Benchmark Factsheet

Secured Overnight Financing Rate - (SOFR)

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

What is SOFR?

SOFR is an interest rate benchmark – also known as a reference rate or a benchmark rate. SOFR is a broad measure of the cost of borrowing cash overnight collateralised by US Treasury securities and represents the "near risk-free rate". SOFR measures the cost to a bank of borrowing cash overnight, and so represents the amount of interest that a bank will have to repay to the lender the following day.

SOFR was first published in April 2018 and is administered by the New York Federal Reserve Bank. The rate for a given business day is published at 8am Eastern Time on the following business day. SOFR is the Alternative Reference Rates Committee's (ARRC) preferred benchmark for transition to US dollar risk-free rates from USD LIBOR.

Differences between SOFR and LIBOR

1. SOFR is described as a risk-free, or near risk-free, rate as unlike USD LIBOR it does not contain material term risk or bank credit risk.

2. SOFR is an overnight rate which is published in arrears. In contrast USD LIBOR is a term rate which is published at the start of the relevant period. This means that for products referencing SOFR, 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 SOFR calculated?

SOFR is calculated as a volume weighted median of the transactions that are involved in borrowing cash overnight collateralised by Treasury Securities - also known as Repo Transactions.

Features to consider

- Interest for SOFR products is typically payable for periods longer 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 at the start of that period.** 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 discussed below.

Conventions for interest calculation

Where SOFR is used as a reference rate in a loan or derivative, the rate of interest is calculated on either a 'compound' basis (that is, interest is calculated on both the notional and any interest already accrued) or 'simple' basis (interest is calculated on the outstanding principle of the loan throughout the period).

As the interest rate for a period is calculated by aggregating daily rates, the last piece of data for the calculation will only be available at the end of the interest period. This may present operational difficulties in making timely payments, as amounts due 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 observation lag, sometimes called lookback, or 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 the different conventions. SOFR loans provided by Lloyds Bank on a bilateral basis will have the floating interest rate calculated by compounding SOFR on a daily basis with a 5 New York 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 payable 4 business days before the payment date.

You should ensure that you understand the requirements of the convention applicable to your transaction. More information about the calculation conventions referenced in this factsheet is available in our RFR Floating Rate Conventions Factsheet. If you have any questions please contact your Lloyds Bank representative, or for further information 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.newyorkfed.org/markets/treasury-repo-reference-rates-information
https://www.newyorkfed.org/arrc

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