October 24, 2023

Ms. Louise Stevens
Director Risk Management, Strategy and Products – Securitization
CMHC

Re: CDOR NHA MBS Fallback Rate: One-Month Daily Compounded CORRA vs Fallback CORRA

Dear Ms. Stevens

As of October 1, 2023, there were 2,284 CDOR-linked pools, amounting to $36.9 billion, issued by 40 issuers. Of these, 1,710 pools are expected to mature beyond CDOR cessation, June 28, 2024, and impacted by CDOR cessation, amounting to $31.6 billion. Also, the alternative pool types to CDOR that were developed that reference CORRA have continued to grow and as of the same date there were 836 CORRA-linked pools, amounting to $22.2 billion. The CORRA NHA MBS pools have been successfully accepted by market participants as the new standard of floating rate NHA MBS.

The MBSIA became aware that the CDOR fallback rate (i.e., Fallback CORRA) applicable to the CDOR-based NHA MBS pools could differ from the One-Month Daily Compounded CORRA applicable to CORRA-based NHA MBS pools. This discrepancy is due to a technical issue in how observation periods for each interest period are determined.

The MBSIA members have extensively deliberated on this issue and have concluded that it would be in the best interest of issuers and investors to maintain a single methodology to determine CORRA compounded in arrears for each interest period rather than having two different methods to determine CORRA compounded in arrears. The CARR recommended fallback language applicable to NHA MBS contains a conforming changes provision that would allow alignment of the calculation of the fallback rate to the accepted market practice for the CDOR alternative. Therefore, it is the view of the MBSIA that the alignment of the CORRA calculation methodology used in NHA MBS is consistent with the CARR recommendations. The MBSIA recommends that CMHC utilize the conforming changes provision in consultation with issuers to calculate the fallback rate for CDOR NHA MBS using One-Month Daily Compounded CORRA together with the CARR recommended spread adjustment of 0.29547% instead of using Fallback CORRA. This recommendation is applicable for the CDOR NHA MBS with the interim fallback language as well as for the legacy CDOR NHA MBS that did not contain fallback language.

The reasons and benefits for this recommendation are as follows:

Overarching concerns

- Firstly, MBSIA's understanding was that the fallback would result in the same compounded CORRA in arrears rate as is used in the new issue CORRA pools.
- As discussions about the future role of CMB continue, it is in the NHA MBS industry's best interests to contribute to product simplicity, efficiency and standardization, rather than risking product fragmentation, resulting in lower liquidity and lower overall efficiency of the NHA MBS market.

- Using One-Month Daily Compounded CORRA avoids situations where the CORRA for a single day is utilized in two different coupon periods. This approach more closely reflects the interest rate environment applicable to NHA MBS than the Fallback CORRA rate.

- In terms of simplicity, having all CORRA-linked pools referring to a single monthly CORRA rate after CDOR cessation is clearer, more straightforward and more transparent. It is also easier to reconcile and replicate than having two distinct monthly rates.

Alignment with CORRA Transition

- The publication of a rate on Bloomberg should not be viewed as a critical feature of the Fallback Rate. The key feature of the Fallback Rate is that it is term adjusted rate based on CORRA plus the spread relating to CDOR. The NHA MBS market has already adopted a robust alternative to CDOR using the CORRA Index published by the Bank of Canada.

Investor Considerations

- Numerous CDOR pools are owned by NHA MBS issuers themselves. Those issuers can attest to their strong preference as, both investors and issuers, to maintain a single CORRA index rate.
- Maintaining distinct CORRA determination methods will result in product fragmentation. Alignment in the rate could be expected to contribute to promoting the NHA MBS market's efficiency.
- Investor friendliness is another consideration. An investor holding CDOR pools and CORRA pools may not immediately understand the reason for the underlying index rates to be different. This discrepancy would work against the aim of standardizing and improving the efficiency of the NHA MBS market overall.
- With regards to availability, all NHA MBS investors have access to the Bank of Canada's CORRA Index. However, not all NHA MBS investors have access to Bloomberg to verify the interest amount payable on their investment.
- Investors track certain pool attributes, such as whether the pool pays an indemnity or whether the pool contains collateral mortgages. If the NHA MBS universe contains, essentially, twice as many CORRA-based pool types, where index rates may differ, investors may find such market fragmentation unhelpful, reducing their interest in CORRA-linked pools overall.

Implementation Considerations

- From a technological perspective, without the alignment of the fallback to CDOR with the One-Month Daily Compounded CORRA rate, NHA MBS issuers will have to separately track and calculate two distinct rates. This process would involve uploading both rates into their securitization platforms to calculate monthly interest payments, an operation that could incur significant technology development costs. The development provides no tangible benefit and will only be used for the remaining life of the pools.
- Central Payer and Transfer Agent: Computershare will be required to keep track of an additional rate rather than a single CORRA based rate. This may result in additional costs to Computershare which may be passed on to MBS issuers, making the transition from CDOR to CORRA more burdensome and less efficient.

- In terms of accrued interest, NHA MBS issuers' system infrastructure has been developed to calculate monthly interest and accrued interest based on the One-Month Daily Compounded CORRA. Systems have been updated to accommodate the conversion of CDOR pools to CORRA pools, enabling issuers to calculate accrued interest using the infrastructure developed for CORRA NHA MBS pools.
- As NHA MBS issuers have developed capabilities to issue CORRA-linked pools, issuers have created proprietary pricing and valuation engines. These engines estimate future monthly CORRA settings to determine forecasted cashflows. These calculators can be carried over to valuing CDOR pools post CDOR cessation, provided that the same index rate and related conventions are used. However, if the rate is not aligned, alternative calculators may need to be developed or existing calculations may need adjustment. This would necessitate additional model vetting and validation to ensure that the existing CORRA calculation engines can be used in their original form.
- Issuers and investors typically do not enter into interest rate swaps to hedge interest rate risk in CDOR NHA MBS. Hence, alignment with ISDA fallbacks is of limited significance to CDOR NHA MBS.
- Combined, the complexity of implementing a new calculation methodology for a very short period of time will result in significant changes to the processes supporting timely, accurate NHA MBS reporting. The system development time, implementation and testing for each issuer represent significant operational burdens that can be avoided by aligning the fallback provisions with the market standard calculations established by CMHC in the CORRA pool framework (the One-Month Daily Compounded CORRA rate).

We believe that the use of CARR's "conforming change" clause is appropriate and warranted, allowing NHA MBS fallback rate to be One-Month Daily Compounded CORRA:

Applicable Fallback Rate Conforming Change:

Notwithstanding the foregoing, in connection with the implementation of an Applicable Fallback Rate, the Calculation Agent may, in consultation with the Issuer, <u>make such adjustments to the Applicable Fallback Rate</u> or the spread thereon, as well as the business day convention, Reset Dates and related provisions and definitions including the Fallback Observation Day, <u>in each case that are consistent with accepted market practice</u> for debt obligations such as the CDOR Floating Rate Notes in such circumstances.

We would be happy to discuss this matter and answer any questions you may have. Please contact us at info@mbsia.com.

Regards,

Mortgage-Based Securities Issuers Association

cc: Canadian Alternative Reference Rate Working Group Co-Chairs
Harri Vikstedt, Senior Policy Director, Bank of Canada
Karl Wildi, Managing Director and Vice Chair, Global Markets, CIBC Capital Markets