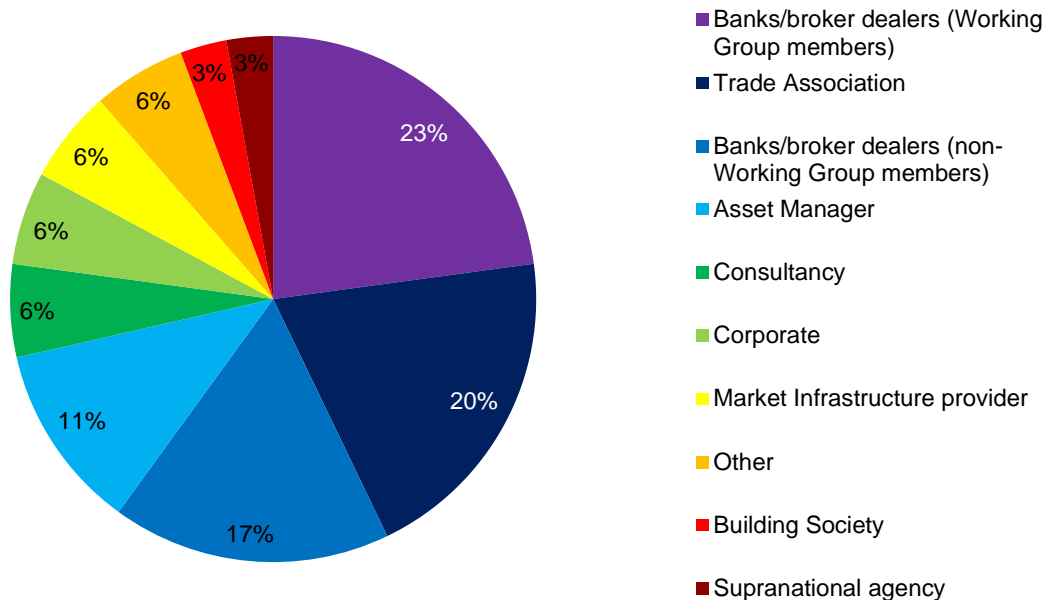


Summary responses to White Paper questions

Number of responses

The Group had received 35 responses to its White Paper from a diverse range of organisations (Chart 1).

Chart 1: Breakdown of respondents by organisation-type



Question 1: Based on the Group's assessment of the candidates against the selection criteria, do you agree with the choice of SONIA as the preferred RFR? Do you have any additional views on this assessment?

Of the 26 respondents who expressed a preference, 23 agreed with the choice of SONIA as the RFR. Of the 19 respondents who were not members of the Working Group and expressed a preference, 18 expressed support for SONIA as the RFR. The following benefits were cited as supporting SONIA as the RFR:

- The fact SONIA is based on actual transactions, with SONIA reform significantly increasing the population of underlying transactions.
- The existing liquid SONIA OIS market and the use of OIS for discounting purposes;
- SONIA's strong correlation with Bank Rate.
- Stronger market understanding and simplicity.
- Reassurance that SONIA is administered by the Bank of England.

Question 2: Do you have any views on the preferred design and use of a SONIA futures contract?

- Term of contract – some respondents emphasised the benefits of aligning SONIA futures with existing LIBOR futures through having a quarterly series matching international monetary market (IMM) dates.
- Interest calculation – most respondents expressed preference for a compound interest calculation to avoid convexity risk, align with the OIS calculation and match the economics of lending overnight.
- Settlement – most of those who expressed a preference recommended cash settlement as the preferred option.
- Backward or forward looking – some respondents favoured a backward looking rate, akin to OIS, for any SONIA futures in which settlement was derived from a backward looking view of SONIA over the contract period. Others preferred a future which settles on a forward looking term benchmark, akin to existing LIBOR futures, in order to promote adoption.

Question 3: Do you have any views on the extension of maximum maturities for cleared sterling OIS products?

The vast majority of respondents supported extending the maximum maturity for cleared sterling OIS products beyond the current 31 years. Some respondents supported the planned extension out to 51 years to match the gilt curve and current LIBOR swap curve. Other respondents felt that the maximum maturity should be longer at up to 60 or 70 years to fully match long-dated liabilities.

Question 4: Are there any other issues related to the development of interest rate derivatives products referencing SONIA, which the Group needs to consider?

