THE CESSATION OF THE 6-MONTH AND 12-MONTH CDOR TENORS

Posted on December 17, 2020

Categories: Insights, Publications

On September, 2020, Refinitiv Benchmark Services (UK) Limited ("**Refinitiv**") issued a consultation in which it requested feedback from stakeholders and users of the Canadian Dollar Offered Rate ("**CDOR**") on the effect of two proposed changes to CDOR that were under consideration. One of the proposed changes was the cessation of the 6- and 12-month tenors of CDOR[1].

As part of the consultation, Refinitiv found that there is minimal activity in the Canadian Bankers' Acceptance ("**BA**") maturities that underlie the 6- and 12-month tenors of CDOR. In fact, from November 2016 to 2019, the daily average dollar value of BAs created in the primary market was 0.3% and 0.1% of the overall BA dollar issuance for 6- and 12-month BAs, respectively, while the percentage by number of unique BAs created in the primary market over the same period was 0.4% and 0.1%, respectively.[2] Additionally, market participants consistently recommended that a satisfactory transition period should accompany any decision to discontinue publishing the 6- and 12-month tenors.[3]

As a result of the consultation, on November 12, 2020, Refinitiv announced that the calculation and publication of the 6-month and 12-month tenors of CDOR would cease indefinitely effective as of May 17, 2021 (the "**Effective Date**").[4] Publication of the 1-month, 2-month and 3-month tenors of CDOR will continue after the Effective Date.

Financial market participants are currently faced with the challenge of transitioning financial instruments that reference 6- and 12-month CDOR to an alternative rate.

1. What is CDOR?

CDOR is a domestic benchmark reference rate that is administered by Refinitiv and is currently published in tenors of 1, 2, 3, 6 and 12 months.[5] Each CDOR tenor is calculated and published daily at 10:15 a.m. ET Monday-Friday. Refinitiv calculates CDOR by using submitted rates from a panel of contributor banks that are active in the BA market.[6] Each contributor bank's submission represents the rate at which they are contractually willing to lend funds to corporate borrowers with existing BA facilities for set terms.[7] The highest and lowest quotes are dropped and the remaining quotes are then averaged to set the daily CDOR benchmark for each

tenor.

CDOR is closely linked to overall money market conditions, but may be influenced by a number of other factors, such as regulatory costs; credit market conditions; seasonal funding pressures; and the supply-demand dynamics for BAs.[8] Currently, CDOR is used as the main interest rate benchmark to price a range of Canadian financial instruments, including certain over-the-counter and exchange-traded derivatives; floating-rate notes and other securities; and loans between corporate borrowers and banks.[9]

2. The CARR

The Canadian Alternative Reference Rate Working Group ("**CARR**") was established in 2018 in response to recommendations published by the Financial Stability Board, which emphasized the need to both strengthen existing interbank offered rate benchmarks and to develop risk-free reference rates.[10] CARR is a consultative group comprised of financial sector firms, large financial instrument end users and public sector institutions, with an initial mandate to enhance the Canadian Overnight Repo Rate Average ("**CORRA**") and to analyze the need for, and potentially develop, a new Canadian dollar risk-free term rate.[11] On October 19, 2020, CARR's mandate was expanded to include an analysis of CDOR to determine its efficacy as a credit-sensitive benchmark, as well as to make recommendations based on that analysis.[12] As part of this new mandate, CARR will be responsible for assessing the impact of the discontinuance of the 6- and 12-month tenors of CDOR on financial instruments that reference CDOR and addressing issues that may arise from such discontinuance.

CARR initially discussed the issue of the discontinuance of the 6- and 12- month tenors of CDOR at its meeting on November 16, 2020 and there was a follow-up discussion during CARR's December 14, 2020 meeting. The minutes of the December 14, 2020 CARR meeting were not available at the time of publication.

