

The Working Group on Sterling Risk-Free Reference Rates

Statement on behalf of the Working Group on Sterling Risk-Free Reference Rates –

The Bank of England and FCA, as the secretariat of the market-led Working Group on Sterling Risk-Free Reference Rates, conducted a survey of 15 dealers in non-linear Sterling interest rate derivatives to understand the preferred approach of market participants for the trading of interbank SONIA swaptions and caps and floors. Below are the questions posed and an aggregated and anonymised summary of the results. The Working Group has chosen to publish these results and sees this information as helpful in establishing the interbank SONIA non-linear market.

SONIA Swaption Market

1. Is Cleared Physical Settlement generally the preferred standard for swaptions in the inter-dealer market?

There was a split of opinion between cleared physical settlement (6/15) and collateralised cash price with a slight majority (8/15) preferring collateralised cash price. 1 respondent did not offer an overall preference.

2. Which cash settlement method might be used as a preferred fallback/alternative?

- a. Collateralised Cash Price
- b. Par yield curve unadjusted
- c. Other, please state (e.g. Cash Price)

The majority (13/15) selected collateralised cash price as the preferred alternative.

3. Which benchmark rate might be used as a preferred rate for cash settled swaptions?

- a. A SONIA Swap Rate fixing (when available)
- b. Other, please state

All respondents were in favour of using a SONIA Swap Rate fixing.

4. If a SONIA Swap Rate fixing has not been developed, what rate might be preferred for cash settled swaptions?

There was a mixture of opinions in response to this question. 5 suggested that a SONIA Swap Rate fixing was a requirement for a sterling SONIA swaption market and a further 5 were in favour of using an alternative swap fixing to a SONIA Swap Rate fixing. The other specific alternative offered was a calculation agent/dealer poll, which was suggested by 4 participants. 1 suggested falling back to break clause bilateral legal documentation.

5. Which expiry time is preferred?

- a. 11am London
- b. Other, please state

All respondents were in favour of having 11am London time as the expiry time.

6. Which swap conventions/frequencies might be preferred?

- a. Annual/Annual Act/365 (matching Sonia OIS)
- b. Other, please state

All respondents were in favour of option “a” to match the SONIA OIS swap.

7. Should the same conventions be generally used for all swap tenors (including 1y)?

All respondents were in favour of having the same conventions for all swap tenors

8.a What convention might be preferred for tenors where no SONIA Swap Rate fixing is in production?

There was a mixture of responses to this question. 3/15 suggested using a dealer poll and further calculations, such as fixings either side of the unproduced tenor. 3/15 selected purely interpolation. 4/15 favoured physical settlement. Additional suggestions included an 11am broker page, bilateral agreement on calculation method and ensuring all GBP LIBOR swap tenors are represented as SONIA Swap Rate fixings.

8.b. What convention might be preferred when the SONIA Swap Rate fixing is temporarily unavailable for a given tenor?

There was little consensus for this question. A selection of potential choices are listed here: Physical settlement; moving settlement forward to the next day (with a limit for rollovers); interpolation from adjacent tenors; broker screens, market aligned fallbacks from the benchmark administrator and an around the clock panel fixing.

SONIA Caps/Floors Market

9. What form of pay-off might be preferred for caps/floors?

- a. Single observation of compound O/N in-arrears rate
- b. Daily observation of every individual fixing (i.e. a stream of daily caplets/floorlets)
- c. Other, please state

A majority (9/15) selected single observation of compounded in arrears overnight rates. 3/15 favoured a forward-looking rate, while 1 respondent suggested daily observation of every individual fixing. 2 respondents suggested that their preference would be driven by the underlying markets: 1 favouring the swap market and 1 favouring the loan and bond markets.

10. What observation/payment frequency is preferable in the inter-dealer market?

- a. 3 months (in-line with current cap/floor payment frequency convention)
- b. 12 months (in-line with Sonia swap payment frequency convention)
- c. Other, please state

A majority (9/15) favoured 3 months as the observation/payment frequency. 3 preferred 12 months, but 2 of the 3 chose 12 months to be aligned with swap conventions rather than expressing a distinct preference for 12 months. The remaining 3 responses suggested the frequency should be driven by conventions in the floating rate note and loan markets.

11. Should Act/365 be the generally preferred day count convention?

A majority (13/15) agreed with this statement.

Additional Points

In at least one answer, 11 respondents highlighted the need for a SONIA Swap Rate fixing. This survey was carried out between 10 December 2019 and 4 February 2020.

Any questions should be directed to RFR.Secretariat@bankofengland.co.uk.