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Canada: Bankers' Acceptance Purchase Facility¹

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Yale Program on Financial Stability Case Study
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Abstract

Bankers' acceptances (BAs) are a form of investment security guaranteed by banks to fund loans to businesses against their credit lines. In Canada, BAs underpin the Canadian Dollar Offered Rate (CDOR), the main benchmark used to calculate floating interest rates in Canada's derivatives market. In 2018, BAs formed the largest segment of money market securities traded in the secondary market at around CAD 35 billion (USD 26 billion) per week. When asset managers and the country's public pension providers began shedding BAs amid the COVID-19 pandemic in early 2020, CDOR spiked, and the effects threatened to ripple throughout the Canadian financial system. On March 13, 2020, the Bank of Canada (BoC) established the Bankers' Acceptance Purchase Facility (BAPF). The BAPF conducted multi-rate reverse auctions with Canadian primary dealers for highly rated BAs of remaining maturities up to 76 days. In its first two operations, dealers sold the BoC the total offered amounts of CAD 15 billion and CAD 20 billion, and the BA market stabilized. The BoC bought another CAD 12 billion of BAs in four operations in April. It continued to offer to buy CAD 10 billion in weekly, then biweekly reverse auctions until October, with no further bids from banks.

Keywords: banker's acceptance, BAPF, BAs, Canada, CDOR, COVID-19 pandemic, market liquidity

¹ This case study is part of the Yale Program on Financial Stability (YPFS) selection of New Bagehot Project modules considering market support programs in response to COVID-19. Cases are available from the *Journal of Financial Crises* at <https://elischolar.library.yale.edu/journal-of-financial-crises/>.

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Overview

A banker's acceptance (BA) is a short-term (generally one-month) funding tool for corporate borrowers that provides a "direct and unconditional order" from the borrower to draw down against its established line of credit (McRae and Auger 2018, 1). The bank offering the line of credit also guarantees the BA, providing funding for small and medium-sized corporate borrowers that may not otherwise have access to the primary funding market due to their size or credit ratings. BAs sold in the secondary market are often purchased by institutional investors because they are very liquid and carry an attractive yield over similarly rated Government of Canada bonds (Vikstedt and McRae 2020, 6). In 2018, BAs accounted for the largest share of outstanding Canadian money market instruments issued by nongovernment entities (McRae and Auger 2018, 13).

When COVID-19 began to spread globally in early March 2020, investors' daily sales of BAs to bank dealers essentially quadrupled from CAD 500 million to CAD 2 billion (USD 373 million to USD 1.5 billion)³ (Fontaine et al. 2021, 11). Bank dealers lowered their prices as the demand for BAs fell. On March 13, the Bank of Canada (BoC) announced it would purchase high-quality, one-month BAs in the secondary market to support the "continuous functioning" of financial markets (BoC 2020h). The Bankers' Acceptance Purchase Facility (BAPF) conducted multi-rate reverse auctions with primary dealers, which originated almost all BAs.

On March 23, the BAPF conducted its first auction. The BoC purchased 45 BAs worth CAD 15 billion—the full amount offered—at yields between 1.11% and 1.65%. Its next auction, for CAD 20 billion on March 30, also resulted in full usage. Participation waned over the next four auctions, with utilization falling to zero by May 2020. The BoC reduced the frequency of auctions to biweekly in July and discontinued the BAPF on October 26, 2020. In all, the BoC purchased CAD 47 billion. The BAPF was small in comparison to the BoC's repurchase agreements and purchases of government bonds and bills during the pandemic crisis, as

Key Terms

Purpose: "to support the continuous functioning of financial markets . . . and a key source of financing for small- and medium-size corporate borrowers" (BoC 2020h)

