Cassels

Interest Rates Watch: Publication of Recommended CDOR Fallback Language for Loan Agreements

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Welcome back to our *Interest Rates Watch* series, developed to provide timely updates and practical advice on developments related to interest rates and benchmarks on a regular basis. As always, we are here to help.

The Canadian Alternative Reference Rate working group (CARR) has released recommended fallback language for the Canadian Dollar Offered Rate (CDOR) for new and existing syndicated loan agreements.[1] This language follows the May 16, 2022, announcement by Refinitiv Benchmark Services (UK) Limited (Refinitiv), the administrator of CDOR, that Refinitiv will cease to publish all tenors of CDOR following a final publication on June 28, 2024. As such, loan agreements and other contracts which reference CDOR will need to transition to an alternative benchmark rate.

Similar to the most recent iteration of the fallback language recommended by the Alternative Reference Rates Committee (ARRC) in connection with the transition away from the USD London Interbank Offered Rate (LIBOR),[2] the CARR recommended fallback language adopts a hardwired approach.

Notable Elements

Key elements of the recommended fallback language include:

- **CORRA-based replacement reference rate:** The CARR recommended fallback language incorporates a two-step waterfall to determine the replacement reference rate which, in either case, is pegged to the Canadian Overnight Repo Rate Average (CORRA):
    - The first step of the waterfall provides for a replacement rate of (a) term CORRA (as recommended by the Bank of Canada, CARR or another committee endorsed or convened by the Bank of Canada) plus (b) the applicable credit spread adjustment (CSA). Although CARR expects that a term CORRA rate will be published ahead of the CDOR cessation date, there is no guarantee that it will be available by then and, as such, a second step in the fallback has been included.
    - If a term CORRA rate is not available, the second step of the waterfall provides for a replacement rate of (a) CORRA compounded in arrears plus (b) the applicable CSA. To the extent the rate in this second step is applied, the CARR recommended fallback language

also addresses the fact that an interest payment frequency would need to be selected (as, unlike a term CORRA rate which would feature a tenor, CORRA is a daily rate).

- **Credit spread adjustments:** the CSAs included in the CARR recommended fallback language, which are meant to account for the economic difference between the CORRA-based replacement rate and CDOR, are consistent with the CSAs that will be used in ISDA documentation and reflect the historic economic difference between CORRA and CDOR as of the date of Refinitiv's announcement that it would cease publication of CDOR.[3] However, as was seen in the transition away from LIBOR, the recommended CSAs may not reflect the economic difference between CORRA and CDOR at a point in time and, as such, parties may ultimately agree to use different CSAs.
- **Ability to "climb the waterfall":** in the event that a term CORRA rate is not available at the time of CDOR cessation, the CARR recommended fallback language includes the ability to "flip forward" or "climb the waterfall", such that once a term CORRA rate becomes available, term CORRA will replace daily compounded CORRA as the applicable reference rate.
- **No early opt-in ability:** unlike the LIBOR fallback language, the CARR recommended fallback language does not include a mechanism to transition to a CORRA-based reference rate ahead of the CDOR cessation date. As such, where the fallback language recommended by CARR is adopted, the reference rate will continue to be CDOR until the CDOR cessation date.
- **Bankers' acceptances:** through workshops held by the Canadian Fixed Income Forum on the potential impact of CDOR's discontinuation on bankers' acceptances (BAs), many Canadian banks have indicated that they would move away from BA lending upon the cessation of CDOR. As such, the CARR recommended fallback language provides the option to cease BA funding as of or following the cessation of CDOR in 2024, with the result that requests to rollover or convert a loan to a BA would be ineffective, and requests for new BAs would be deemed to be a request for a CORRA loan. Outstanding BAs would be unaffected and continue to maturity.

Implications and Recommendations

Going forward, parties should strongly consider including the CARR recommended fallback language in amendments to existing paper and new originations, together with any modifications as may be negotiated/appropriate for a particular deal (for example, modifications for bilateral facilities).

Parties to loan agreements where the only form of borrowing is under a BA facility should be mindful of the fact that the CARR recommended fallback language will not be sufficient to address CDOR cessation, since such facilities likely would not have a mechanism to borrow via CDOR/CORRA loan. As a result, a CORRA loan mechanism should be added to such loan agreements prior to the CDOR cessation date.

Parties should also monitor the market on this issue, as conventions may change as market practices evolve. In particular, as was seen on many transactions in the transition away from LIBOR, CSAs may vary

from CSAs included in the CARR recommended fallback language, depending on the specifics of a particular transaction and interest rates.

We will be issuing further articles relating to interest rates. Find other articles in our Interest Rates Watch Series here.

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[1] https://www.bankofcanada.ca/wp-content/uploads/2022/08/recommended-fallback-language-loans-referencing-cdor.pdf

[2] https://cassels.com/insights/interest-rates-watch-libor-transition-updated-fallback-language-for-usd-libor-syndicated-and-bilateral-loans/

[3] https://assets.bbhub.io/professional/sites/10/ibor-fallbacks_cdor_cessation_technical-note_220516.pdf

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