Impact of CDOR Cessation on Bankers' Acceptance Market

Executive Summary

On May 16, 2022, the Canadian Dollar Offered Rate's (CDOR) regulated administrator, Refinitiv Benchmark Services (UK) Limited (RBSL) <u>announced</u> that it would cease the publication of CDOR after June 28, 2024. With the cessation of CDOR's publication, it is expected that the Bankers' Acceptance (BA) based lending model, which is responsible for creating the BAs that are sold to money market investors, will be discontinued. As a result, there will be no or very limited BA issuance taking place after June 2024, however, issuance is expected to remain relatively robust until the end of 2023. BA issuance is expected to progressively drop as we approach the CDOR cessation date.

BAs are important short-term Canadian dollar money market assets, currently comprising about 20% of the notional outstanding in the Canadian money market. They are the second largest money market instrument after Government of Canada (GoC) treasury bills, and account for a signification portion of the investable product in the 1-month maturity bucket.

In response to investors' concerns about the likely cessation of BA issuance, the Canadian Fixed-Income Forum (CFIF)¹ sponsored a series of targeted workshops to collect feedback and discuss potential options for investors and other market participants to replace BAs. Over 80 industry experts, representing banks, dealers, issuers, asset managers, pension funds, insurance companies, regulators, and financial infrastructure providers, have participated in the workshops.

Below are the key themes that emerged from the workshop discussions:

- Investors have varying needs for their money market investments regarding liquidity, yield, term, credit quality, amount, and predictability of issuance.
- While financial issuers and borrowers prefer longer-term funding, money market investors tend to prefer shorter-term investment instruments. Consequently, it is unlikely that a single instrument will emerge to fully replace BAs in the 1-month tenor, which constitutes the vast majority of BA issuance.
- There are varying degrees of implementation complexity amongst potential BA substitutes, thereby increasing the importance to plan and allocate the required resources expediently given resource pressures and process timelines.
- Some money market investors are governed by regulations that restricts their ability to potentially pursue some of the investment options discussed at the workshops.

Expansion of the investable money market universe, including through the development of new types of investment products, will play an important role in facilitating an orderly transition away from BAs as a result of the CDOR cessation.

¹ <u>CFIF</u> is a senior level industry committee established by the Bank of Canada to discuss developments in fixedincome market structure and functioning, market practices and related policy issues. CFIF would like to thank the co-leads, Greg Moore (TD) and Earl Davis (BMO GAM), for their leadership and contributions to the workshops.



Another approach to expand the investable universe for certain types of money market investors is through the continued evolution of the Canadian regulatory regime, specifically in reference to rules administered by the Canadian Securities Administrators (CSA). Generally, the second most significant investor group in BAs are asset management firms, the majority of whom manage investment funds regulated by *CSA's National Instrument 81-102 Investment Funds (NI 81-102)*. In addition to NI 81-102, there are other CSA rules that would apply to market participants seeking to issue or use alternative investment products to BAs.

A heightened level of awareness from investors, issuers, regulatory authorities, and policy makers on alternative investment options to BAs, and the potential ability for investors to purchase them, is needed to ensure a successful transition given the relatively short timelines before BA issuance ceases. CFIF, working with industry, will continue to monitor and help facilitate, where appropriate, a smooth 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).



1. Introduction

The Canadian Dollar Offered Rate (CDOR) was originally created in the 1980s as the basis for pricing BA related credit facilities, which are responsible for creating the BAs that are sold to money market investors. These types of loan facilities are offered primarily by the major Canadian lenders and therefore they account for the vast majority of wholesale bank lending to Canadian corporate and commercial borrowers. BAs are also an important short-term asset for money market investors, comprising about 20% (approximately \$80B to 90B) of the notional outstanding in the Canadian money market.