Launch Dates	Announced: March 13, 2020
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Operational Date	March 23, 2020
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End Date	October 26, 2020
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Legal Authority	Bank of Canada Act, articles 18(g)(i) and 18.1(1)
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Source(s) of Funding	Bank of Canada balance sheet
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Administrators	Bank of Canada
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Overall Size	No fixed ceiling
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Purchased Assets	Canadian BAs with remaining maturities of up to 76 business days rated at least R-1 (low)
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Peak Utilization	CAD 38.8 billion on April 8
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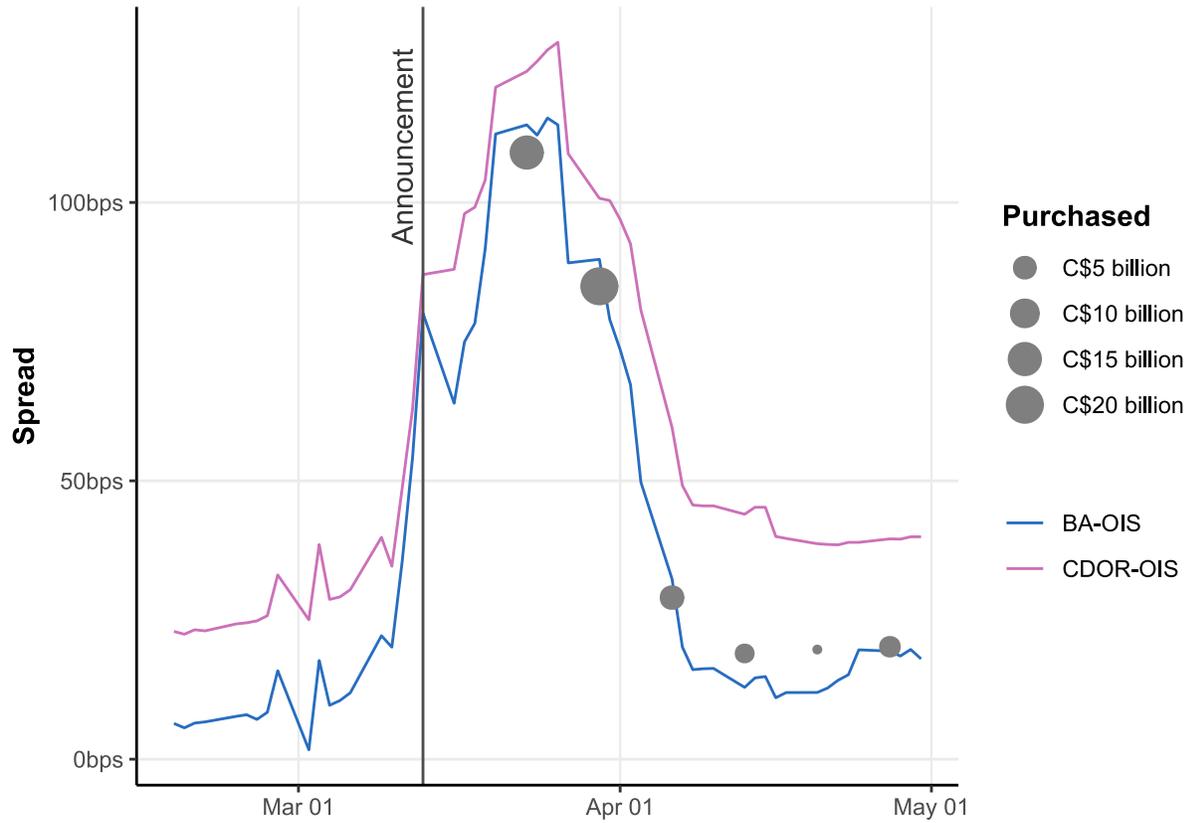
³ USD 1 = CAD 1.34 during March 2020.

shown in Figure 3. But the facility had a much larger impact because of the role of the BA market in determining the Canadian Dollar Offered Rate (CDOR). The CDOR was the main benchmark used to set floating interest rates in the Canadian derivatives market. The CDOR administrator sets the CDOR daily from a survey of banks on the rate at which they provided firms credit through BAs and transacted in secondary-market BAs. Figure 1 shows the co-movement of the spreads of the secondary-market BA rate and the CDOR lending rate to overnight index swaps (OIS) before and during the BAPF.

Summary Evaluation

The BA-OIS spread widened significantly in early March but settled near its pre-crisis level after the first several BAPF auctions (see Figure 1). Fontaine et al. (2021, 23) write that, “By early May, BA rates fell below the Bank’s reserve rate, indicating that the BA market had recovered sufficiently to be ineligible for central bank support.” However, no literature has attempted to isolate or estimate the effect of the BAPF’s purchases on the market or their effect on lending to businesses, the facility’s other stated purpose. A BoC working paper, the fullest treatment of the facility, estimates how the announcement of the BAPF on March 13 affected the BA market even before its first purchase. It finds that the announcement reduced BA yields in the secondary market by 15 basis points (bps). When additional details were announced between March 13 and 23, 2020, BA yields further decreased by 20 bps to 70 bps relative to bank-sponsored asset-backed commercial paper and senior deposit notes, asset classes that share many features with BAs (Arora et al. 2020). A BoC report also asserts that the central bank’s policies “likely helped alleviate scarcity in money markets and restore trading conditions in broader bond markets” (Fontaine et al. 2021, 22). It notes that the way the BoC used asset purchases to improve bank lending could be an indicator of future directions for monetary policy.

