Canadian Alternative Reference Rate Working Group – Terms of Reference

Background
Interest rate benchmarks are a cornerstone of the global financial system and are used by market participants across a wide range of financial products and contracts. In 2013, the Financial Stability Board (FSB) established the Official Sector Steering Group (OSSG) to advise the FSB on recommendations to strengthen existing interbank offered rate benchmarks ("IBORs") and to promote the development of alternative risk-free or nearly risk-free reference rates (RFR) that could be used for many types of transactions, including derivatives. Based on the OSSG’s work, the FSB published in 2014 a set of recommendations for reforming major interest rate benchmarks. Under these recommendations, both existing and new benchmarks would need to adhere to the International Organization of Securities Commissions (IOSCO) Principles for Financial Benchmarks.

In response to the FSB’s recommendations, major jurisdictions have since formed national working groups, comprising key market participants, central banks and market infrastructure organizations. These working groups work to develop recommendations and implementation strategies based on the objectives set out by the FSB to develop alternative risk-free benchmarks.

Consistent with the work being done in other major jurisdictions, the Canadian Fixed-Income Forum (CFIF) established in 2018 the Canadian Alternative Reference Rate working group (CARR). CARR’s mandate has been oriented around two primary objectives: 1) to enhance the existing ‘overnight’ RFR (CORRA); and 2) to analyze the need for, and potentially develop, a new Canadian dollar risk free ‘term’ rate. The work on the first objective was completed in 2019 after a set of enhancements to CORRA were identified, consulted upon, and enacted by the Bank of Canada, which took over calculation and publication of the rate on June 15, 2020.

CARR operates in conjunction with the effort to reform interest-rate benchmarks around the world. Globally, this body of work has pivoted over time from the creation of ‘overnight’ RFRs to the transition and adoption of these rates. At the same time, the focus of national working groups and market participants has also shifted to developing ‘term’ RFRs and/or credit sensitive benchmarks.

CARR has already implemented a subgroup tasked with the adoption of, and transition to, CORRA. The work on a ‘term’ RFR is still at a preliminary stage and the demand for such a benchmark is inherently intertwined with Canada’s existing credit sensitive ‘term’ rate CDOR (Canadian Dollar Offered Rate). To date, CDOR has been outside the scope of CARR.

CDOR has been the prevailing Canadian credit benchmark rate for the past 30 years. While CDOR is structurally different than LIBOR and did not suffer from the same frailties as LIBOR, it is also a survey-

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2 Reforming Major Interest Rate Benchmarks, Financial Stability Board, July 22, 2014. [https://www.fsb.org/2014/07/r_140722/]  
3 For example, the Alternative Reference Rates Committee (ARRC) in the US [https://www.newyorkfed.org/arrc/index.html](https://www.newyorkfed.org/arrc/index.html).  
4 In Canada, an overnight RFR, the Canadian Overnight Repo Rate Average (CORRA), has existed since the late 1990s and is used primarily as the floating rate benchmark for Canadian overnight index swaps. CARR has therefore focused on enhancing CORRA rather than developing a new RFR.
based rate. Using expert judgement, the six CDOR panel banks provide daily submissions to Refinitiv, CDOR’s administrator, that reflect the rate at which they are willing to offer credit to companies against banker’s acceptances (BAs) across various tenors.

Recent reforms to CDOR have focused on the submission process rather than its underlying structure, including the BA market. The CDOR submission process has been subject to enhanced oversight, including a code of conduct initially published by IIROC in 2013 and new supervisory guidelines from OSFI in 2014. Nonetheless, a fulsome analysis on the architectural underpinnings of CDOR, including its reliance on the BA funding market, has yet to be undertaken. This is in spite of the fact that global reforms to banking regulation has adversely impacted the effectiveness of BAs as a short-term funding instrument for banks.

In recognition of these developments and CARR’s unique role in ensuring Canada has robust interest rate benchmarks, CFIF broadened CARR’s Terms of Reference in September 2020 to include both a review of CDOR and follow-on recommendations based on the outcome of that review.

Key Objectives
CARR’s primary objectives will be to 1) support the adoption of, and transition to, CORRA as a key financial benchmark for Canadian derivatives and securities; and 2) analyze the current status of CDOR and its efficacy as a benchmark, as well as make recommendations on the basis of that analysis. This work should examine both its function as a credit sensitive rate and as a term rate.

CARR will execute on these objectives to ensure Canada’s interest rate benchmark regime is robust, relevant and effective in the years ahead. Any recommendations made by this subgroup will take into account the feedback from relevant stakeholders.

Organization
- CARR will comprise senior members of the Canadian financial industry that have excellent understanding of (1) capital markets, including derivatives; and/or (2) the functioning of bank funding markets.
- Members will be selected based on their breadth of expertise/experience and anticipated ability to contribute to the work. Members represent their firms and are expected to:
  - Help promote and lead in transitioning to using CORRA across Canadian financial products, including in derivatives and floating rate notes;
  - Dedicate the necessary time and resources to the work of CARR and any applicable subgroup;
  - Have sufficient authority to commit their firms’ support and endorsement for CARR’s activities;
  - Aim to achieve outcomes that improve the overall efficiency and integrity of the Canadian financial market;
  - Actively participate in the meetings and provide the resources to support the work as needed;
  - Communicate issues identified to their senior management;
  - Lead and/or allocate staff to participate on subgroups or workstreams formed to focus on specific issues;\(^5\)

\(^5\) Subgroup composition can be broader or narrower than the existing individual CARR members or member institutions and will take into account the relevant required expertise.
- Attend all regularly scheduled meetings in-person, when in-person meetings are held, or via video when meetings are virtual. Delegates can attend on an exceptional basis with the agreement of the co-chairs;
- Be aware of their obligations under the Competition Act and avoid the disclosure of any competitively sensitive information. Members should inform co-chairs of any Competition Act concerns of which they become aware and which arise from CARR discussions.

- CARR will be co-chaired by a senior representative of the Bank of Canada and a CFIF member. A Bank of Canada lawyer or an external counsel retained by the Bank of Canada will also attend each CARR meeting (either in person or by video) as an observer.
- CARR membership will be comprised of 18 institutions from across the Canadian financial industry, in addition to the Bank of Canada. It will include participants from buy- and sell-side firms, as well as issuers. Relevant infrastructure providers may be included as additional (non-voting) members. The chair of the CORRA Advisory Group will be an observer member of CARR.\(^6\)
- Changes to the size or composition of CARR will be at the discretion of the co-chairs.
- Decisions taken by CARR should be made by consensus, but in the event of an inability to reach consensus decisions will be made with a two thirds majority.
- The Bank of Canada will provide the secretariat function to CARR. The terms of reference, membership, meetings agendas and minutes, once approved, will be made public on the CARR webpage.
- Subgroups will be purely advisory and report their assessment and/or recommendation to CARR on a regular basis for discussion and approval.
- CARR will reach out to and seek feedback from a wide range of stakeholders to create the transparency necessary to achieve broad consensus around CARR’s proposals. This could include through targeted industry roundtables and through the publication of consultation papers.
- CARR and any subgroup will meet as required. Meetings will be held either virtually or, if in-person, either at the Bank of Canada’s office in Toronto, or at the offices of a member institution.

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\(^6\) If the CAG chair is already a member of CARR, they will retain this membership.