

# 4<sup>th</sup> Annual CASLA Securities Lending Conference

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## Fixed Income Panel Discussion

*Thursday May 8<sup>th</sup>, 2014*

*Toronto, Ontario*

**Moderator:** Nick Chan, BMO Capital Markets

**Panelists:** Jeff Benner, Northern Trust  
Charles Lesaux, RBC Capital Markets  
Steve Novo, State Street  
Chris Tigert, BNY Mellon

# CASLA 2014: Fixed Income Repo Panel Discussion

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- **Regulatory Changes**
  - *Basel III*
  - *Opportunities for the industry?*
- **Central Counterparty Clearing Models**
  - *The impact on the repo market*
- **Scarcity of AAA Rated Collateral in the Financial System**
  - *What are the drivers?*
  - *Is this cyclical or structural? Where do we go from here?*

# CASLA 2014: Fixed Income Repo Panel Discussion

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*“The securities-lending market facilitates an increase in overall market liquidity and in the flexibility of financing. It promotes market efficiency by enhancing the price-discovery mechanism in cash securities markets. For these reasons, and because of its role in supporting market-making activities, the securities-lending market has been identified by the Bank of Canada as one of the five core funding markets.”<sup>1</sup>*

*“The Role of Securities Lending in Market Liquidity”, Nadja Dreff  
The Bank of Canada Financial System Review, June 2010*

<sup>1</sup> The other core funding markets are: (i) the market for Government of Canada treasury bills and bonds; (ii) the repo market; (iii) the market for bankers' acceptances; and (iv) spot and swap foreign exchange markets.

# Regulatory Changes

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Under Basel III, the Basel Committee on Banking Supervision has introduced the following ratios as guidelines with respect to bank funding:

- **Basel III Leverage Ratio**

- *Public disclosure begins January 2015, full implementation scheduled for January 2018*

- **Net Stable Funding Ratio**

- *Comment period ended April 11, 2014 and it will become a minimum standard by January 1, 2018*

# Regulatory Changes

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- **Basel III Leverage Ratio**

$$\text{Leverage Ratio} = \frac{\text{Capital Measure}}{\text{Exposure Measure}}$$

- Capital Measure is defined as Tier 1 Capital
- Exposure Measure is defined as the sum of on-balance sheet exposures, derivatives exposures, securities financing transaction exposures and off-balance sheet exposures.
- Institutions must attain a minimum Basel III Leverage Ratio of 3% by January 1, 2015

# Regulatory Changes

- **Example calculation for a 1-year repo under Basel III leverage ratio**
  - 1-year repo rate **1.05%** for 365 days: 239 days fall in calendar 2014 and 126 days in 2015
  - The repo rate which would reflect the **full** cost of capital under a 3% leverage ratio would be:

	<b>Scenario 1</b>	<b>Scenario 2</b>
	Leverage Ratio @ 3% Cost of Capital @ 15%	Leverage Ratio @ 3% Cost of Capital @ 10%
1-Year Repo Rate	<b>1.205%</b>	<b>1.153%</b>

# Regulatory Changes

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- **Net Stable Funding Ratio (NSFR)**

$$\frac{\text{Available amount of stable funding}}{\text{Required amount of stable funding}} \geq 100\%$$

- Comment period ended April 11, 2014 and it will become a minimum standard by January 1<sup>st</sup>, 2018

# Regulation: The Unintended Consequences

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**“Liquidity Trap Hitting AAA Bonds Has ATP CEO Sounding Alarm”** – *Bloomberg May 1, 2014*

**“Junk Loans Pulled As Investors Say No After Fed Raises Concerns”** – *Bloomberg May 1, 2014*

**“Leveraged Loan Crackdown Drives Borrowers to ‘Shadow Banks’”** – *FT April 29, 2014*

**“Banks Increase Borrowing From US Home-Loan System – Rise Attributed to Meeting Basel III Liquidity Rules”** – *WSJ, April 16, 2014*

**“We Will Dedicate Extraordinary Effort in 2014 Adapting to the New Global Financial Architecture”** – *Jamie Dimon, Chairman & CEO of JPMorgan Chase, writing in his 2013 Annual Letter to Shareholders*



# Central Counterparty in Repo Initiative in Canada

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- **Increased ability for participants to capture the benefit by netting down trades inside the CCP**
- **Expansion of the platform to include buy-side participants**
- **The increasing amount of collateral tied up in margin at CCPs**

