CANADIAN
FIXED INCOME
FORUM

January 2024

Summary of comments received in the public consultation and GMF responses

Question 1: Do you support the introduction of a fee for failure to settle GoC transactions? If not, please explain.

Comments	Responses
Commenters generally support the introduction of the fee. One commenter expressed concern that the fee could have adverse impacts on GoC market functioning.	**No change.** The fail fee framework was carefully calibrated to be appropriate for the Canadian market. The framework's calibration and extensive trial phase have been designed to ensure that the framework works as intended and remains flexible in case changing market conditions warrant adjustments to the framework. The governance group will monitor for any unintended consequences and recommend changes, if necessary. Please also note that the current overnight rate, which reflects the cost of failing to deliver securities, has not impacted GoC market functioning.
One commenter suggested getting feedback from international investors	**Change made.** The GMF will do some limited further outreach. We note that the fail fee consultation was public in addition to being flagged in bilateral conversations, including with a number of international investors active in the GoC market.

Question 2: Are the parameters of the fail fee (e.g., level of the fee, thresholds for the dynamic component) appropriate for the GoC market? If not, please explain.

Comments	Responses
Commenters generally consider the parameters appropriate.	**N/A**

One commenter suggested using a longer time period for the calibration.	**No Change.** Fails data is not available prior to Oct. 2014. Fails in 2015 are generally above the 2016-2017 levels, but their inclusion would be unlikely to change the calibration materially. Having the start date for the initial trial period after the implementation to T+1 settlement will also allow for vetting the calibration of the various parameters for suitability in the T+1 environment.
One commenter suggested using a uniform fail fee, which could potentially be adapted to specialness. Another commenter suggested a fixed fee at some spread below CORRA.	**No Change.** The 50bp floor is a fixed amount. If the dynamic component is activated, the resulting fail fee would only change infrequently when the Bank changes its target for the overnight rate. The GMF had considered alternative specifications. The chosen calibration balances the simplicity of the 50bp floor against potentially needing a larger fee, which would be provided by the dynamic component if warranted by market conditions. Varying the fee with specialness or as a function of CORRA would result in a more complicated and volatile fee that is less transparent to market participants.

Question 3: Are monthly exchanges of fail fee payments appropriate? If not, at what frequency should they occur?

Comments	Responses
Commenters view the monthly exchanges as appropriate.	**N/A**

Question 4: Is the communication of a "warning" or "activation" appropriate as described? If not, please explain

Comments	Responses
Commenters generally consider communication of the warnings and activations appropriate. One commenter suggested daily reporting of the 10-day moving average fail rate on the Bank's website.	**No change.** As per the Framework, there will be public dissemination of daily fails data alongside the moving average. The exact distribution channel will be determined before the start of the trial phase.
Two commenters suggested that the proposed communication for the dynamic component	**No change.**

may be burdensome and could be avoided with a fixed fee.	The fail fee has been calibrated in a way that the fee is effectively fixed at 50bps, unless the dynamic component is triggered during a rare time of significant stress. Should this occur, the Governance Group would monitor the activation of the dynamic component and could make changes to framework based on the lessons learned.
One commenter is concerned that, as calibrated, the thresholds may not be appropriate in a T+1 settlement environment.	**No change.** As designed, the fail fee would be in the first stage of the trial phase after the transition to T+1 settlement. No fee payments would be exchanged during this period, and the Governance Group would monitor how the transition is adopted by the marketplace. It would also allow for vetting the suitability of the calibration in the T+1 environment. Should changes to the framework be necessary, they could be made before fail fee payment exchange is turned on during the potential second stage of the trial period.

Question 5: Is the bilateral claim process appropriate for capturing fails from non-DvP transactions? If not, please explain.

