# Replacement of GBP LIBOR with SONIA

## Background Information & Draft Guidance Notes

SONIA, the Sterling Overnight Index Average rate, cannot be used to replace LIBOR with a simple ‘search and replace’ as it is commercially different to LIBOR, and as a forward-looking term rate LIBOR cannot be replaced with a daily rate without any reference to how the new interest rate is calculated, over what period the rate should be taken, how negative rates should be treated, etc.

* To calculate SONIA over a period, the daily rates are compounded over the period to smooth out the impact of any daily fluctuations, according to the means of calculation and using conventions defined by the Bank of England. This calculation is included in the new defined term ‘SONIA Compounded in Arrears’.
* There are tools available to help calculate SONIA over a period, including on-line interest calculators offered by NatWest and IHS Markit. These tools utilise the calculation in the new defined term ‘SONIA Compounded in Arrears’. Using an on-line tool is administratively simpler than calculating SONIA compounded in arrears manually or with a spreadsheet.
* As the interest rate for a period is only known at the end of the period, a ‘lookback’ may be needed to allow for a few days to calculate interest prior to payment. It is often not practical to calculate interest, check the calculation, agree with a counterparty and process a payment all on the payment date so a ‘lookback’ such that the interest rate calculation period starts and ends 5 working days prior to the interest period provides a balance between having an up-to-date rate and enough time to calculate and process this payment plus aligns with [Bank of England recommendation for loans](https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/statement-on-behalf-of-rfrwg-recommendations-for-sonia-loan-market-conventions.pdf?la=en&hash=074583D7080993CE84B6A381B554BEFD6594C076). There is no change to the number of days for which interest is charged.

## Structure of this Paper

This paper is divided into 3 Parts.

* Part A – JOA: Provides recommendations on drafting changes for the OGUK Industry Standard Joint Operating Agreement
* Part B – DSA: Provides recommendations on drafting changes for the OGUK Industry Standard Decommissioning Security Agreement; and
* Part C – Calculators: Provides guidance on the use of online SONIA rates calculators

## Part A - JOA

## Proposed Recommended SONIA Wording to replace GBP LIBOR in OGUK Industry Model Form Joint Operating Agreement (JOA)

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| **Clause in JOA** | **Proposed Drafting** |
| New Definition (clause 1.1) | "SONIA" means, with respect to any day, the Sterling Overnight Index Average rate published for such day by the Bank of England as the administrator of the benchmark (or a successor administrator), on their website. If on any such day there is no publication, the rate shall be the rate for the immediately preceding publication date. If SONIA is below zero for any day during the relevant period, SONIA will be deemed to be zero for that day. If the resulting SONIA rate is in excess of that permitted by applicable law, then the SONIA rate applied shall be the maximum permitted by applicable law. If SONIA publication permanently ceases, it shall be replaced for the purposes of this Agreement by its successor benchmark rate nominated or recommended by the Bank of England (or a successor administrator). |
| New Definition (clause 1.1) | “SONIA Compounded in Arrears” means the following calculation rounded to four (4) decimal places:  Where:  “*do*”, for any calculation period, is the number of London banking days in the relevant calculation period;  “*i*” is a series of whole numbers from one to do, each representing the relevant London banking days in chronological order from, and including, the first London banking day in the relevant calculation period;  “*SONIAi*”, for any day “i” in the relevant calculation period, is a reference rate equal to the daily SONIA rate;  “*ni*” is the number of calendar days in the relevant calculation period on which the rate is SONIAi; and  “*d*” is the number of calendar days in the relevant calculation period. |
| Definitions (clause 1.1) | Delete definition of “LIBOR” |
| Optional Addition to ‘Interpretation’(clause 1.2.7) | References to the calculation of interest using SONIA Compounded in Arrears shall allow for the Participants to calculate the applicable rate by using an on-line calculator, including those offered by NatWest Markets and IHS Markit, provided that the calculation in the definition of “SONIA Compounded in Arrears” is adhered to. |
| Sole Risk (clause 15) | SONIA Compounded in Arrears from the date on which the costs were incurred to the date the invoice is issued, with a five (5) Working Day lookback. |
| Default Interest (clause 17) | SONIA Compounded in Arrears from the due date to the date of payment, with a five (5) Working Day lookback |
| Funding & Finance Fee (Schedule A Accounting Procedure, para 4) | SONIA Compounded in Arrears from [the start to the end of the relevant processing Month, with a five (5) Working day lookback][ from the mid point date plus one (1) of the preceding processing Month to the mid point date of the relevant processing Month (inclusive)]. |

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| Materials (Schedule A Accounting Procedure, para 6) | SONIA Compounded in Arrears from the start to the end of the Month in which material is issued. |

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## Alternative JOA Drafting

The 2021 LIBOR task finish group (TFG) agreed that the replacement SONIA language provided above was the recommended solution, and OGUK’s operators’ legal committee endorsed this. The model JOA has been amended accordingly and the JOA guidelines will be amended to reflect this.

