



LLOYDS BANK

## 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 based on the terms of actual overnight transactions and so the rate is largely unaffected by bank credit risk. It is the near risk-free rate (“RFR”) for sterling markets. SONIA was introduced in 1997 and reformed in April 2018. Since 2016 it has been calculated and administered by the Bank of England. The rate for a given London business day is published at 9am on the following London business day.

SONIA is the Bank of England-initiated Working Group on Sterling Risk-Free Reference 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 interest 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 periods longer than overnight (e.g. monthly, quarterly), so the daily SONIA 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 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 is calculated on both the notional and any interest already accrued).

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 different conventions. SONIA loans provided by Lloyds Bank on a bilateral 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 payable 4 London 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 links below.

**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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