Comments	Responses
Commenters generally view the bilateral claims process as appropriate. Three commenters highlighted that the bilateral process could create administrative burdens.	**No change.** Due to the nature of non-DvP transactions, it is not feasible to further simplify or somehow centralize the bilateral claims process.
Two commenters requested more details on the bilateral process, e.g., on whether there are carve-outs (e.g., margin transfers), how partial fails should be treated, and whether there would be a deadline for claims.	**Change made.** The final framework will make certain intended carve-outs more explicit and suggest similar practices to how ISDA suggests handling the TMPG fail fee. The Governance Group will subsequently discuss the treatment of partial fails within the suggested bilateral claims process and provide a recommendation for best practices.
One commenter questioned whether the deletion of trade instructions could be abused to avoid paying the fee, and whether settlements after CDSX Payment Exchange would still be subject to the fail fee.	**Change made.** The fail fee is not intended to incentivize settlements after the 4pm CDSX deadline, which can create settlement risks for any resulting movement of uncollateralized funds. However, some inter-affiliate settlements commonly occur after payment exchange. To not interfere with such

	settlements, a deadline of 7:30pm will apply to the definition of a fail in the context of a non-centrally cleared transactions. The Governance Group will monitor the prevalence of settlements taking place after CDSX Payment Exchange. The Group will also monitor for trade submitters abusing their ability to unilaterally delete settlement instructions in CDSX. Accompanying best practices will reference the deletion of settlement instructions.
One commenter requested more detail on which costs can be passed on.	**Change made.** The intent for the fee is to be passed on to the ultimate party responsible for the fail. As a best practice, direct CDS participants should follow this guideline in passing on the fee, although this pass-through would be governed by the bilateral arrangements between the direct participant and its client. As noted above, the Governance Group will discuss the treatment of partial fails and provide a recommendation for best practices.
One commenter requested more details on a potential dispute resolution mechanism.	**Change made.** CDS will resolve disputes related to any potential clerical errors in administering the fee. There is no formal dispute mechanism for issues other than clerical or administrative errors, as such disputes would be between counterparties and, not with CDS. The best practices will include some language as per the TMPG to “handle claim disputes bilaterally and in good faith.”

Question 6: Are there any situations where the fee, as proposed, would duplicate financial penalties already levied for non-delivery of a GoC security by, e.g., market infrastructure providers? If yes, please explain.

Comments	Responses
Commenters generally did not view the fee as duplicative of already existing penalties.	**N/A**
One commenter noted that other costs exist, e.g., relating to capital requirements or reputational impacts.	**No change.** The fail fee addresses the unique situation of a lack of financial incentives during a low-rate environment, which is inadequately captured by other existing measures.

Two commenters highlighted that a fail could also lead to an overdraft for a simultaneous buy.	**Change made.** The accompanying best practices will incorporate language to discourage abusing the framework, e.g., to deliberately fail in order to extract the fee or induce an overdraft. This best practice would also be applicable without the implementation of a fail fee.

Question 7: Is the information that will be provided by CDS to its members sufficient? If not, please explain.

Comments	Responses
Members generally viewed information as sufficient based on the description provided, but would welcome more detail.	**Change made.** The final published framework will include more granular specifications for the reports. These reports can potentially be refined during the trial phase, based on industry feedback.

Question 8: Does the proposed pass-through approach of the fail fee beyond direct CDS participants ensure a level playing field in the GoC market? If not, please explain.

Comments	Responses
Commenters generally consider the pass-through appropriate.	N/A
Two commenters highlighted that direct CDS participants have a much better window into settlements than non-participants (clients), which would allow them to mitigate fail fee exposures more easily.	**No change.** Whether clients are charged the fail fee would be a business decision by the direct participant. The audit trail provided by CDS should be sufficiently granular to appropriately allocate the fail fee (whether paying or receiving) to clients. Should the fee exchange be turned on, the Governance Group would conduct industry outreach to gauge whether uneven pass-through of the fee poses a problem.
One commenter suggested that the pass-through creates uneven incentives if not governed by the depository.	**No change.** CDS will only allocate fail fee charges/disbursements to direct participants (CUIDs), and not to individual sub-accounts, but will provide participants with a detailed audit trail of the underlying failed settlement. Accompanying best practices will lay out an expectation for an even pass-through of the fee.

One commenter suggested that spreading the administrative costs of operating the fail fee evenly among CDS participants creates a disproportionately higher cost for smaller participants.	**No change.** The administrative costs will be allocated evenly among CDS participants transacting in GoC securities. These costs are not expected to be material.

Question 9: Is there any further information that custodians and other fiduciaries need to collect or pass on a fee to clients? If yes, please explain.