# Shortage of AAA Rated Collateral in the Financial System

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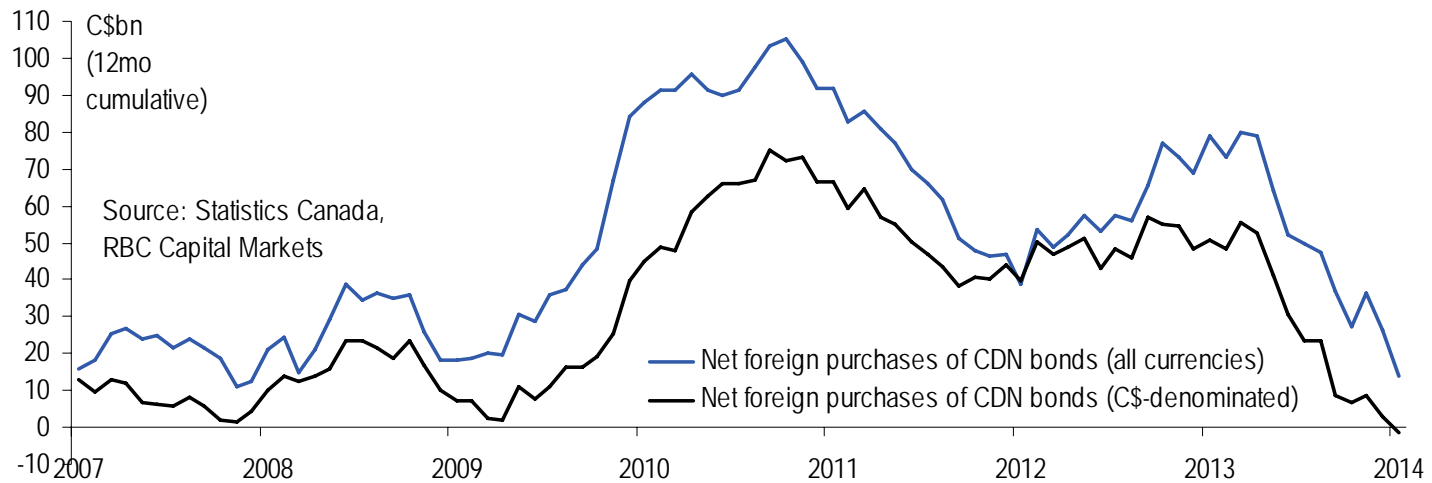
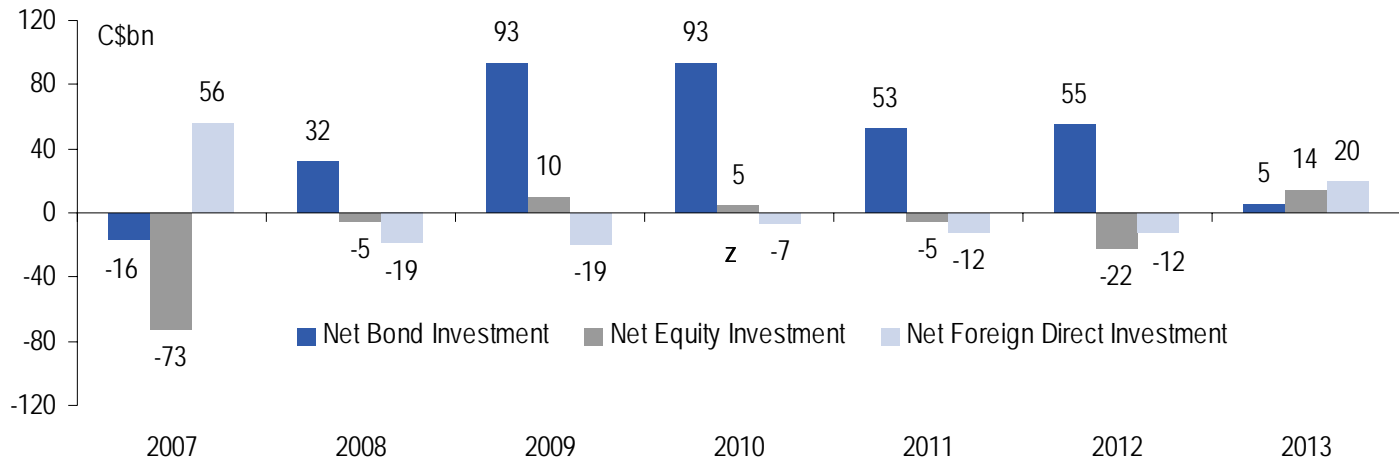
- **“Triple A Sovereign Ratings Deposed”**

