TMX MONTRÉAL EXCHANGE

Canadian Annual Derivatives Conference 2023

JUNE 8

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Wrap-Up Stats

OVERVIEW

278 Registrants

97% Participation Rate

REGISTRATION BREAKDOWN

29% Buy-Side Participation

59% Sell-Side Participation

77% Canada

23% International (US & Europe)

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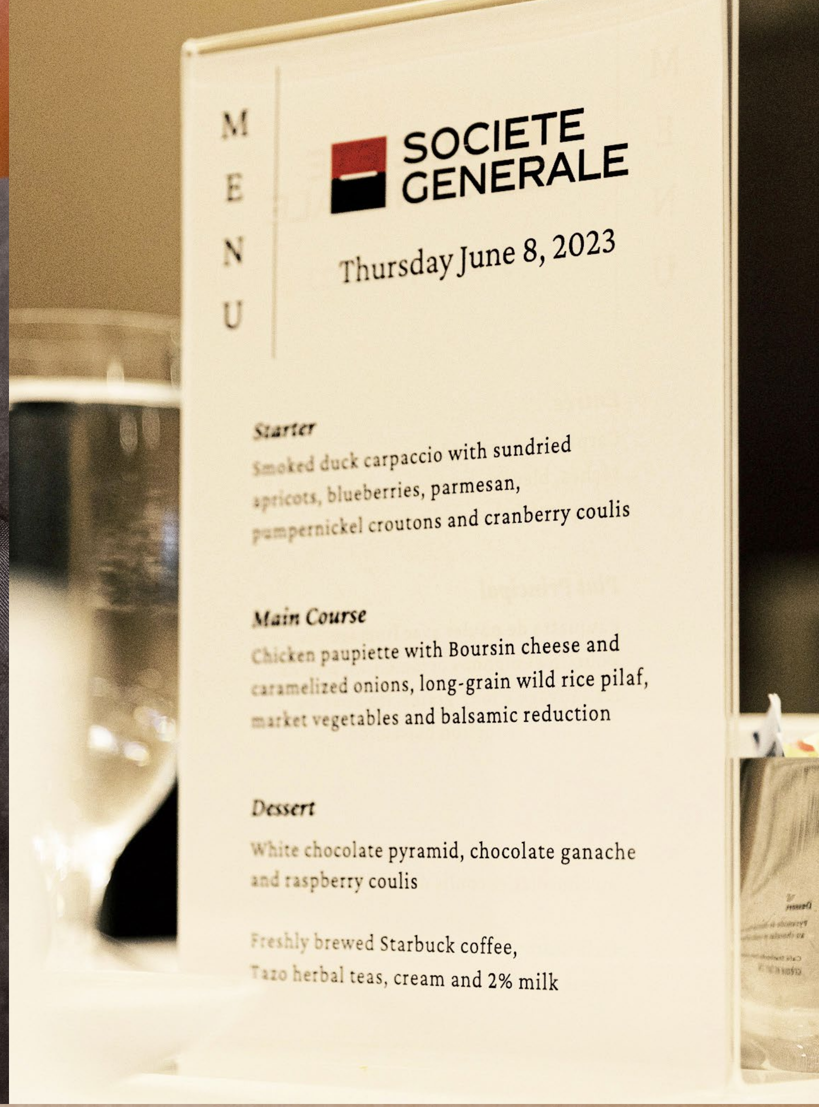


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THE FUTURE IS YOURS TO SEE.
Canadian Annual Derivatives Conference
THE MARKET IS OPEN

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Leaders' Exchange: Navigating Through Uncertain Economic Times

SPEAKERS

Étienne Dubuc
National Bank of Canada

Luc Fortin
Montréal Exchange, TMX Group

The interconnected financial landscape continuously evolves as we navigate an extraordinary macroeconomic environment. Inflation remains more resilient than anticipated, driven primarily by demand-side pressures. Addressing this calls for interest rate hikes that sufficiently dampen this demand. The Bank of Canada recently adopted this approach and may be echoed by the Federal Reserve soon, given signals of a robust economy and continually rising prices.

The equity and the bond markets exhibit starkly divergent views on the economy's trajectory, with the former expecting a soft landing and the latter predicting a hard landing. The rise of structured products in Canada opens up new opportunities for hedging exposures. With structured products increasingly featuring digital elements, options with zero days to expiry can help offset significant exposure swings.

The Canadian options market has room to grow as it competes with the highly liquid US market. Strategies for fostering a sustainable options business include narrowing the gap between retail and upstairs markets, implementing delta-neutral order types, creating crossing sessions after hours, aligning trading costs with those in the US and incentivizing market makers. Importantly, offering tight spreads will be vital as this makes up a large part of the market appeal.

However, the key to growth in the options market is education. Investment advisors and retail investors alike need to understand the potential advantages of options in portfolio management. Currently, only 30% of Investment Advisors in Canada are equipped to deal with options, a lower percentage than in any other G7 economy. Regulatory work and education initiatives could help increase this proportion and keep up with the rapid pace of financial innovation.