However, short-form alternative SONIA provisions, which do not include the definition for “SONIA Compounded in Arrears” showing the rate calculation, may be deemed acceptable to a JOA group. If a JOA group chooses to use the short-form alternative, the following alternative drafting updates may be considered.

* An additional sentence (in purple) can be included in the SONIA definition.
* The definition of “SONIA Compounded in Arrears” should not be used.
* An edit (in purple) to the Optional Addition to ‘Interpretation’ should be made.
* References to ‘SONIA Compounded in Arrears’ in other clauses are replaced with ‘SONIA compounded in arrears’.
* All other drafting updates described in the section “***Proposed SONIA Wording to replace GBP LIBOR in OGUK Industry Model Form Joint Operating Agreement (JOA)***” shall be included.

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| **Clause in JOA** | **Proposed Drafting** |
| New Definition (clause 1.1) | "SONIA" means, with respect to any day, the Sterling Overnight Index Average rate published for such day by the Bank of England as the administrator of the benchmark (or a successor administrator), on their website. If on any such day there is no publication, the rate shall be the rate for the immediately preceding publication date. SONIA shall be compounded utilising a three hundred and sixty-five (365) day year and shall be rounded to four (4) decimal places. If SONIA is below zero for any day during the relevant period, SONIA will be deemed to be zero for that day. If the resulting SONIA rate is in excess of that permitted by applicable law, then the SONIA rate applied shall be the maximum permitted by applicable law. If SONIA publication permanently ceases, it shall be replaced for the purposes of this Agreement by its successor benchmark rate nominated or recommended by the Bank of England (or a successor administrator). |
| Optional Addition to ‘Interpretation’ (clause 1.2.7) | References to the calculation of interest using SONIA compounded in arrears shall allow for the Participants to calculate the applicable rate by using an on-line calculator, including those offered by NatWest Markets and IHS Markit, in line with Sterling interest calculation conventions. |

***OGUK will leave the previous JOA model on the website until the end of 2021 (with a warning notice on LIBOR) in case any parties wish to follow that alternative approach – though we do not expect that to be the case. Subject to any such responses OGUK will remove the old model in early January 2022.***

# Part B – DSA

# Proposed SONIA Wording to replace GBP LIBOR in OGUK Decommissioning Security Agreement (DSA) (Compliant with both PRT and Non-PRT versions)

#### The New Definitions of SONIA and Compounded in Arrears, and deletion of the LIBOR definition, are to be identical in the JOA and DSA.

