FIXED INCOME MARKET REGULATORY UPDATE

October 2017

Keeping you informed on recent policy and regulatory developments shaping credit markets in Canada & abroad

Canada

Canadian Monetary Policy

On October 25, 2017, the Bank of Canada (BoC) maintained its target for the overnight rate at 1 per cent. The Bank Rate is correspondingly 1 1/4 per cent and the deposit rate is 3/4 per cent. In its rate decision, the BoC noted that measures of core inflation have edged up and projects inflation to rise to 2 per cent in the second half of 2018. The BoC still expects global growth to average around 3 1/2 per cent over 2017-19. However, this outlook remains subject to substantial uncertainty about geopolitical developments and fiscal and trade policies, notably the renegotiation of the North American Free Trade Agreement.

Detailed information surrounding the BoC's assessment of current and expected economic conditions and the key risk factors it has identified are contained within its Monetary Policy Report.

DBRS Ratings for Canada and its Crowns

On October 13, 2017, DBRS Inc. confirmed the Government of Canada's Long-Term Foreign and Local Currency Issuer Ratings at AAA and Short-Term Foreign and Local Currency Issuer Ratings at R-1 (high). DBRS supports Canada's AAA ratings by noting the country's large and diverse economy, prudent macroeconomic policymaking, and strong public institutions. Furthermore, it says the economic recovery in Canada has recently accelerated and become more broad-based with a positive near-term growth outlook supported by robust foreign demand and strengthening business confidence. However, uncertainty over U.S. trade and tax policies poses risks to the outlook, and domestic imbalances remain a source of concern. Other potential risks noted by DBRS include high levels of household debt and house prices in the Toronto and Vancouver areas above levels consistent with economic fundamentals.

DBRS also confirmed the AAA long-term ratings and the R-1 (high) short-term ratings on the following Crown Agencies: Business Development Bank of Canada, Canada Mortgage and Housing Corporation, Canada Post Corporation, Export Development Canada and Farm Credit Canada.

CSA Proposes Changes to Mandatory Clearing of Derivatives

The Canadian Securities Administrators (CSA) have published for comment proposed amendments to National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives* (the National Instrument), and proposed changes to Companion Policy 94-101 *Mandatory Central Counterparty Clearing of Derivatives* (the CP). The purpose of the Proposed Amendments is to refine the scope of counterparties to which the Clearing requirement applies and the types of derivatives that are subject to the Clearing requirement.

United States

Treasury's Recommendations for U.S Capital Markets Regulatory Reforms

The U.S. Department of the Treasury ("Treasury") released a review of the regulatory framework for U.S. capital markets identifying what it sees as significant opportunities for reform. The recommendations aim to promote economic growth and vibrant financial markets, while maintaining strong investor protection, preventing taxpayer-funded bailouts, and safeguarding the financial system. Treasury's recommendations are organized in the following categories:

- Promoting access to capital for all types of companies, including small businesses, through a reduction of the regulatory burden and improved market access to investment opportunities;
- Fostering robust secondary markets in equity and debt;
- Appropriately tailoring regulations on securitized products to encourage lending and risk transfer;
- Recalibrating derivatives regulation to promote market efficiency and effective risk mitigation;
- Ensuring proper risk management for CCPs and other financial market utilities;
- Rationalizing and modernizing the U.S. capital markets regulatory structure and processes; and
- Advancing U.S. interests by promoting a level playing field internationally.

The report reaffirms Treasury's prior recommendations pertaining to improving the availability of secured repo financing through adjustments to Basel III capital requirements and supporting corporate bond liquidity by revisiting aspects of the Volker Rule and capital standards. Also included in the report is a recommendation that trading platforms operated by FINRA member broker-dealers that facilitate transactions in Treasury securities be required to identify customers in their reports of Treasury security transactions to TRACE. This recommendation is largely targeted at obtaining increased visibility on the trading of treasuries conducted by Principal Trading Firms who are not FINRA members and hence not required to report into TRACE. Treasury intends to work with SEC and FINRA to assess the feasibility of, and implement, this policy.

In Canada, the Investment Industry Regulatory Organization of Canada (IIROC) has currently out for public comment its own proposal to require client identifiers on all transactions submitted by IIROC dealer members to a marketplace or on fixed income transactions.