Figure 1: Daily Interbank Funding Spreads and BAPF Auctions



Sources: BoC 2020a; BoC 2020h; "Canadian Dollar Security 1M" 2019–2021; IIROC 2019–2021; Renfinitiv 2019–2021.

Context: Canada 2019–2020	
GDP (SAAR, nominal GDP in LCU converted to USD)	\$1,778.4 billion in 2019 \$1,777.1 billion in 2020
GDP per capita (SAAR, nominal GDP in LCU converted to USD)	\$46,327 in 2019 \$43,258 in 2020
Sovereign credit rating (five-year senior debt)	Data for 2019: Moody's: Aaa S&P: AAA Fitch: AAA Data for 2020: Moody's: Aaa S&P: AAA Fitch: AA+
Size of banking system	Data not available for 2019 Data not available for 2020
Size of banking system as a percentage of GDP	Data not available for 2019 Data not available for 2020
Size of banking system as a percentage of financial system	Data not available for 2019 Data not available for 2020
Five-bank concentration of banking system	84.2% in 2019 84.5% in 2020
Foreign involvement in banking system	Data not available for 2019 Data not available for 2020
Government ownership of banking system	Data not available for 2019 Data not available for 2020
Existence of deposit insurance	Yes, in 2019 Yes, in 2020
<i>Sources: Bloomberg; World Bank Global Financial Development Database; World Bank Deposit Insurance Dataset.</i>	

Key Design Decisions

1. Purpose: The BAPF aimed to stabilize a core funding market and support lending to nonfinancial businesses.

The close link between corporate borrowing and derivatives forged by the Canadian Dollar Offered Rate explained why the BoC cited both “the continuous functioning of financial markets” and “financing for small- and medium-size corporate borrowers” in its announcement of the BAPF (BoC 2020h).

The BA market is one of Canada’s “core funding markets” (BoC 2020h). A BA is “a direct and unconditional order from a corporate borrower to draw down against its established line of credit” (Vikstedt and McRae 2020, 3). After a bank lends funds to a borrower, the bank can sell the BA liability on the secondary market; it represents a liability of the borrower but carries the bank’s guarantee. Since BAs stopped carrying issuer names in the 1990s, BAs carried the rating of the guaranteeing bank. In 2017, seven primary dealers⁴ issued 98% of the BA market (McRae and Auger 2018).

Because they are almost always issued by a primary dealer, most BAs are highly rated. The market is also highly liquid; as of March 11, 2020, 91% of the average daily BA trading volume since 2015 carried one-month maturities, with another 8% carrying two- to three-month tenors. Since they still “offer[ed] a relatively attractive yield pickup in the secondary market over [Government of Canada] and provincial treasury bills,” BAs became a favorite of institutional investors, who would purchase new BAs once those it held reached maturity (Vikstedt and McRae 2020, 6). After competing with commercial paper for several decades, BAs became the largest privately issued money market instrument after the Global Financial Crisis (GFC) and accounted for more than 25% of Canada’s money market in 2017, only slightly less than GoC bills (McRae and Auger 2018, 13).

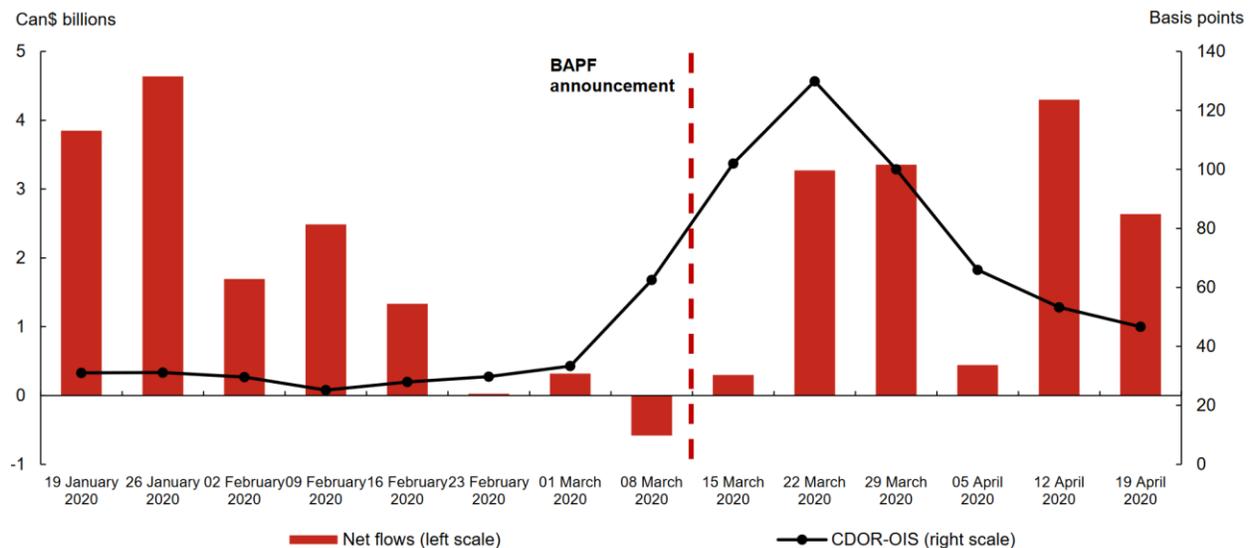
Institutional investors began dumping BAs in March 2020 to weather a storm of outflows related to the pandemic. Canada’s public pension companies, which usually bought CAD 4 billion a week in BAs, became net sellers during the week of March 8, as seen in Figure 2. Meanwhile, businesses drew heavily on their lines of credit. The crisis deterred some larger borrowers from commercial paper, while smaller borrowers drew on lines to fund near-term liabilities (Arora et al. 2020). Each of these factors pushed yields higher.

