IIAC ACCVM

Investment Industry Association of Canada Association canadienne du commerce des valeurs mobilières

May 3, 2023

Nicolas Moreau
Associate Assistant Deputy Minister
Department of Finance

Dear Nicolas,

Re: CMB Consolidation Consultation

We are writing you on behalf of the Investment Industry Association of Canada (IIAC) and its members.

The IIAC is the national association representing investment firms that provide products and services to Canadian retail and institutional investors. The IIAC represents financial services firms, and registration categories, of every size and type, operating in Canadian and global capital markets. The IIAC represents members that manufacture and distribute a variety of securities including mutual funds and other managed equity and fixed income funds and provide a diverse array of portfolio management, advisory and non-advisory services. IIAC members trade in and equity on all marketplaces, provide carrying broker services and underwrite issuers in public and private markets.

The IIAC would like to express its concern with the Department of Finance over the plan to undertake market consultations on the proposal to consolidate the Canada Mortgage Bonds (CMB) within the government's regular borrowing program.

The IIAC has a number of questions for the Department of Finance including:

1) How will funding cost over Government of Canada (GoC) issuance level be determined and will it be in a transparent, predictable, and fair way?

2) Assuming there are program revenue savings, what assurance is there that the savings will be used towards affordable housing programs?

3) How will investor needs be managed both in terms of liquidity of existing issues held and availability of products with similar yield and risk characteristics? Will holders of existing issues have a rightful complaint that CMBs held were purchased under false pretext if liquidity in these issues declines? Legacy CMB assets will potentially trade by appointment, much like old Farm Credit and Export Development Canada (EDC) bonds.

4) What are the implications for mortgage lending competition, and will there be an impact on smaller specialty lenders and rates on shorter term mortgages? Will the new structure maintain the existing eligibility requirements for sellers to the program and intermediation swap counterparties? Will the program continue with a non-amortizing principal reinvestment swap feature, and will the program continue to accept all MBS pool types with a consistent pricing methodology?

5) What are the main implementation considerations which may affect the availability of competitive mortgage lending during the phase in period?

6) Are there any potential alternatives to the consolidation of CMB borrowing into the government's regular borrowing program being considered?

7) Is it really the government's role to set the funding cost for insured mortgages?

We have identified a number of potential risks particularly with respect to market functioning:

- Currently there is approximately $260 billion in CMBs outstanding, and it is estimated that roughly $100 billion, or 40%, are held by non-residents. How many of these foreign investors will exit the Canadian market and will this have an effect on market functioning?
- What work has been done to provide a high level of confidence that the consolidation of the CMB program into the GoC borrowing program would not increase GoC yields? Ultimately, GoC bonds outstanding will increase by approximately 20%.
- What shift in higher rates would negate potential savings from a consolidated borrowing program? Higher GoC yields would also add to the cost of financing for other government and corporate borrowing programs.
- Any temporary or permanent re-pricing of the GoC curve from the structural inclusion of C$40bln CMB Issuance annually, will indirectly impact costs paid by Issuers who borrow as a referenced spread to the GoC curve. Some the of largest borrowers include Provincial, Municipals, Pensions and Corporates.
- Consolidation of the CMB program will remove regular benchmark Issuance of 5yr and 10yr tenors within the Government credit sector, which will constrain liquidity for other regular borrowers like Provincials. This could result in larger Bid Offer spreads being charged to Investors which over time could raise the cost of primary market offerings for Provincials as liquidity in secondary markets is reassessed by investors. Other borrowers will experience a similar dynamic across smaller borrowing programs relative to Provincials.

Considerations for mortgage lenders and consumer choice:

- Smaller mortgage lenders have provided options for Canadian consumers away from the large Banks, which the CMB program has promoted and supported over the years. A consolidation of the CMB program will result in smaller lenders incurring additional costs to participate in this market, which could see consolidation within the Canadian mortgage market to the larger lenders. As a result. Canadians could see less choice and higher borrowing costs which will not support the Federal Government objective to improve affordability of housing for Canadians.
- The CMB program has been a predictable source of funding with flexible issuance. Under consolidation into the GOC issuance program lenders may be impacted by the GOC auction calendar that is committed to only two months in advance and doesn't provide a range of issuance sizes. While GoCs will allow originators to hedge out interest rate risk, CMBs offer both rate and spread protection to mortgage commitments with a high degree of correlation to the mortgage market. The notion of setting a fixed spread vs GoCs, which is not tradeable, essentially eliminates a component of market-based pricing for Canadian borrowers and moves away from the global regulatory movement to transparent market set rates.
- While single family residential is generally a 120-day (or shorter) commitment period, multi-residential (10y) can take 8+ months. The GoC debt schedule is only posted quarterly. What happens if they decide not to issue a sector in any given quarter?
- Funding Capacity: Is the amount of funding generated by the CMB program is significantly larger than implied by the $40B in new annual issuance, largely due to the current Intermediation swap process which allows for principal reinvestments on the amortization of Original Sale Assets?

Alternative proposals and other items to consider:

- Would the Government propose alternatives to a CMB program consolidation?
- What are the implications of removing the CMB FRN program (vs no GoC FRN issuance) on variable rate mortgage offerings to Canadian homeowners? Does the Department of Finance assume that you can hedge fixed/floating rate risk at no additional cost ?
- If a large portion of L1HQLA investible assets were removed from the bond market, which replacement products would be available to the investment community (investor exposure to other credits, such as provincial bonds, is already limited). Pension funds are unlikely to create additional supply. This could potentially benefit the maple bond market and SSA's should see increased demand.
- Has the Department of Finance considered repo market implications?
- Is there credence to the idea around potentially using a combination of increasing GoC bonds and T-Bill issuance?

The IIAC appreciates your consideration of our recommendations. Should the Department of Finance have any questions regarding this letter, please do not hesitate to contact us.

Sincerely,

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