Canadian Alternative Reference Rate
Working Group

August 2020

Canadian interest rate benchmark reform

Global financial markets are undergoing a major transformation

LIBOR, a set of key global interest rate benchmarks, is set to disappear after the end of 2021 because it is not a robust, transaction-based benchmark that meets global standards. This will affect trillions of dollars of loans, bonds and swaps. Global authorities are working with the private sector to prepare markets to transition from LIBOR to risk-free rates. Similar work is underway in non-LIBOR jurisdictions, including Canada.

- In Canada, benchmark reform efforts are being led by the Canadian Alternative Reference Rate Committee (CARR), a group of financial sector firms and public sector institutions. CARR's mandate includes promoting the use of the Canadian Overnight Repo Rate Average (CORRA) as a key risk-free interest rate benchmark in Canada.
- CORRA is a robust, transaction-based benchmark that reflects billions of dollars in daily overnight repo transactions. It meets global benchmark standards and is similar to other global risk-free rates (RFRs).
- While the Canadian Dollar Offered Rate (CDOR), Canada's other main interest benchmark, is not anticipated to immediately go away, we expect its relevance to decline, like other credit-based benchmarks, as markets globally move to RFRs. As a voluntary, survey-based measure, CDOR may ultimately be discontinued.

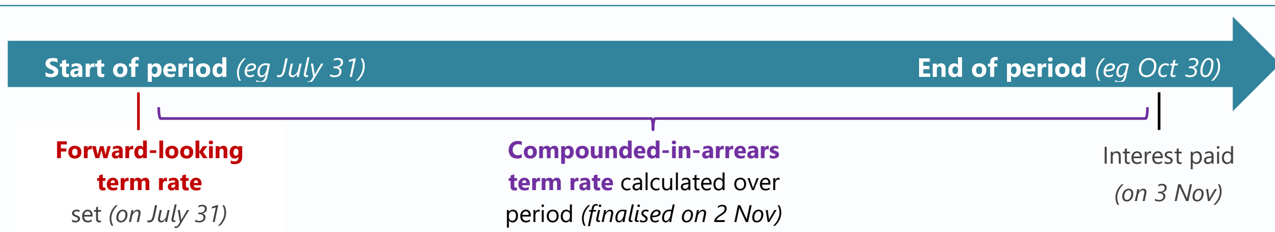
Canadian Dollar Offered Rate (CDOR)

- Measures the rate that Canadian banks are willing to lend to clients with existing credit agreements via banker's acceptances
- Survey-based, intended to reflect Bankers Acceptance transaction rates
- Term rate (1, 2, 3, 6 and 12-month)
- **Forward-looking term rate** (payment is known in advance)
- Incorporates both term and credit risk premium
- Administrator: Refinitiv
- Publication delay for free usage

Canadian Overnight Repo Rate Average (CORRA)

- Measures the cost of overnight lending via general collateral repo transactions secured by Government of Canada debt
- Transaction-based (i.e. reflects actual market transactions)
- Overnight rate
- Needs to be **compounded in arrears** to calculate a term rate and payment
- Reflects the overnight risk-free rate, closely tracks the Bank of Canada's Target Rate.
- Administrator: Bank of Canada
- No publication delay for free usage

- A **forward-looking term rate** is set at the start of the period over which you calculate interest, while a **compounded-in-arrears term rate** is based on a daily interest rate compounded over the calculation period. In other words, you know how much interest you will have to pay on a loan referencing a **forward-looking rate** at the start of the loan. For an **in-arrears rate**, you will not know the amount paid until the end of the period.



This document is not intended to serve as legal advice, or as a substitute for firms' conduct obligations when offering products linked to CDOR.

- Since **in-arrears** rates are compounded daily over a period of time, they are less likely to be impacted by short-term spikes (as these will be averaged down by all the other observations over the calculation period).
- The CORRA in-arrears rate is relatively stable if there is no change to the Bank of Canada's policy rate. However, it will immediately reflect the new rate if there is a change to the policy rate.
- Derivatives (interest rate swaps such as overnight index swaps) can be used to lock in a fixed rate for any length of time, so that payment schedules are known in advance.
- Systems and processes developed for using **forward-looking rates** (e.g. financial software) may need to be updated to handle **in-arrears rates**. It is expected that over time most systems will adapt to being able to handle both.

CARR is hard at work preparing the Canadian market for CORRA as a key risk-free interest rate benchmark.

- CARR has developed an enhanced calculation methodology for CORRA, contributed to the development of a CORRA futures contract, and kept Canadian businesses informed on benchmark issues.
- CARR is now working on:
    - ✓ Developing "**fallback language**" for Canadian financial products like floating rate bonds. "Fallback language" is robust legal language that determines what happens to financial instruments if CDOR stops being published.
    - ✓ Assessing and monitoring whether systems providers, such as software companies that develop systems for market participants, have incorporated CORRA and in-arrears methodologies.
    - ✓ Identifying and working with other groups on accounting, tax and regulatory issues that might arise from the transition from CDOR to CORRA, as well as from the LIBOR transition happening globally.
    - ✓ Developing voluntary standards for how to calculate CORRA when **compounding-in-arrears** for cash products like loans and floating rate notes.

Work to prepare derivative and swaps markets for benchmark transition is being coordinated globally by the International Swap and Derivatives Association (ISDA).

- ISDA has developed new robust **fallback language,** including for CDOR, for swaps and derivatives that are not cleared by central counterparties (CCPs). This fallback language has also been adopted by the CCPs.
- ISDA has also developed a "protocol" to integrate these new fallbacks into any legacy contracts.

Recommended next steps

- Make sure you understand the reform efforts going on in the benchmarks that you have exposure in.
- Make sure you have robust fallback language in place so that you are ready if the benchmark used in financial products you own stop being published.
- Make sure your internal/external systems can incorporate these new benchmarks.
- Benchmark reform is a complex issue, so discuss with your bank, dealer or trusted financial counterparty how benchmark reform may impact you and how you can start using these more robust benchmarks going forward.

Stay informed! **Visit these national working groups.**	CARR	ARRC	RFRWG	EUR WG	JPY WG	CH NWG