Cassels

Interest Rates Watch: CARR Releases New Guidance on CDOR Transition

Jennifer Wasylyk

May 7, 2024

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 published new information[1] relating to the transition of loans, derivatives, and cash securities referencing the Canadian Dollar Offered Rate (CDOR) or bankers acceptances (BAs). CDOR will cease to be published after June 28, 2024 and, accordingly, market participants that have financial contracts referencing CDOR or BAs must transition these contracts to the Canadian Overnight Repo Rate Average (CORRA), Term CORRA, or another alternative reference rate in advance of that date.

Loans

After June 28, 2024, borrowers will not be able to draw by way of CDOR and BA rates. Unless the underlying loan agreements have been remediated to transition to one or more alternative reference rates (e.g., Daily Compounded CORRA or Term CORRA), borrowers will be forced to utilize other existing borrowing options available to them under their loan agreement (if available).

It is important to note that the existence of the CARR-recommended CDOR loan fallback language[2] in a loan agreement does not typically provide for automatic transition to Term CORRA and/or Daily Compounded CORRA. While the CARR-recommended fallback language incorporated in many loan agreements provides a mechanism for transitioning loan agreements away from CDOR and/or BAs, it does not contain CORRA borrowing mechanics to allow loan agreements to automatically transition. As such, loan agreements with the CARR-recommended fallback language must be amended to enable borrowing by way of Term CORRA and/or Daily Compounded CORRA.

Market participants should review their loan agreements and remediate as soon as possible to avoid any disruption or legal issues.

Derivatives

Cleared Derivatives

Market participants that have cleared derivatives contracts that reference CDOR will have their contracts automatically converted to Daily Compounded CORRA, based on the International Swaps and Derivatives Association (ISDA) fallback rate, on the specific date determined by each central counterparty. For contracts cleared on the CME, the primary conversion date is May 17, 2024[3] and for contracts cleared on LCH, the conversion will take place over the June 8-9, 2024 weekend.[4]

Non-Cleared Derivatives

Non-cleared derivatives contracts outstanding on June 28, 2024 which either (a) incorporate the 2020 IBOR Fallbacks Supplement[5] produced by ISDA or (b) are subject to the 2021 ISDA Interest Rate Derivatives Definitions will be subject to the ISDA fallback methodology referencing Daily Compounded CORRA (calculated in-arrears) plus the spread adjustment published by Bloomberg on May 16, 2022.

CARR encourages market participants that have not yet signed ISDA's 2020 IBOR Fallbacks Protocol[6] to do so as soon as possible to ensure that the ISDA fallback rate is incorporated into all legacy transactions. Alternatively, contracts can be bilaterally amended to transition from CDOR to Daily Compounded CORRA. Again, market participants should review their contracts and take any required actions as soon as possible.

Derivatives Hedging Loans

If a derivative hedges a CDOR-based loan, implications of transitioning both the loan and derivative hedge should be considered and discussed jointly, including any potential impact on hedge effectiveness and pricing. CARR has indicated that best practice is to align bilateral derivatives that hedge loans with the loan(s) they hedge. This includes, for example, potential adjustments to loan conventions, such using a two day lookback period (consistent with ISDA derivative convention) as opposed to a five day lookback period (which is the generally accepted loan convention).

Cash Securities

Issuers and their respective investors should review underlying issuance documentation to ensure that fallback language has been incorporated and that fallback language is sufficient to transition from CDOR to a replacement rate on or prior to CDOR's cessation. If fallback language has not been incorporated or if existing fallback language is inadequate, issuers should work with their legal counsel to address the relevant issuances, which CARR notes may include one of the following approaches:

- Work collaboratively (where possible) to restructure or amend the securities through direct consent or a consent solicitation process to include sufficient fallback language;

- Issue a statement of intent that the issuer will, if necessary at a future date, seek consent to amend the securities to reflect CARR's recommended fallback language[7]; or
- At the discretion of the issuer, and after an evaluation of the economic impact and risks, call or tender the affected securities prior to June 28, 2024.

CARR encourages issuers to provide CDS Clearing and Depository Services Inc. (or through any other public means) the necessary information to publish details, through the CDS Bulletin Service (or equivalent), of the CDOR fallback for each issued security.

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

---

[1] https://www.bankofcanada.ca/2024/04/carr-reiterates-that-market-participants-with-cdor-based-loans-derivatives-or-securities-must-prepare-cdors-cessation-post-june-28-2024/.

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

[3] https://www.cmegroup.com/content/dam/cmegroup/trading/interest-rates/files/cme-conversion-for-cad-cdor-cleared-swaps.pdf.

[4] https://www.lch.com/system/files/?file=media_root/swapclear-cad-cdor-quickquide-021624-03.pdf.

[5] https://www.newyorkfed.org/medialibrary/Microsites/fmlg/files/2020/isda-ibor-fallbacks-supplement.pdf.

[6] https://www.isda.org/protocol/isda-2020-ibor-fallbacks-protocol/.

[7] For all cash securities except NHA MBS, CARR's recommended fallback was published on July 6, 2021. For CDOR-based NHA MBS securities, CARR amended the recommended fallback on November 30, 2023.

This publication is a general summary of the law. It does not replace legal advice tailored to your specific circumstances.