

Recommended terms for CORRA-based loans

This note describes the methodology and terms recommended by the Canadian Alternative Reference Rate working group (CARR) for new loan agreements where the borrower and lender have agreed to reference the overnight Canadian risk-free rate (RFR) benchmark, known as the Canadian Overnight Repo Rate Average (CORRA), either as an additional rate option, or instead of the Canadian Dollar Offered Rate (CDOR) rate option.

These recommendations may be especially relevant for multi-currency loan agreements that previously referenced the London Interbank Offered Rate (LIBOR)¹ for the foreign currency borrowing rate option. With most of the main global currency rate options moving from referencing LIBOR to either solely referencing overnight RFRs, or referencing RFRs as an additional rate option, it is important for market participants to have a corresponding RFR option for Canadian dollars.

The methodology and terms have been developed through a consultative process with a number of Canadian borrowers and lenders. They also take into account work done in other jurisdictions to develop RFR loan conventions for their respective currencies. There may be a wider selection of conventions available in other currencies than for the Canadian dollar due to a wider range of benchmark choices, including potentially a term RFR option. Term CORRA is currently not available in Canada.

The methodology and terms are only recommendations and can be voluntarily included in the documentation for CORRA-based loans. Borrowers and lenders are free to modify the recommended conventions as required or to use terms of their own choosing. For greater certainty, firms are not obliged to follow these recommendations. The recommended conventions may be subject to change as market practices evolve.

CARR is recommending these terms as part of a broader effort to develop and promote market standards for products referencing risk-free rates, both in the Canadian marketplace, and globally as part of the benchmark reform efforts. The development of robust market conventions across different types of financial products can help promote liquidity and facilitate a wider use of risk-free rates. With the imminent cessation of LIBOR, the development of robust markets for risk-free rates in Canada will gain importance.

The cessation of LIBOR has highlighted the significant difficulties that can arise when a major benchmark is discontinued, particularly for contracts without fallback language (language that describes what happens to the contract if the main reference rate is no longer available) or with inadequate fallback language. To address these issues in Canada, CARR is considering developing fallback language for loan contracts that reference CDOR, similar to the recommended CDOR fallback language [published](#) by CARR in July 2021 for floating-rate notes. Borrowers and lenders that continue to use or reference the CDOR rate option are encouraged to include this eventual new voluntary CDOR fallback language in their loan documentation.

¹ LIBOR is published for five currencies (USD, GBP, JPY, EUR, and CHF). All GBP, JPY, EUR and CHF LIBOR tenors, as well as the USD 1-week and 2-month tenors will be discontinued after the end-2021, while the remaining five USD tenors (overnight, 1-, 3-, 6- and 12-month) will continue to be published until the end June 2023.

1. Key differences between CDOR and CORRA rate options

While both CDOR and CORRA can be used to calculate the interest due on loans, they are economically somewhat different. While CDOR is forward-looking term rate (e.g. the 1-month CDOR rate tells you up front the interest rate that will apply over the term of a 1-month loan), CORRA is an overnight rate (i.e. CORRA is the interest rate on overnight repurchase agreements using Government of Canada securities as collateral). Also, while CDOR incorporates both term and bank credit risk premia (i.e. the interest rate compensates lenders for term risk and bank credit risk), CORRA is a risk-free rate (there is no compensation for term risk or bank credit risk) that closely tracks the Bank of Canada's policy or target rate. As a result of these differences in the benchmark rate there are two key factors that market participants need to understand/consider in using the CORRA rate option in a loan agreement:

1. Since CORRA is an overnight rate the actual amount of interest payable needs to be calculated in-arrears. In other words, CORRA's daily values over the interest rate period are compounded to produce an interest rate that matches the term of the loan or interest rate period.² Therefore, the actual payment is backward-looking as opposed to being forward-looking using the CDOR rate option. A Prime rate option is also calculated in-arrears. As CORRA tracks the Bank of Canada's target rate relatively closely, market participants can forecast relatively accurately the payment at the start of the period, especially if there is no expectation of a policy rate move by the Bank of Canada during the interest period. Should market participants want certainty as to the payment for the period they can enter into an overnight index swap for the term of the interest period with their counterparty. Figure 1 illustrates the methodology differences between the two rate options.
2. Since CORRA does not incorporate a bank credit or term premia, it is a lower-yielding rate than CDOR. The degree of the difference between the two is a function of the demand and supply conditions in the short-dated bank funding market and therefore varies with time. During periods of financial stress CDOR can be substantially higher than CORRA. Figure 2 below shows the CDOR – CORRA spread for 1- and 3-month terms respectively.³