The additional issues raised included:

- The need for international coordination, particularly with regard to adoption in cross-currency swap markets, given the transition to alternative RFRs in other currencies.
- The operational challenges of transitioning to SONIA, particularly for less sophisticated end-users. Challenges cited included not knowing cashflows in advance and the need to settle interest payments on the same day as determining the interest calculation given reformed SONIA is published on a T+1 basis.
- Whether clearing eligibility could be extended to SONIA swaps with quarterly and semi-annual payments, in addition to swaps with annual payments, in order to reduce collateral requirements and align with gilt and bond coupons.
- Whether other SONIA-linked products may be created in addition to futures, for example swaptions, caps, floors and collars.
- The current use of LIBOR in the EIOPA RFR curve for Insurance liability valuation.

Question 5a): What do you think is the appropriate scope of SONIA adoption across the broader financing instruments?

The vast majority of respondents said that adoption should be as broad as possible across all the products referenced in the White Paper. Respondents cited the following benefits of broad adoption:

- Ensuring consistency and limiting basis risk.
- Improving network efficiency and concentrating liquidity in a single benchmark in order to hasten adoption.
- Ensuring that benchmarks in underlying products match those used by hedging derivatives in order to meet hedge accounting criteria.

5b) What issues might arise in relation to referencing SONIA in these instruments?

Respondents raised the following potential issues:

- The challenge of converting legacy portfolios to reference SONIA (covered in more detail in response to question 8).
- The need to update documentation, where relevant, for different products such that it references SONIA rather than Libor. Respondents noted that this may be a particular challenge given the range of documentation in which Libor is referenced.
- Difficulties for smaller market participants in adapting to using a backward-looking rate in which interest due is not known until the day of settlement, in contrast to Libor where it is known in advance.
- Potential impacts on end-user product pricing.
- The lack of robust fallback provisions for existing financial products which reference Libor;
- The impact of any transition on hedge accounting effectiveness particularly if the benchmarks referenced in the underlying product and hedging instrument don't match and therefore lead to increased P&L volatility.
- Impact of alternative RFR choices in multi-currency loan drawings;
- The risk that market participants are not sufficiently incentivised to adopt SONIA as long as Libor still exists.

5c) Are there other instrument types for which SONIA could be adopted as the primary reference rate, which the Group should consider?

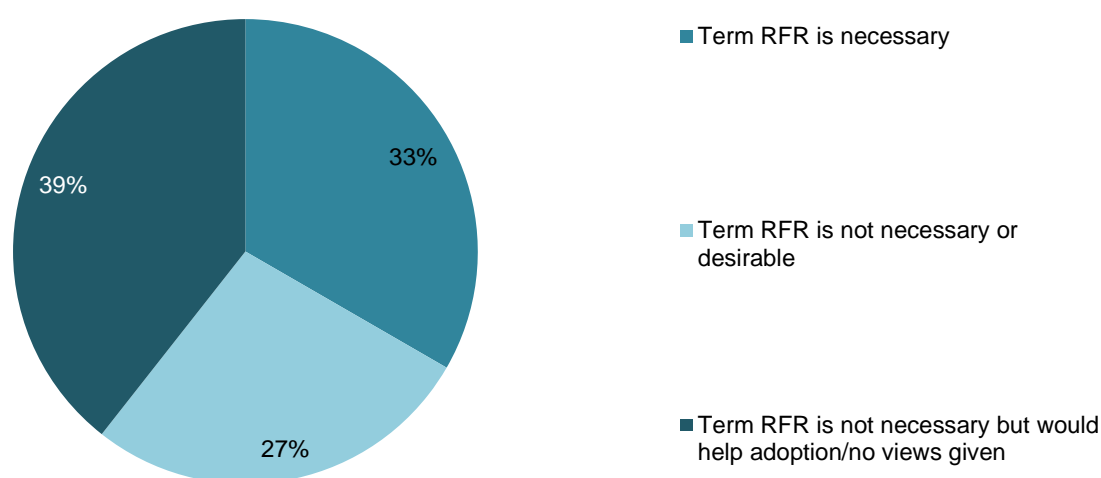
A number of respondents recommended the Group fully engage with relevant trade bodies in order to identify the full range of instruments which could reference SONIA.

Specific instruments identified for which SONIA could be adopted included swaptions, caps, floors, collars, cross-currency swaps, FX forwards, floating rate notes and reinsurance contracts.

Question 6a) Recognising the trade-offs between a backward- and forward-looking RFR, do you believe that a term RFR is necessary?