SEC Announces Relief on Cross-Border Implementation of MiFID II's Research Provisions

On October 26, 2017, the U.S. Securities and Exchange Commission (SEC) issued three related no-action letters to provide market participants with greater certainty regarding their U.S. regulated activities as they engage in efforts to comply with the research requirements of MiFID II in a manner that is consistent with the U.S. federal securities laws. Specifically: (1) broker-dealers, on a temporary (30-month) basis, may receive research payments from money

managers in hard dollars or from advisory clients' research payment accounts; (2) money managers may continue to aggregate orders for mutual funds and other clients; and (3) money managers may continue to rely on an existing safe harbor when paying broker-dealers for research and brokerage.

During the period of the temporary relief, SEC staff will monitor and assess the impact of MiFID II's research provisions on the research marketplace and affected participants to determine whether more tailored or different action, including rulemaking, is necessary and appropriate in the public interest.

U.S. and EU Reach Equivalence Decision on Derivatives Trading Rules

On October 13, 2017, the U.S. Commodities Futures Trading Commission (CFTC) and the European Commission (EC) announced they have come to an agreement to recognize each other's rules governing derivatives trading. Specifically, the CFTC stated that a swap dealer or major swap participant that is subject to the both the CFTC's and EU's margin rules with respect to an uncleared swap may rely on substituted compliance wherever available under the CFTC's margin rules. Any such swap dealer or major swap participant that complies with the EU's margin rules would be deemed compliant with the CFTC's margin rules, but would remain subject to the CFTC's examination and enforcement authority.

The EC also announced an equivalence decision which similarly finds that the CFTC's uncleared swap margin rules are comparable in outcome to the EU's corresponding margin requirements for uncleared OTC derivatives.

Additionally, the CFTC and EC announced a common approach regarding certain CFTC and EU authorized derivatives trading venues.

The agreements reached by the CFTC and EC reduces the regulatory burden for cross-border market participants by avoiding the need for two compliance regimes. Furthermore, the decisions reached should help avoid disruption in trading when Europe's revised Markets in Financial Instruments Directive takes effect in January, 2018.

Europe

Monetary Policy in Europe

On October 26, 2017, the European Central Bank (ECB) announced it will keep interest rates unchanged at zero percent for the main refinancing rate and minus 0.4 percent for the deposit rate. The ECB continues to expect the key ECB interest rates to remain at their present levels for an extended period of time, and well past the horizon of the net asset purchases.

The ECB also announced a reduction in its bond-buying economic stimulus program. Specifically, purchases under the asset purchase programme (APP) will continue at the current monthly pace of €60 billion until the end of December, 2017, before being cut to a monthly pace of €30 billion until the end of September, 2018, or beyond, if necessary. The ECB reaffirms it stands ready to increase the APP in terms of size and/or duration should its economic outlook becomes less favourable, or if financial conditions become inconsistent with further progress towards a sustained adjustment in inflation.

International

FSB Issues Progress Report on Benchmark Reforms

The Financial Stability Board (FSB) published a progress report on implementation of the FSB's 2014 recommendations to reform major interest rate benchmarks such as interbank offered rates (IBORs). The 2014 recommendations included developing alternative nearly risk-free benchmark rates (RFRs).

The progress report concludes that IBOR administrators have taken important steps to implement the FSB's recommendations such as anchoring benchmarks to a greater number of transactions, where possible, and improving the processes and controls around submissions. However, in the case of some IBORs, such as LIBOR and EURIBOR, underlying reference transactions in some cases are scarce and submissions therefore necessarily remain based on a mixture of factors including transactions and judgement by submitters.

The report also states regulators have made good progress in supporting workstreams focused on identifying new or existing RFRs that could be used instead of IBORs in a range of contracts, in particular derivatives. However, limited progress has been made on migration from major IBORs to RFRs even where they are already available.

NSFR and Treatment of Derivative Liabilities

The Basel Committee on Bank Supervision (BCBS) announced it has discussed the net stable funding ratio (NSFR) standard and agreed to allow national discretion for the NSFR's treatment of derivative liabilities. Specifically, the NSFR assigns a 20 percent "required stable funding" factor to derivative liabilities but the BCBS has agreed that, at national discretion, jurisdictions may lower the value of this factor, with a floor of 5 percent. The BCBS is also considering whether any further revisions to the treatment of derivative liabilities are warranted.

NSFR continues to be a major concern among market participants globally with respect to its unintended effects on market functioning. The use of national discretion, if applied more broadly throughout the NSFR framework, could help mitigate some of the risks.

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