CARR's allowable use cases for Term CORRA - *Finalized*[1]

Globally, many major jurisdictions are transitioning their financial system from a forward-looking interbank bank offered rate (IBOR) to an overnight risk-free rate (RFR). In Canada, the IBOR rate is the Canadian Dollar Offered Rate (CDOR) and the overnight RFR is the Canadian Overnight Repo Rate Average (CORRA). The Canadian Alternative Reference Rate working group (CARR) expects that the vast majority of the financial products (or exposure) currently referencing CDOR will transition to overnight CORRA calculated in-arrears. This is consistent with the practice in other jurisdictions. The importance of adopting overnight risk-free rates, where possible, has been underscored by the Financial Stability Board[2] and the International Organization of Securities Commissions (IOSCO)[3] as well as by the Bank of Canada and other central banks and regulators.

Certain jurisdictions have recognized that in certain use cases a forward-looking "term RFR" is appropriate in the successful transition from IBORs to RFRs. To determine if a forward-looking term rate is appropriate for particular products, these jurisdictions have created working groups comprised of relevant stakeholders. Similarly, CARR formed such a group to determine the permitted use cases for a forward-looking term CORRA (Term CORRA). The resulting use cases have been approved by CARR and Canadian Fixed-Income Forum (CFIF)[4] members. The use of Term CORRA will be restricted through applicable licensing agreement with TMX Datalinx.

The goal of limiting Term CORRA's use to only those products that truly need it is to help ensure that the size of the market referencing Term CORRA is appropriate to the size of the market used to determine Term CORRA (i.e., managing the "inverse pyramid" issue). To this end, the use of Term CORRA will be only allowed as a reference rate for business loans, as well as any derivatives associated with such business loans. This is broadly similar to the restrictions applicable to Term SOFR [5] and it aligns with the majority of responses CARR received in its consultation on Term CORRA.

[1] This document updates CARR's approved use cases for Term CORRA that were published January 11, 2023.

[2] For example, see: FSB Final Reflections on the LIBOR Transition, FSB Statement Welcoming Smooth Transition Away from LIBOR, FSB 2022 Progress report on LIBOR and Other Benchmarks Transition Issues, Global Transition Roadmap for LIBOR, FSB statement on the impact of COVID-19 on global benchmark reform.

[3] See IOSCO's Statement on Alternatives to USD LIBOR published July 3, 2023.

[4] CFIF is a senior level industry committee established by the Bank of Canada to discuss developments in fixed-income market structure and functioning, market practices and related policy issues.

[5] Term CORRA will not be allowed to be used as fallback reference rate to CDOR in cash securities.

The allowable use cases for Term CORRA are set out below and described in greater detail in the attached Annex.

Approved uses for Term CORRA	Not approved uses for Term CORRA
• Business loans (as defined in the Annex) • Single currency derivatives for lenders, borrowers and guarantors hedging Term CORRA based loans[6] • Cross-currency derivatives for borrowers hedging Term CORRA based loans • Inter-dealer trading of CORRA-Term CORRA basis swaps, with certain limitations	All other uses of Term CORRA, including but not limited to: • Consumer loans • Floating rate notes • Securitizations • Capital securities • Structured notes • Derivative uses not explicitly identified as eligible • Fallback rates for any of the products listed above

Notwithstanding the use cases, CARR encourages those borrowers that have the operational and technical capacity to use overnight CORRA to do so in preference to using Term CORRA, particularly those that hedge their loans with derivatives.[7] It is expected that the overnight CORRA derivative market will be much deeper and more liquid than the Term CORRA derivative market. Furthermore, all CDOR derivatives subject to the International Swaps and Derivatives Association (ISDA) 2020 fallbacks protocol or supplement, or ISDA 2021 Interest Rate Derivative Definitions will be converted to a rate based on overnight CORRA following the cessation of CDOR on June 28, 2024.

Borrowers that wish to hedge Term CORRA loans with Term CORRA derivatives could see higher hedging costs than if they were using overnight CORRA for both their loan and their derivative hedge. This is due to the one-sided nature of the hedging demand from bank loan end-user clients. The higher hedging costs would be in the form of a positive 'basis' (additional spread relative to overnight CORRA derivatives), similar to that seen in the Term SOFR derivative market. In an effort to encourage a more balanced market for Term CORRA derivatives, CARR will include lenders' Term CORRA hedging transactions in the approved Term CORRA derivatives use cases.

Market participants will require a license from TMX Datalinx in order to offer products that use Term CORRA as the reference interest rate.[8] Even though borrowers will not require a license, they are expected to adhere to the use cases. Going forward the approved use cases will be governed by the Term CORRA administrator, CanDeal Benchmark Administration Services Inc (CBAS) and will be available on their website. CBAS is expected to be regulated by the Ontario Securities Commission and the Autorité des marchés financiers as a benchmark administrator under Multilateral Instrument 25-102.

[6] Lenders can hedge their Term CORRA loan exposure internally with their own dealer or with external dealers.
[7] Note that Prime based borrowing also references an overnight rate.
[8] This includes financial institutions, corporate entities, and government entities that provide business loans, as well as infrastructure platforms or operators that provide trading or clearing services for Term CORRA based derivatives. The licensees are tiered depending on the use and size of the institution.

