

SECTOR COMMENT

29 February 2024



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ABCP – Canada

Strong counterparties will support credit quality of upcoming repo-backed ABCP

The Canadian Derivatives Clearing Corporation's (CDCC) upcoming asset-backed commercial paper (ABCP) program for repurchase obligations (repos) will provide money market investors with a substitute for Bankers' Acceptances (BAs) as BAs wind down in mid-2024. In the ABCP program, set to launch in April, repo counterparties' credit strength will uphold the ABCP's credit quality, with the counterparties' repo payments flowing directly to ABCP note repayments.¹ CDCC's repo program will be the first of its type in the Canadian ABCP sector, which currently consists only of bank-sponsored, multi-seller programs.

As the new ABCP's credit quality will fully depend on the repo counterparties, the ratings floors and other requirements for participating banks and investment dealers will help uphold ABCP performance. To participate in the program, CDCC will require all counterparties to have ratings of at least Aa3/P-1. Participating entities will sell eligible securities to CDCC's Securitized General Collateral (SGC) Trust, and unconditionally agree to repurchase those securities on a fixed future date, typically in 30, 60, or 90 days. The trust will fund each purchase by issuing notes (SGC Notes) matched to the amount and term of each repo agreement (see the exhibit).

Exhibit 1

Comparison of the SGC Notes program with bank-sponsored ABCP programs and BAs

Characteristics	SGC Notes	Bank multi-seller ABCP	Bankers' Acceptances
Issuer	Special-purpose trust	Special-purpose trust	Canadian banks
Trust sponsor and administrator	CDCC	Canadian banks	n/a
Servicer(s)	CDCC	Canadian banks and finance companies	n/a
Form of assets	HQ liquid securities	Term and trade receivables	n/a
Note series	Separate series of SGC Notes for each repo counterparty	Single series	n/a
Issuance terms	Typically 30 to 90 days, matched to the amount and term of the related repo	Typically 30 to 90 days	Typically one month
Primary repayment source	Counterparty payment to repurchase assets at repo close	Collections from assets	Obligation of issuing bank
Liquidity backup	Repo agreement serves as both credit and liquidity support	Trust can conditionally draw on liquidity lines from bank sponsors	n/a

HQ = high quality.

*For partially supported programs, liquidity will fund only up to the level of performing assets plus accrued and unpaid interest, so investors have some exposure to credit risk on the assets. In fully supported programs, liquidity must fund up to the face amount of outstanding ABCP, shielding investors from exposure to credit risk on the assets.

Source: Moody's Investors Service

When BA issuance ends this year because of the June discontinuation of a key benchmark interest rate, the SGC Notes program will provide investors with a similar type of debt obligation to help uphold access to the money market. By increasing repo accessibility, CDCC's new program will make the Canadian money market similar to other jurisdictions, where repo is used to invest cash by a wide range of participants, including by money market mutual funds and corporate treasuries.

An orderly transition away from BAs will help support the Canadian money market's functioning. BAs are the second largest component of Canada's money market, after Government of Canada Treasury bills, with about CAD80 billion of BAs outstanding at the end of 2023. BA pricing is linked to the Canadian Dollar Offered Rate (CDOR), which is being discontinued on 28 June 2024, resulting in the cessation of BA issuance.

Makeup and size of Canada's ABCP sector

The Canadian ABCP sector comprises 19 multi-seller programs, sponsored and administered by the six largest Canadian banks. Sponsors are all rated Aa3/P-1 or higher and provide liquidity support for their respective programs. Most programs are partially supported, though some moved to full support in 2023.

Aggregate outstanding ABCP issued by the Canadian programs has grown consistently over the past decade and was just over CAD48 billion in December 2023. These programs fund traditional asset classes originated and serviced by experienced Canadian finance companies, supporting their high credit quality. Prime residential mortgages and auto receivables are the leading asset classes, recently making up 43% and 38% of outstandings, respectively.

CDCC's repo experience, regulatory oversight will help mitigate operational risk

To support its roles as servicer and administrator for the SGC Notes program, CDCC will be able to draw upon its lengthy repo and derivatives experience. Established in 1975, CDCC is the central clearing counterparty (CCP) for all exchange-traded fixed-income repo and derivatives products in Canada. CDCC executes repo trades with multiple counterparties, oversees funds transfers, and is responsible for the movement, retention and monitoring of securities collateral. In 2022, it cleared a daily average of CAD32 billion in repos and CAD102 billion in exchange-traded derivatives.

At the federal level, CDCC is subject to ongoing regulatory oversight by the Bank of Canada (BoC), Canada's central bank, under the Payment Clearing and Settlement Act. CDCC is one of only five Canadian entities designated by the BoC as being systemically important within the Canadian financial system, reflecting the value of the transactions it clears and its critical support role.

At the provincial level, CDCC is regulated by Quebec's Autorité des marchés financiers (AMF), the Ontario Securities Commission and the British Columbia Securities Commission. It is through the AMF that CDCC, as a regulated clearinghouse under the Derivatives Act (Quebec), has the authority to adopt operating rules that are binding upon its clearing members and will govern the SGC repo transactions.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody's.com> for the most updated credit rating action information and rating history.

Endnotes

- 1 Similar to non-bank-sponsored repo ABCP programs in the US and Europe, repayment is not intended to come from proceeds of the purchased assets at their maturity.

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