REMEMBER, REMEMBER, THE 1ST OF NOVEMBER; NAVIGATING THE NOVEMBER 1ST DEADLINE IN THE CDOR TRANSITION AND TERM CORRA'S LAUNCH

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The financial landscape is on the verge of a significant transformation as the transition from the Canadian Dollar Offered Rate ("**CDOR**") to the Canadian Overnight Repo Rate Average ("**CORRA**") gains momentum. On July 27, 2023, the Canadian Alternative Reference Rate working group ("**CARR**") released further recommendations[1] regarding the timeline for transitioning from CDOR to CORRA. As a result, loan market participants will need to become familiar with the use of CORRA sooner than they may have initially anticipated.

This bulletin delves into two key aspects of CARR's announcement: the new November 1, 2023 deadline and the recently established CanDeal/TMX Term CORRA.

Background

Prompted by international efforts to adopt more robust benchmark interest rates, CARR published a white paper on December 16, 2021 stating that in order to enhance the efficiency, stability, and transparency of the financial system, CORRA should replace CDOR as the primary Canadian benchmark interest rate. This transition will impact an estimated $20 trillion gross notional exposure across the Canadian wholesale financial system.[2] As discussed in our previous bulletins last year and in January 2023, the change from CDOR to CORRA is a fundamental transformation in the way the Canadian financial market is structured. As part of the transition away from CDOR, two new rates are being introduced: (i) daily compounded CORRA, which is an overnight risk-free rate calculated daily from overnight repurchase transaction using Government of Canada bonds and bills as collateral and administered by the Bank of Canada as a public service ("**Overnight CORRA**"); and (ii) a term rate calculated daily, derived from 1- and 3-month executable bids of CORRA interest rate futures, traded on the Montreal Exchange and administered by CanDeal Benchmark Administration Services Inc. ("**Term CORRA**").[3]

New November 1, 2023 Transition Date

In order to facilitate the transition from CDOR and reduce the backlog of potential loans that need to be amended, CARR proposed a new two-stage transition to CORRA:

1. As of November 1, 2023, new credit agreements or credit agreements undergoing material amendments (which includes key elements such as interest rates, maturities, increases and other critical terms) should no longer reference CDOR and there should be no new banker acceptance loans ("BA Loans"). Such agreements should instead reference Overnight CORRA, Term CORRA or the bank's prime rate.
2. The deadline for the second stage remains June 28, 2024 (the date on which CDOR will cease publication), when all existing credit agreements referencing CDOR must be transitioned to CORRA and all BA Loans must either be terminated or be restructured to reference CORRA.

Term CORRA Update

On September 5, 2023[4], CanDeal Benchmark Solutions and TMX Datalinx, will launch the forward-looking 1- and 3-month Term CORRA benchmark rates which will be available on the CanDeal Benchmark Solutions website and through TMX Datalink[5]. An application was submitted on February 28, 2023 (which was amended and restated on June 20, 2023) to the Ontario Securities Commission ("**OSC**") and Autorité des marchés financiers ("**AMF**") for the designation of: (i) Term CORRA as a designated interest rate benchmark; and (ii) CanDeal Benchmark Administration Services Inc. as the designated administrator of Term CORRA. The comment period for the application closed on August 8, 2023 and we anticipate that the OSC and AMF will publish designation orders shortly. With the advance publication of Term CORRA, and the pending approval by OSC and AMF, market participants can take comfort in knowing that the rate can be adopted by the bilateral and syndicated credit markets on November 1, 2023 as a replacement for CDOR.

We expect borrowers will typically prefer Term CORRA compared to Overnight CORRA due to its operational simplicity and certainty of funding. This was the case in the United States where loans referencing United Stated Dollar London Interbank Offered Rate (USD LIBOR) were primarily replaced by the forward-looking term version of the Secured Overnight Financing Rate (Term SOFR). However, CARR's 'Best Practices' Guide recommends that credit agreements reference both Term CORRA and Overnight CORRA with a 'Rate Flip' built into the credit agreement.[6] The Rate Flip is a relatively non-complex, uniquely Canadian approach that allows borrowers to change between Term CORRA or Overnight CORRA without having to amend the credit agreement. The Rate Flip also provides borrowers who are sensitive to hedging costs under Term CORRA with the option to flip to Overnight CORRA, which is anticipated to have a lower hedging cost compared to Term CORRA. Based on the market approach in the United States, it remains to be seen if either Term CORRA or Overnight CORRA will be the preferred rate in the Canadian loan market.

As mentioned in our previous updates, Term CORRA is only approved for specific activities including loans, trade finance, and associated derivatives. It remains to be seen if Term CORRA can be used for inter-dealer single currency derivative transactions.[7]

Limiting Term CORRA to specific use cases will be accomplished by requiring that lenders and derivatives dealers obtain licenses from CanDeal Benchmark Solutions. Such licenses will only be granted for approved use cases. Both CanDeal Benchmark Solutions and CARR have clarified that borrowers and derivatives end-users are not required to obtain licenses to enter into products which reference Term CORRA.

Next Steps and Key Takeaways

- Lenders should monitor the CanDeal Benchmark Solutions website to determine when licenses to use Term CORRA for approved use cases become available and take steps to obtain such licenses.
- Assuming designation by OSC and AMF is granted, on or before September 5, 2023, credit agreements can begin to reference Term CORRA as soon as licenses become available (which will almost certainly be before November 1, 2023).
- From November 1, 2023 and onward, new credit agreements and credit agreements which undergo a material amendment should reference CORRA rather than CDOR and there should not be any new BA Loans. Lenders and borrowers should consider whether Overnight CORRA, Term CORRA or both should be used in these new or materially amended agreements and associated hedges.
- Market participants are urged to evaluate the impact on borrowing costs, new loan structures and addressing material amendments in alignment with the November 1, 2023 transition date.
- Market participants should review CARR's recommended language guide to determine how to update their credit agreement templates to appropriately reference Overnight CORRA, Term CORRA or both, as applicable.

Should you have any questions regarding this newsletter or require further information, please contact one of the authors or a member of McMillan's Financial Services group.

[1] CARR publishes its recommendations for transitioning loans from CDOR to CORRA and provides a "no new CDOR or BA loan" milestone.
[2] CARR's Review of CDOR: Analysis and Recommendations.
[3] CORRA Loan Conventions Comparison Table.
[4] Term CORRA to be launched on September 5, 2023.
[5] A beta version of the 1- and 3-month tenors of Term CORRA has been available on the CanDeal Benchmark Solutions website and through TMX Datalink since July 2023. Unlike this beta version, the data available beginning September 5, 2023 is available to be used for permitted transactions.
[6] Transitioning Loans from CDOR to CORRA – Best Practices.

[7] We note that in the application to the OSC and AMF it states that Term CORRA would not meet the criteria to be considered a critical benchmark and as such we do not expect this use case to be approved (because approval of such use case would likely raise the notional amount of Term CORRA transactions above the threshold for a benchmark to be regulated as a critical benchmark).

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.