

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

### **Progress on adoption of risk-free rates in sterling markets**

15 May 2019

It is now just over a year since the Bank of England implemented reforms to the SONIA<sup>1</sup> interest rate benchmark, improving the sustainability and representativeness of the UK's chosen alternative risk-free reference rate.

Following that change, sterling-denominated financial markets have begun to shift decisively away from LIBOR and towards SONIA. In the derivative markets, the share of swaps traded using SONIA is already broadly equivalent to that linked to LIBOR. Liquidity and open interest in SONIA futures is also growing steadily: in the last three months over 25,000 lots a day have been traded across three exchanges.

SONIA is also being adopted in cash markets. SONIA-linked Floating Rate Notes (FRNs) have rapidly become the market norm, with around £25bn issued since June last year, and LIBOR-linked sterling FRN issuance beyond 2021 has all but ceased. Recent weeks also saw the issuance of the first distributed SONIA-linked Residential Mortgage-Backed Security (RMBS).

Looking ahead, the next goal is to reduce reliance on LIBOR in other sterling cash markets, including loans.

Given the rapid development of liquidity in markets referencing overnight SONIA outlined above, and the strong case for using the same reference rate in both cash products and the derivatives that hedge them, the Working Group on Sterling Risk-Free Reference Rates (RFRWG) anticipates that corporate borrowers will increasingly prefer contracts that reference compounded overnight SONIA. For those already able and willing to do so, the RFRWG encourages providers and users of such products to press ahead with their transition efforts, thereby reducing the risk of disorderly adjustment closer to end-2021 and helping to develop liquidity in SONIA-referencing markets even further.

The RFRWG also supports work currently underway to develop a term benchmark based on the sterling risk-free rate, known as a Term SONIA Reference Rate (TSRR). A consultation conducted by the RFRWG in 2018 identified demand for such a rate from some participants in cash markets where usage of forward-looking rates has historically been common, and potentially also to support transition of certain legacy contracts.<sup>2</sup> Respondents to the consultation identified a number of potential bases for developing a TSRR, including current SONIA-referencing derivatives markets. The RFRWG

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<sup>1</sup> SONIA (Sterling Overnight Index Average) is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions. Further information can be found at [www.bankofengland.co.uk/markets/sonia-benchmark](http://www.bankofengland.co.uk/markets/sonia-benchmark)

<sup>2</sup> <https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/consultation-on-term-sonia-reference-rates>

nevertheless expects future use of forward risk-free term rates in cash markets to be more limited than the current use of LIBOR.

In December 2018, the RFRWG published a statement inviting interested benchmark administrators to consider the summary of responses to the TSRR consultation and to share any views on the development of such benchmarks.<sup>3</sup> Three administrators (FTSE Russell, ICE Benchmark Administration and Refinitiv) have confirmed they are working on the development of a TSRR, and each delivered a short factual presentation to the RFRWG at its meeting on 14 May 2019. Over the remainder of 2019, the RFRWG expects administrators will work to establish if a robust TSSR, compliant with international standards, can be produced on a timetable consistent with the broader transition work. The RFRWG welcomes these developments, and has established a new Task Force to ensure this work remains on track and help provide market-wide input where appropriate to do so. Through these and other means, the RFRWG will work to support production of a new TSRR. It nevertheless encourages market participants not to delay preparations to conduct new business using overnight rates while the development of a TSRR takes place.

Commenting on the progress made Tushar Morzaria, the Chair of the RFRWG, said:

*“SONIA adoption has proceeded rapidly over the past year, across a wider range of products than some market participants initially expected, including not only derivatives, but also floating rate notes and securitisations. Given the benefits of the consistent use of benchmarks across markets, and the robust nature of SONIA, this is very much to be welcomed. The Working Group encourages lenders, borrowers and infrastructure providers to take advantage of this momentum and growing liquidity wherever they can, pressing ahead with transition to the use of overnight rates, and making the necessary investment. For the subset of cases where a risk-free term rate may be needed, the Working Group is committed to supporting its development.”*

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<sup>3</sup> <https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/term-sonia-reference-rates-consultation-summary-of-responses>