Minutes of the Canadian Alternative Reference Rate Working Group

Hybrid, 29 April 2024, 11:30 a.m. to 1:00 p.m.

1. Introduction

Members were welcomed to the meeting. The CARR co-chair reminded members that CDOR's publication will cease in just over two months. He reiterated that there will be no extension to that date and that there will be no synthetic CDOR rate published after June 28.

The co-chairs welcomed Andrew Munn, Head of CanDeal Benchmark Solutions, as the new observer on CARR from CanDeal. Andrew replaces Louise Brinkmann who retired recently. The co-chairs expressed their gratitude to Ms. Brinkman for her leadership in the development of Term CORRA and wished her the best in her future endeavours.

2. CDOR cessation announcement update

A representative from Refinitiv Benchmark Services (UK) Limited (RBSL) outlined the potential implications of declining BA volumes for the calculation of CDOR ahead of the June 28 cessation date. He noted that BA volumes are declining as expected, consistent with the CFIF recommendations for the winding down of the BA market. Traded volumes in Q1-2024 were down 18% from Q4-2023. While the spread between CDOR and secondary market traded rates has remained around 25bps on average, the spread between CDOR and CAD OIS has narrowed to its lowest level since 2022. RBSL noted they are closely monitoring BA activity and the banks' CDOR submissions. They have engaged with the six CDOR submitters and shared "best practices" on the CDOR submission as BA volumes decline. They are also in regular communication with the OSC and AMF as cessation approaches. RBSL will publish a market notice to remind stakeholders in CDOR of the upcoming cessation date. They also noted that CDOR commercial licenses will be terminated after June 28. RBSL is also seeking feedback from CARR members on the appropriate time period for retaining historical CDOR data.

The CARR co-chairs noted that CARR will publish a market notice following RBSL's outlining the steps that market participants need to take to be fully prepared for the cessation of CDOR.

3. CARR's recommended FRN fallbacks – how they work

A representative from CMHC presented detailed illustrative examples on how the CARR recommended fallbacks work for calculating the coupon for Canada Mortgage Bonds (CMB) and NHA MBS securities that reference CDOR. He emphasized that CARR's recommended fallback rate calculation methodologies are slightly different for the two programs. For floating-rate CMBs that reference CDOR, the fallback rate is the same one that would apply for ISDA based derivatives and other CDOR FRNs which adopt CARR recommended fallback language for FRNs. Operationally, this rate can be found on the FBAK page on the Bloomberg terminal under the "CDOR" tab or using the Bloomberg ticker "VCDOR03M <index>".[1] The appropriate fallback rate is the one that corresponds to the fallback observation day and the original IBOR rate record

[1] This fallback rate includes the spread adjustment published by Bloomberg for CDOR on May 16, 2022. The published spread adjustment is 0.29547% for 1-month CDOR and 0.32138% for 3-month CDOR.

day. If the fallback rate for the original IBOR rate record day is not available for the fallback observation day, the first prior published fallback rate for 3-month CDOR is to be used. He reminded CARR members that the fallback rate for CMBs will only be applied for the interest period starting September 15, 2024 as a 3-month CDOR setting will be published for the interest period June 15, 2024, to September 14, 2024.

For NHA MBS the fallback rate calculation will align with the methodology for current CORRA based NHA MBS. Starting July 1, 2024 the 1-month CDOR rate will be replaced by the 1-Month Daily Compounded CORRA rate, plus the Bloomberg published spread of 0.29547%. For legacy CDOR NHA MBS pools, issued prior to November 2020, which do not have fallback language, investors are urged to reach out to the issuers to ensure that appropriate updated fallback language can be included in the documentation.

A representative from Bloomberg walked through an illustrative example on how to calculate the accrued interest on an existing CORRA based FRN on the Bloomberg terminal. Bloomberg will adapt this same approach to calculate the accrued interest for those CDOR based FRNs that fallback to CORRA using CARR's recommended fallback methodology. They noted that in certain cases, the usual two day observation lookback may need to be adjusted, but that this will be automatically incorporated into Bloomberg functionality.

CARR members noted that these two presentations were very helpful to lay-out the methodology for calculating the coupon and accrued interest for those securities that use the CARR's recommended fallback methodologies. Members suggested that these presentations be published separately through a market notice to help promote investor awareness of the calculations. In addition, it was recommended that CMHC and CARR engage with industry groups such as the Mortgage-Backed Securities Issuer Association (MBSIA) and Canadian Bond Investors Association (CBIA).

4. Term CORRA update

Andrew Munn from CanDeal Benchmark Administration Services (CBAS) informed members that CBAS's "Republication of Term CORRA Rates Policy" discussed at the last CARR meeting has been posted on its website. The normal publication time for Term CORRA is 1pm ET, but if there are technical or operational issues impeding its calculation or publication or if CBAS has reason to believe that input data is compromised or incomplete or otherwise deficient, it could delay publication until 2pm ET. He also mentioned that if a material error was detected after publication but before 3pm ET, the rate would be republished. A "material error" is one that results in a net change equal to or greater than (+/–) 1 basis point compared to the previously published Term CORRA rate for that day. An error identified after 3pm ET will not lead to a correction or republication for that day. CBAS will publish an error summary quarterly like other benchmark administrators.

