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Uncollateralized overnight lending in Canada

Scott Hendry & Nadja Kamhi

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Abstract

Loan-level data on the uncollateralized overnight loan market is generated using payment data from Canada's Large Value Transfer System (LVTS) and a modified version of the methodology proposed in Furfine (1999). There were on average just under 100 loans extended in this market each day from March 2004 to March 2006 for a total daily value of about $5 billion. This makes the market slightly larger than the brokered repo market but only about one-tenth of the estimate for the direct trade repo market. The implied uncollateralized overnight rate was found to be remarkably stable relative to other measures of the overnight rate. Loan rates are found to vary with market conditions, the size of the loan, and the type (big versus small) of the borrower and lender.

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Notes

[1] For further information on the overnight market in Canada, see Lundrigan and Toll (1997/98) and Reid (2007).

[2] Occasionally, there may be a few late-day collateralized loan payments sent via the LVTS but this is done infrequently and only when CDS is unable to process the trade before the close of the day.

[3] This information was communicated to the Bank of Canada during the meetings with major financial market players in Canada which took place between April and May 2006.

[4] See Reid (2007).

[5] When the repo trade does not differentiate between specific Government of Canada securities, it is a part of the GC repo market.

[6] There are between 5 and 15 brokered repo trades each day. This implies a range of $150–$450 million for the size of a typical repo transaction.

[7] See Reid (2007).

[8] CORRA is used by market participants in determining the floating rate of an Overnight Index Swap (OIS). For further information on both rates, please see http://www.bankofcanada.ca/en/rates/monmrt.html

[9] The data are only filtered for USD transactions as they comprise the vast majority of Canadian FX transactions. Other currency FX transactions are infrequent and could not be identified with any reliability.

[10] D'Souza (2007) finds that the average transaction in the CAD–USD market is 2 000 000 USD with very little variation around this value.

[11] The true number of overnight loans during this period is probably larger since some transactions are ‘clean-up’ loans allowing a participant to achieve a zero closing balance. These loans are usually not rounded to the nearest dollar which is one of the criteria we use in selecting potential loans.

[12] The fact that we have loans at interest rates equal to the upper and lower bounds of our permissible range implies that there may be overnight loans that are being excluded by the interest rate criteria. We do not believe, however, that this is a significant risk or bias given the small number of loans already observed between 25 and 50 bps, above or below the target.

[13] See Reid (2007) for a more complete analysis of the recent developments with respect to the movements in OMMF and CORRA.

[14] There is still a possibility of collateralized trades after 4:00 pm using the pledge function in CDS. This involves pledging securities in CDS against a flow of funds in LVTS.

[15] Reid (2007) finds that the overnight rate derived from partially collateralized morning, Receiver General auctions, does not have a material impact on CORRA so it is likely to have even less impact on the uncollateralized rate. Therefore, we do not include this measure in our analysis.

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