SUMMARY OF THE DISCUSSION

Toronto, November 29, 2022, 4:00 p.m. to 6:00 p.m.

1. Introduction

The co-chairs welcomed TJ Sutter, Macro Portfolio Manager, Fixed Income, Connor, Clark & Lunn, and Elaine Lindhorst, Vice President & Director, TD Asset Management to the Canadian Fixed Income Forum. The co-chairs also informed members that Sandra Lau, Greg Moore, and Graeme Robertson will be leaving the Forum. The co-chairs expressed their gratitude to Ms. Lau, Messrs. Moore, and Robertson for their contributions to the Forum.

2. Recent bond market developments

The session began with two members discussing the impact of central bank actions on banks and market functioning. A combination of delayed repricing of commercial loan spreads and market volatility-driven challenges faced by corporations trying to raise funds through capital markets resulted in material growth of loan assets on commercial bank balance sheets. In light of higher bank funding costs and pressure from increased capital requirements, attention has now shifted from growing assets to managing funding and optimising balance sheet and capital usage. One potential outcome of this is to reduce the dealers' ability to provide liquidity in fixed income markets.

Members were asked how current liquidity conditions in the Government of Canada securities market compared to the peak of the stress period in 2020. Although liquidity has declined and despite some CFIF liquidity indicators showing worsening liquidity, members agreed that current conditions are nowhere close to the extreme low levels reached back in March 2020. In fact, members were somewhat surprised by the orderly unwinding of risky assets in general, while recognising there were pocket of stress (e.g., UK Gilts market), and are actively monitoring for the next stress event.

There was a discussion on how current level of interest rates may affect investors' view on risk-adjusted returns, particularly for private assets. Some members thought a sustained elevated level of interest rates may lead investors to rebalance their exposure away from less liquid private debt into more liquid public debt markets.

Members also discussed the potential impact of geopolitical risks on fixed income markets. Most think the current geopolitical tensions may exacerbate or prolong supply chain issues and potentially increase inflation risks.

The discussion then turned to the government's recent announcement to cancel issuance of real return bonds (RRB). The Bank of Canada, respecting its role as fiscal agent for the government, recused itself from the RRB announcement discussion. The following minutes reflect comments made by the private sector CFIF members.

CFIF members disagreed with the Government's reasons to stop the issuance of RRBs. All strongly agreed that inflation indexed-linked bonds are a very important asset class that serves a crucial role in allowing Canadian investors to manage their exposure to inflation and, in a well-functioning market, provides central banks and market participants with an important market measure of inflation expectations. With the decision to eliminate new RRB issuance, market participants lost a way to express their inflation views and some members enunciated that the decision may create a perception that the government may not have full confidence in containing inflation.

For retail and institutional investors, the cancellation removes a risk-free security that helps them manage short and longer-term inflation risks. Several members noted that demand for RRBs has increased across the curve in the current higher inflationary environment and is expected to increase further with the aging Canadian population. They also pointed to the fact that Canada is now the only G7 country not issuing new sovereign inflation index-linked bonds.

Members disagreed that liquidity for RRBs was an issue material enough to cancel the program. Most noted that while it is somewhat worse than liquidity for nominal GoC bonds, they are still able to transact in quantities they need. Some members felt that RRB liquidity is generally better relative to inflation index-linked bonds in several other jurisdictions, for example, in the UK.

Many members also expressed major concern with the governance process supporting the decision by the government, noting the lack of consultation, and transparency around the decision. This is seen as inconsistent with the government's stated objective to promote transparency and predictability of its borrowing program. A member noted that the Department of Finance had just completed a Debt Management Strategy consultation and no questions were related to the cessation of RRB issuance. As well, members disagreed with the characterization of the RRB market in the "2022 Fall Economic Statement" and in other government commentary with regards to low demand for RRBs, saying that it was overly negative and not an accurate reflection of industry views.

Several members mentioned that the decision has left insurance companies, pension funds and asset managers that offer inflation-linked financial products, and by extension their Canadian clients in a difficult situation. These products, which include mutual funds and ETFs, will become more costly to hold and trade as liquidity has now substantially declined in RRBs. These cost increases could have potentially been minimised if both buy and sell-side businesses had sufficient warning to plan for the change in RRB issuance. The industry must now consider eventually withdrawing the mutual funds and ETFs, which would hurt Canadians' capacity to protect their savings from the costs associated with inflation.