These recommendations only provide guidance on the payment and calculation methodology for using the CORRA rate option. They do not contain any guidance on any additional spread that may be associated with the CORRA rate option as compared to a CDOR rate option, arising from the economic difference between CDOR and CORRA illustrated in Figure 2. Such a spread should be bilaterally negotiated between borrowers and lenders. Market participants can use the above illustrations as an indication of how that spread has behaved over the past fifteen years.

² See [this](#) backgrounder for more detail.

³ For comparison purposes the graphs show the spread between 1-month CDOR and OIS, and 3-month CDOR and OIS instead of overnight CORRA, since the OIS rate is the expected average value of CORRA over the specific time period. Market participants can lock-in the OIS rate using an overnight index swap if they so choose to.

Figure 1 – Comparing CDOR and CORRA-in-arrears loans

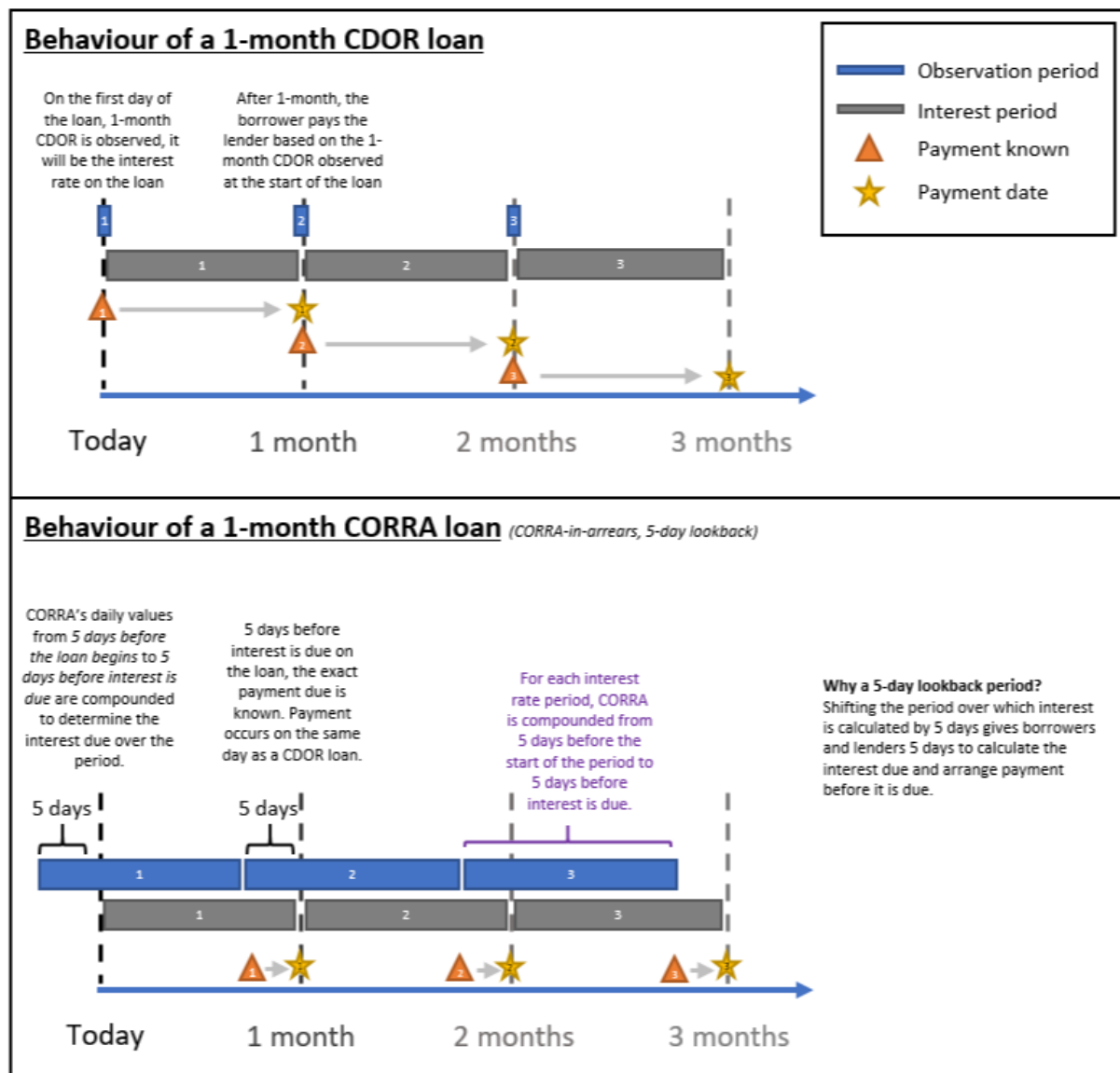
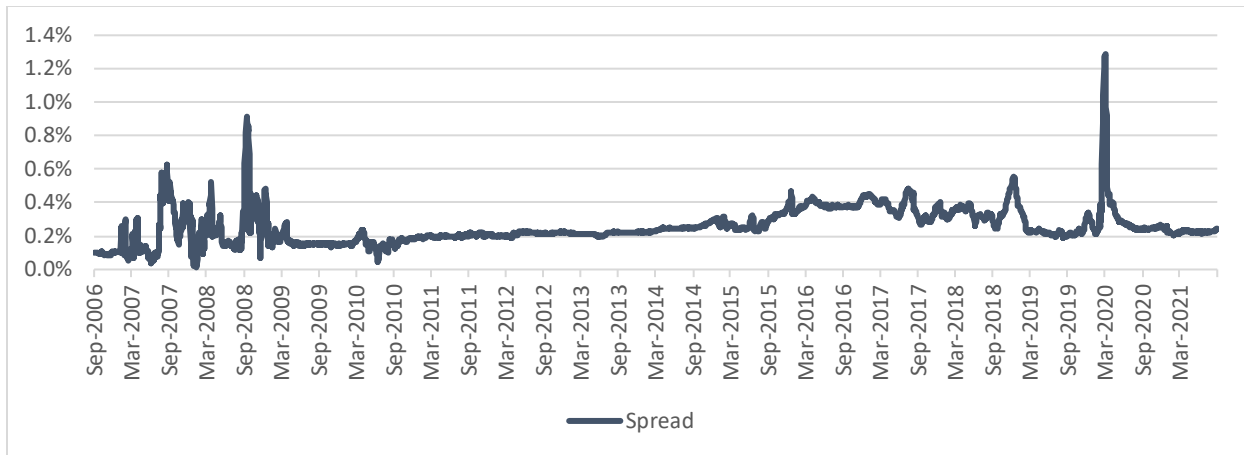


