

December 2016

Responses will be submitted on BOE online platform

LCH response to Bank of England SONIA reform online questionnaire

Question 4 *Do you have any views on how the contingency methodology should be constructed?*

We agree that clearly established contingency procedures are key in order to ensure broader market stability. We also agree that the procedures should be periodically reviewed, to satisfy both the IOSCO Principles for financial benchmarks (IOSCO Principles) and the EU Benchmarks regulation. However, we would suggest that greater detail is provided on the short-term contingency arrangements. We understand from the paragraph 35 that these arrangements will be confirmed by the Bank of England only after this consultation has closed. We refer particularly to the additional commentary regarding longer-term evolution of the methodology. Should the Bank of England confirm a methodology as outlined, and we believe that using the average of SONIA to BaseRate over a defined time period is a sensible approach, we would advocate a time weighted decay factor to ensure most recent observations get most weight, particularly as base rate can be static for months or even years.

Question 5 *Do you agree with the Bank's proposed structure for the definition of SONIA, which separates the definition of the underlying interest from the statement of the methodology?*

We understand that the Bank of England's intention to change the definition of SONIA it is to better reflect the current international standards for benchmarks administration. We are neutral towards this proposal.

Question 6 *Do you agree with the Bank's proposed definition of the underlying interest of SONIA?*

Although the definition of the underlying interest does not specify whether SONIA is a measure of activity in the unsecured or secured sector, we note that the definition of the methodology explicitly refers to unsecured activity. We note also the discussion within the consultation paper (e.g. section 3.3 paragraph 19) of the use, in certain circumstances, of secured market activity data.

During stress market periods the markets in secured and unsecured funding can diverge. A measure of unsecured activity will therefore have a very different performance in these periods than a measure of the secured market. While we appreciate the need to account for fall-backs and contingencies as required under the IOSCO Principles, we are also keen to ensure that SONIA maintains a clear identity. LCH, through its SwapClear service, clears SONIA-referencing OIS with maturities up to 31 years. During this time, we anticipate periods of stress when recourse to apparently remote contingencies may well be required. On this basis, we have some reservations about the possibility that secured market data could be used in an index that has until now been defined exclusively as a measure of unsecured market rates.

Question 7 *Do you agree that the Bank's proposed description of the methodology for calculating SONIA appropriately reflects the methodology proposed in Section 2?*

We agree that the proposed description accurately reflects the methodology proposed in Sections 2.1 – 2.3

Question 8 *Do you agree with the Bank's proposed approach to facilitating the evolution of SONIA, and that this should be specifically incorporated into the definition of SONIA?*

We understand the requirement for the SONIA methodology to evolve to cater for developments in the structure of the market from which input data are collected, which the Bank of England states in the case of SONIA to be the market in unsecured overnight wholesale deposits. In our view a key success factor in any rate reform will be to remove as much ambiguity from the definition and meaning of the new rate as possible. The question is whether the proposed Definition of the underlying interest in SONIA, which does not make reference to this market in unsecured deposits, in combination with the proposed Statement of methodology, which does prescribe the exclusive use of unsecured market data, is compatible with a potential evolution of the methodology which explicitly contemplates the inclusion of secured market data. We are not convinced that a switch to the predominant use of secured data, perhaps driven by a permanent decline in unsecured volumes, can be characterised as an evolution. A better solution in this scenario may be to stop using the unsecured measure, which clearly remains by definition an unsecured measure, and to take up the use of a secured measure.

Question 9 Are there any other standard form contractual definitions of SONIA which may need to be amended in light of the Bank's reforms?

The Bank of England's continued work with ISDA is vital in this regard.

Question 10 Do you agree with the proposed approach to transition?

We agree with the proposed approach, and recommend that TS is chosen as a Monday.

Question 12 Are there any further operational or other issues which the Bank needs to consider prior to the implementation of the change to publication day?

In section 4.2 the Bank of England notes that LCH is an interested party to the deferral of SONIA publication to the next day. We are considering the implications for our internal processes, and are engaged in industry forums which are addressing this issue.

Question 13 Do you agree that the notice period for transition should be at least nine months?

We believe that nine months is the absolute minimum and would welcome a longer transition period.

Question 14 Do you agree with the Bank's approach of specifying the relevant month in its response to this document, and subsequently confirming the precise date at least six months in advance?

We agree with the proposed approach.

Question 15 Are there any specific dates, or market events, which the Bank should seek to avoid, or target, in choosing the specific date for the implementation of these reforms?

As per our answer to Q10, we recommend that TS is chosen as a Monday.

Question 16 Are there any other types of SONIA usage which the Bank should consider in its approach to licensing?

In terms of licensing, we do not envisage any other types of usage. We believe the market would benefit from confirmation from the Bank of England that SONIA will be licensed under FRAND terms.

Question 18 Do you agree that it is appropriate to set the republication threshold at two or more basis points?

We agree that it is appropriate to set such threshold.

Question 19 Is it helpful to place a deadline on potential republications and is 16:00 appropriate?

We agree that it is helpful to set a deadline for the potential republications. We believe that 16.00 may be too late, dependent upon the outcome of industry deliberations as per those outlined in answer to Q.12. We believe that 12:00 may be more appropriate.

Question 20 Would you prefer that any republications are published at the earliest opportunity or at a set point in time (ie 16:00)?

Setting a point in time is our preferred solution.