The Working Group on
Sterling Risk-Free Reference Rates

From LIBOR to SONIA and what you need to know:

Why do I need to transition away from LIBOR?

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What is LIBOR?

LIBOR is an interest rate benchmark designed to capture the rate at which banks borrow in the wholesale markets.

It widely used to calculate the interest rate for many different products. This includes loans, mortgages, bonds, securitisations, derivatives, but also other non-financial services contracts.

LIBOR interest is known at the start of the interest period, and rates are published for seven tenors across five currencies – overnight, 1 week, 1 month, 2 months, 3 months, 6 months and 1 year.

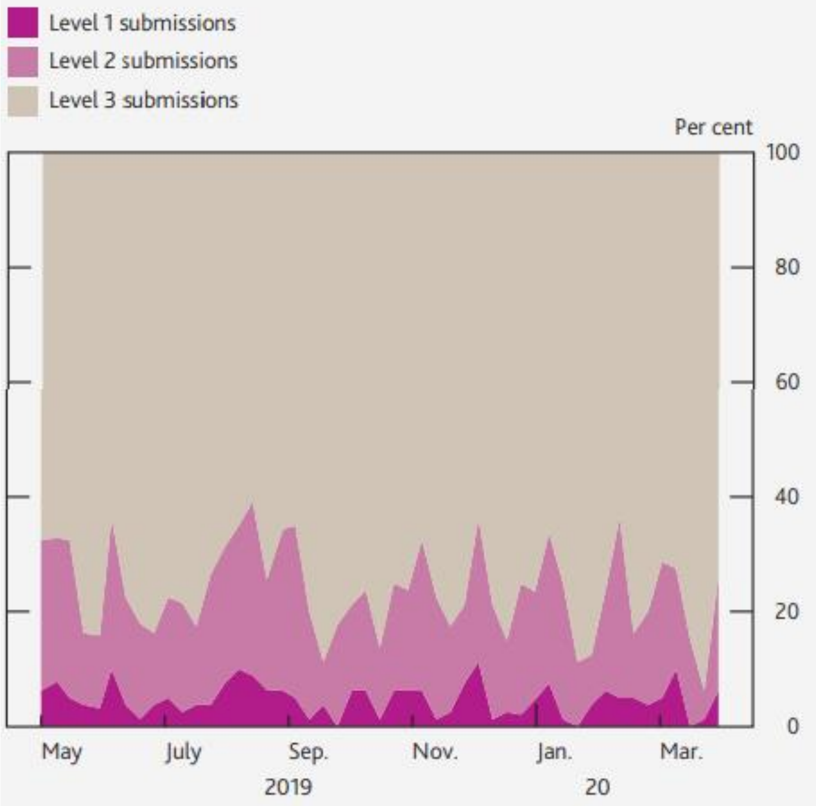
Why is LIBOR being replaced?

The LIBOR benchmarks rely on submissions from banks of their borrowing costs. However, the market on which LIBOR is built has fundamentally changed since the global financial crisis.

The lack of activity in the underlying market means that LIBOR is no longer sustainable given its widespread use.

LIBOR is sustained by the use of "expert judgement" by the submitting banks *(Level 3 submissions in the chart).*

Proportion of 'Level 1', 'Level 2' and 'Level 3' submissions underlying three-month sterling Libor[a]



Source: IBA.

(a) Input data to Libor are categorised using a 'waterfall' with increasing levels of judgement, as summarised in footnote (2).

LIBOR cannot be relied upon after end-2021

The FCA has secured agreement from the submitting banks that they will keep contributing to LIBOR until end-2021. This will give users time to switch to alternative rates based firmly on transactions.

There is no guarantee these banks will continue to make submissions after 2021, so LIBOR cannot be relied upon beyond this date.

As banks withdraw, LIBOR may become volatile or cease to be available for use.

It is important all counterparties exposed to LIBOR beyond 2021 take action. This may include amending your contracts to reference alternative rates – such as SONIA, as the primary risk-free rate in sterling markets, or Bank Rate – or provide contractual arrangements for when LIBOR is no longer available for use.

Moving from LIBOR to new rates…

Robust alternative benchmark rates have been established to replace LIBOR, such as SONIA in the UK

GBP LIBOR	SONIA
Based on panel bank submissions, lacks an active underlying market	Deep and liquid underlying market, not based on panel bank submissions
Forward-looking term rate	Overnight rate
Is set daily for a range of lending periods e.g. 1 week, 3 months, 6 months, 1 year	Published daily reflecting economic reality, but needs to be aggregated for use over the lending period
Interest is known at the start of the period	Interest is not known at the start of the period
Exposes the borrower to movements in bank credit risk	Nearly risk-free rate, minimising term bank credit or liquidity premium

The availability of LIBOR cannot be guaranteed beyond 2021

To find out more about what is replacing LIBOR, please see the video 'What is SONIA?'

Key resources on LIBOR and why it is being discontinued

- Andrew Bailey speech “The Future of LIBOR” – July 2017
- Last Orders: Calling Time on LIBOR event – June 2019
- Speech by Sir Dave Ramsden (Bank of England) – June 2019
- Working Group on Risk-Free Reference Rates factsheet – January 2020
- Andrew Bailey speech LIBOR: entering the end game – July 2020
- The FCA webpage - Transition from LIBOR