London Stock Exchange Group

SONIA

Driving interest rate benchmark reform

Contents

Interest rate benchmark reform

Interest rate benchmarks play a vital role in the capital markets. They provide a useful reference rate for short-term wholesale market financing activity, and thereby create a platform upon which businesses can borrow and lend money with confidence.

Each individual business has its own financing needs and its own credit and liquidity profile. Benchmarking a firm's activity to a reliable reference level enables a focus on the specific needs of that business. For example, investors can concentrate on the credit premium they require above the benchmark for a given borrower's new debt issue without needing to assess general interest rate conditions from first principles each time. This allows the markets to function more efficiently. It does, of course, rely on confidence in the benchmark.

In February 2013, G20 leaders requested Financial Stability Board (FSB) members undertake a fundamental review of major interest rate benchmarks in response to cases of attempted manipulation and to the decline in liquidity in underlying markets.

In July 2014, the FSB report recommended the market reduce reliance on LIBOR and associated benchmarks and identify alternative "risk-free reference" rates (RFRs). This was and remains a global process, affecting the capital markets in all currencies. Industry initiatives were launched in all major markets. If we focus on the UK market, in March 2015, the Bank of England (BoE) convened the Working Group on Sterling Risk-free Rates (RFRs) in an effort to identify and then drive adoption of alternative RFRs in the Sterling market. SONIA was selected as the recommended alternative to GBP LIBOR, at the same time as reforms to the SONIA methodology were being introduced by the Bank of England, which had taken over from WMBA as the benchmark administrator.

More recently in July 2017 and 2018, Andrew Bailey's speech on the **Future of LIBOR** and **transition to a world without LIBOR**, which stated that panel bank support to sustain LIBOR until end-2021 will enable a transition, prompted market participants to expedite transition to alternative RFRs.

Here are a number of RFR selections that have been made to date:

Market	Target benchmark	Recommended alternative	Date of implementation
US, USD	USD LIBOR	SOFR	Summer 2017
UK, GBP	GBP LIBOR	SONIA	Spring 2017
EU, EUR	EURIBOR, EONIA	ESTER	Summer 2018
Switzerland, CHF	CHF LIBOR	SARON	Autumn 2016
Japan, JPY	JPY LIBOR	TONA	Winter 2016

"Work must begin in earnest on planning transition to alternative reference rates that are based firmly on transactions."

Andrew Bailey, Chief Executive, FCA

LSEG support of UK interest rate benchmark reforms

LSEG is working to support market transition from LIBOR across the group businesses, including LCH (swaps transition), CurveGlobal (SONIA futures), London Stock Exchange plc (supporting SONIA issuers) and FTSE Russell (potential provider of term rate and fallbacks). We will be organising events to engage with market participants over the coming months, to support this important regulatory agenda.

£5.5tn

LCH monthly average volume
(April – June 2018)

1. Interest rate derivatives: clearing

LCH has long supported the SONIA market, going back to 2009 when it included SONIA as an eligible benchmark in its initial launch of OIS product eligibility. Volumes go from strength to strength, both on an absolute and on a relative basis.

In absolute terms, LCH have recently been averaging £5 trillion per month (April – June 2018: £5.5 trillion) of newly registered SONIA activity, triple the volumes of a year earlier.

On a relative basis, SONIA volumes are now approaching 20% of cleared Sterling product volumes on a duration-adjusted basis (17.9%, January 2018 – June 2018) compared to slightly over 10% a year ago (10.7%, January 2017 – June 2017).

Additionally, LCH is looking to drive SONIA activity further through expansion of its clearing capability. It has extended the maximum eligible tenor for SONIA OIS from 30 years to 50 years earlier this year, and will be introducing further eligibility extensions in November this year to allow greater end-user customisation. This will increase the number of cases in which a tailored product using Sterling LIBOR can be directly replicated with a SONIA equivalent, thereby enabling more widespread adoption of SONIA. These extensions and enhancements to SONIA eligibility are examples of LCH's wider support of global benchmark reform initiatives.

For more information on SONIA clearing please visit www.lch.com.

2. Interest rate derivatives: trading

The CurveGlobal® Three month SONIA Futures contract allows firms to gain exposure to the Bank of England's reformed LIBOR index. Based on the overnight rate published by the BoE it was the first interest rate futures contract based on the three month compounded SONIA rate when it was launched on 30 April 2018, volume to 31 December 2018 was 556,728 lots equivalent to notional £278.4 billion.

CurveGlobal simultaneously launched an Inter-Commodity Spread (ICS) between Three month SONIA and their Three month Sterling LIBOR Futures contract. This ICS allows CurveGlobal's clients to effectively manage their transition from LIBOR to SONIA.

LSEG support of UK interest rate benchmark reforms

Issuers can use the ICS to transform LIBOR liabilities into SONIA (or vice-versa), furthermore the outright SONIA future contracts can be used by issuers of SONIA-based paper to convert SONIA liabilities into fixed cashflows. The ICS is the listed equivalent of FRA/OIS spread, and generates significant volumes. When measured by strategy type, it accounts for 49% for Three month SONIA futures and has grown to 20% for Three month Sterling.

For further information on the Three month SONIA future please visit www.curveglobal.com, or email info@curveglobal.com.

3. Capital markets: Lloyds SONIA-backed bond case study

London is an important centre for issuance and innovation in relation to SONIA products.

London Stock Exchange welcomed Lloyds bank as the first corporate bank to price a bond using the reformed interest rate benchmark SONIA, issuing £750 million of debt that is linked to the alternative benchmark.

Following from Lloyds, Santander UK and Royal Bank of Canada have also listed bonds linked to the SONIA benchmark on London Stock Exchange with Santander raising £1 billion and RBC raising £750 million across two transactions. More issuers are looking at SONIA linked bond issuance as a potential funding tool, supported by our markets. The World Bank issued £1.25 billion on 22 September 2018 and the European Investment Bank (EIB) issued the first SONIA linked bond in June raising £1 billion.

For further information about London Stock Exchange's markets for listing, please visit www.lseg.com/debt-securities.

"We are proud to be the first corporate company to issue a SONIA linked bond on London Stock Exchange, and pleased with the strong investor demand for the trade from both UK and non-UK accounts. This shows confidence in the bank and its strategy, and also interest in this new product. By continuing to innovate, the Group is well placed to continue its strong support for its customers and deliver superior returns for its shareholders, as it remains focused on its purpose of Helping Britain Prosper."

Toby Rougier, Group Corporate Treasurer at Lloyds Banking Group

£750m

Three-year sterling benchmark issued by Lloyds Banking Group, the floating rate covered bond tied to SONIA, raised £750 million from institutional investors.

LSEG support of UK interest rate benchmark reforms

4. Benchmarks

FTSE Russell is exploring the construction of term versions of alternative RFRs to support certain market segments with benchmark transition.

There is sentiment in the market that for cash products, there is a need for a forward-looking term rate or rates.

Term versions of RFRs can be developed utilising the most appropriate liquid derivative markets that reference the underlying overnight RFR.

FTSE Russell is working with key industry participants, initially focused on the sterling market, to build consensus on an industry-led technical design.

For further information about benchmarks, please visit **www.ftserussell.com**.

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