On May 16, 2022, after a public consultation, CDOR's regulated administrator, Refinitiv Benchmark Services (UK) Limited (RBSL) <u>announced</u> that it would cease the publication of CDOR after June 28, 2024. With the cessation of CDOR's publication, it is expected that the BA based lending model will be discontinued and therefore BA issuance will likely cease after June 2024. Based on discussions with the CDOR panel member banks, BA issuance is expected to remain relatively robust until the end of 2023, with no or very limited BA issuance taking place after June 28, 2024. BA based lending is expected to transition to either an overnight CORRA or a Term CORRA based lending model with no money market instruments being issued as a result of the loan drawdown.

1.1 The Canadian Fixed-Income Forum (CFIF) and benchmark reform in Canada

The Canadian Fixed-Income Forum (CFIF) is a senior level industry-wide committee established by the Bank of Canada to discuss developments in fixed-income market structure and functioning, market practices, and related policy issues. The goals of CFIF are to:

- enhance the efficiency and resilience of the Canadian fixed-income market;
- improve the quality, clarity and market-wide understanding of Canadian fixed-income trading practices;
- evaluate and propose changes to market infrastructure; and
- communicate any recommendations and analysis to oversight authorities, regulators, industry groups and other market participants as needed.

The Canadian Alternative Reference Rate working group (CARR) was established by CFIF in March 2018 to help guide benchmark reform efforts in Canada. In December 2021, CARR <u>recommended</u> that RBSL should cease the calculation and publication of CDOR after June 2024.²

² CARR has recommended a two-staged approach to the transition from CDOR. The first stage will run until June 30, 2023, and the second and final stage will end on June 28, 2024. By the end of stage one, it is expected that all new derivative contracts and cash securities to have transitioned to using the Canadian Overnight Repo Rate Average (CORRA), with no new CDOR exposure after that date except with limited exceptions. Those exceptions include derivatives that hedge or reduce CDOR exposures of derivatives or securities transacted before June 30, 2023, or in loan agreements transacted before June 30, 2024. The second stage to June 28, 2024, will provide firms with additional time to transition their loan agreements and deal with potential issues related to the redocumentation of "legacy" securities. The longer time window will also allow for more existing CDOR-based securities exposures to mature.



1.2 Workshops to discuss impact of CDOR cessation on Canadian money market

In response to investors' concerns about the likely cessation of BA issuance, CFIF sponsored a series of targeted workshops to collect feedback and discuss potential options for investors and other market participants to replace BAs. Over 80 industry experts, representing banks, dealers, issuers, asset managers, pension funds, insurance companies, regulators, and financial infrastructure providers, have participated in the workshops.

This whitepaper summarizes the key findings from the workshops, highlighting the importance of a heightened level of awareness from investors, issuers, regulatory authorities, and the policy makers to ensure a smooth transition away from BAs.

2. BAs as a key Canadian money market instrument

The structure of BA-based lending was originally developed in the 1960's to facilitate the development of a corporate loan market in Canada.³ At their core, BA credit facilities are committed credit lines offered by banks to their corporate and commercial clients: when these clients borrow against their credit line, a short-term security (the BA) with the same maturity as the loan drawdown is created, which the lending bank can either hold on its balance sheet or sell into the market.⁴ The tenor of the BA is determined by the corporate borrower and since most of BAs are created from revolving loan facilities, they are primarily 1-month in term (85-90%). The BAs are usually rolled monthly if the loan remains drawn. Canada is the only major jurisdiction that has retained the original BA-loan construct as its wholesale lending model. Most other jurisdictions moved away from the BA-approach decades ago as bank funding models evolved, since the issued BA was no longer used to fund the loan drawdown. Australia was the last jurisdiction to move away from the BA-construct after the Global Financial Crisis (GFC), primarily as a result of the Basel III reforms, introduced in response to the GFC, which encouraged banks to move away from issuing very short-dated wholesale funding (i.e., 1-month BA type instruments).⁵

BAs are important short-term Canadian dollar money market assets, currently comprising about 20% of the notional outstanding in the Canadian money market. They are the second largest money market instrument after Government of Canada treasury bills, and account for a signification portion of the investable product in the 1-month maturity bucket. A wide variety of firms invest in BAs including insurance companies, pension funds, money market funds, ⁶ corporations, bank treasuries, government agencies and asset management firms (see Chart 1 for a breakdown of BA purchasers by type of investor). For these investors, BAs offer a relatively attractive yield over other short-term assets, including GoC and provincial treasury bills, while still being relatively liquid and well-rated since they share the same credit

³ Similar lending models based on the creation of a related money market instrument were developed in many other jurisdictions.