Figure 2 – Spread between 1-month CDOR and 1-month OIS



However, should CARR publish recommended CDOR loan fallback language, CARR will outline a methodology for calculating a Credit Spread Adjustment (CSA) for loans that reference CDOR in the case that CDOR is no longer published and these loans will fallback to reference CORRA. CSAs are included in fallback language to ensure, to the extent possible, that borrowers and lenders are economically as well off when a loan’s main benchmark disappears and is replaced with a new rate. For CDOR loan fallback language, the CSA would make the CORRA loan as economically equivalent as possible to the original CDOR loan when CDOR is no longer available. This equivalence approach was used by ISDA in designing the new derivative fallback language for LIBOR and other equivalent global benchmarks, including CDOR. ISDA worked with industry to develop a transparent methodology for calculating the CSA for derivative fallbacks. This ISDA methodology has now also been incorporated into fallbacks for some cash products globally, including CARR’s recommended CDOR FRN fallbacks.

2. Recommended terms

Pricing Calculation Methodology

CARR recommends using the daily compounded in-arrears methodology for CORRA based-loans as it reflects more accurately the time value of money and aligns with several key market standards, including:

- the methodology recommended by CARR for use in CORRA-linked floating rate notes (FRNs);
- the fallback language CARR recommends for use in FRNs referencing CDOR.⁴
- ISDA's market convention for CAD and other currency derivatives; and
- the methodology recommended by the LMA for global syndicated lending in a number of currencies.