— *FT, March 31<sup>st</sup>, 2014*

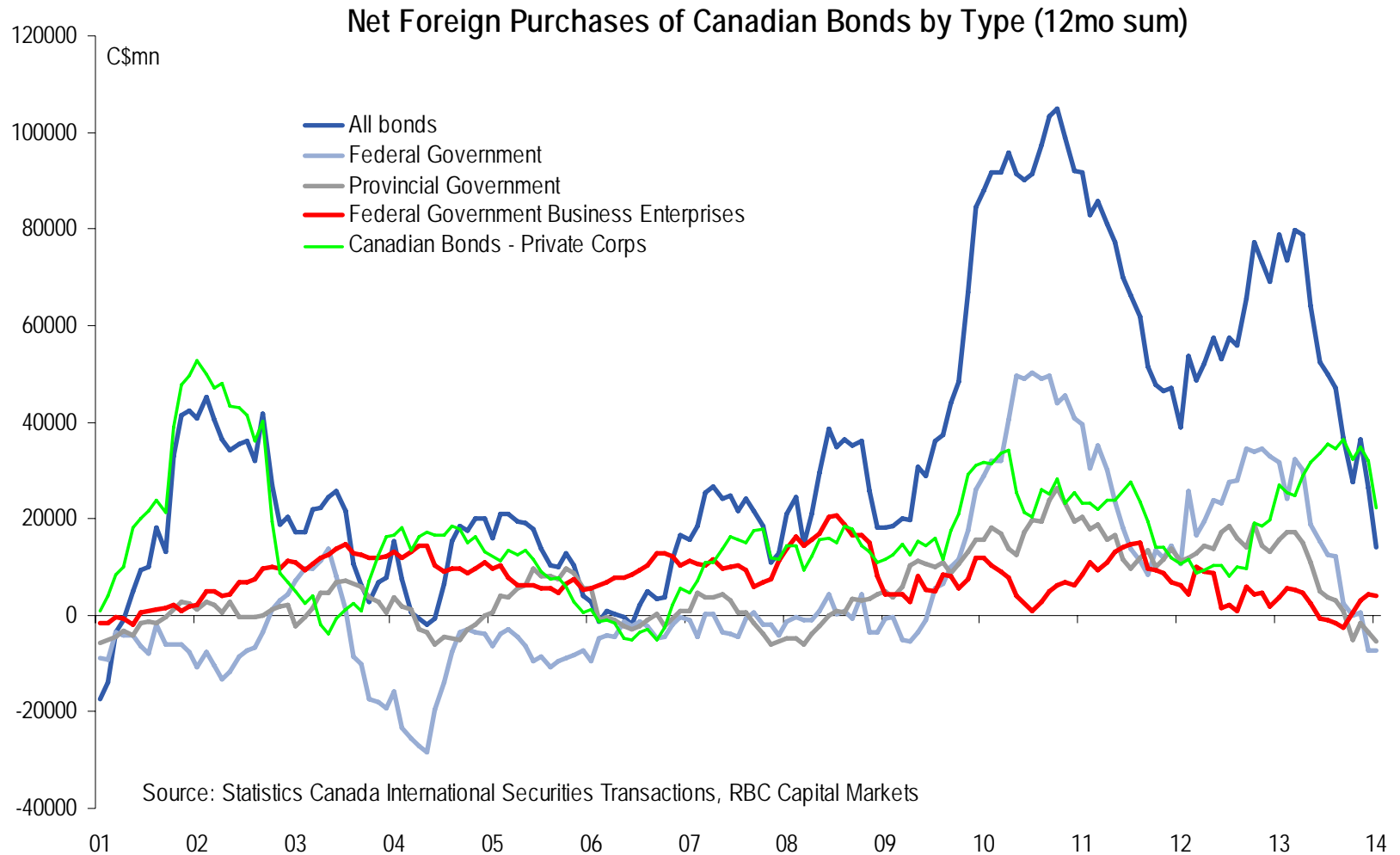
- **“Not Enough 30-Year Bonds in \$12.1 Trillion Treasuries Market”** — *Bloomberg*