⁴ BA-based credit facilities are mostly committed but can also be uncommitted.

⁵ For more information on the BA-loan construct and developments in the BA market, please see "<u>CARR's Review</u> <u>of CDOR: Analysis and Recommendations</u>", and the Bank of Canada's "<u>Primer on the Canadian Bankers'</u> <u>Acceptance Market</u>"

⁶ Money market funds are governed by NI 81-102, which includes minimum liquidity requirements, maximum term to maturity provisions, maximum issuer concentration protocols, and other constraints that significantly limit the scope of their investable assets. For these funds, BAs are an important investable asset.





rating as their issuing bank. Chart 2 depicts the available yields between BAs and GoC treasury bills. For example, since 2019, BAs has yielded about 30 bps more than Government of Canada treasury bills at equivalent term to maturity. It is expected that the spread between BAs and comparable term GoC treasury bills will potentially narrow as BA issuance declines and BAs become scarcer leading into June 2024.⁷

While many investors may prefer to continue to have access to BAs, they need to recognize that BA issuance will likely disappear totally after June 2024 with the cessation of CDOR, since this will mean the disappearance of the BA lending model in Canada. This lending model is reliant on having a credit-based reference rate or benchmark (i.e., CDOR) to price the loan. Therefore, investors will need to look at other alternative investment options to be able to transition their investment portfolios successfully from BAs by June 2024.



⁷ As a result, it is expected that the spread between CDOR and BAs will potentially widen.



3. Key themes from CFIF sponsored workshop series

In response to investors feedback CARR received during its work on the recommendation to RBSL to cease the publication of CDOR and the impact that recommendation would potentially have on BAs, CFIF sponsored a series of targeted workshops to discuss the issues. These workshops brought together buyand sell-side participants to share their perspectives on the disappearance of BAs, explore potential substitutes, and identify any constraints that may be associated with potential alternatives to BAs. CFIF also engaged the Canadian Securities Administrators (CSA) in the discussions as some investors are subject to CSA regulation.⁸ Below are the key themes that emerged from the workshop discussions.

Investors have varying needs for their money market investments regarding liquidity, yield, term, credit quality, amount, and predictability of issuance. Investors generally evaluate the suitability of an instrument based on these factors. Their needs and preferences will vary depending on their respective mandates and regulatory requirements. For instance, the portfolio manager of a cash or liquidity portfolio will likely be willing to accept lower yield in return for higher liquidity, whereas a manager with specified return objective will put more weight on the yield of the asset. For some investors, structured or non-security type products may also pose additional challenges from a governance and operational perspective.

Discussions with market participants revealed that no single money market instrument will be able to fully replace BAs in the 1-month tenor. While issuers and borrowers prefer longer-term funding, money market investors tend to prefer shorter-term investment instruments. Other than bank treasuries, plans for non-bank money market issuers will unlikely change materially in response to the disappearance of the BA market. For non-bank issuers, their primary consideration for the frequency, term, and amount of issuance is their funding needs, making them unlikely to make material adjustment in their issuance plan in response to changes in the BA market.

Bank treasuries, on the other hand, noted that they would increase the issuance of other types of shortterm funding instruments, including Bearer Deposit Notes (BDNs) and term deposits as BA issuance disappears. The degree to which banks will replace BAs with BDNs will depend on investor demand, and the cost of alternative funding sources, including term deposits and foreign funding swapped back into Canadian dollars. However, their preferred tenor will be in the 3- to 12-month term instead of the 1month tenor prevalent in BAs. This preference for longer term money market funding is driven by the changes to bank funding models imposed globally by the Basel III reforms and other regulatory requirements.⁹ Discussions with the Canadian banks that issue BAs suggest that the gap between the decrease in BA issuance and the potential increase in BDN issuance could be as much as two-thirds of the current stock (approximately \$60 billion), with roughly a third of new BDN issuance expected to have a 6 to 12-month maturity.