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| **Clause in DSA** | **Proposed Drafting** |
| New Definition (clause 1.1)  *(identical to recommended JOA drafting)* | "SONIA" means, with respect to any day, the Sterling Overnight Index Average rate published for such day by the Bank of England as the administrator of the benchmark (or a successor administrator), on their website. If on any such day there is no publication, the rate shall be the rate for the immediately preceding publication date. If SONIA is below zero for any day during the relevant period, SONIA will be deemed to be zero for that day. If the resulting SONIA rate is in excess of that permitted by applicable law, then the SONIA rate applied shall be the maximum permitted by applicable law. If SONIA publication permanently ceases, it shall be replaced for the purposes of this Agreement by its successor benchmark rate nominated or recommended by the Bank of England (or a successor administrator). |
| New Definition (clause 1.1)  *(identical to recommended JOA drafting)* | “SONIA Compounded in Arrears” means the following calculation rounded to four (4) decimal places:  Where:  “*do*”, for any calculation period, is the number of London banking days in the relevant calculation period;  “*i*” is a series of whole numbers from one to do, each representing the relevant London banking days in chronological order from, and including, the first London banking day in the relevant calculation period;  “*SONIAi*”, for any day “i” in the relevant calculation period, is a reference rate equal to the daily SONIA rate;  “*ni*” is the number of calendar days in the relevant calculation period on which the rate is SONIAi; and  “*d*” is the number of calendar days in the relevant calculation period. |
| Definitions (clause 1.1) *(identical to JOA)* | Delete definition of “LIBOR” (*if used*) |
| Optional Addition to ‘Interpretation’(clause 1.7) *(consistent with JOA)* | References to the calculation of SONIA Compounded in Arrears shall allow for the [Licensees/Parties] to calculate the applicable rate by using an on-line calculator, including those offered by NatWest Markets and IHS Markit, provided that the calculation in the definition of “SONIA Compounded in Arrears” is adhered to. |
| Definition of “Default Rate” (clause 1.1)(consistent with JOA) | SONIA Compounded in Arrears from the date interest becomes payable to the date of payment, with a five (5) Business Day lookback. |
| Definition of “Discount Rate, Option (a)” (clause 1.1) | SONIA Compounded in Arrears from [[1st April] in the Year immediately preceding such Year/[1st January]] to [31st March] in such Year, or other such [twelve (12)/three (3) Month] period as may be agreed amongst the Parties, on an after Tax basis, where such effective tax adjustment reflects the expected tax treatment of funds and the income arising from those funds, as if such funds were placed on deposit by the Trustee at such SONIA Compounded in Arrears rate from the Relevant Year and remitted in the Year of the respective cash flow to be discounted (such Tax adjustment, without limitation, to  reflect the impact of corporation tax, income tax and inheritance tax) |
| DSA RBridge (clause 6) | SONIA Compounded in Arrears from [[1st April] two Years preceding such Relevant Year/[1st January]] to [31st March] in the Year preceding such Relevant Year [*note: or insert such other [twelve (12)/three (3)] Month period as may be chosen by the Parties*] |

# Part C – Calculators

# Sterling interest calculation conventions and SONIA Calculators

## Current Characteristic Selection Options

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| **Bank of England Recommendation \*** | **NWM** | **IHS Markit** |
| Compound in Arrears | Default | Default |
| Lookback without Observation Shift | Default | Default |
| Lookback/Lag Days = 5 | Default | Default |
| Day Count = Actual/365 | Default | Manual |
| Zero floor applied to SONIA on a daily basis | Manual | Manual |
| Rounding = 4dp | Default | Set to 7dp \*\* |

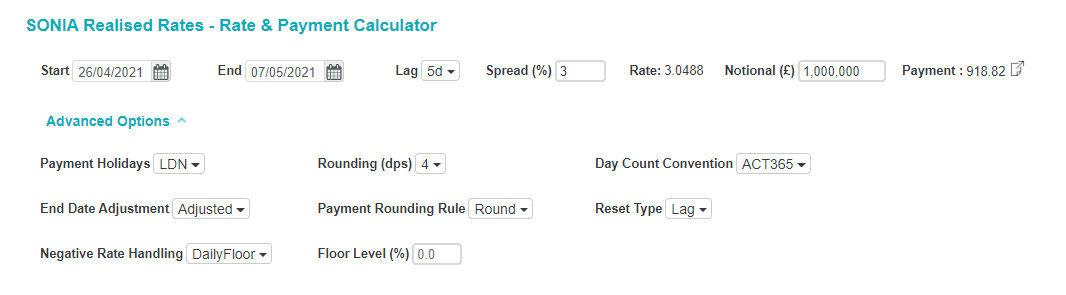
\* Details of the Bank of England [Recommendation](https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/statement-on-behalf-of-rfrwg-recommendations-for-sonia-loan-market-conventions.pdf?la=en&hash=074583D7080993CE84B6A381B554BEFD6594C076)  
\*\* Rates shall be amended to rounding to 4 decimal places

## Online Calculators

The Bank of England is strongly supportive of [Freely available independent RFR calculator summary (bankofengland.co.uk)](https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/rfrwg-freely-available-calculator-summary.pdf?la=en&hash=A31D445ED76D918B0E33E749D11DF2D917BFD4E5) The currently available calculators use slightly different terminology and are evolving, hence including specific details such as the name of a specific field in a contract could cause problems in the future hence the proposal to include the formula.

The example below uses a rate of SONIA+3% on £1m from 26th April to 7th May 2021, thus including a bank holiday. Interest in both calculators is £918.82.

[RFR Realised Rate Calculator](https://www.realisedrate.com/SONIA)



[RFR Calculator (ihsmarkit.com)](https://rfrcalculator.ihsmarkit.com/)

