Canadian Bond Investors' Association
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July 5, 2023

Funds Management Division
Financial Sector Policy Branch
Department of Finance Canada
90 Elgin Street
Ottawa, ON
K1A 0G5
Via email: CMBconsultation-consultationsOHC@fin.gc.ca

Re: Consultation on the Proposal to Consolidate Canada Mortgage Bonds

Dear Sir/Madam,

The Canadian Bond Investors' Association (the "CBIA") thanks the Department of Finance for the opportunity to comment on your consultation on the potential elimination of Canada Mortgage Bonds (CMBs).

The CBIA represents over 50 of the largest fixed income institutional investor organizations in Canada, with over $1.8 trillion in fixed income assets under management. Our member organizations include sophisticated institutional investors such as insurance companies, bank-owned investment managers, pension funds and investment advisers. Our mandate includes acting on behalf of institutional fixed income investors in addressing key issues with legislators, regulators, bond issuers, investment dealers and other industry participants. We are the voice of Canadian bond investors and speak not only for those investors but also for the pensioners, policy holders and retail investors who depend on our members for the sound management of their investments.

The CMB program has been a successful, highly liquid component of the fixed income market supporting Canadian consumers and mortgage borrowers, in particular. The program has been a large component of the development of the Canadian capital markets over the last twenty plus years. It has attracted many international investors to undertake a deep examination and analysis of Canada, its capital markets and the housing and mortgage markets as an investment opportunity – and has ultimately led to a significant flow of foreign capital into the Canadian capital markets.

The Canadian bond investment community notes that the loss of CMBs would be a significant change for the market which deserves careful consideration. Thus, we welcome the formal consultation process. There are both foreseeable and likely unforeseeable impacts of eliminating this product that have created significant benefits over the last several decades in our market.

It should be noted that based on investor comments we have heard so far, it is highly likely that many of today's investments in CMBs by both local and international investors will not flow into replacement Government of Canada (GoC) bonds. This reduced investor demand combined with the incremental issuance of GoC bonds needed to continue to support mortgage borrowers will likely lead to increased yields on all GoC bonds. While the Government of Canada would not be taking on credit risk by eliminating CMBs, it would be adding significant supply of new debt through new issuance, management and refinancing over time, which is expected to add rollover and other risks to the existing GoC program. These dynamics are likely to offset the perceived benefit to the Government of Canada of replacing CMBs with GoC bonds.

Bond investors also note that the elimination of CMBs is expected to cause other changes in the fixed income market. Liquidity is always a major concern within the investment community and most importantly at times of heightened volatility that we have been experiencing in recent times. The CMB liquidity will be negatively impacted as issues mature through the run-down of the program. The broker-dealers will have much reduced incentives to facilitate market making and maintain orderly market. We have already observed these changes when the real return issuance ceased unexpected last year.

CMBs are an important source of supply of floating rate instruments (FRN), which have been especially important in the rising interest rate environment. The reduction of FRN supply will adversely impact an already depleted space since FRN issuance has been challenged for some time. The timing is also important because of the upcoming migration to CORRA and the expected elimination of banker's acceptances (BA) which will have a material impact on money markets. There is a significant concern about overall impact on many Canadians looking for these specific investment opportunities.

It is very difficult to predict how much the GoC bond yields will change as a result of the consolidation of the CMB program, or how markets would otherwise be impacted. But it would have material impacts in our view, and without a clear understanding of what the costs and broad implications would be, we feel it is unwise to upend such a successful, well-developed and honed program.

The Department of Finance is encouraged to consider carefully since GoC yields are used as a foundation for pricing risk assets, including government or corporate credit securities. A change in the underlying GoC yields will increase funding costs for issuers and will reduce valuations of existing securities. We have already observed a trend of domestic issuers funding in foreign markets and this change will likely cause more issuances to be diverted outside of Canada.

The CBIA thanks the Department of Finance for the opportunity to comment on the potential elimination of the Canada Mortgage Bond program and requests that it carefully consider whether the elimination of the CMB program is indeed beneficial for Canadians broadly.

Sincerely,

Peter Waite

Peter Waite
Executive Director