In contrast, investors indicated a strong desire for shorter-dated products, driven by liquidity, interest rate risk management and regulatory requirements. Therefore, based on the results of the workshops,

⁸ For example, most asset management firms offering money market products are subject to NI 81-102.

⁹ Key regulatory metrics which impact short-dated bank issuance include the Basel III Liquidity Coverage ratio (LCR) and Net Stable Funding Ratio (NSFR), and OSFI's Net Cumulative Cash Flow (NCCF).



multiple alternative investment options will likely be needed as no one existing product can cover the potential large gap in the 1-month tenor when BA issuance disappears. Many workshop participants saw this as an excellent opportunity to evolve and bring more transparency to the Canadian money market, including developing new products to fill the gap left by the disappearance of BAs. This included the potential introduction of a 1-month Government of Canada treasury bill, which was seen by some as the most viable option to potentially replace a large share of the current demand in 1-month BAs despite its lower yield.

There are varying degrees of implementation complexity amongst potential BA substitutes, thereby increasing the importance to plan and allocate the required resources expediently given resource pressures and process timelines. Some options discussed during the workshops, such as BDNs, commercial paper or provincial and GoC treasury bills, may be relatively easy to deploy for investors as in many cases, they are already part of the universe of investible products. Other alternatives, such as reverse repos and term deposits, may require education, signing of new legal documentation and other operational investments, including potentially updating internal portfolio policies and trading systems.

Some market participants may also have regulatory constraints that limit their investment choices despite these choices being seen as potentially very viable alternatives. To facilitate an orderly transition to other viable investment products, those market participants that are subject to regulation can potentially try to seek regulatory relief¹⁰ with respect to certain investment parameters given the impact that the disappearance of BAs will have on their investment options. However, since the process can be lengthy, it is important to start the planning process as early as possible considering that CDOR will cease to be published after June 28, 2024, and BAs are expected to be no longer issued after that date. To facilitate an orderly transition away from BAs, market participants are encouraged to retain legal counsel, if necessary, and file applications for exemptive relief with the applicable securities regulators as early as possible.¹¹

4. Potential investment substitutes for BAs

This section highlights the various investment options to replace BAs discussed during the workshop series. It begins with existing alternatives that are broadly organized by the level of implementation complexity; however, the degree of operational readiness will depend on individual circumstances, including the investors' organizational setup, mandate, knowledge, and regulatory oversight. The section ends with a high-level overview of other potential investment products that were raised during the workshop series, that are either new or are not as readily used currently by Canadian money market investors.

¹⁰ Typical timeline for a change in regulation can take more than 5 years. However, investors may seek regulatory relief through a blanket order or exempted relief either for a single investor or a group of investors.

¹¹ As indicated in this paper, money market mutual funds seeking to use alternative short term investment products to BAs may need exemptive relief from certain provisions in NI 81-102. Other market participants seeking to issue or use alternative investment products to BAs should consider whether they need exemptive relief from any other provisions of applicable securities legislation.



