Results from the CARR Consultation on Enhancements to the Canadian Overnight Repo Rate Average

The Canadian Alternative Reference Rate Working Group (CARR) began a consultation on proposed enhancements to the methodology for calculating the Canadian Overnight Repo Rate Average (CORRA) on February 26, 2019. The consultation concluded on April 30, 2019.

CARR received 15 responses to the consultation: 10 from sell-side firms, 3 from buy-side firms, 1 from a non-financial firm and 1 from a trade association.

Respondents were very supportive of the proposed methodology for enhancing CORRA. The most frequent responses focused on the treatment of "tomorrow-next" (tom-next) trades and on ensuring that the proposed enhancements to the calculation methodology remain appropriate going forward.

CARR carefully considered all comments. This document outlines CARR's responses to broad themes in the comments received.

Based on supportive feedback from respondents, CARR recommended to the Canadian Fixed-Income Forum (CFIF) that the enhanced methodology for calculating CORRA, outlined in the consultation paper and summarized in **Table 1**, be adopted with no changes. CFIF unanimously approved this recommendation. CFIF also agreed that CARR, through its transition subgroup, would work to develop recommendations on governance and monitoring of the methodology.

Table 1: Summary of proposed methodology to enhance the calculation of CORRA

	Description of methodology
Counterparty types	Transactions include repurchase transactions (repos) that are conducted between any two unaffiliated counterparties where data can be sourced. Repos conducted with the Bank of Canada or as part of the Receiver General auctions are excluded.
Term and time to settlement	Transactions are for an overnight term for same-day settlement (i.e., trades that are agreed to and settled on the same day or T+0).
Securities and currency	Transactions involve only Government of Canada (GoC) bond or treasury bill collateral and are settled in Canadian dollars.
Rate calculation	The final rate will be computed as the daily trimmed volume-weighted median (trimmed median) of eligible transactions defined above. • The trimmed median is calculated after removing the lower volume-weighted 25th percentile of transactions by repo rate from the set of eligible repos listed above (with the intent to exclude transactions that aim to source a specific scarce security, "specials," rather than funding).

Comments on consultation paper and CARR responses

Inclusion of tom-next trades

One respondent stated that tom-next trades should be included in the enhanced methodology for calculating CORRA because they represent a large share of the repo market.[1] In contrast, several others suggested that including tom-next trades be re-evaluated if that segment continues to grow as a share of the Canadian repo market.

CARR response

CARR continues to believe that incorporating tom-next trades in an enhanced CORRA may result in including rates that do not reflect the cost of overnight general collateral funding. Tom-next trades differ from other general collateral trades due to their timing and focus on specific securities as collateral. Further, incorporating tom-next trades was not seen as necessary because the enhanced methodology for calculating CORRA would already be based on $10–20 billion in daily repo transactions.

However, CARR recommends that the enhanced CORRA's administrator adopt a framework to monitor and review the rate's methodology (further described below). This framework could consider whether changes in the structure of the Canadian repo market warrant changes to the methodology for calculating CORRA. One such change in market structure could be a continued rise in the share of repo market transactions that are conducted tom-next, especially if this comes at the expense of same-day trades.

Governance and monitoring

Several respondents suggested that an enhanced methodology for calculating CORRA be monitored on an ongoing basis and that the methodology be reviewed to ensure that it reflects practices in the domestic market. Respondents specifically suggested monitoring the relative importance of tom-next trades in the market as well as the appropriateness of the 25 percent filter to mitigate the impact of special transactions.

CARR response

CARR agrees that the administrator for an enhanced CORRA should monitor and review the methodology on an ongoing basis to ensure it remains appropriate. Nonetheless, CARR believes that the methodology should change only infrequently to provide predictability and stability to the market.

As part of its continued work on transition, CARR may propose further suggestions for CORRA's monitoring and review. For example, it may discuss the appropriate frequency to review the methodology and other potential triggers for a review (e.g., new data sources become available, specific quantitative thresholds are breached).

CARR may also consider the types of metrics and data that should be published with the daily CORRA rate (e.g., quartiles of that day's distribution of rates, historical data) to increase transparency in the rate-setting process and to allow market participants to monitor the relevance and reliability of the rate.

Other issues

Inclusion of overnight repo and reverse repos with the Bank of Canada

One respondent stated overnight repo and reverse repo transactions with the Bank of Canada should be included in the methodology for an enhanced methodology for calculating CORRA because those transactions meet all other criteria laid out by CARR (e.g., currency, collateral type, term).

CARR response

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[1] A tom-next repo trade is an overnight repo trade that is executed on T+0, with the opening leg of the transaction settling on T+1 (tomorrow), and the closing leg of the transaction settling on T+2 (following next day).

Only a segment of market participants transacts with the Bank of Canada for its open market operations. Therefore, these transactions may not be representative of broad market funding conditions. CARR continues to believe the transactions resulting from the Bank of Canada's open market operations should be excluded from the calculation.

Exclusion of overnight repo transactions conducted on fixed announcement dates

One respondent stated that overnight repo transactions conducted before 10:00 ET on fixed announcement dates should be excluded from the enhanced methodology for calculating CORRA.

CARR response

Repo trades conducted before 10:00 ET on fixed announcement dates reflect market conditions on that day and should therefore be included in the CORRA calculation. CARR members also noted that repo volumes are typically low before an announcement when there is significant uncertainty about the rate decision. When repo transactions are traded before an announcement, the rate is frequently finalized afterward based on an agreed spread to the Bank of Canada target rate. Finally, some respondents expressed concerns that it may be operationally difficult to determine exactly when a repo trade occurred.

Inclusion of open-term repos

Citing the inclusion of open-term repos in the US Secured Overnight Financing Rate, one respondent asked why they are not proposed to be included in the enhanced CORRA calculation.

CARR response

CARR continues to believe that open-term repos should be excluded from an enhanced methodology for calculating CORRA because there were differences among institutions as to whether open term repo rates are set in the same manner as overnight repo rates.

Effect on credit support annexes

One respondent noted that definitions of CORRA in credit support annexes may not match exactly with an enhanced CORRA and that this may lead to disputes in interest payments as the market transitions to a new methodology.

Follow-up discussions suggested that an issue may exist where contractual language very specifically refers to practices underpinning the current CORRA, such as the time at which CORRA is published. If practices were to change as part of the transition to an enhanced methodology for calculating CORRA, amendments might be required to the language in contracts.

CARR response

Market participants should consider changes to CORRA and its implications for credit support annexes as part of their broader work related to benchmark reform.