3. Fallback provisions for Cash Products

Financial instruments other than derivatives (often termed "**cash products**") that reference CDOR generally contain a fallback provision that has been agreed upon by the parties to address the potential unavailability of CDOR. If the fallback provision in a cash product is triggered by the discontinuance of the 6- and 12-month CDOR tenors, the fallback provision will govern the method for determining the applicable alternative rate.

Fallback provisions can generally be sorted into two categories: the "traditional" approach and the "new" approach. The traditional approach to fallback provisions is to include general language to address the potential unavailability of CDOR. The traditional fallback provision is often triggered by the unavailability of the "CDOR Screen Rate" (for any reason) during an interest period. If triggered, the traditional fallback provision provides for various mechanisms by which to determine the applicable alternative rate. For example, one

common traditional fallback approach provides that an alternative rate (such as an interpolated rate or a rate quoted by a designated reference bank) is to be used for any interest period where CDOR is unavailable. Another common traditional fallback approach provides that upon CDOR becoming unavailable, all CDOR loans shall convert into fixed rate loans or prime rate loans. However, these traditional fallback approaches are generally intended to address a situation where CDOR is temporarily unavailable. As a result, they likely do not provide a desirable long-term solution to the permanent discontinuance of 6- and 12-month CDOR.

More recently, market participants have begun incorporating new fallback provisions for CDOR in their cash products. The shift to new fallback provisions is intended to address a scenario where CDOR is entirely discontinued as a reference rate. On November 24, 2020, CARR published a consultative document recommending specific fallback language to be used in floating rate notes referencing CDOR.[13] Although there is no definitive fallback provision yet for the permanent cessation of CDOR, most market participants have adopted an approach broadly similar to that referenced in the CARR consultative document.

The new fallback approaches generally contain two scenarios, either of which may trigger the application of the fallback provisions: (i) discontinuation of CDOR resulting from a public statement or regulator announcement and (ii) discontinuation of CDOR resulting from a failure to publish. If triggered, the fallback provision specifies the mechanism for selecting a successor benchmark rate. For example, the new fallback language recommended by CARR for floating rate notes provides for a prioritized "waterfall" of potential successor rates.[14] The potential successor rates may include: (i) a future benchmark rate officially endorsed by the Bank of Canada (or a committee thereof); (ii) term CORRA; and/or (iii) overnight CORRA compounded-in-arrears.[15] However, all of these successor rates have either not been identified, do not currently exist or are not widely adopted in the market. As a result, these potential successor rates are not desirable alternatives to 6- and 12-month CDOR as it is unlikely that the market will be ready to adopt these successor rates by the Effective Date.

4. Fallback provisions for derivatives

Unlike cash products, the fallback provisions for derivatives are generally prescribed by the International Swaps and Derivatives Association, Inc. ("**ISDA**") in market standard definitions referenced in the derivative.

On November 17, 2020, in response to the Refinitiv announcement regarding the discontinuance of 6- and 12-month CDOR, ISDA published guidance on the fallbacks currently in place for the cessation of publication of these rates where they are referenced in a derivative (the "**ISDA Guidance**").[16]

The ISDA Guidance references two separate possibilities for the fallback rate to be adopted depending on what market standard documentation is used by the parties to a particular derivative. For derivatives which rely on the 2006 ISDA Definitions as currently drafted, the parties must apply their own Alternative Continuation

Fallback prior to the Effective Date (the default appears to be overnight CORRA but there is no provision for a spread adjustment).[17] For derivatives entered into on or after January 25, 2021, more recent definitions could apply which would use overnight CORRA with a possible spread adjustment for 6-month CDOR (no adjustment is required for 12-month CDOR).[18] There is also an ISDA protocol which could apply to transactions entered into prior to January 25, 2021 if both parties have adhered to the protocol. Such protocol would have the same impact as the January 25, 2021 supplement.