Summary table – Potential investment substitutes for BAs

Options	Term	Predictability/ Consistency of Issuance	Secondary Market Liquidity (equal or stronger than BA)	Credit Quality (equal or stronger than BA)*	Yield (vs. BA for a given tenor)	Single Security with Identifier (CUSIP / ISIN)
Existing Instruments**						
BDN	Mostly≥ 3M	Varies by issuer	Tenor dependent	Yes	Similar⁺	Yes
Regular GoC treasury bills	≥ 3M	Yes	Yes	Yes	Lower	Yes
Provincial Bills	Mostly≥ 3M	Varies by issuer	Yes	Yes (in general)	Lower	Yes
ABCP	Varies	No	No	Yes	Higher	Yes
Commercial paper	Varies	No	lssuer dependent	No (in general)	lssuer dependent	Yes
Term Deposits	Flexible	No	No	Yes	Varies	No
Bilateral Reverse Repo	Flexible	No	No	Yes	Lower	No
Tri-Party Reverse Repo	Flexible	No	No	Yes	Lower	No
Potential New Instruments						
Regular 1M GoC treasury bills	1M	Yes	Yes	Yes	Lower	Yes
CDCC GC Basket Units	1M to 3M	TBD	TBD	Yes	Lower	Yes
Structured Deposits	Flexible	No	No	Yes	Varies	No
Floating Rate BDN	> 3M	TBD	TBD	Yes	Varies	Yes
Structured BDN	Flexible	TBD	TBD	Yes	Varies	Yes

* Assume from the same issuer for applicable products issued by commercial banks.

** Table only includes CAD denominated instruments. See section 4.2 for potential foreign currency option.

⁺ Normally within 5bps

4.1 Alternative investment options with the lowest level of implementation complexity for most participants

Bearer Deposit Notes (BDNs)

BDNs are issued to provide general funding for a banks' treasury rather than being specifically created from a loan drawdown initiated by the borrower, as is the case for BAs. They are issued directly by a bank in its own name and are the closest substitutes to BAs in terms of credit quality and yield. Since BDNs are issued in response to a specific bank's funding need and investor demand, their issuance is slightly less predictable. Similar to BAs they are tradeable in the secondary market and are seen as an equivalent credit to BAs since they are issued by the same entities. BDNs are, however, generally issued for longer maturities, ranging from three months to one year. BA issuing banks have confirmed that as they reduce the issuance of BAs, they would increase the issuance of BDNs but their preference will be to issue BDNs in longer money market tenors than the 1-month term in BAs given the higher regulatory costs of issuing very short-dated bank paper.

Although most workshop participants saw the liquidity of equivalent maturity BAs and BDNs as similar, some investors expressed reservations about their liquidity. In part, this reflects the generally longer underlying tenor of BDNs. Basel regulations introduced since the GFC specifically discourage banks from buying other banks short-term paper, especially when it matures after their monthly regulatory reporting window. The very short-dated nature of the majority of BAs means that purchases of other banks BAs do not necessarily impact the bank's liquidity and funding ratios. Therefore, banks are potentially more willing to buy other banks BAs (or BDNs) if they mature before the reporting window. Instead of the paper maturing within 30 days, BDNs' longer maturity cycle implies more reliance on liquidity provided by the issuing bank's dealer if an investor needs to sell an existing BDN. This potentially makes them somewhat less appealing for portfolio managers with a defined liquidity mandate.

In discussions with Australian market participants who had gone through similar changes to their shortterm bank issuance with the elimination of the Australian Bank bill lending model¹², it was noted that bank issuance has lengthened from 1-month to primarily 3- and 6-month tenors, with very limited issuance taking place in the 1-month term. They also mentioned that the secondary market liquidity is being primarily provided to market participants by the issuing bank of the negotiable certificates of deposit (their BDN equivalent product), which have replaced the shorter-dated bank bills (BAs).

It should be noted that while market participants consider BAs liquid, they lacked liquidity at the start of the Covid-19 pandemic in Canada. As a result, the Bank of Canada had to intervene to support the continuous functioning of the BA market, by introducing the Bankers Acceptance Purchase Facility.¹³

¹² This loan structure created an BA equivalent Australian money market product.

¹³ The COVID pandemic provided us with a unique window into the functioning of the secondary BA market during a market stress event. The Investment Industry Regulatory Organization of Canada (IIROC) publishes, on a T + 1 basis for informational purposes only, a transaction based 1- and 3-month BA rate based on BA transactions reported to its Market Trade Reporting System. If there is inadequate volume on a given day, IIROC publishes the prior day's rate rather than one based on that day's transactions. In March 2020, IIROC was not able to publish a new 3-month BA rate for 7 consecutive trading days as their minimum volume criteria was not met. This was the first real test of BA volumes in a crisis since IIROC began publishing BA data in January 2019.