Comments	Responses
Two commenters noted that a template would be helpful, and that standardized information would be helpful.	**Change made.** As noted in the response to Q7, the reports will be more fully developed ahead of the trial phase and can also be adjusted during the trial phase, based on industry feedback.

Question 10: Do you support the proposed structure of the trial period? If not, please explain.

Comments	Responses
Commenters generally viewed the structure of the trial period as appropriate. One commenter requested more certainty around the dates.	**Change made.** The timeline has been updated to better accommodate other industry projects, including the transition to T+1 settlement and CDS Post-Trade Modernization.

Question 11: Do you agree with a notice period of 6 months prior to potentially activating fail fee exchange in stage 2 of the trial period? If not, please explain.

Comments	Responses
Commenters generally agreed that a 6-month notice period is appropriate.	**N/A**

Question 12: Are the governance considerations appropriate? If not, please explain.

Comments	Responses
Commenters generally considered the governance considerations appropriate; one commenter requested more details on the mandate and make-up of the committee.	**No change.** Governance of the framework is proposed to rest with the newly to-be-formed Collateral

	Infrastructure and Market Practices Advisory Group (CIMPA). CIMPA will be an Advisory Group reporting to CFIF, with a broad mandate to promote operational efficiency in the Canadian securities financing and collateral markets through industry coordination.
One member requested more detail on how CDCC fails will be handled.	**Change made.** The final framework will provide more detail on CDCC fails. In brief, CDCC fails and any associated fees will be assessed as of the CDSX Payment Exchange deadline. Fails and any associated fees will be assigned to participants using the existing procedures and priority hierarchy for settlements when insufficient collateral is delivered to CDCC.

Question 13: Are there any other aspects of the fail fee or market functioning that the Governance Group should monitor? If yes, please explain.

Comments	Responses
One commenter requested further analysis on the fail fee's impact on CORRA, liquidity, and different types of market participants. The commenter also suggested applying the fee to aged fails only.	**No change.** The trial period is designed to provide transparency on the fee before any potential activation of the fail fee exchange. Only applying the fee to aged fails was considered by the GMF, but ultimately not pursued further.
One commenter suggested that the Governance Group report fails metrics, such as size of fails, collateral type, type of failing counterparty, etc.	**Change made.** The Governance Group will monitor fails characteristics and provide updates to CFIF. High-level takeaways could be made public.
Another commenter suggested monitoring the impact on repo specialness for individual ISINs.	**Change made.** The Governance Group will monitor repo specialness.

Question 14: Additional comments

Comments	Responses
A few commenters requested investigating the potential adoption of FoP deliveries in the future.	**No change**. There are unique challenges related to FoP deliveries that would make it very difficult to impose a fail fee via a centralized CDS infrastructure. However, within the current proposed framework,

	market participants would be able to claim an FoP fail fee bilaterally if an FoP delivery fail feeds into a DvP fail that incurs the fail fee. The Governance Group will develop best practices for these types of fails.
One member questioned the necessity of a permanently active 50bp floor.	**No change**. As outlined in the framework, the trial period provides for decision points on whether to turn on fee exchange, and, if turned on, whether to keep it active. The lessons learned during the trial phase will inform any decision on this issue. The GMF had discussed on "off-switch" during its deliberations, but its governance was deemed to be burdensome. We also note that experiences in other jurisdictions suggest that toggling the fee on and off is undesirable; nevertheless, the Governance Group will be able to make recommendations that are appropriate for the Canadian market.
Two members questioned whether the fee could incentivize large holders of bonds to withhold their inventory in order to "extract" the fail fee.	**No change**. In principle, hoarding securities to extract the special spread is possible in the absence of a fail fee. Yet we are not observing such behaviour with today's higher policy rates. This type of activity is also discouraged by rules such as IIROC DMR 2800.
One commenter suggested that a fail fee could stifle innovation in the GoC market and divert resources from core operations or other initiatives like T+1 settlement.	**Change made**. The GMF has adjusted the timeline of the trial phase to minimize competing priorities. Since the fail fee is governed by a single depository, providing transparency and ensuring the pass-through of the fee is expected to be much more efficient than in jurisdictions with multiple depositories. The fee should also encourage market participants to make their settlement processes as efficient as possible.