*May 5, 2014*

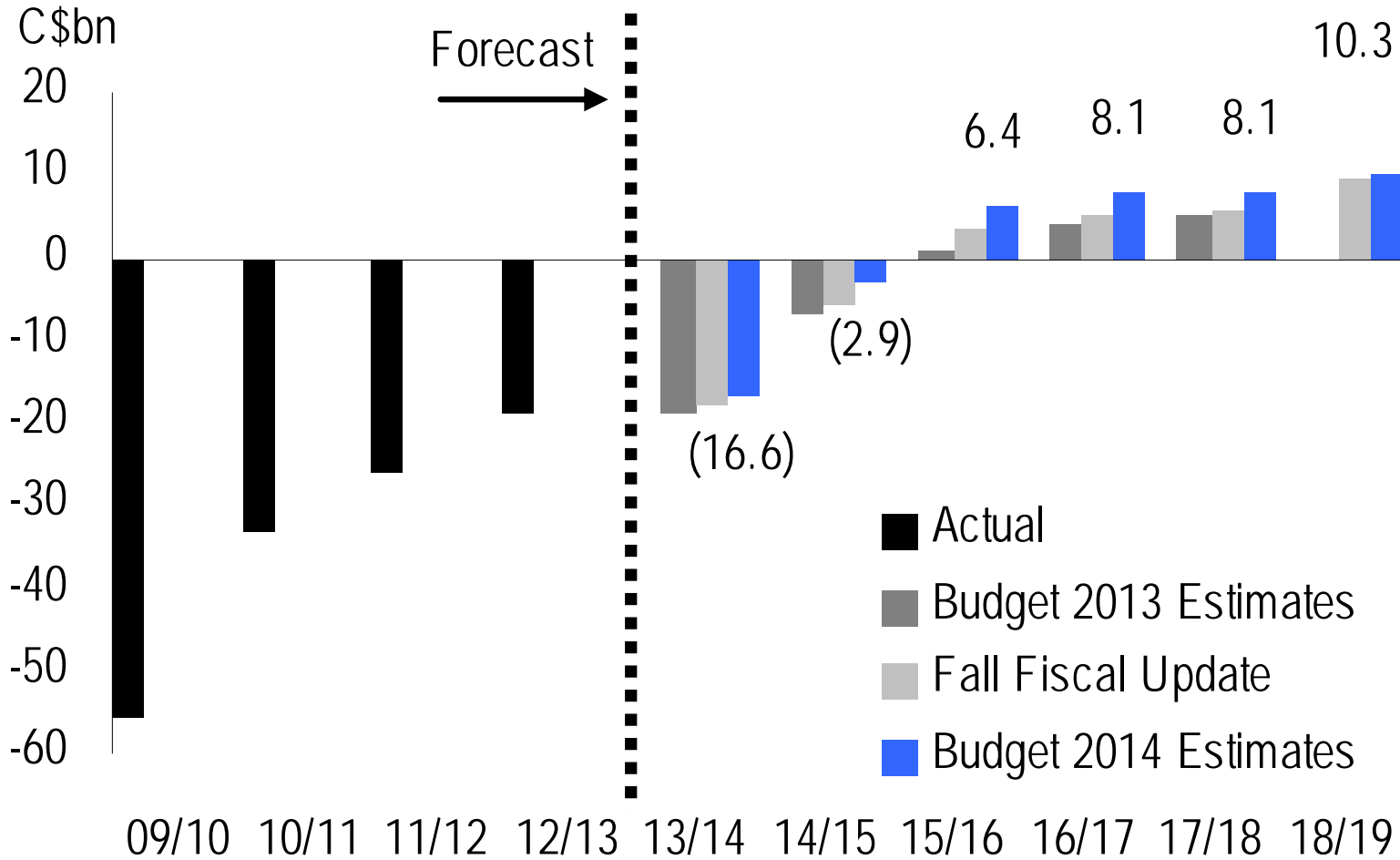
# Flows into Canadian Bonds Have Supported the Currency, Capped Yields