Government of Canada treasury bills

Government of Canada treasury bills represent the largest segment of the Canadian money market. They are issued on a regular basis and have a strong credit rating. They are liquid in the secondary market, and are widely accepted as collateral for margin calls; however, GoC treasury bills are substantially lower yielding than BAs. Since they are deemed a high-quality liquid asset (HQLA) for Basel III purposes, their demand and therefore pricing, can also be driven by global factors.

Regular GoC treasury bills are currently only issued in 3-, 6- and 12-month maturities. The Government of Canada also periodically issues cash management bills (CMBs). CMBs are treasury bills with maturities of less than three months (they can be as short as one day) and are used as a source, when required, of short-term financing for the Government of Canada and are therefore issued only as needed. Shorter-dated GoC treasury bills (less than 3 months) are not available for purchase in sufficient quantities in the secondary market as they are mostly held to maturity by the investors that acquire them through or after they are auctioned.¹⁴

Provincial treasury bills

Provincial treasury bills are generally slightly higher yielding instruments compared to GoC treasury bills and have solid credit ratings. However, their issuance in general is less regular and less predictable, with issuance patterns and processes varying substantially between provinces. Moreover, similar to current GoC treasury bills, they are issued in longer tenors and therefore cannot replace BA issuance in the 1month tenor.

Asset-Backed Commercial Paper

Asset-backed commercial paper (ABCP) is the fourth largest product segment in the Canadian money market and is usually issued at a slightly higher yield than BAs. However, ABCPs importance for the Canadian money market declined substantially after issues arose with some types of non-bank sponsored ABCP in 2007-08. Despite the fact that in Canada, the majority of ABCP being issued today is from major Canadian bank sponsored entities, ABCP nevertheless retains a negative stigma with some investors who are still not willing to buy the product. The developments in the BA market are not expected to materially impact ABCP supply in the short term since issuance is dependent on the growth of the underlying assets supporting the programs.

Commercial Paper

Few corporate issuers have as high credit rating and issuance needs as the bank-based BA issuers. Additionally, the number of corporate issuers and the size of corporate issuance in Canada is limited in comparison to other jurisdictions. The yield offered by commercial paper (CP) depends on the credit rating of the issuers, although equivalent rating CP can be somewhat comparable to BAs in terms of yield, its

¹⁴ Some participants expressed interest to have a new 1-month treasury bills, as part of the Government's regular auction schedule, to help smooth the impact of the reduction of BA supply. Further discussion can be found in section 4.3 below.

issuance is dependent on the specific funding needs of the issuer and therefore does not have the frequency or consistency of BA issuance. There may also be additional governance cost to the investor to add new CP issuers to the list of eligible issuers.

4.2 Alternative investment options with increased level of implementation complexity for some participants

Term Deposits

Investors can earn interest by placing cash either overnight or on a term basis with deposit taking institutions. Term deposits have a similar credit profile as BAs from the same institution, however, they are subject to potential early redemption fees should investors require funds before maturity. Interest rates offered on term deposits can also be more variable as they can be dependent on the type of investor¹⁵ and the specific funding needs of the deposit taking institution. Operationally, they are also seen as somewhat more time consuming to set up as investors will need to open accounts with individual banks prior to making a deposit. Mandate documentation changes may also be required. The account opening process is subject to regulatory requirements (e.g., know-your-client requirements) and can introduce additional governance cost.

Term Reverse Repo

A repo is essentially a collateralized loan. One party to a repo lends cash and earns interest on the cash lent (reverse repo). The other party borrows the cash and pays the interest (repo). The borrower secures the loan by posting the agreed type of security as collateral (e.g., GoC bonds or treasury bills). Repo transactions can be conducted bilaterally, through a third-party custodian, or through a central counterparty (CCP). Under a bilateral repo transaction, a holder of securities sells them to an investor with an agreement to repurchase at a predetermined date and rate, effectively creating a collateralized loan. In a tri-party or CCP repo, a common custodian or the CCP arranges for custody, clearing and settlement of repo transactions. The custodian or CCP provides for delivery versus payment (DVP) settlement, substitution of securities, automatic marking to market (including for the collateral backing the repo), reporting and daily administration.