This credit crunch spilled over to the CDOR, at which banks were “willing to lend their balance sheet to corporate borrowers with existing BA facilities” (Vikstedt and McRae 2020, 9–10). This committed lending rate applied directly to the CAD 90 billion BA market, but—like the London Interbank Offered Rate (LIBOR)—also underpinned a much larger market of

⁴ The seven dealers were: Bank of Montreal (BMO), Bank of Nova Scotia (BNS), Canadian Imperial Bank of Commerce (CIBC), Hongkong and Shanghai Banking Corporation (HSBC), National Bank of Canada (NBC), Royal Bank of Canada (RBC), and Toronto-Dominion (TD) Bank (McRae and Auger 2018, 15).

derivatives. When the spread of CDOR above the overnight index swaps rate climbed 100 bps above its pre-crisis level near 25 bps, it also threatened some CAD 11 trillion in over-the-counter and exchange-traded derivatives that used CDOR (Bédard-Pagé et al. 2021, 12; McRae and Auger 2018, ii; Vikstedt and McRae 2020, 9–10). BoC staff also referenced the importance of the CDOR in the BoC’s decision to create the BAPF. Of the four papers that evaluate the BAPF, all consider the facility’s effect on CDOR, and none estimate its effect on corporate borrowers.

Figure 2: Net Weekly BA Purchases by Large Pension Funds



Source: Bédard-Pagé et al. 2021, 8.

2. Part of a Package: The Government of Canada packaged the BAPF with other business-credit programs.

The Government of Canada also discussed the BAPF as business credit and liquidity support in its Economic Response Plan (Department of Finance 2020). The BoC announced the BAPF on the same day it lowered its overnight rate from 1.25% to 0.75% and a day after it had expanded purchases of government debt (BoC 2020f; BoC 2020g).

3. Legal Authority: The BoC issued a policy under the Bank of Canada Act that allowed it to purchase BAs outright.

Section 18 of the Bank of Canada Act (1985) afforded the BoC broad powers in the service of monetary policy and financial stability. Subsection 18(g)(i) allowed the BoC to trade in virtually any security except equities but mandated that the BoC publish a policy in the legal gazette describing the securities and transactions it would undertake.

From 2015 to 2020, the BoC's policy allowed it to acquire BAs but only by reverse repurchase agreements (BoC 2015).⁵ On March 18, 2020, the BoC amended the 2015 policy, permitting it to also purchase securities—such as BAs—outright. The amendment allowed such purchases to address financial system stress or monetary policy in support of market functioning.

The BoC clarified that such purchases—known as *exceptional transactions*—followed the BoC's authority under 18(g)(i) and were “distinct from” its 18(g)(ii) authority (BoC 2020e). Subsection 18(g)(ii), which has never been invoked, allowed the BoC to purchase securities, including equities, “if the Governor is of the opinion that there is a severe and unusual stress on a financial market or the financial system” (Bank of Canada Act 1985). These powers augmented the BoC's explicit authority to purchase securities issued or guaranteed by Canada, its provinces, the United States, Japan, the United Kingdom, or European Union member states.

The BoC lobbied for the creation of subsection 18(g)(i) during the Global Financial Crisis. During parliamentary committee hearings, officials from the BoC and Ministry of Finance argued that, when the GFC began, “some of the central banks had more room to move than did” the BoC (Rudin, McKay, and Flaherty 2008). They noted the securities that the Bank of Canada Act explicitly allowed the BoC to purchase—bills of exchange (such as BAs) and promissory notes, in addition to government securities—and that:

The relevance of a number of those securities to the financial markets has decreased over time because of financial innovation . . . for example, we cannot buy, for the purposes of resale, money market securities longer than 180 days. We cannot buy corporate bonds. There is a host. We cannot buy term asset-backed securities. We cannot buy municipal bonds, or we cannot buy corporate commercial paper (Carney and McKay 2008, 6).

