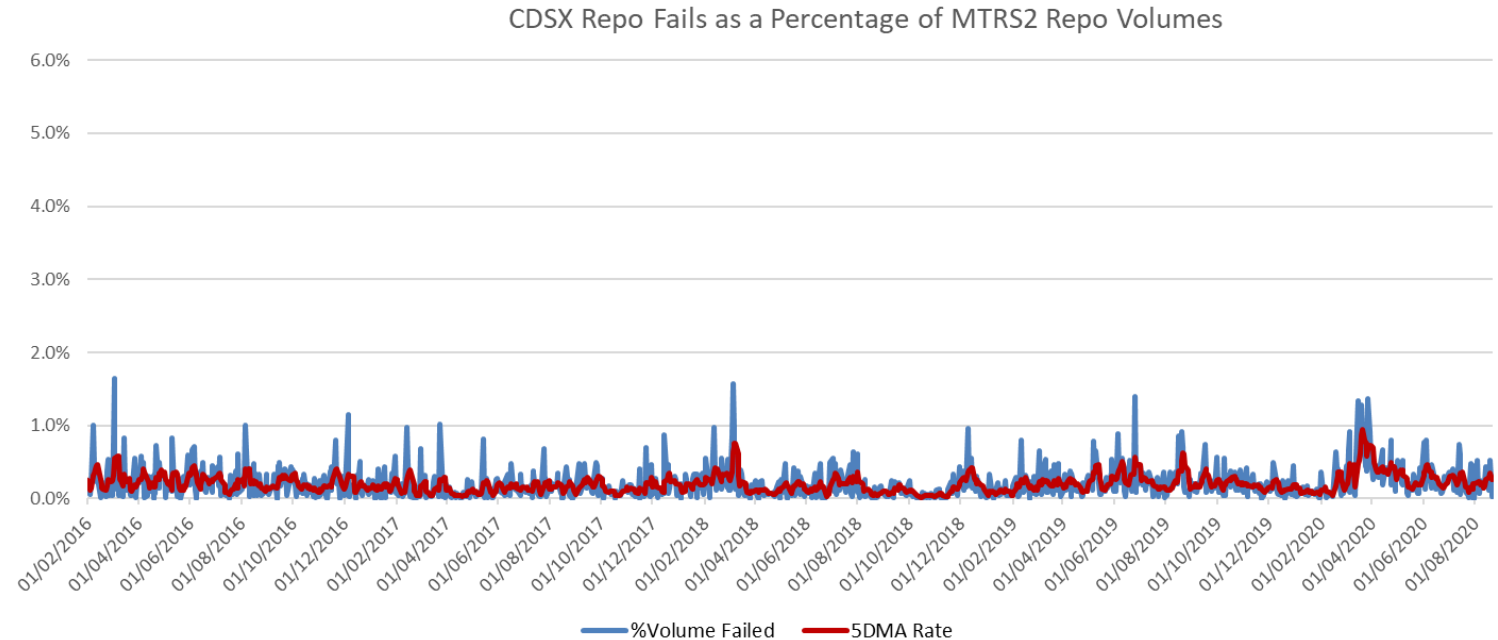
- Average repo fail rate over sample period is 0.21%
- Daily fail rate spikes in the 1% range occur with regularity

Update on GMF's recent work

The GMF is concluding Stage 1 of the Design Phase

Sep 15 CFIF Meeting
Update CFIF on progress so far and get feedback on next steps

Q2 2021: CFIF Meeting
GMF delivers feasibility and design recommendations

June-August

GMF resumes work:
1. Outreach to other jurisdictions on market functioning during Covid-19 and experiences with financial incentive mechanisms
2. Discussion on which incentive mechanism(s) to investigate during Blueprint Stage

Sep 22 Virtual Meeting, 4-5pm
Pending CFIF feedback, proceed with Blueprint Stage of the Design Phase

H2 2021
Potential white paper and broad industry consultation

Stage 1: Incentive mechanism identification	Stage 2: Blueprint Stage	Potential Implementation Phase (pending CFIF endorsement and further direction)
Design Phase		

Takeaways from jurisdictional outreach and GMF recommendations on framework design

❖ Major key jurisdictions have been analysing and adopting measures to address settlement fails over the past decade

❖ Jurisdictions have adopted different approaches, but generally a strong framework has several pillars:

Financial incentive mechanism
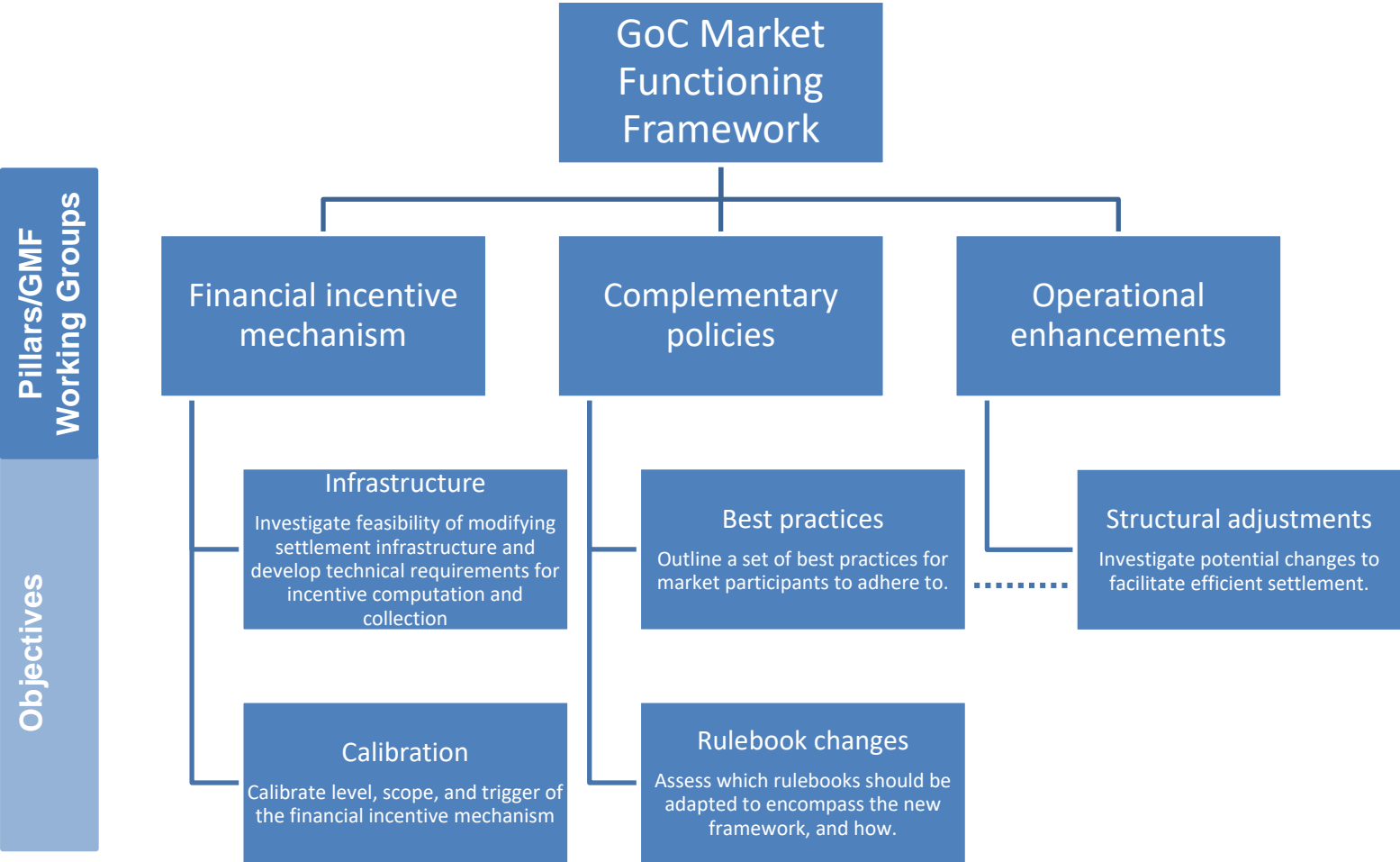- E.g., fail fee, mandatory buy-ins

Complementary policies
- E.g., TMPG best practices, AFMA code of conduct

Operational enhancements
- E.g., changes in cut-off times for settlement in Japan; harmonization of settlement conventions in the EU

❖ GMF members consider an approach that incorporates the three pillars as a useful backbone in the proposed Blueprint Stage of the Design Phase

Possible approach for the framework in the Blueprint Stage

Pillars/GMF Working Groups

Objectives

GoC Market Functioning Framework

Financial incentive mechanism

Complementary policies

Operational enhancements

Infrastructure
Investigate feasibility of modifying settlement infrastructure and develop technical requirements for incentive computation and collection

Best practices
Outline a set of best practices for market participants to adhere to.

Structural adjustments
Investigate potential changes to facilitate efficient settlement.

Calibration
Calibrate level, scope, and trigger of the financial incentive mechanism

Rulebook changes
Assess which rulebooks should be adapted to encompass the new framework, and how.

The "Blueprint" deliverable to CFIF:
- A document on feasibility and design recommendations for a framework
  - Objectives for each pillar of the framework are shown in the diagram
- Overall, a high-level approach, but for each pillar also tackling questions on:
  - Operational considerations
  - Cost to implement
  - Timeline to build

GMF recommendations on next steps

GMF recommendations for the Blueprint Stage

❖ Members discussed two incentive mechanisms and two approaches of how the mechanism(s) could work:

– Mechanism type: fail fee or mandatory buy-ins

– Approach:

- exclusive – either a fail fee or mandatory buy-ins serve as the sole incentive mechanism
- hybrid – both a fail fee and mandatory buy-ins are part of the framework

❖ The GMF is making the following recommendations:

1. Work should **move forward into the Blueprint Stage** with feasibility and design recommendations (the "Blueprint") delivered to CFIF in Q2 2021 for endorsement and further direction

2. The **fail fee** should be further investigated as the sole incentive mechanism in the Blueprint Stage

3. In developing the blueprint, **thought should be given to how the framework could be staged:**

- Should certain components of the framework be implemented/activated before others?
- Could components apply in a graduated manner, e.g., depending on the persistence of failed transactions?

Do CFIF members support the GMF's recommendations?

Thank you