ETFs present another compelling story where being receptive to innovation and new entrants in the market is crucial. The acceptance and success of synthetic ETFs in the past, especially in commodities, underscores this. Financial institutions that remain agile and receptive to such innovations, coupled with careful risk management, have the potential to reap significant benefits. The lesson is to keep listening to clients and continually adapt to changing market demands, particularly with a new generation of investors.

Transparency in markets is a central theme. As price discovery increasingly occurs in ETF markets, it's evident that the shift towards transparent listed trading will continue to gain traction. However, the trend towards private debt and equity, primarily driven by institutional investors seeking to avoid volatility, seems counterintuitive.

Meanwhile, crypto platforms seeking to gain regulatory credibility face challenging hurdles. Regulatory bodies like the SEC aim to protect investors from scams that, unfortunately, have previously marred the crypto industry. The SEC's increasing scrutiny of crypto exchanges and altcoins reflects its commitment to regulate this volatile market. However, Bitcoin might be immune to regulatory advances because of its widespread acceptance as a commodity.

The financial world is at an inflection point. The financial markets' agility will be tested as we grapple with economic uncertainties and inflation. Success will depend on the industry's ability to adapt to these macroeconomic challenges, investors' evolving demands, and innovation in fostering a robust financial ecosystem.

Transparency in markets is a central theme.




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The Future of Credit Trading

MODERATOR

Marina Mets
FTSE

PANELISTS

Brian D'Costa
Algonquin Capital

Darcy Hall
National Bank of Canada

Dominic Siciliano
iA Global Asset Management

In the span of 20 years, the cash bond market has witnessed a significant evolution in issuance patterns, market accessibility and technological innovation. Despite these developments, much of the market awaits its next big evolutionary leap forward.

One of the most notable shifts is the rise of the Investment Grade (IG) credit component. Previously non-existent, IG credit now constitutes a significant 35% of the index, a shift catalyzed by lower rate structures. This change has made the capital markets more accessible and increased the weight and importance of corporate bonds. Portfolio managers are now more comfortable incorporating high-yield leveraged loans into their offerings. Despite limited derivative products in the credit space, the growing demand shapes the future market.

However, as the market evolves, the quality of credit ratings has experienced a meaningful change. Despite BBB companies having a low default risk, the index's credit quality has declined due to increased weight in these components. As the BBB segment grows, it provides diversification in issuance and promotes more diversity in the credit space. This trend reflects a corporate strategic decision to maximize shareholder value rather than maintain higher credit ratings for minor savings.

Moreover, the bond market is also experiencing slow evolution in terms of technology and electronic trading. There's a noticeable gap compared to the stock market, where transactions can be executed with a few taps on a smartphone. In the bond market, market-making still predominantly involves the sell-side providing liquidity.

The advent of Exchange-Traded Funds (ETFs) has significantly enhanced market accessibility. Although still in its growth phase, ETFs are being increasingly adopted, especially after recent market crises. However, trading ETFs is currently expensive for institutional investors, creating a need for a more efficient method.

Derivatives have emerged as an essential tool in the financial sector, especially in ETFs and credit space. Yet, the lack of a credit derivative product in Canada hampers its use in hedging Canadian corporate risks. TMX and MX have proposed creating a synthetic spread tethered to underlying Canadian corporate bond issuance to remedy this. Such a move would improve liquidity, facilitate larger trades and contribute to efficient trading linked to credit markets.

Creating and adopting a derivative product in Canada is not just about solving funding issues but also about regulation. Collaboration between regulators and industry stakeholders, including the Bank of Canada, is needed to successfully launch such a product.

The last decade has seen banks and sophisticated asset managers increasingly turn to derivatives for credit exposure, paving the way for a two-way market. Regulatory changes have also allowed mutual funds to use leverage and derivatives, creating a broader market for these products.

The evolution of the cash bond market is an ongoing process driven by changes in credit components, technological advancement and the rise of derivatives. As the market adapts and evolves, stakeholders must continually innovate to stay ahead, ensuring the market continues serving its crucial role in the financial ecosystem and is more accessible, diverse and efficient.

> **Derivatives have emerged as an essential tool in the financial sector, especially in ETFs and credit space.**




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Digital Assets: Signs of a Crypto Spring?

SPEAKERS

Andy Baehr
CoinDesk Indices

Robert Tasca
TMX Group

In 2022, the cryptocurrency industry experienced a harsh winter with unique macroeconomic conditions and catastrophic failures among well-known crypto entities. However, 2023 has shown early signs of growth and rejuvenation characterized by increased adoption, investment, innovative products and breakthroughs.

One of the most appealing aspects of cryptocurrencies like Bitcoin was the promise of being trustless. The concept was that people could store value without depending on countries, institutions, or managers. However, the need for trust becomes more apparent as digital assets move from early adoption to early mass adoption. As crypto evolves to the mainstream, users will desire a digital asset experience that aligns with their traditional financial services. Making the crypto experience as familiar and trustworthy as traditional assets is crucial to attracting mass adoption.

