CANADIAN
FIXED-INCOME
FORUM

SUMMARY OF THE DISCUSSION

Toronto, November 21, 2023, 4:00 p.m. to 6:00 p.m.

1. Bond Market Structure

The discussion began with a presentation by the Federal Reserve Bank of New York (FRBNY) on the US Treasury market. Ellen Correia Golay, Treasury Markets Advisor, FRBNY, provided an overview of the US Treasury market structure and discussed a recent Federal Reserve Bank of New York staff report on all-to-all trading in the US Treasury market. This was followed by a Bank of Canada presentation on the Government of Canada (GoC) securities market structure and recent trends.

Trading in benchmark[1] bonds dominates the trading volume in both the US and Canadian markets, with much of this trading being done electronically in the US, especially in the inter-dealer market. However, the relative share of benchmark trading versus non-benchmark[2] bonds in the US, including through the inter-dealer market, is much higher than in Canada. This may be a result of the differences in the inter-dealer market structure between the two. The US market has principal or high-frequency trading firms involved in the inter-dealer market, while they are not present in Canada due to inter-dealer platforms imposing a minimum quote life for electronic orders which limits the ability to algorithmically trade the market. This difference is likely the driver behind the divergence in the average size of the transactions taking place in the inter-dealer market between the two jurisdictions, with average trade size in Canada being bigger in the inter-dealer market.

In both countries dealers play a key intermediation role in non-benchmark bonds, where they hedge their duration risk either through benchmark bonds or bond futures. The presenters noted that in Canada 2- and 5-year benchmark bond trading volume has decreased as 2- and 5-year futures volume has increased with potentially more risk transfer taking increasingly place through bond futures than cash bonds.

The presenters also shared their analysis of the potential of all-to-all trading in their respective markets.[3] In both set of analysis, the presenters calculated the percentage of customer trading volume with dealers that has offsetting customer trading volume in the same security for the same settle day and with the same time interval. On average, about half of client GoC bond transactions, approximately 70% for benchmark bonds and 35% for non-benchmark bonds, can potentially be offset with other clients each day.[4] The share of offsetting trades in a day is higher in the US Treasury market, with 90% for benchmark Treasuries and just over 50% for non-benchmark Treasury bonds and notes.

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[1] Also known as on-the-run bonds.

[2] Also known as off-the-run bonds.

[3] "All-to-all trading" is a term used by market observers to describe a range of trading protocols that, in their purest form, would enable any market participant to trade directly with any other market participants.

[4] The equivalent share of offsetting client trades in the 10-year Canadian bond futures contract is over 90%.

Members discussed the possibility and challenges of increasing all-to-all trading adoption and transparency in less liquid securities. They also discussed the benefits of various trading protocols to promote more liquidity in non-benchmark bonds.

CFIF members thanked the presenters for sharing their work and look forward to more discussions on market structure topics at future meetings.

2. CIMPA Update

CIMPA co-chair presented the proposed structure of the group and its proposed Terms of Reference. The key objective of CIMPA is to promote the well-functioning of the Canadian securities and financing markets through improved operational efficiency and reduced market segmentation through industry coordination on related issues and initiatives. The initial efforts will be focussed on getting broad participation in TMX's Canadian Collateral Management Service, which will bring tri-party repo to Canada and help modernize the Canadian repo market. Membership will be comprised of 15 to 20 senior market participants from across the various types of relevant stakeholders in the Canadian financial industry, in addition to the Bank of Canada.

The proposed next step is to host an industry meeting in early Q1-2024 to gain broader buy-in for the initiative, with the group expected to be launched towards the end of Q1-2024.

CFIF members were supportive of the proposed structure and next steps.

3. CARR update

CARR's co-chairs provided an update on the group's work since the last CFIF meeting in September, noting that the CDOR transition is progressing well. Over 90% of interest rate swap trading activity references CORRA, with over 60% of interest rate futures now referencing CORRA.

With CARR's November 1 "no new CDOR loans" milestone being in effect and endorsed by the Office of the Superintendent of Financial Institutions, the loan market is expected to begin to transition in earnest.

The co-chair informed CFIF that TMX has made good progress in signing up clients for Term CORRA licenses. He also reminded members that all market participants who provide financial products referencing Term CORRA need to obtain a license, including all banks that are part of a lending syndicate. Efforts continued to be made by TMX to come to an agreement with Bloomberg on how to distribute Term CORRA over its platform. Term CORRA has been available through Refinitiv since October 9 and can also be obtained directly from TMX Datalinx.

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.

4. 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. The GMF continues to work on finalising the final framework and summary of public comments, both of which are expected to be published by the end of the year.

5. Recent bond market developments

A member provided a debrief of the Debt Management Strategy update from the Fall Economic Statement.

CFIF was joined by Nabeel Rajan, Managing Director, Head of Canada Government Bond Trading, RBC Capital Markets, for a discussion on recent volatility in the long-end GoC markets.

A member introduced the topic by sharing his perspective on the issue. He thought that the supply-demand imbalance in Canadian long bonds could potentially create a liquidity vacuum should demand increase. He is concerned that episodes of acute illiquidity could deter foreign participants from investing the Canadian markets and result in extreme valuations which may send distorted market pricing signals and therefore affect the transmission of monetary policy.

Another member noted that insurance companies and corporate pension plans have been buying longer-dated bonds in recent months to hedge annuities or de-risk their pension portfolio, adding further pressure to GoC long bonds. He also remarked that elevated intra-day volatility has worsened the "winners' curse", and further discouraged market participants from providing liquidity to the market.

Mr. Rajan agreed that there has been a significant increase in volatility in global fixed income markets, including in Canadian bonds, with the Canadian long end sharply outperforming both on the curve and relative to other currencies. He noted that despite volatile price action, client activity has remained robust throughout the year, and he believes that the market functioned relatively well with bid-offer spreads remining generally stable. This is supported by the Bank of Canada published CFIF liquidity dashboard where the liquidity metrics for the long bonds remained steady in the current period.

CFIF members agreed recent concerns raised by participants are mainly due to structural GoC supply issues, which have been further reinforced by reduced provincial long issuance. A few members noted that they expect long provincial issuance to eventually increase to fund upcoming infrastructure needs. Members noted that the recently announced increase in the long GoC bond issuance was helpful.

Meeting participants:

CFIF members:
Jim Byrd, RBC Capital Markets, Co-Chair
Brian D'Costa, Algonquin Capital
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
Jason Lewis, Ministry of Finance, Province of British Columbia
Paul Scurfield, Scotiabank
Elaine Lindhorst, TD Asset Management
Eugene Lundrigan, SLC Management

External participants:
<u>Item 1</u>
Ellen Correia Golay, Treasury Markets Advisor, Federal Reserve Bank of New York
Alain Chaboud, Senior Economic Project Manager, Board of Governors of the Federal Reserve System
Michael Fleming, Head of Capital Markets Studies, Federal Reserve Bank of New York
Frank Keane, Senior Policy Advisor, Federal Reserve Bank of New York
Stephen Spera, Policy and Market Analysis Associate, Federal Reserve Bank of New York
Robert Catani, Head of Institutional Fixed Income and Derivatives Sales and Trading, TMX Group

<u>Item 5</u>
Nabeel Rajan, Managing Director, Head of Canada Government Bond Trading, RBC Capital Markets

Bank of Canada:
Toni Gravelle, Co-Chair
Wendy Chan, Secretariat
Harri Vikstedt
Sheryl King
Jabir Sandhu
Rishi Vala