While investing cash through a term reverse repo is a viable option for many investors, it is not a tradeable security. Therefore, if an investor needs access to the cash before the contractual maturity of the repo the investor would need to have the ability to execute both reverse repos (for investing cash) and repos (for obtaining cash by re-hypothecating the collateral received through the reverse repo).

Operationally, term reverse repos are more complex than traditional money market securities, as they are subject to daily margining from any changes to the value of the collateral, or the potential substitution of collateral during its term, if this is allowed. However, reverse repos are securitized transactions, and they bear lower credit risk relative to unsecured exposure from the same counterparty. The available yield depends on the counterparty type (i.e., credit rating) and the collateral type underlying the reverse repo. For example, a reverse repo collateralized with GoC bonds or bills would offer a lower yield than one

¹⁵ Under Basel regulations the liquidity value to the bank from the deposit is dependent on the type of depositing institution.



collateralized with investment grade corporate bonds. TMX, in partnership with Clearstream, is developing a made in Canada tri-party collateral management service, which will modernize the Canadian repo infrastructure, optimize collateral, and facilitate the easier use of repo as an investment product.

Foreign money market instruments swapped to Canadian dollars

These were seen as a viable option for investors, whose mandate and setup allows for foreign currency transactions hedged into Canadian dollars. While they can substantially expand the range of available investable money market assets, their relative attractiveness depends on the yield available on the foreign money market asset and the foreign exchange basis between Canadian dollars and the foreign currency. They are also operationally more complex than traditional money market securities since they require both the purchase of a foreign money market security and the execution of a foreign exchange swap¹⁶. Should the investor need liquidity before the maturity of the foreign security, they would have to sell the security and unwind the swap transaction. As a result, they would be exposed to any price movement (profit or loss) in both the foreign security and the foreign exchange swap. Note that some foreign money market instruments potentially do not allow purchase by Canadian domiciled investors.

4.3 Potential 'new' products discussed at the workshops

Regular 1-month Government of Canada treasury bills

Some participants expressed interest in having a new 1-month GoC treasury bill, as part of the government's regular auction schedule, to help smooth the impact of the reduction in BA supply. Participants noted that a regular 1-month GoC treasury bill would be a welcome option for investors when BA issuance declines or disappears. Its liquidity, predictability, and high credit rating were seen as very attractive features, particularly for investors with a liquidity-focused mandate. Participants also mentioned that it would bring increased transparency to the Canadian money market and provide an important 1-month pricing benchmark, in addition to the 1-month overnight index swap rate, for other money market products. Several international investors have also indicated their potential interest in a 1-month GoC treasury bill at other benchmark reform events.

The proposed 1-month GoC treasury bill could be issued as either a new maturity in addition to the 3-, 6and 12-month tenors or as a replacement for potentially the 12-month treasury bill. However, many participants expressed a preference for a new 1-month GoC treasury-bill in addition to maintaining all three existing maturities citing increased demands for treasury bills (as collateral) for the daily exchange of variation margin. ¹⁷

¹⁶ A foreign exchange swap is a contract in which one party borrows a specific currency, for a specific term, from another and simultaneously lends a different currency to the same counterparty for the same term.
¹⁷The Government sought views on possible demand for a 1-month treasury bill at the <u>Fall 2022 Debt Management</u> <u>Strategy Consultation</u>. While several participants that were consulted noted there could be good demand for a 1-month treasury bill, most felt that one or more market solutions could arise to meet the need for 1-month collateral.