5. General Advice

Financial institutions have exposures to CDOR across multiple financial instruments. In order to prepare for the discontinuance of the 6- and 12-month tenors of CDOR, the preferred approach is for financial institutions to identify all of their financial instruments that reference 6- and/or 12-month CDOR and to amend them as necessary prior to the Effective Date to ensure the desired alternative rate will apply. This preferred approach is consistent with the Canadian Securities Administrators' guidance for existing financial instruments that reference 6- and 12-month CDOR.[19] However, this approach is not practical for many financial institutions as they do not have sufficient resources to identify all of their applicable financial instruments prior to the Effective Date.

As an alternative approach, financial institutions should consider informing all of their borrowers that use CDOR (the "**relevant borrowers**") that the 6- and 12-month tenors will no longer be published as of the Effective Date. This may involve a statement on the financial institution's website and/or direct communication to each relevant borrower. In either case, the relevant borrowers should be encouraged to contact the financial institution directly if their financial instrument (i) uses 6- or 12-month CDOR as a reference rate; and/or (ii) provides the relevant borrower with the option to request a borrowing that uses 6- or 12-month CDOR as a reference rate. The financial institution's statement to the relevant borrowers should also set out their general intention in terms of fallback where the 6- and 12-month tenors of CDOR are referenced. This may involve adopting a replacement rate (such as 3-month CDOR) or removing the borrower's option to request CDOR borrowings that reference the 6- and/or 12-month tenors. Financial institutions should implement their preferred fallback approach as the issue is identified in each financial instrument, even if the issue is only identified after the Effective Date.

For new financial instruments that will extend past the Effective Date, market participants should only use 1-, 2- and 3-month tenors of CDOR. If market participants were planning to use either 6- or 12-month tenors of CDOR, they should consider selecting a replacement rate. Financial institutions should also update their systems to ensure that they do not permit lending at 6- or 12-month CDOR and inform their staff of this change in order to prevent the offering of these rates to their current or future borrowers.

by Shahen A. Mirakian, Alex Ricchetti, and Samantha Irving, Articling Student

[1] The other proposed change was to introduce a three-month delay to the publication of submissions from the contributors to the CDOR daily calculation (individual submissions are currently published on a daily basis). This proposal was rejected during the public consultation.
[2] See Canadian Alternative Reference Rate Working Group, "Overview of CDOR and the Underlying Bankers' Acceptance Market" (16 November 2020) at slide 14.
[3] See Refinitiv Benchmark Services (UK) Limited, "Announcement Following Public Consultation" (12 November 2020), [Refinitiv Consultation] at 2.
[4] *Ibid*.
[5] See Canadian Securities Administrators, "CSA Staff Notice 25-302 Matters Relating to CDOR, LIBOR and Other Interest Rate Benchmarks" (26 November 2020), [CSA Staff Notice].
[6] *Ibid*.
[7] *Ibid*.
[8] See Bank of Canada, "A Primer on the Canadian Bankers' Acceptance Market" (June 2018), [Bank of Canada 2018] at 20.
[9] See CSA Staff Notice, supra note 5.
[10] See Canadian Alternative Reference Rate Working Group, "Canadian Alternative Reference Rate Working Group – Terms of Reference" (21 September 2020).
[11] *Ibid*.
[12] See Bank of Canada, "CARR's Mandate Expanded to Include Analysis of CDOR (19 October 2020), online.
[13] See Canadian Alternative Reference Rate Working Group, "Consultation Paper: CORRA-in-arrears Calculation Methodology and CDOR Fallback Language for Floating Rate Notes" (24 November 2020), [CARR's Consultation Paper].
[14] *Ibid*.
[15] *Ibid*.
[16] See International Swaps and Derivatives Association, Inc., "Tenor Cessation Guidance – 2006 ISDA Definitions" (17 November 2020), [ISDA Guidance].
[17] *Ibid*.
[18] *Ibid*.
[19] See CSA Staff Notice, *supra* note 5.

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.

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