

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)¹ to advise the FSB on recommendations to strengthen existing interbank offered rate benchmarks (commonly known as IBORs) as well as to promote the development of alternative risk-free or nearly risk-free reference rates that could be used for some types of transactions². Both existing and new benchmarks would need to adhere to the International Organization of Securities Commissions (IOSCO) Principles for Financial Benchmarks.³

In response to the OSSG's report, major jurisdictions have since formed working groups, comprising constituents from key market participants, central banks and market infrastructure organizations, to develop recommendations and implementation strategies based on the objectives set out by the OSSG to develop alternative risk-free benchmarks.⁴

In Canada an overnight risk-free rate benchmark has, in the form of the Canadian Overnight Repo Rate Average (CORRA), existed since the late 1990s and is used primarily as the floating rate benchmark for Canadian overnight index swaps. However, consistent with the work being done in other major jurisdictions, Canada is now establishing a Working Group (WG) sponsored by the Canadian Fixed-Income Forum (CFIF) to identify and seek to develop a new Canadian dollar (CAD) risk-free 'term' rate and to examine enhancements to the existing CORRA rate. The term risk-free rate would act as a complementary reference rate for the Canadian market and would operate alongside the Canadian Dollar Offered Rate (CDOR). As the liquidity builds in this new term risk-free rate, it could be potentially used as the reference rate/benchmark in certain types of financial products or contracts in place of CDOR.

Key Objectives

The Canadian Alternative Reference Rate Working Group (CARR)'s main objective will be to identify and seek to develop a CAD term risk-free, or nearly risk free, rate benchmark that is robust, reliable and resilient to market stress and manipulation, as well as consistent with the IOSCO Principles for Financial Benchmarks and compliant with any applicable regulations. The work should also look to review and enhance the existing overnight risk-free rate⁵, specifically broadening the volume of trades that are used to calculate the rate. The WG will specifically:

¹ <http://www.fsb.org/what-we-do/policy-development/additional-policy-areas/reforming-financial-benchmarks/>

² Reforming Major Interest Rate Benchmarks, Financial Stability Board, July 22 2014. (http://www.fsb.org/wp-content/uploads/r_140722.pdf)

³ Principles for Financial Benchmarks, IOSCO, July 2013. (<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf>)

⁴ For example the Alternative Reference Rates Committee (ARRC) in the US (<https://www.newyorkfed.org/arrc/index.html>).

⁵ CORRA is currently calculated from overnight Government of Canada General Collateral transactions transacted through three inter-dealer brokers. Thomson Reuters is the current administrator of CORRA.

1. Identify and evaluate alternative options for a risk-free, or nearly risk-free, overnight reference rate.
2. Determine the specifications of the new term risk-free, or nearly risk-free, rate including which maturities there would be a demand for.
3. Propose possible steps to ensure that the new term and overnight reference rates are consistent with other global risk-free benchmarks, including that they are based on sufficient transaction volumes.
4. Consult with market participants (market makers and end-users) and other relevant stakeholders to facilitate broad-based adoption of the new term rate and reformed overnight rate.
5. Develop an implementation plan and timeline for both the new term rate and reformed overnight rate based on stakeholder input.

Organization

- The WG will be comprised of senior members in the Canadian financial industry that have an excellent understanding of at least one of the following: (1) CAD derivative market making/trading; (2) CAD repo market functioning; (3) End user hedging and products referencing CAD benchmarks; and, (4) risk management and collateral implications affecting CAD benchmarks. Membership composition will balance these various aspects of the benchmark's usage.
- 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:
 - Dedicate the necessary time and resources to the work of the WG and any applicable sub-group;
 - Have sufficient authority to commit their firms' support and endorsement for the WG'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;
 - Participate and/or lead ad-hoc sub-groups formed to focus on specific issues;
 - Attend all regularly scheduled meetings in person or in special cases via video conference. Delegates are allowed to 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 the WG's discussions.

- The WG 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 working group meeting (either in person or by telephone) in an observer capacity.
- WG membership will be initially comprised of 21 individual members representing 14 institutions, across the Canadian financial industry, in addition to the Bank of Canada. Relevant infrastructure providers may be included as additional (non-voting) members. Changes to the size or composition of the WG will be at the discretion of the co-chairs.
- Decisions taken by the WG should be made by consensus, but in the event of an inability to reach consensus decisions will be made with a two thirds majority where each WG member institution will have one vote.
- The Bank of Canada will provide the secretariat function to the WG. The WG's Terms of Reference (ToR), membership, meetings agendas and minutes, once approved, will be made public on the CARR webpage.
- The WG may form ad-hoc sub-groups to focus or study specific issues such as calculation methodology, infrastructure requirements and legal or accounting implications. Sub-group composition can be broader or narrower than the existing WG individual members or member institutions, and will take into account the relevant required expertise.
- Sub-groups will be purely advisory and report their assessment and/or recommendation to the WG on a regular basis for discussion and approval.
- The WG will reach out to and seek feedback from a wide range of stakeholders to create the transparency necessary to achieve broad consensus around the WG's proposals. This could include through targeted industry roundtables and through the publication of consultation papers.
- The WG and any sub-group will meet as required. Meetings will be held either at the Bank of Canada, or at a member institution.