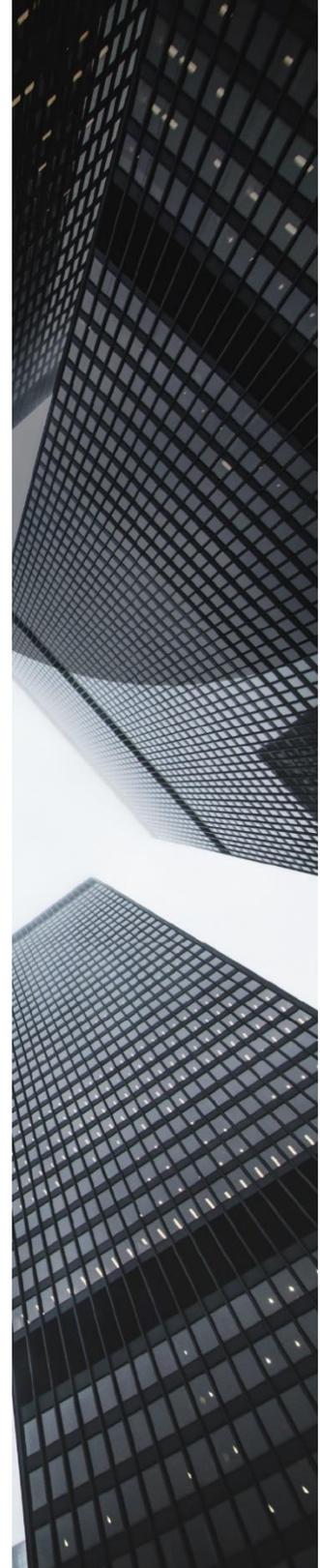


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Fixed Income Report





State of the Primary Fixed Income Market

On April 22nd 2016, treasurers from some of Canada's largest corporate and financial debt issuers gathered at the CFA Society Toronto luncheon to share their experiences in the financial markets and corporate finance. The Overbond team engaged with the industry professionals to uncover key trends and challenges in the fixed income markets.

Experienced Treasurer Panel

Panelists included Ali Suleman (Vice-President & Treasurer) from Hydro One, Max Chan (Director, Treasury) from Enbridge and Peter Levitt (Executive Vice-President & Treasurer) from CIBC. Rob Brown (Co-Head of Debt Capital Markets) from RBC Capital markets moderated the panel discussion.

Treasurers' Take on the Market

Discussion topics included investor relationship management, price discovery in challenging market environments, borrowing program management, order book allocation, hedging strategies, selecting a syndicate, rating agency relationships, regulatory and legal framework and international market access.



Investor Relationship Management

Treasurers stressed the importance of an engaged investor base and actively managing their new issue process to align investors' goals with the issuers.

Investor Engagement Channels

- One-on-one meetings
 - Regional visits (international, Toronto, Montreal, Vancouver, Victoria, Winnipeg, Regina, Edmonton)
 - Dealer-sponsored fixed income events
 - Non-deal roadshows
 - Regular national investor calls
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Investor Engagement

Building and maintaining a robust investor base was top of mind for treasurers. Even for the most established borrowers, active engagement with investors is becoming a prerequisite to run a successful borrowing program. For financial institutions that issue securities with complex structures, such as CIBC, significant time and resources are dedicated to properly educate the institutional investor base.

Mr. Suleman mentioned his team's successful strategy of investing his resources in engaging with smaller fixed income investors, whose typical participation would be in the \$1-5 million range. Mr. Suleman added, "sure enough, these investors' orders grew to \$10-20 million over the years as their asset base grew and they gained further comfort on Hydro One's credit profile."

Order Book Allocation

Treasurers generally agreed that the allocation process is largely driven by dealers – however, treasurers emphasized the importance of a 'fairness' to ensure long term success of their borrowing programs. Mr. Chan stated that he actively ensures that long term supporters who express early interest are rewarded in the allocation process.

There seemed to be a conundrum when it came to allocation for "buy and hold" vs. "quick money" investors. It was mentioned that there is a preference towards rewarding long term investors but on the other hand, fast money investors bring value by providing secondary market liquidity.

Price Discovery

Secondary market liquidity continues to be challenging.
Reverse inquiries are a critical component of the price discovery process.

Liquidity Provider	Products						Regions		
	GoC Bonds	CMBs	Provincial Bonds	CTB	Money Market	CAD IRS	Canada	USA	Europe
Bank of America Merrill Lynch	√	√	√	√		√	√	√	√
BMO Capital Markets	√	√	√	√	√		√	√	√
Casgain & Company Ltd.	√	√	√				√	√	
CIBC World Markets	√	√	√	√	√	√	√	√	√
Desjardins Capital Markets	√	√	√	√	√		√	√	√
HSBC	√	√	√	√	√	√	√	√	√
Laurentian Bank	√	√	√		√		√	√	
National Bank Financial	√	√	√	√	√	√	√	√	√
RBC Capital Markets	√	√	√	√	√	√	√	√	√
Scotiabank	√	√	√	√	√		√	√	√
TD Securities	√	√	√	√	√	√	√	√	√

Navigating Low Secondary Market Liquidity Environment

Even though new regulations were introduced to encourage greater transparency, the low liquidity nature of fixed income markets presents challenges in price discovery for issuers – sizeable secondary trade points, although scarce, are a valuable source of information for the price discovery process.