# More Foreign Flows into Corps = Waning Safe-Haven Demand?

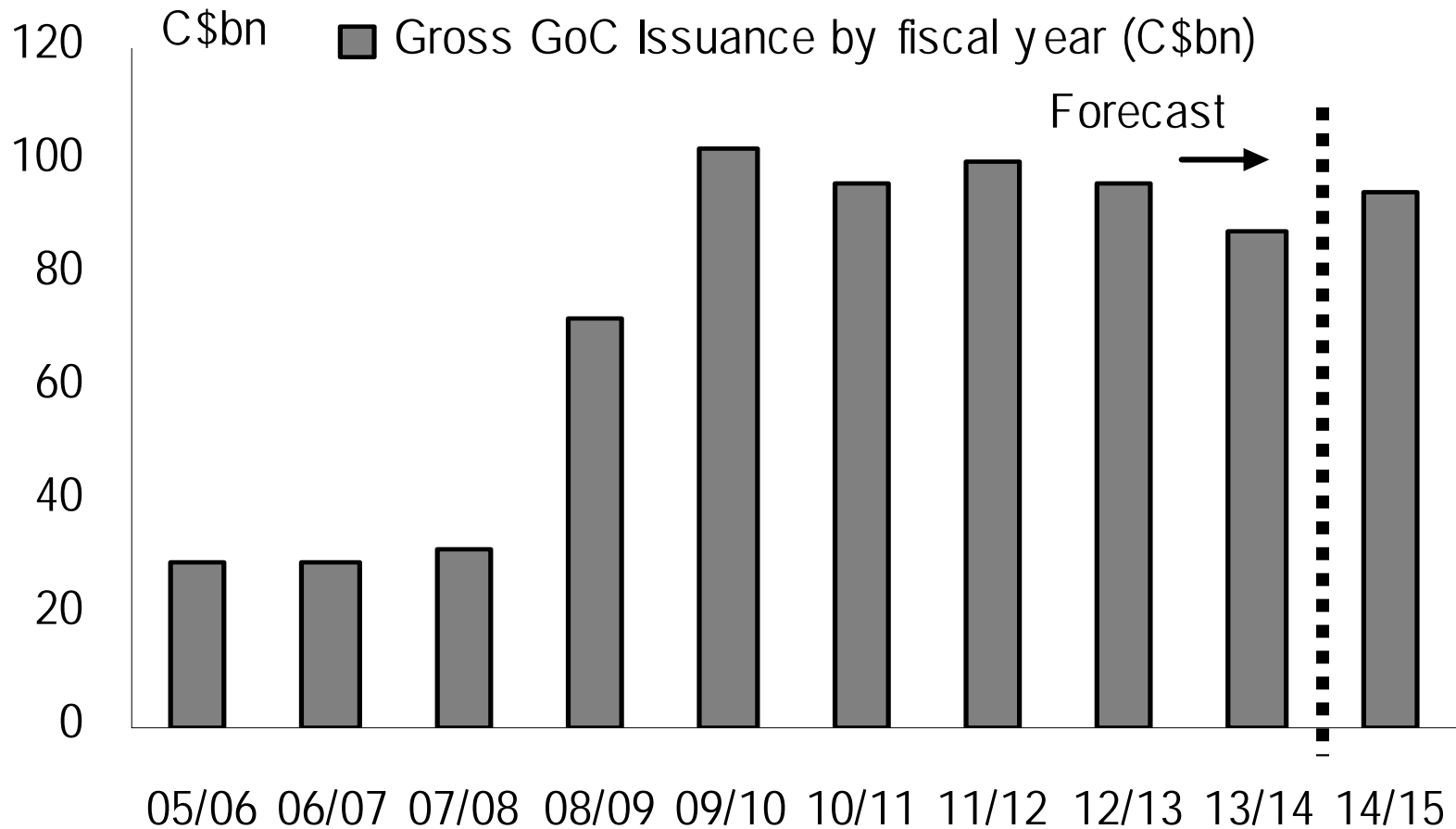


# Canadian Federal Government Budgetary Balance

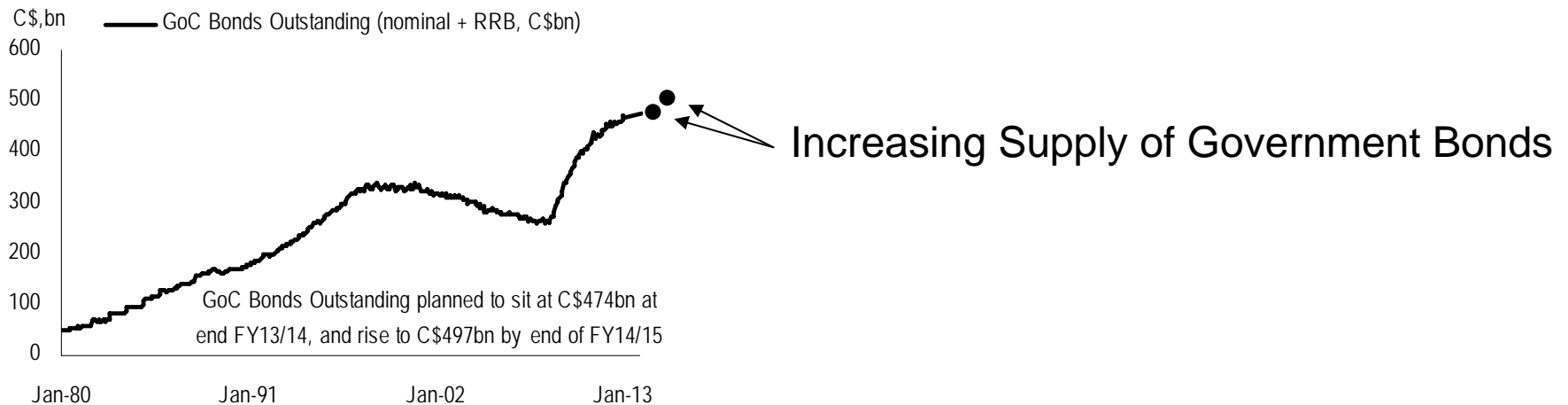
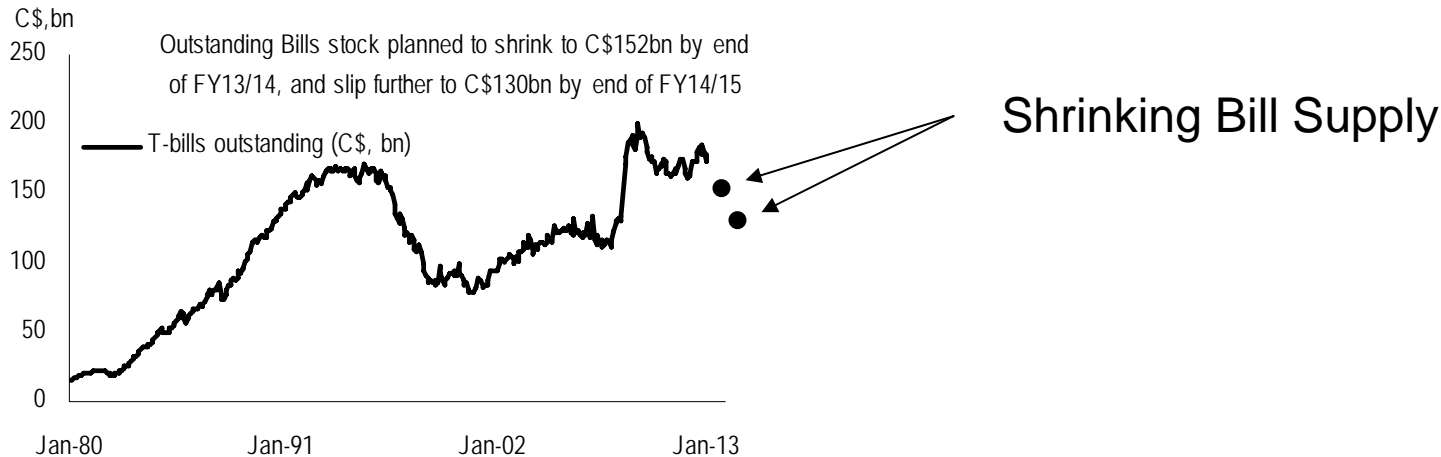


Source: Department of Finance, RBC Capital Markets

# Gross GoC Issuance by Fiscal Year (C\$bn)



# Canadian T-Bill Supply Expected to Shrink Further and Bonds Outstanding to Near C\$500bn



# Central Bank Demand Has Held Up Reasonably Well