Motivated by the legislative constraints, the amendment that created 18(g)(i) used the Bank of England and European Central Bank as models of central banks with broad authorities. When the BoC published its first policy in the *Canada Gazette* describing the securities it would purchase, its exceptional transactions were limited to repurchase agreements for terms of up to 180 days.

4. Governance: The BoC was required to publish its 18(g)(i) policy before it came into force.

The Bank of Canada Act required the BoC to publish its policy allowing outright transactions in the *Canada Gazette*. The central bank was then required to wait seven days before enacting its policy.

⁵ In Canada, these repos are known as *purchase and resale agreements* (PRAs).

The Bank of Canada Act (1985, vol. c. B-2, sec. 28) also enabled the minister of finance to appoint auditors of the BoC and to require that those auditors report on bank affairs to the minister “from time to time.”

5. Administration: Although the BoC administered the BAPF, it is not clear how it organized its staff to implement the facility.

BoC notices listed two directors in the Treasury auctions and settlement systems team of the Financial Markets Department as key contacts. This indicates that the BAPF used the familiar infrastructure of Treasury auctions to communicate with primary dealers. Other documents do not address further how the BoC implemented the BAPF.

Successful bidders delivered BAs through the CDSX platform, owned and operated by Clearing and Depository Services (CDS) (BoC 2021b; BoC 2020d). Settlement occurred two days later.

6. Communication: The BoC announced the BAPF by press release.

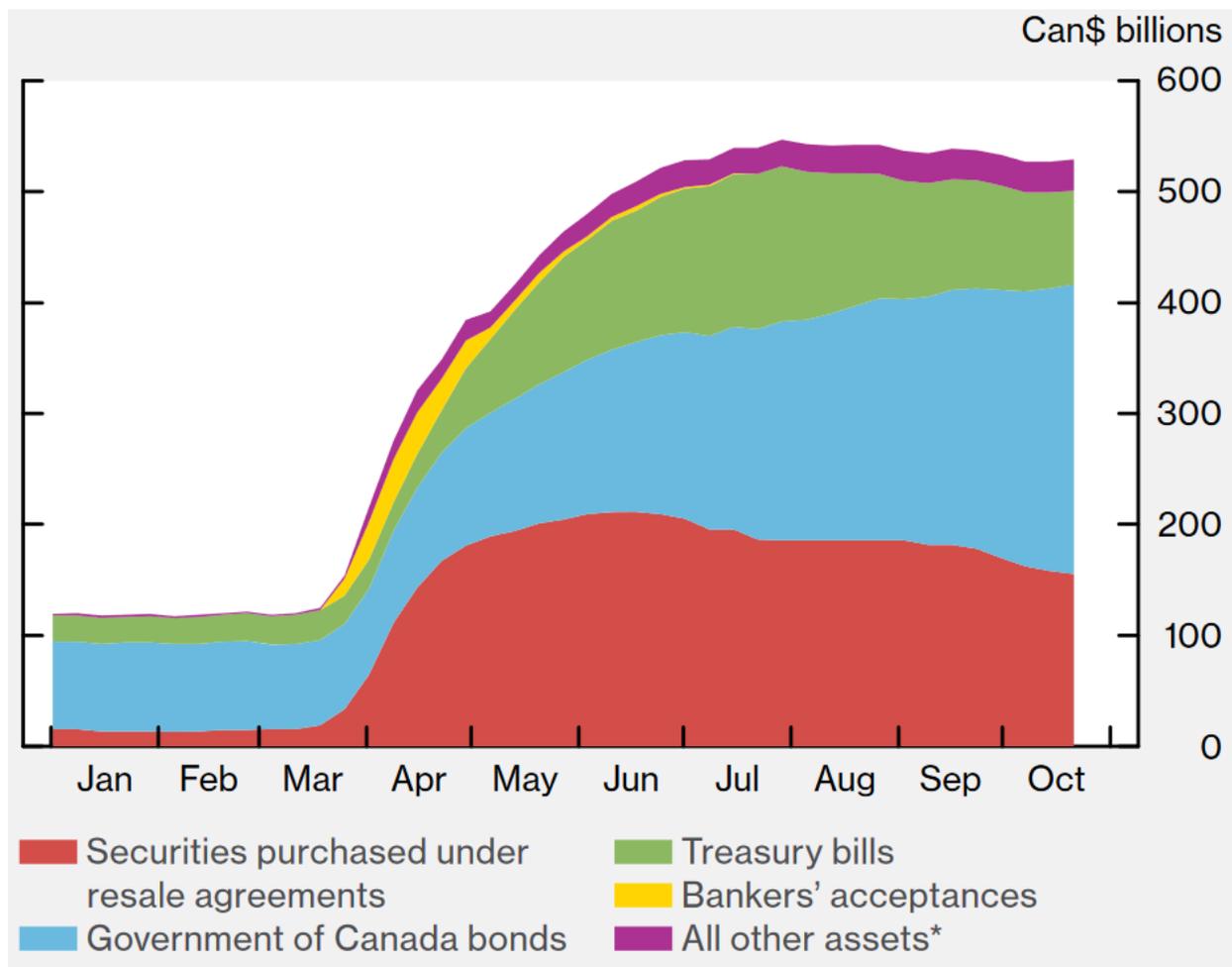
The BoC announced the BAPF on March 13, 2020, via market notice and released the facility’s terms and conditions on its website (BoC 2020h). Newspaper archives revealed few acknowledgements of—and no commentary on—the announcement. Nonetheless, BoC researchers estimate that the announcement reduced the BA-OIS spread by 15 bps (Arora et al. 2020). The BoC then released further operational details on the facility via notices on March 17 and 19. The BoC appeared to have increased the amount on offer from CAD 10 billion to CAD 15 billion in the second of these notices (BoC 2020b; BoC 2020c). The same BoC researchers find an additional 20–70-bp decrease in the BA-OIS spread following the announcement of these details (Arora et al. 2020).