It is also one of the calculation conventions recommended by the ARRC and the LSTA. Banks are operationally prepared to deal with this pricing methodology.

Daily compounding in-arrears refers to the calculation of interest over a period based on the compounding of a daily interest rate like CORRA published daily over that period. Using this approach, the exact interest due on a loan is only known at the end of the interest period and differs from a forward-looking term rate which is set at the start of the interest period.

CORRA Administrator

Bank of Canada is the administrator of CORRA.⁵

CORRA Publication Time

CORRA is published each day that Schedule I banks under the *Bank Act (Canada)* are open for business in Toronto, Ontario, Canada. CORRA for a given business day is published on the Bank of Canada's CORRA webpage⁶ on the following business day (i.e. T + 1 basis) at 9am ET.

CORRA Republication Time

In the event of an error of at least 1 basis point, republication of CORRA occurs by 11am ET on the day that the rate was originally published.

Holiday and Weekend Convention

The holiday convention for CORRA follows the Bank of Canada Holiday Schedule. Interest is compounded on banking days only; for each calendar day which is a weekend or holiday, the immediately preceding banking day's rate is applied, weighted by the number of calendar days until the next banking day. In multi-currency contracts, banking/non-banking days of other currencies will be applied based on the holiday schedule for each respective jurisdiction.

Notice of Election

CARR's recommendation is that borrowers should make their borrowing selection at least 2 business days prior to the borrowing date, which is in line with current market standards

Availment Options

1-month, 3-month or any tenor as negotiated between the counterparties which is in line with interest periods for risk free rates that have succeeded IBOR.

⁴ [Final recommended CDOR FRN fallback language](#)

⁵ [Bank of Canada becomes administrator of Canadian Overnight Repo Rate Average](#)

⁶ [CORRA Webpage](#)

Lookback and Observation Shift

Like other RFR's, CORRA is a backward-looking overnight rate. Without a lookback period, a borrower would only know the interest payment amount at the end of the period, on the same day it is due. Adding a "lookback" period allows the borrower to know its interest payment in advance of the payment date.

For greater clarity, with a lookback, the CORRA rate used to determine the compounded RFR is calculated over a reference period which starts a certain number of business days prior to the start of the interest period and ends a certain number of business days prior to the end of the interest period.

A five-business day lookback with no observation shift is recommended for CORRA loans. A lookback period of five business days allows the administrative agent to determine the interest rate, and therefore interest payment five business days before the end of the period. This facilitates the invoicing and payment process for both the borrower and the lender, in particular, when using daily compounded in-arrears methodology.

An observation shift means that the applicable rate is weighted according to the number of business days to which that rate applies in the relevant observation period rather than in the interest period. Depending on how non-Banking Days fall, the weighting applied with lookback without observation shift will differ from the weighting applied with lookback with observation shift. Please refer to the example in the Appendix.

Payment Delay

CARR recommends that interest payments are due and payable at the end of the interest period or at the time of prepayment on any amounts of principal repaid.

Daycount – Year Basis

CARR recommends Actual/365 days for CORRA, which is the standard convention in the Canadian money markets. For multi-currency facilities, daycount conventions usually follow the market convention for the specific currency and therefore can be different for each currency option.

Business Day Convention

CARR's recommendation is to use the "Modified Following Business Day" convention for CORRA, meaning that payments that should be paid on a day that falls on a non-Business Day will be adjusted to the next succeeding business day, unless that business day falls in the next succeeding calendar month, in which case the interest payment date will be the preceding business day.

Rounding

CARR's recommendation with respect to the rounding of the interest rate is five decimal places and Canadian dollar amounts is 2 decimal places.

Floor Calculation Methodology

For credit agreements that include interest rate floors, it is recommended that the floor be calculated daily (rather than at the end of an interest period) as loans accrue interest daily.

Breakage Costs

Breakage costs to be determined for product by the counterparties.

3. References

[Statement on behalf of the Working Group on Sterling Risk-Free Reference Rates – Recommendations for SONIA Loan Market Conventions](#)

[SOFR “In Arrears” Conventions for Syndicated Business Loans](#)