Benchmark Factsheet

Sterling Overnight Index Average - (SONIA)

This document must be read in conjunction with the respective *Product Summary*

What is SONIA?

SONIA is an interest rate benchmark – also known as a reference rate or a benchmark rate. It is the near risk-free rate ("RFR") for sterling markets – meaning limited bank credit risk is included. SONIA was initially introduced in 1997 and has been administered by the Bank of England since April 2016. The rate for a given London business day is published at 9am on the following London business day. SONIA is the Bank of England Working Group on Sterling Risk Free Rates' preferred benchmark for the transition to sterling risk free rates from LIBOR.

Differences between SONIA and LIBOR

1. SONIA is described as a risk-free, or nearly risk-free, rate as unlike LIBOR it does not contain material term risk or bank credit risk.
2. SONIA is an overnight rate which is published in arrears. In contrast LIBOR is a term rate which is published at the start of the relevant period. This means that for products referencing SONIA, unless adjustments are made to the methodology, the actual amount of interest payable is not known until the end of the agreed interest period.

How is SONIA calculated?

SONIA is a weighted average rate (rounded to four-decimal places) of interest rates paid on certain eligible sterling denominated deposit transactions.

Eligible transactions are categorised as those which are:

- Unsecured,
- One business day maturity which are executed between 00:00 hours and 18:00 hours UK time and settled the same day, and
- Equal to or greater than GBP25million in value.

Features to consider

- Interest for SONIA products is typically payable for lengths of time greater than overnight (e.g. monthly, quarterly), so the daily rate is aggregated in order to determine the effective interest rate that will apply for the relevant interest period.

- **Please note: The effective interest rate for a period will not be known when the transaction commences.** As RFRs are overnight rates, the interest due for the respective period will not be known until the end of the interest period i.e. on the actual payment date. A number of alternatives have been designed to address this uncertainty and these are explained below.

Conventions for interest calculation

Where SONIA is used as a reference rate in a loan or derivative, the rate of interest will be calculated on a 'compound' basis (that is, "interest on interest")

As the interest rate for a period is calculated by aggregating daily rates, which are only known at the end of the relevant interest period, the last piece of data for the calculation will only be available at the end of the interest period. This may make timely payments operationally challenging, as payment amounts will not be known until the actual payment date.

To address this, the market is developing a range of different conventions, with a number of different calculation methods, for example an observation *lag* or *shift* or a payment delay (such as 2 days or 5 days). Conventions continue to evolve as the market develops and consequently there may not be an exact match for certain structure or derivatives types. However the expectation is that, in most circumstances, the difference in floating rate calculated between methodologies is likely to be minimal.

Lloyds Bank will be able to structure derivatives to accommodate different conventions. SONIA loans provided by Lloyds Bank on a bi-lateral basis will have the floating interest rate calculated by compounding SONIA on a daily basis with a 5 [London] business day lookback. This is consistent with conventions established in bond markets and used in early RFR loan products. Using this convention, you will receive a communication of the interest rate payable 4 London business days before the payment date.

You should ensure that you understand the requirements of the convention applicable to your transaction. If you have any questions please contact your Lloyds Bank Representative for further information, or refer to the below links.

It is important for all parties to a transaction to understand:

- **The calculation method that will be used to determine the aggregate rate of interest**
- **When the floating interest rate for a given period will be known**

Further Information:

- https://www.bankofengland.co.uk/markets/sonia-benchmark/administration-of-sonia
- https://www.bankofengland.co.uk/markets/sonia-benchmark
- https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/discussion-paper-conventions-for-referencing-sonia-in-new-contracts.pdf

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