After the first operation, Smith (2020) reports “that there is some way to go before stress is reduced in Canadian money markets.” The article offers what may be the only commentary on the BAPF in a major news outlet.⁶

7. Disclosure: The BoC published transaction-level data and the BAPF’s aggregate purchases.

In weekly financial statements, the BAPF appeared as “Bankers’ Acceptances,” a new line on the asset side of the central bank’s balance sheet, shown in Figure 3 along other BoC assets (BoC 1981–2021). The BoC ultimately published transaction-level data for the BAPF, detailing each bond it made eligible for purchase, their amounts, and their price (BoC 2021a).

⁶ Analysts such as those at TD Securities offered more commentary, but efforts to locate those articles failed.

Figure 3: BAPF Compared to Other Canadian Market Liquidity Programs

Note: All other assets included provincial treasury bills and bonds, corporate bonds, and commercial paper.

Source: BoC 2020k, 25.

8. Use of SPV: The BAPF did not use an SPV.

The BoC did not use a special-purpose vehicle to administer the BAPF.

9. Size: The BoC offered to buy CAD 15 billion to CAD 20 billion in the first three auctions, and CAD 10 billion in each auction thereafter.

The announcement of the BAPF did not specify its total size (BoC 2020h). A later notice announced that the BoC would purchase up to CAD 15 billion in BAs and target CAD 10 billion for most auctions (BoC 2020c). Over 24 auctions, the BoC ultimately purchased just more than CAD 47 billion. After the first three operations, the BoC offered to buy CAD 10 billion of BAs in each auction. The BoC offered to purchase CAD 15 billion, CAD 20 billion, and CAD 20 billion in the first three auctions, respectively, and then CAD 10 billion for the remaining auctions (BoC 2020a). Documents do not suggest how the BoC determined how much it

would purchase. As Tucker (2009, 11) notes, a market liquidity program should be “catalytic, helping ideally to kick-start the market rather than replace it.” The question is important and more difficult to answer than it is in auctions for central bank money, where the imbalance in reserves is precisely known.

10. Source(s) of Funding: The Bank of Canada funded purchases by expanding its balance sheet.

To fund the BAPF, the BoC credited primary dealers’ accounts with reserves held at the BoC.

11. Eligible Institutions: Primary dealers in government bonds participated in BAPF auctions.

The BoC allowed the 11 Canadian primary dealers⁷ to participate in the BAPF (BoC 2020d). It did not disclose which dealers participated in auctions.

12. Auction or Standing Facility: The BAPF conducted reverse multi-rate auctions.

Ahead of each operation, the BoC announced the date, purchase amount, minimum bid rate, settlement date, and maturity range of eligible securities. Between 8:30 and 9:00 on the morning of the operation, participants submitted up to 10 bids. Each identified the security to be sold and its short-term credit rating, the yield a bidder was willing to pay, and the amount a bidder would sell in CAD 5 million increments. The BoC then accepted bids starting with the highest yield rates until the accepted bids exhausted the total amount offered. Successful bidders received the rate they offered (BoC 2020d). Results of the subscribed auctions are shown in Figure 4.

