The FCA and the Bank of England encourage market participants in a switch to SONIA in the sterling exchange traded derivatives market from 17 June

Following close engagement with market participants, the FCA and Bank of England support and encourage market users and liquidity providers in the sterling exchange traded derivatives market to switch the default traded instrument to SONIA instead of LIBOR from 17 June this year. This is to facilitate a further shift in market liquidity toward SONIA, bringing benefits for a wide range of users as they move away from LIBOR.

A key milestone recommended by the Working Group on Sterling Risk-Free Reference Rates ('the Working Group') is to cease initiation of new GBP LIBOR exchange traded derivatives expiring after 2021 by end-Q2 2021, other than for risk management of existing positions. The Working Group milestones have supervisory backing from the PRA and FCA as set out in the recent 'Dear CEO' letter sent to regulated firms.

To support market participants in meeting this milestone, the Working Group's Path to ending new use of GBP LIBOR linked derivatives suggested exploring the potential to change standard trading conventions in exchange traded derivatives to a SONIA basis during Q2 2021. To determine support for, and the feasibility of, this approach, the FCA has therefore been engaging with a broad set of participants in the exchange traded derivatives markets, including liquidity providers, bank dealers, buy-side firms and exchanges.

An FCA survey of these market participants identified strong support for a change in the standard trading conventions, which would see SONIA rather than LIBOR become the default traded instrument from 17 June 2021.

The FCA and the Bank of England support and encourage all participants in the sterling exchange traded derivatives market to take the steps necessary to prepare for and implement these changes to standard trading conventions on 17 June and thereby assist transition to SONIA. In the period leading up to 17 June, the FCA and Bank of England will engage with market participants to determine whether market conditions allow the switch to proceed smoothly.

Background & technical notes

This is an extension of the successful similar change to the interdealer quoting convention for linear sterling swaps during Q4 2020. That change supported a substantial move in trading volumes from GBP LIBOR to SONIA over subsequent months, and so helped to reduce risk around LIBOR transition before the end of 2021. Extending this to exchange traded derivatives is intended to increase alignment in sterling markets and help to accelerate a reduction in new LIBOR exposures.

SONIA derivatives are likely to be the appropriate market convention for most contracts, particularly those maturing after 2021.

The proposed change will involve market participants switching new trading in sterling exchange traded derivatives that expire after the end of 2021 from GBP LIBOR to SONIA.

These changes would not prohibit trading in GBP LIBOR exchange traded derivatives, which would remain available until later in 2021 to facilitate risk management of existing positions, but would accelerate SONIA, rather than GBP LIBOR, becoming the primary source of liquidity. This, in turn, should encourage a greater proportion of GBP exchange traded derivative trading volumes to switch to SONIA.

FCA Survey results

Total respondents: 26

Q1. Do you support a 'SONIA-First' Convention Switch for the exchange traded derivatives market? Yes / No.

100% of respondents selected 'Yes' to this question.

Q2. If you answered Q1 with Yes: Do you think a switch on 17 June 2021 would be an appropriate date for the exchange traded derivatives market?

92% of respondents who selected 'Yes' to the first question supported the 17 June date.