Respondents varied in the degree to which they thought a forward looking term RFR would be necessary. Respondents were divided into roughly three groups: those who felt that a term RFR would be essential to minimise cashflow uncertainty and construct term pricing; those who were opposed to a term RFR as it could undermine the benefits of a transaction-based benchmark and create opportunities for conflicts of interest to be exploited; and those who either expressed no opinion or felt a term RFR would be beneficial but not essential (Chart 2).

Chart 2: Responses to Question 6a



6b) Are there particular markets which could struggle to adapt to using overnight fixings?

Respondents cited a number of potential markets which could struggle to adapt including: corporate lending, particularly for small businesses; floating rate notes; asset backed securities; and trade finance. Respondents also noted particular groups of market participants which could struggle to adapt including cash market end-users, buy-side entities and custodians. Respondents noted that the main challenge would be end-users adapting to the daily compounding SONIA interest rate calculation, which could challenge timely settlement. Respondents noted that end-users would likely need to update IT systems to resolve these issues.

c) Do you have a preference for the potential construction of a forward-looking term RFR?

Most respondents suggested that, if a term RFR was deemed necessary, using the SONIA OIS curve as a basis would be the most appropriate means of construction. Some respondents proposed that an OIS construction should be based on executed transactions whereas others were content with a

construction based on actionable prices on regulated trading platforms with the existing ICE swap rate¹ noted as a precedent.

However, a number of respondents cited concerns regarding an OIS-based construction. In particular, some were concerned that it could create conflicts of interest as the entities streaming the OIS prices could have an exposure to the setting of the benchmark. Others noted that it could undermine SONIA as the RFR if term rates are not firmly grounded in transactions. Respondents emphasised that any term RFR benchmark produced would need to be compliant with relevant benchmark regulations.

A small number of respondents suggested that prices derived from SONIA referencing futures rather than SONIA-OIS would be another potential option for setting a term RFR.

d) Would multiple term options (e.g. 1-month, 3-month, and 6-month) be necessary, or could a single term fixing option be acceptable?

Respondents were divided on whether one term benchmark or multiple term options would be necessary. Some felt that a single term would be preferable in order to limit basis risk. 1m and 3m were the most frequently cited potential tenors for this purpose. Others felt that having multiple tenors but limiting the term structure to the most frequently used LIBOR terms of 1m, 3m and 6m would be sufficient. A final group felt that there should be multiple terms fully aligning with LIBOR terms in order to ease transition and facilitate legacy conversion.

Question 7: Do you agree that there are merits in exploring the conversion of legacy portfolios – across both interest rate derivatives and other instruments – to reference the RFR?

The majority of respondents agreed that there would be merits in exploring options for converting legacy contracts to reference SONIA. Respondents noted that this had become particularly pertinent in light of Andrew Bailey's speech on the 'Future of Libor'² in which he stated that, beyond 2021, "(the FCA's) intention is that, at the end of this period, it would no longer be necessary for the FCA to persuade, or compel, banks to submit to LIBOR." The benefits of legacy conversion for mitigating basis risk and boosting SONIA liquidity and consolidation were also highlighted by many respondents.

Respondents were divided on whether legacy conversion should take place across all instruments at a single point in time or via a more staggered approach.

Question 8: What other issues might arise as part of an effort to convert legacy Libor portfolios to reference SONIA?

The following issues were raised regarding legacy conversion:

¹ <https://www.theice.com/iba/ice-swap-rate>

² <https://www.fca.org.uk/news/speeches/the-future-of-libor>

- Determining a fair 'spread' over the RFR to which Libor products would be converted and ensuring there is no economic value transfer in doing so. Respondents noted that this would require strict governance to ensure certain market participants were not disadvantaged.
- Concern that a converted contract, from referencing Libor to referencing the RFR, would count as a new contract and therefore become subject to margining rules under the European Market Infrastructure Regulation (EMIR). Respondents also noted that the converted contracts could trigger tax liabilities.
- The need to update contractual documentation such that it references the RFR and the risk of contractual frustration in the event that market participants felt there was a breach of contract in doing so.
- The lack of fallbacks in existing contracts, particularly in cash markets, and therefore the risk that Libor discontinuation would create significant market disruption.
- The need for international coordination on cross-currency instruments given some jurisdictions had chosen secured rates and others unsecured. Respondents noted that, unless a fair market basis was reflected in the conversion of cross-currency instruments, this could lead to economic value transfer.
- Potential basis risks if some products are converted to an alternate rate whilst other products remain on Libor. This could lead to increased ineffectiveness, and therefore P&L volatility, for hedge accounting packages.