No participant could sell the BoC more than either 12.5% or 25% of a single auction’s offering amount, depending on the dealer’s market share of government bonds. Participants could bid the maximum amount each auction. The BoC did not publish a rationale behind this rule. Because the BoC did not disclose which banks sold which securities, these maximum amounts cannot be imputed.

⁷ These were Bank of Montreal (BMO) Nesbitt Burns, Casgrain & Company, CIBC World Markets, Desjardins Securities, HSBC Securities, Laurentian Bank Securities, Merrill Lynch, NBC Financial, RBC Dominion Securities, Scotia Capital (subsidiary of Bank of Nova Scotia [BNS or Scotiabank]), and TD Bank.

Figure 4: Operation Results of BAPF Auctions

Settlement date	Maturity start date	Maturity end date	Amount offered	Purchased	Minimum bid yield	Average yield
3/25/2020	3/26/2020	5/4/2020	\$15 billion	\$15 billion	0.63%	1.57%
4/1/2020	4/2/2020	7/21/2020	\$20 billion	\$20 billion	0.43%	1.15%
4/8/2020	4/9/2020	7/28/2020	\$20 billion	\$5.57 billion	0.4%	0.52%
4/15/2020	4/16/2020	8/4/2020	\$10 billion	\$2.66 billion	0.37%	0.39%
4/22/2020	4/23/2020	8/11/2020	\$10 billion	\$190 million	0.4%	0.4%
4/29/2020	4/30/2020	8/18/2020	\$10 billion	\$3.63 billion	0.4%	0.4%

Source: BoC 2020a.

13. Loan or Purchase: The Bank of Canada purchased BAs outright from dealers.

The BoC had been accustomed to purchasing securities with the intention of reselling them later. No documents indicate that the BoC attempted to make a market in BAs by later selling them. The BAPF was one of the BoC's first forays into outright purchases of private securities.

14. Eligible Assets: The BAPF purchased Canadian BAs rated at least R-1 (low) with remaining maturities of up to 76 business days.

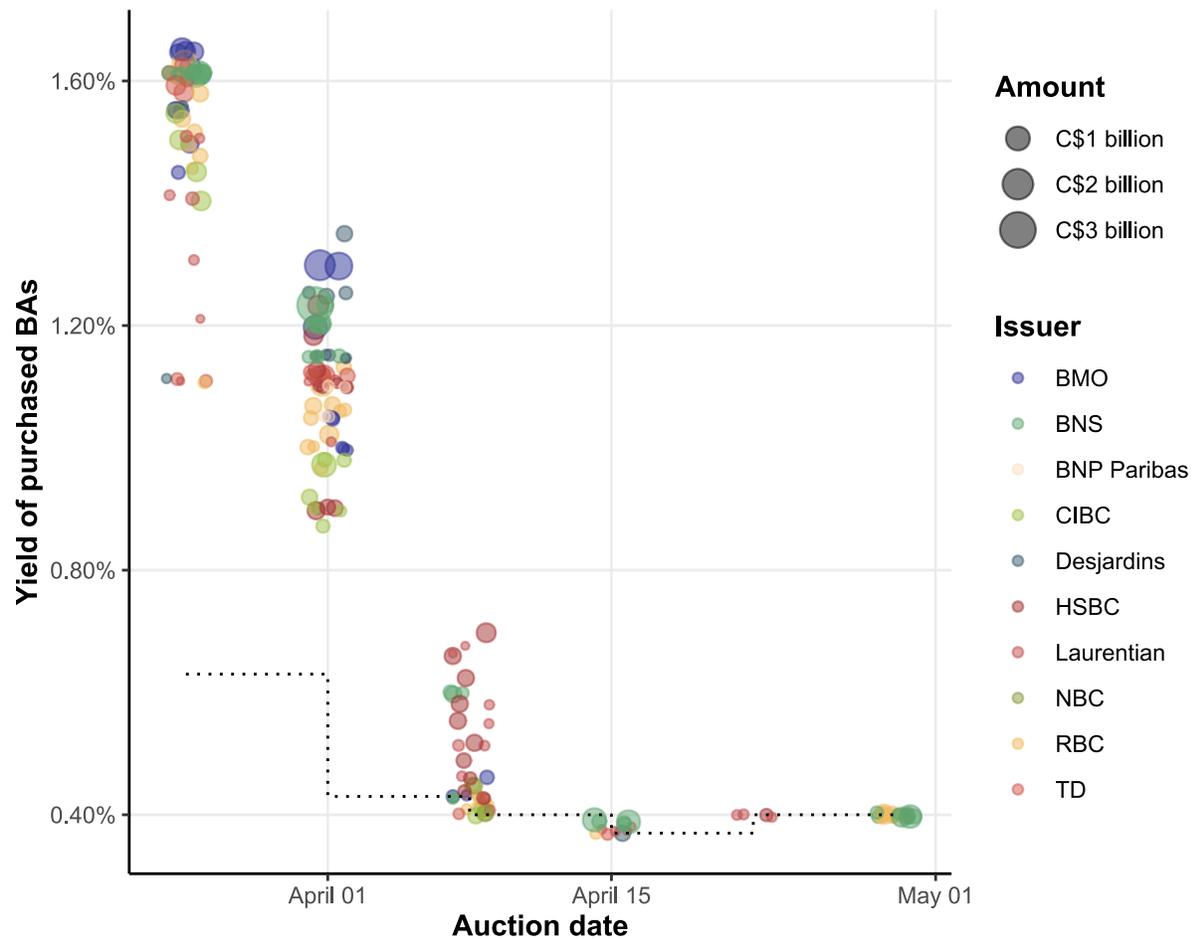
The BAPF purchased BAs issued by Canadian banks and branches of foreign banks in Canadian dollars. Though it allowed remaining maturities up to 76 Canadian business days, the BoC set an exact maturity range before each operation. This range encompassed most BAs; 98% of BAs carried one- to three-month maturities (Vikstedt and McRae 2020, 4).

