

## Recommended terms for inter-bank CDOR/SOFR cross-currency basis swaps

This note describes contractual terms that CARR recommends for interbank cross-currency basis swaps referencing the Canadian Dollar Offered Rate (CDOR) and the Secured Overnight Financing Rate (SOFR).

CARR is recommending these terms as part of a broader effort to develop and promote market standards for products referencing risk-free rates in the Canadian marketplace. The development of robust market conventions across different types of financial products can help promote liquidity and facilitate both market making and hedging activities. In doing so, market conventions can lead to a more robust market.

These terms are recommended to be voluntarily included in term sheets for new CDOR/SOFR cross-currency basis swaps in the inter-bank market. Banks are free to modify the suggested conventions or to use terms of their own choosing. For greater certainty, firms are not obliged to follow these recommendations.

The first section of this note provides a brief overview of the recommended terms, while the second section provides a term sheet summarizing the recommended terms.

### Section 1: Brief overview of recommended terms

The terms recommended by CARR follow existing market conventions for SOFR and CDOR for key parts of the contract including for day count conventions, holidays, and recount conventions.

#### **Frequency of payments**

Quarterly payments are recommended. The current market convention for cross currency swaps is for quarterly payments.

#### **Exchange of notional principal cash flows**

The current market convention is to exchange notional principal cash flows on the start and maturity dates of a cross currency swap, and that is expected to continue.

#### **Interest convention**

Interest conventions should follow the conventions in the single currency OIS market on each leg, which is generally compounded averages of daily rates settled in arrears. It is also recommended that transactions use the day count convention of the underlying OIS market of each currency (i.e. act/360 or act/365).

#### **Alignment of interest payment or rate fixing dates**

Single currency OIS transactions have different payment lags (ie: t+2 in USD and t+1 in CAD). CARR recommends the practice of moving the interest payments to the later of the lags. In the case of CDOR/SOFR, this would be t+2 for exchange of interest. This would allow harmonization or individual reset dates on both legs while limiting unnecessary credit risk of having different interest payment dates.

#### **Spot (2 business days) start**

In line with current market convention, it is recommended that transactions be based on a spot (2 business days) start.

### Reset of notional principals

The resetting of notional principal is a feature of the interbank cross currency market as a tool for reducing counterparty credit exposures.

CARR recommends setting the FX 2 days prior to the calculation period and exchanging notionals on the roll dates, with the interest payments for the prior period happening 2 days after the notional exchange.<sup>1</sup>

### Discounting and PAI

While there are currently no stated market practices for discounting and price alignment interest (PAI) in cross-currency transactions, prices quoted in the interbank market are assumed to be based on USD discounting (which is current transitioning from EFFR to SOFR). Once a trade point is agreed, an adjustment to the basis is agreed upon to reflect the CSAs of the counterparties. Thus, while it is important to have a standard for the discounting and PAI interbank prices are reflecting there is no need for a formal market convention at this time (at least until the transition from EFFR is complete).

### Example

The table below illustrates an example of how the recommended terms would translate for the timing of a swap.

Day count	Example date	Event
<b>t</b>	5 March 2021	Trade date
<b>t+2 business days</b>	9 March 2021	Trade begins (notionals exchanged)
<b>t (+ 2 business days – 2 business days) + 3 months</b>	7 June 2021	FX reset for mark-to-market
<b>t+2 business days + 3 months</b>	9 June 2021	Interest calculated for 9 March 2021 to 9 June 2021 period
<b>t+2 business days + 3 months + 2 business days</b>	11 June 2021	Interest paid
	(...)	
<b>t + 2 business days + 3 years</b>	11 March 2024 (9 March is a Saturday)	Interest calculated for 9 December 2023 to 9 March 2024 period Notionals exchanged
<b>t+2 business days + 3 years + 2 business days</b>	13 March 2024	Interest paid

<sup>1</sup> There are other potential solutions including a) shifting the RFR reset dates to begin on the notional reset date, b) delaying the notional re-exchange to match the interest payment.

## Section 2: Recommended term sheet

Notional Amount in USD	To be set at the time of trade using prevailing spot FX
Trade Date	5Mar2021 (T)
Start Date	9Mar2021 (T+2)
Maturity Date	9Mar2024
Initial/Final Notional Exchange Dates	Start date/Maturity date
FX Reset for MTM	-2 TOR&NY business days prior to the start of calculation period
Notional Exchange	Quarterly on roll dates

### Counterparty A pays to Counterparty B

Reset frequency	Daily
Reset reference rate	SOFR
Interest Calculation Method	Daily compounding
Interest Calculation Period	Quarterly, 9 <sup>th</sup> rolls
Interest Payment Frequency	Quarterly, in arrears
Interest Payment Lag	+2 business days
Day Count Convention	Act/360
Business Day Convention	Modified Following
Holiday Calendars	TOR&NY for calculation & payment, USGS for resets

### Counterparty A receives from Counterparty B

Reset Frequency	Quarterly
Reset Reference Rate	CDOR
Spread	'xxx' bps
Interest Payment Frequency	Quarterly
Interest Payment Lag	+2 business days
Day Count Convention	Act/365F
Business Day Convention	Modified Following
Holiday Calendars	TOR&NY for calculation & payments, Toronto for resets

Discounting Reference Rate	Defined by underlying CSA. Market quotations will assume USD discounting (EFFR or SOFR).
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