Robust Fallbacks for Term CORRA

CARR has worked with subject matter experts across the various stakeholders in the financial industry to create an IOSCO compliant, forward looking, Term CORRA benchmark. While CARR has endeavoured to create a robust and sustainable benchmark, there are certain dependencies underpinning Term CORRA that mean its long-term sustainability is not guaranteed. In particular, the ongoing viability of Term CORRA will depend on the liquidity of the underlying CORRA futures contracts that are used to derive Term CORRA. If the depth of liquidity in these contracts is not sufficiently robust, the benchmark administrator will be required to amend its methodology.[9] If changes to the methodology do not result in a sufficiently robust benchmark, the benchmark administrator will be required to either (i) take steps necessary to ensure that the benchmark accurately and reliably represents that part of the market or the economy that it is intended to represent or (ii) to cease the publication of the benchmark with appropriate notice. CARR therefore expects any users of Term CORRA to have robust fallback language in place, in most cases referencing overnight CORRA calculated in-arrears. Users are advised to build the operational capacity to transact in these fallback rates should Term CORRA cease to be published in the future.

[9] Changing the methodology could result in Term CORRA becoming a T+1 instead of a T+0 rate.

Annex - Allowable use cases for Term CORRA

1. Business loans

Term CORRA may be used as a reference rate in business loans, which includes loans or other extensions of credit that are primarily for business or commercial purposes. These loans may be bilateral or syndicated facilities with banks or other financial and non-financial entities. Business loans include corporate loans; commercial loans; small business loans; letters of credit, intercompany loans, commercial mortgages, trade finance transactions including receivables finance/purchases and discounting; commercial leases; and loans or other extensions of credit for business or other governmental purposes to non-profit enterprises, municipalities, or other governmental or public entities.

Business loans do not include consumer loans of any kind. Additionally, loans that are structured and arranged or facilitated by securitization groups at financial institutions, which are used by special purpose vehicles or commercial paper conduits to fund the purchase of assets for securitization, are not considered business loans under these use cases and may not use Term CORRA.

2. Derivatives hedging business loans

Term CORRA may be used in derivatives to hedge business loans that reference Term CORRA by direct parties to the relevant Term CORRA business loan, including the lender, borrower or guarantor under such loan.

For clarity:

(i) Lenders, borrowers and guarantors can hedge single-currency floating rate Term CORRA loan payments using Term CORRA derivatives.

(ii) Borrowers can use Term CORRA in cross-currency basis swaps to hedge Canadian dollar draws on multicurrency loan facilities.

- Example A – Borrower draws down on a loan facility in CAD and swaps proceeds into USD. Term CORRA can be used on the CAD leg.
- Example B – Borrower draws down in USD and swaps proceeds into CAD. The CAD leg must be overnight CORRA.
- In the case of both examples, please refer to the guidance of the US Alternative Reference Rate Committee (ARRC) for the use of Term SOFR in the USD leg.

(iii) A bank (including through its bank treasury) may hedge its Term CORRA loan exposure internally with its own dealer or with external dealers, individually or on a portfolio basis.

(iv) Derivative hedges to business loans include both linear (including, but not limited to, fixed-float, float-float) derivatives as well as non-linear derivatives (including, but not limited to, caps, floors, collars, swaptions).

(v) A firm that issues fixed-rate debt may not swap the debt to Term CORRA, because the firm is not a direct party to a Term CORRA business loan.

3. Inter-dealer trading

Swap dealers, who are licensed to use Term CORRA, are permitted to hedge their CORRA/Term CORRA basis risk with another dealer according to the following provisions:

(i) Following the launch of Term CORRA

(a) a swap dealer whose parent bank has a Canadian dollar corporate loan balance of CAD$20 billion or larger, as reported to the Office of the Superintendent of Financial Institutions (OSFI),[10] or has a Tier 1 license to use Term CORRA, is permitted to trade with another swap dealer directly or through an inter-dealer broker.

(b) a swap dealer (i) whose parent bank has a Canadian dollar corporate loan balance of less than CAD$20 billion and equal to or greater than CAD$1 billion and (ii) has agreed to abide by the additional responsibilities associated with Tier 1 licensees, including participating in CORRA futures market making, is permitted to trade with another swap dealer directly or through an inter-dealer broker. Those banks or dealers meeting the loan balance criteria and interested in participating in inter-dealer trading as set out in this clause (b), are asked to contact CARR at CARR-WG@bankofcanada.ca.

(ii) After December 31, 2024, a swap dealer whose parent bank has a corporate loan balance of less than CAD$20 billion are permitted to trade with another swap dealer directly or through an inter-dealer broker. Notwithstanding the foregoing, swap dealers described in this clause (ii) are permitted to enter into swap syndications (i.e. when a lead hedge provider syndicates the associated swap to other banks/dealers in the lending syndicate in back-to-back transactions) with another swap dealer or to transact with another bank's treasury unit, following the launch of Term CORRA.

(iii) Notwithstanding subsection (ii), all swap dealers will be able to see all transactions executed through inter-dealer brokers starting on the launch date of Term CORRA.

If you have any questions about a use case not specified in this document, please contact Term CORRA's administrator, CBAS, or CARR. For licensing questions please contact TMX Datalinx.

[10] *Loans to individuals and others for business purposes*, as reported to OSFI in the Balance Sheet (M4) financial return.