Eligible BAs carried credit ratings of at least R-1 (low) from DBRS Morningstar, representing "good credit quality" (BoC 2020d).

Issuers could be any Canadian bank—including the bidder—but those from banks without access to the Large Value Transfer System (LVTS) must have been prescreened a day prior to auction (BoC 2020d). The LVTS was a real-time gross settlement platform used by large Canadian banks. To facilitate real-time transactions, the BoC granted participants intraday credit secured by collateral pledged to the BoC through CDSX; the BoC was accustomed to reviewing collateral from these banks in a short period of time (Engert, Gravelle, and Howard 2008, 5). The BAPF ultimately purchased securities issued by 10 institutions, nine of which were affiliates of primary dealers (BoC 2021a).

15. Purchase Price: Bids required a minimum yield over overnight index swaps.

Banks offered a minimum yield called a *reserve rate* that was expressed as a spread over OIS (BoC 2020d). This rate started at 0.60% and fell to below 0.40% before the BoC increased it for the final two auctions in which banks participated (BoC 2021a). As seen in Figure 5, some successful bidders accepted more than double the reserve rate in the first two auctions. In later auctions, yields settled at the minimum rate, with a much narrower range of yields bid.

Figure 5: Purchased Securities; Minimum Bid Rate Indicated by Dashed Line

Source: BoC 2021a.

16. Haircuts: The BAPF had no haircuts.

As an asset purchase program, the BAPF did not have haircuts.

17. Interest Rates: The BAPF purchased securities based on the auction results.

The BAPF paid prices resulting from its reverse auction.

18. Fees: The BoC did not charge any fees.

No documents suggest that the BoC charged fees to issuers of securities that it purchased.

19. Term/Repayment: Assets matured at their scheduled coupon dates.

The BAPF did not amend the scheduled maturities of assets it purchased.

20. Other Restrictions on Eligible Participants: The BOC did not add restrictions to eligible participants.

Documents do not indicate other conditions beyond those discussed elsewhere in this case study.

21. Regulatory Relief: Participants received no regulatory relief when participating in the BAPF.

No documents suggest that banks received relief from capital or liquidity regulations as a result of participating in the BAPF.

22. International Coordination: The BoC did not coordinate with other countries for the BAPF.

The Canadian BA market was not mirrored abroad, and programs similar to the BAPF were not implemented in other countries.

23. Duration: The BoC purchased its last BAs on April 27, 2020, but auctions continued until October 26, 2020.

The BoC purchased its last BAs in the sixth auction, conducted on April 27, 2020. The BoC continued to offer weekly BAPF auctions until July 6, when it reduced the frequency of BAPF auctions from every week to every other week. The BoC cited “substantial improvements in short-term funding conditions recently, as well as reduced participation” when making this change (BoC 2020i).

After 17 operations without participation, the BoC announced on October 15, 2020 that it would retire the BAPF amid continuing improvement of financial conditions, and the declining usage in crisis facilities (BoC 2020a; BoC 2020j). Its last operation—also not used—occurred on October 26, 2020.

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