Mr. Chan stated “secondary trade points are no longer a great indicator of primary levels (given the lack of liquidity), it is just another data point”.

Reverse Inquiries

It was loud and clear that reverse inquiry, an inquiry a potential investor makes to a corporate issuer about purchasing a particular debt security, is a critical component in gaining comfort on investor demand for issuer’s credit and their price discovery process.

Treasurers mentioned that they closely track reverse inquiries received, either indirectly through dealers or directly from investors, and often reward those investors for expressing their interest and commitment.

“Transparency in the fixed income market is generally limited because it is a negotiated market. Despite significant advances in technology, many bond trades are still completed over the phone. This has hindered the growth of electronic trading platforms and made it more difficult to disseminate information”

– The Canadian Fixed Income Market, Ontario Securities Commission¹

¹ <http://www.osc.gov.on.ca/documents/en/Securities-Category2/20150423-fixed-income-report-2014.pdf>



Techniques to Optimize Borrowing Program

Each corporation had different mandates and objectives, and employs a variety of strategies to optimize cost of funding.

1. Maturity Smoothing

Ladder maturities based on portfolio approach. Issuers can also set limits on the total amount of bonds coming due in a single year to reduce concentration of refinancing risk.

2. Yield Curve

Add shorter tenors to take advantage of steep yield curve. Issuers with longer asset life can finance a portion of their debt with shorter maturities and refinance them periodically to achieve lower cost of funding.

3. Interest Rate Hedging

Lock in low underlying rates using financial instruments such as forward contracts.

4. Issuance Timing

Actively monitor rate and credit spread movements to make informed decisions. Also issuers with larger borrowing program can divide their borrowing needs into sequenced tranches to achieve natural rates diversification.

5. International Markets

Actively seek 'arbitrage' opportunities to issue in foreign market and swap proceeds back to achieve lower overall cost of funding.

More on Interest Rate Hedging

Interest rate hedging policies varied amongst the treasurers – no hedging to active hedging through forward contracts. Key challenges of interest rate hedging were accounting and tax treatments of hedge gains and losses that may be unique to some of the issuers.

One treasurer stated that he does not make speculative market calls. Instead, he ensures that the rates they achieve meets his firm's internal cost of funding targets.

Forecasts by established economists are used to understand the rate environment to make educated decisions.

Rate hedging is challenging given the low interest rate environments where credit spreads, an exposure that cannot readily be hedged, have become a significant component of overall funding costs.



Other Considerations

It is important to manage relationships with multiple stakeholders, including dealer syndicates, regulators, rating agencies and legal counsel.

Canada Corporate Debt Underwriters (2015)

Rank	Bookrunner	Amount (\$M)	Market Share (%)	# of Deals
1	RBC Capital Markets	13,560	29.2	82
2	CIBC World Markets Inc	8,102	17.5	47
3	TD Securities Inc	6,441	13.9	39
4	BMO Capital Markets	6,036	13	42
5	Scotiabank	5,900	12.7	32
6	National Bank of Canada	3,104	6.7	22
7	HSBC Holdings PLC	1,221	2.6	6
8	Bank of America Merrill Lynch	1,099	2.4	7
9	Desjardins Securities Inc	472	1	3
10	Casgrain & Companies Ltee	126	0.3	2
Industry Total		46,449	100	134
Δ Since Last Year		-14%		-19%

Syndicate Selection

Treasurers discussed the factors involved in determining syndicate structure. Mr. Levitt utilizes the three C's approach:

- i) Coverage – quality of ongoing coverage
- ii) Capability – execution, distribution and secondary market making
- iii) Credit – level of commitment in bank credit facilities

Rating Agencies

All treasurers emphasized the importance of prompt and transparent disclosure of information to help rating agencies better understand their credit profiles. The level of engagement has become increasingly important after the 2008 - 2009 financial crisis.

Regulatory Framework

Canadian regulators are actively engaged with the industry to provide practical regulatory updates and promote a stable financial environment.

Issuers work closely with their legal counsel to navigate through changing regulatory environment. One example is changes to prospectus marketing rules. Issuer also stressed the importance of working with counsel to meet all compliance requirements such as black-out periods while preserving flexibility to take advantage of favorable market conditions.

International Markets Considerations

In addition to the potential 'arbitrage' funding opportunities presented by foreign debt capital markets, treasurers stated a few key benefits in accessing foreign markets:

- Natural currency exposure (USD/GBP/EUR/AUD markets were discussed)
- Investor base diversification
- Different structure available



About Overbond

Overbond brings all bond market participants together. It is a platform that makes primary bond issuance digital, transparent and secure. Overbond connects corporate and government issuers with dealers and investors directly.