He informed members of a recent error in the calculation and publication of 1- and 3-month Term CORRA for March 1, 2024. CBAS incorrectly published a Level 1 calculated rate, instead of publishing a Level 2 rate due to insufficient volume in 1-month CORRA futures, which resulted in the 1-month rate being 1.781 bps higher and the 3-month rate being 1.865 bps lower than it should have been. Since no republication policy existed at that time, the correct L2 rate was not republished. CBAS disclosed this information on its website and informed Term CORRA licensees. The disclosure is for information only and not for recalculation of interest payments. He noted that CanDeal has since conducted an internal review of the administrator and calculation agent processes. CBAS has implemented recommended improvements to its internal controls to ensure that this type of error will not happen again.

A representative from the TMX informed members of enquiries it has received on potential use cases for Term CORRA. She noted that certain derived uses of Term CORRA were currently prohibited under licensing agreement to minimize the inverse pyramid. However, there are cases where Term CORRA could be useful for valuations and performance measurement. The co-chairs re-iterated that such use cases could be permitted as long as it does not result in the creation of a financial instrument (or exposure) that references Term CORRA. The co-chairs asked TMX and CanDeal to draft the guidance on these use cases. Finally, the representative reminded members the TMX is continuing to work with Bloomberg to provide Term CORRA on a delayed basis on the Bloomberg terminal.

5. CDOR transition status

A representative from the MX updated members on the April 26 conversion of BAX contracts that expire after June 2024 into their equivalent 3-month CORRA futures contracts. He noted that the process, which involved converting about 130,000 BAX contracts, went smoothly without any technical issues. As a result of the conversion, there are no more BAX contracts expiring after June 2024. The member from LCH noted that it conducted a "dry run" to test the upcoming June 8-9 conversion for cleared CDOR swaps at LCH. Another member noted that the similar dry run done with CME for the May 17 conversion had gone well. Members noted that while most clients have been transitioning their derivatives exposures to CORRA, they have been slower to convert derivatives used to hedge CDOR loans.

Members from the loan transition subgroup reiterated that the conversion of CDOR based loans to CORRA or Term CORRA based loans has been slow so far. However, it is expected to increase in earnest in May and June, just prior to the cessation of CDOR. This is similar to what happened with USD LIBOR based loans. They reminded members that loan agreements still need to be updated to specify the necessary conforming changes to enable borrowing by way of Term CORRA and/or Daily Compounded CORRA. They discussed the conforming changes that the administrative agent of a loan may need to enact (e.g. to timing and frequency of determining rates, or for removing the Bankers Acceptance (BA) drawdown option etc.) as the result of the adoption of a fallback rate.

The cash securities subgroup discussed the upcoming process for issuers to update their FRN fallback information through the CDS Bulletin service, or by publishing the equivalent information on their own website (or equivalent). Investors were encouraged to review these details to ensure that they fully understand the changes to coupon calculation going forward.

6. CARR subgroup updates

The Communications & Outreach subgroup noted it is continuing to seek relief from the CSA regarding trade reporting requirements after the cessation of CDOR, similar to what was done with LIBOR trades. This is due to the operational burden of reporting the large number of OTC derivatives that are expected to transition under fallback provisions on or before July 2, 2024. A similar request has been made to the US CFTC.

Other subgroups noted their work was already discussed in previous sections of the meeting.

7. Other items

A few CARR members will be participating on a panel at the upcoming MX Derivatives conference in Montreal on May 22. The next CARR meeting will take place on May 21, 2024. Members were also reminded that a placeholder will soon be sent for the CARR recognition event in July.

<u>List of attendees</u>

Market representatives

Alexander Nicholson, Bank of America
Andrew Bastien, PSP
Audrey Gaspar, OTPP
Brett Pacific, Sunlife
Bruce Wagner, Rogers Communications
Carl Edwards, Desjardin
Carol McDonald, BMO
Derek Astley, TD Bank
Jason Chang, AIMCO
Jean-Philippe Drolet, National Bank of Canada
Jim Byrd, RBC
Luke Francis, Brookfield
Louise Stevens, CMHC

Observers

Dave Duggan, CAG chair
Philip Whitehurst, LCH
Josh Chad, McMillan LLP
Alex Prince, TMX
Gavin Morris, TMX
Jody Nguyen, TMX
Andrew Munn, CanDeal

Subgroup co-leads

Lisa Mantello, Osler
Elodie Fleury, National Bank of Canada
Robin Das, RBC Capital Markets
Alison Perdue, TS Securities
Mike Elsey, RBC
Carol McDonald, BMO
JP Mendes Moreira, Scotiabank
Sarah Patel, Scotiabank

Bank of Canada

Harri Vikstedt
Wendy Chan
Danny Auger
Xuezhi Liu
Greyson Addo
Thomas Thorn
Zahir Antia