Many felt that the bypassing of the usual governance process, and in particular, the lack of investor consultation, could ultimately contribute to an erosion in the trust that market participants have in Canada's debt management practices. Some felt that the combined impact of the unexpected cancellation of ultra long bonds auction earlier this year and this decision could lead to less demand or participation in the whole GoC bond market going forward, and ultimately resulting in higher borrowing costs for the government than any potential cost savings it could get with the cessation of RRB issuance.

Members unanimously agreed that the government should reconsider the decision to cancel RRB issuance and to continue efforts to maintain a well-functioning market for Government of Canada securities. Many also suggested that more efforts should be made to educate investors on the benefits of the product and how it works.

3. BA Transition Virtual Network

Earlier this year, CFIF sponsored a series of targeted workshops to collect feedback and discuss potential options for investors and other market participants to replace BAs. It was clear from the discussions that a heightened level of awareness from investors, issuers, regulatory authorities and policy makers is needed to ensure a successful transition away from BAs. To help in this effort, CFIF has formed a BA related working group, co-chaired by Elaine Lindhorst (TD Asset Management) and Charles Lesaux (RBC Capital Markets).

The co-chair of the group tabled the draft Terms of Reference (ToR) and provided a high-level overview of the objectives and the tentative workstreams. The intent is to have around 12 to 18 core members across stakeholders with subject matter experts drawn in for specific workstreams. CFIF members were asked to send comments on the ToR and membership suggestions to the co-chairs or to the CFIF Secretariat.

CFIF would like to thank the co-leads, Greg Moore (TD) and Earl Davis (BMO GAM), for their leadership and contributions to the workshops on the impact of CDOR cessation on Canadian money markets. A white paper summarising the key findings from the workshops will be soon published on the CFIF website.

4. CARR update

CARR's co-chairs informed CFIF that the Term CORRA methodology has now been essentially finalized. The Term CORRA methodology to calculate a 1- and 3-month rate will leverage CORRA interest-rate futures, using both futures transactions and executable bids and offers. The methodology is broadly consistent with CME's Term SOFR and elements of ICE's Term SONIA.

CARR intends for overnight CORRA to be the primary benchmark in Canada, and for Term CORRA to be used mostly in lending markets. This is in part motivated by the IOSCO Principles for Financial Benchmarks, which suggest that benchmark design should take into account the potential mismatch between the size of the underlying market on which the benchmark is based and the volume of exposure referencing the benchmark (i.e. the inverse pyramid issue). Term CORRA's administrator will therefore limit the use of Term CORRA through its licensing agreements to specific use cases.

The co-chairs also discussed potential administrative arrangements for Term CORRA.

CARR will continue its work to facilitate a smooth transition away from CDOR, and to ensure Canada's benchmark regime is robust, reliable, and effective.

5. Initiatives to enhance GoC Market Functioning

The GoC Market Functioning Steering Group (GMF) co-chairs shared an update of the group's work since the last CFIF meeting in September.

The GMF has been focusing on socialising the consultation paper published earlier in the month. Members are encouraged to submit their responses before the consultation deadline on December 9, 2022.

6. CFIF Sustainable Finance Virtual Network

The co-chair of the CFIF Sustainable Finance Virtual Network (Network) updated CFIF members on the progress made since the establishment of the Network in April 2021 and presented the themes that the various discussion groups will pursue along with their associated work timelines.

7. Other business

The CFIF Secretariat is seeking feedback on the 2023 CFIF workplan. Members were asked to send their comments and suggestion of new topics directly to the CFIF Secretariat.

Meeting participants:

CFIF members:
Jim Byrd, RBC Capital Markets, Co-Chair
Sandra Lau, Alberta Investment Management Corporation
Brian D'Costa, Algonquin Capital
John McArthur, Bank of America Securities
TJ Sutter, Connor, Clark & Lunn
Karl Wildi, CIBC World Markets
Philippe Ouellette, Fiera Capital
Rob Goobie, Healthcare of Ontario Pension Plan
Kelsey Gunderson, Laurentian Bank Financial Group
Graeme Robertson, Phillips, Hager and North Investment Management
Jason Lewis, Provincial Treasury of BC
Paul Scurfield, Scotiabank
Elaine Lindhorst, TD Asset Management

External participants:
Item 6
Dominique Barker, Managing Director, Head, Sustainability Advisory, CIBC Capital Markets

Bank of Canada:
Toni Gravelle, Co-Chair
Wendy Chan, Secretariat
Harri Vikstedt
Sheryl King
Mark de Guzman
Grahame Johnson
Zahir Antia