CDCC Securitized General Collateral (SGC) Units

CDCC is working to develop a new securitized repo product called <u>securitized general collateral unit</u> (SGC). The SGC converts general collateral repos¹⁸, using multiple general collateral baskets with specific eligibility requirements, potentially including standardized 30-, 60- and 90-day tradeable units (each with a generic ISIN) through a centrally cleared CDS tri-party framework. Although the return and liquidity characteristics of the product are still to be determined, the draft product design seems to address multiple concerns raised by participants during the workshop discussions. CDCC will continue to work on product features and design, and pending industry consensus and regulatory approvals, aims to run industry testing in the second half of 2023.

Floating Rate BDN

Rather than being issued as a typical money market instrument at a discount, floating rate BDNs would be issued at par and pay a coupon linked to CORRA or some other short-term borrowing index. They are similar to a floating rate note, but shorter in tenor.

Structured BDN

Structured BDN are a BDN-like security with a fixed legal maturity date that can be contractually amended. Variations include callable or extendable structures where the decision to call/extend can be at the option¹⁹ of either the investor or issuer.

Similarly, a puttable variation could exist where the investor could exercise the option to put the BDN back to the issuer before its maturity date, for example a 6-month BDN that could be terminated by the investor (put back to the bank) with a 30-day notice. This will address concerns of reliance on liquidity provided by the issuing bank's dealer in the secondary market should investors need to sell their existing BDNs.

Structured Deposit

These are bilateral deposits with a fixed legal maturity date that can be contractually amended. The types of variations that could be available to the investors are similar to those discussed for structured BDNs. The yield offered through structured deposits relative to equivalent structured BDNs is dependent on the type of investor.

5. Preparation for the cessation of BAs

With the upcoming cessation of CDOR's publication, it is expected that the BA based lending model, which is responsible for creating the BAs that are sold to money market investors, will disappear. Therefore, it is expected that there will be no, or at most very limited, BA issuance taking place after June 2024. BA

¹⁸ General collateral (GC) is a basket of high quality, liquid assets that are close substitutes to one another. Any collateral in the defined GC basket can be used in a general collateral repo transaction. The specific securities provided as collateral are not identified until after other terms of the trade are agreed.

¹⁹ Some investors noted that although structured product provides more flexibility, the optionality can introduce more implementation complexity (e.g. pricing and internal governance).



issuance, however, is expected to remain relatively robust until the end of 2023 and is expected to progressively drop as we approach the CDOR cessation date.

Expansion of the investable money market universe plays an important role in facilitating an orderly transition away from BAs as a result of the CDOR cessation. Scaling up existing products, as well as the opportunity to develop new money market products have been discussed throughout the paper. Another venue to expand the investable universe for certain types of money market investors is through the continued evolution of the CSA's regulatory regime. As highlighted in Chart 1, asset management firms, the majority of whom manage funds that are regulated by NI 81-102, are the second largest investor group in BAs. Potential changes to parameters in NI 81-102 that could support an easier transition away from BAs for these types of investors can be found in the Appendix.

A heightened level of awareness from investors, issuers, regulatory authorities, and policy makers on alternative investment options to BAs is needed to ensure a successful transition given the relatively short timelines before BAs disappear. CFIF, working with industry, will continue to monitor and help facilitate, where appropriate, a smooth 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).

Appendix – Potential parameters in NI 81-102 for regulatory relief

The following list includes parameters in NI 81-102, that were discussed at the workshops, for potential regulatory relief in order to expand the investment options for money market mutual funds given the cessation of BA issuance:

- Ratings Allowance
 - Potentially expanding allowable ratings for money market Investments
 - Potentially expanding allowable ratings for major Canadian banks with respect to Bail-in bonds
- Average/Maximum Maturities
 - Potentially extending maximum/average maturities for money market investments
- Eligible Investments
 - Potentially expanding eligibility for ABCP and BDNs issued by affiliated entity
- Foreign Content
 - Potentially increasing allowable foreign content
- Repo
 - Potentially increasing repo/reverse repo term limits
 - Potentially expanding the repo/reverse repo underlying eligible collateral
- Cash Leverage
 - Potentially increasing allowable leverage