SUMMARY OF THE DISCUSSION

Toronto, September 20, 2023, 4:00 p.m. to 6:00 p.m.

1. Recent bond market developments

Warren Lovely, Managing Director, Economics and Strategy (National Bank Financial) shared his insights on the impact of higher interest rates and foreign investors footprint on government deficits and bond supply. He pointed out that federal debt servicing charges have grown significantly since the beginning of the interest rate hiking cycle. However, he noted that the positive surprises to government revenues have cushioned the impact of higher interest rates, allowing the debt burden to remain at modest level when put into historical context. In addition, the speaker noted that Canada's social security system is a clear strategic advantage for the country. The rising net asset positions in the public pension plans help support the long-term sustainability of Canada's fiscal policies.

The discussion then turned to Canada's exposure to foreign bond investors and the risks to the Canadian bond market from potential Japanese investors outflows resulting from possible changes to Bank of Japan's yield curve control policy. Overall, the speaker thinks the risks associated with Japanese investor outflow going forward seem to be modest. Higher currency hedging costs have kicked off wave of net divestment of foreign bonds, including Government of Canada (GoC) bonds, by Japanese investors since early 2022. As a result, Japan investors' relative importance in the Canadian bond market, expressed as their share of foreign holdings of Canadian bonds, is at the lowest level since 1982. The speaker also noted as Japanese footprint fades, other non-residents have continued to purchase Canadian bonds, with both domestic and non-resident investors having increased their holdings of GoC bonds as the Bank of Canada has reduced the size of its holdings through QT.

Lastly, the speaker mentioned that despite having a healthy net international investment position, Canada has less foreign interest-bearing assets compared to liabilities. The resulting growth in interest payments to non-residents will add to Canada's current account deficit, which could lead to a higher share of foreign holdings of GoC bonds in the future.

2. CARR update

CARR's co-chairs provided an update on the group's work since the last CFIF meeting in June, noting that the CDOR transition is progressing well. After the end of June, the second stage of CARR's two-stage transition from CDOR to CORRA began. Market participants are now expected to have transitioned all new derivative and securities transactions to CORRA benchmarks, with limited exceptions. CARR's focus is now on preparing Canadian markets for the cessation of CDOR after end-June 2024, including the transitioning of the Canadian dollar loan market from CDOR to alternative benchmarks.

To facilitate this transition, CARR has now published recommendations for transitioning loans from CDOR to CORRA, including introducing a November 1, 2023 "no new CDOR or BA loan" milestone. CARR has also published a series of frequently asked questions to provide additional details and clarity on certain transition-related issues.

CARR also published its finalized guidance on the allowable use cases for Term CORRA, which was officially launched by its administrator, CanDeal Benchmark Solutions, on September 5.

One of the key components of a smooth CDOR transition is to ensure the well-function of the Canadian money market as market moves away from Bankers' Acceptance (BA) which will no longer be issued after June 28, 2024. Early in the year, CFIF had tasked the BA Transition Virtual Network (BATVN) to monitor and help facilitate, where appropriate, a smooth away transition from BAs. At the meeting, the BATVN sought CFIF endorsement of two initiatives to support this effort: 1) a recommended process for an orderly wind-down of BA issuance starting in November 2023 that balances the needs of BA investors and issuing banks, as well as CDOR benchmark submitters; and 2) a proposal to Department of Finance to temporarily issue 1-month treasury bills through regular bi-weekly auctions using the re-allocation of supply from existing treasury bill stock.

CFIF members endorsed both initiatives, including the release a market notice outlining the recommended path for winding down BA issuance. 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.

3. 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. They noted that the comments received from the public consultation were generally supportive of the proposed fail fee and its parameterization and considered the trial period and governance considerations generally appropriate. Since the consultation, GMF has focused its efforts on addressing some of the technical questions raised through the consultation including the overlap with the transition to T+1 settlement[1], handling of trade deletions, CDCC fails, and settlements after CDSX Payment Exchange.

As a result of the major industry efforts required for a smooth transition to T+1 settlement, GMF is recommending delaying the start of the trial phase for the GoC fail fee, originally slated to start in Q1 2024, to Q4 2024, with the start date aligning with the implementation of CDS's Post Trade Modernization (PTM) initiative. The co-chairs also provided an overview of the changes to technical aspects of the fail fee framework.

CFIF members approved the new proposed timeline for the trial phase, as well as the changes to the technical aspects of the fail fee framework. The GMF targets publication of the final framework and the summary of public comments by the end of the year.

4. CIMPA Update

Following CFIF approval to create the Collateral Infrastructure and Market Practices Advisory Group (CIMPA) in June, members were informed that Nick Chan, Managing Director and Head of Financial

[1] The settlement period for securities trades in North America is transaction date (T) plus two business days, commonly referred to as T+2. In December of 2021, the Canadian Capital Markets Association (CCMA) confirmed its plans to shorten Canada's standard securities settlement cycle from T+2 to one day after trade date (T+1). The CCMA is recommending that the Canadian markets implement its T+1 changes over the weekend of May 24, 2024, and commence T+1 trading one day prior to the U.S. markets, on Monday, May 27, 2024 (i.e., on the U.S. holiday).

Resource Management, BMO Capital Markets, and Harri Vikstedt, Senior Policy Director, Bank of Canada will be the new CIMPA Co-chairs. Working with the industry, the co-chairs will consider the group structure, and to develop CIMPA's Terms of Reference. The co-chairs mentioned that they expect to officially launch the committee in Q1-2024.

5. Sustainable Finance Virtual Network update

[Secretary note: Item 5 was moved forward to accommodate external speakers.]

The co-chairs of the Sustainable Finance Virtual Network (SFVN) provided an update on the progress on the group's work to CFIF. They were joined by two members of the carbon workstream to present their work on a potential carbon linked bond structure. CFIF members provided constructive comments. The presenters thanked CFIF for their valuable feedback and will further their work considering the key takeaways from the meeting.

6. Other business

CFIF Secretariat tabled the proposed meeting days for 2024 and asked members for potential interest in hosting one of the meetings in the new year.

Meeting participants:

CFIF members:
Jim Byrd, RBC Capital Markets, Co-Chair
Brian D'Costa, Algonquin Capital
Nick Chan, BMO Capital Markets
TJ Sutter, Connor, Clark & Lunn
Karl Wildi, CIBC World Markets
Bronwyn Ward, CPP Investments
Grahame Johnson, Department of Finance Canada
Philippe Ouellette, Fiera Capital
Rob Goobie, Health Care of Ontario Pension Plan
Kelsey Gunderson, Laurentian Bank Financial Group
Vinayak Seshasayee, PIMCO
Jason Lewis, Ministry of Finance, Province of British Columbia
Paul Scurfield, Scotiabank
Elaine Lindhorst, TD Asset Management
Eugene Lundrigan, SLC Management

External participants:
Item 1
Warren Lovely, Managing Director, Economics and Strategy, National Bank Financial

Item 5
John Uhren, Managing Director, Sustainable Finance, BMO Capital Markets
Konstantin Boehmer, Co-head of Fixed Income, Mackenzie Investments
Andrew Vasila, Senior Investment Analyst, ESG & Global Fixed Income, Mackenzie Investments

Bank of Canada:
Toni Gravelle, Co-Chair
Wendy Chan, Secretariat
Harri Vikstedt
Sheryl King
Mark Hardisty
Stéphane Lavoie