Contrary to some perceptions, not all digital assets are the same. Bitcoin and Ethereum have carved out positions as genuine macro assets with distinct use cases. Bitcoin is increasingly recognized as a store of value, while Ethereum is vital for running smart contract platforms. These tokens have demonstrated their endurance and ability to deliver uncorrelated returns, earning their place in diverse investment portfolios.

Macro drivers shape the performance of Bitcoin and Ether. In 2022, for instance, Bitcoin responded to changes in real interest rates and acted as an inflation hedge. Its performance was influenced by aggressive central bank activities, which led to significant positive real interest rates and subsequent drops in Bitcoin prices. However, as central bank activities and inflation began to subside, Bitcoin rebounded, providing a return of about 65-66% in the first quarter of 2023.

Regulators' growing acceptance of digital assets is also reshaping the crypto landscape. The futures contracts play a crucial role in market development and provide easier access to digital assets in a regulated product. Investment vehicles like the ETFs in Canada, specifically Bitcoin and Ether, have grown in popularity, leading to the development of other products to meet evolving market needs.

Montréal Exchange also intends to launch a Bitcoin futures contract that provides a more comprehensive market, enabling shorting, facilitating price discovery, and encouraging the use of digital assets alongside traditional macro assets. The exchange has signed a licensing agreement with CoinDesk Indices on the XBX index for this futures contract. These developments offer myriad structuring possibilities for the wealth channel and increase the ability to repatriate onshore activity.

There's a lot of excitement around new products like the Ethereum rates market, an innovation born out of Ethereum's recent switch from a proof-of-work to a proof-of-stake consensus methodology. The rates market will allow Ethereum validators to swap their variable income stream for a fixed rate, introducing a fascinating element into the crypto market structure.

The crypto industry shows signs of resurgence and innovation driven by market trends and new products that underscore the growing integration of cryptocurrencies into the broader financial landscape.

> **Making the crypto experience as familiar and trustworthy as traditional assets is crucial to attracting mass adoption.**


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Term CORRA. The Evolution of Risk-Free Rates

MODERATOR

Robert Catani
TMX Group

PANELISTS

Robin Das
RBC Capital Markets

Marc Laberge
Desjardins

Philippe Seyer-Cloutier
National Bank of Canada

Harri Vikstedt
Bank of Canada

In anticipation of the cessation of the Canadian Dealer Offered Rate (CDOR) by June 2024, the Canadian Alternative Reference Rate working group (CARR) has endorsed the forward-looking term Canadian Overnight Repo Rate Average (CORRA). This transition also presented an opportunity to develop a suite of risk-free rate products to meet the needs of the Canadian loan market.

The development of Term CORRA followed extensive feedback from corporate and commercial borrowers, who underlined the significance of term indices. It aims to address the needs of the Canadian loan market, offering cash flow predictability and operational simplicity. The decision was partially influenced by the Term SOFR in the United States – a crucial consideration given that many Canadian borrowers hold multi-currency facilities, including US Dollars.

However, the benchmark transition does bring about several challenges. For instance, term and daily risk-free rates appeal to different market segments. While the former caters to the operational simplicity and cash flow certainty required by lending clients, the latter dominates the liquidity of the derivatives market. Therefore, striking a balance between a robust index and the unique needs of clients across jurisdictions becomes an intricate task.

Moreover, the usage and scope of these rates can also pose a challenge. In the US, the term rate has predominantly been used for lending, which could potentially create a mismatch for floating lending clients looking to hedge, given the liquidity of the derivatives market is primarily daily-based. These complexities, alongside the concerns surrounding inter-dealer swaps and conflicts of interest, continue to be discussion points within the CARR and may influence the potential use cases of Term CORRA.

Another outcome of this transition is the one-month CORRA futures (COA) contract on Montréal Exchange. This instrument is particularly beneficial for speculators and hedgers interested in Canada's direction of interest rates. Furthermore, as the Term CORRA swap market grows, one-month CORRA futures could be a tool to hedge reset exposure, increasing market activity.

The shift to CORRA will likely enhance liquidity in the Canadian swaps and futures market. The initial phase of this market will primarily feature corporate commercial accounts paying against Term CORRA, leaving dealers to manage the basis risk. In conjunction with the larger term loans market, this may put a cap on how wide the basis can go.

At the same time, it's essential to consider the potential implications. For instance, the "inverted pyramid problem" refers to the risk of a large notional market based on a smaller sample market, creating potential conduct risk and capital implications. This concern is especially relevant if Term CORRA swaps are not considered liquid instruments, which would increase their capital costs.

While Term CORRA is generally seen as beneficial, there is a slight possibility that it might not succeed, necessitating a fallback to daily CORRA. The lending clients using Term CORRA must be educated about the daily option to reduce their hedging cost should a fallback arise. This would also provide extra time for these clients to adapt to daily CORRA.

The current transition highlights the lessons learned from global benchmark reforms, emphasizing the importance of robust fallbacks in financial contracts. Striking a balance between the index's robustness and the market's unique needs and managing potential risks and implications will ensure a smooth transition and maintain market integrity.



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