



SONIA/SOFR Term Rate Usage April 2022

Dear Client,

We are sending you this communication in response to your expressed interest in entering into a derivative transaction with us using the Term Sonia rate and/or the Term SOFR rate.

Standards for Use of Term SONIA

You may be aware of reports published by the Working Group on Sterling Risk-Free Reference Rates (available [here](#)) and the FICC Markets Standards Board (available [here](#)) (the "Reports") on the subject of the use of Term SONIA reference rates.

The Reports both contain a view that overnight SONIA, compounded in arrears, will and should become the norm in most derivatives, bonds and loan markets, given the robust nature of overnight SONIA, and that the use of Term SONIA rates should be limited, particularly with regard to derivatives transactions.

The FMSB Report points out that supervisory authorities have expressed a number of concerns about a broad based adoption of RFR-derived term rates beyond specific use cases, in the interests of maintaining a robust overall market and maintaining the conditions from which a robust term rate can be produced.

In addition, the Reports highlight certain risks with regard to the use of Term SONIA rates when compared to the compounded overnight rate, some of which are:

- SONIA compounded in arrears is inherently more robust than a Term SONIA rate
- SONIA Term rates face the structural vulnerabilities associated with LIBOR
- [The Term SONIA market, and the market from which Term Sonia rates are derived, are likely to lack the liquidity of the main SONIA compounded in arrears market]
- Widespread use of Term SONIA may detract from liquidity in products referencing SONIA compound in arrears, which in turn may directly or indirectly reduce volumes in the SONIA- based interest rate swaps from which term SONIA is derived;
- Since Term SONIA rates use SONIA interest rate swap order book data a conflict of interest could exist where a dealer is both providing prices to the relevant OIS order books used to construct Term SONIA and providing swaps or other products based on term SONIA

Therefore, for a number of reasons, the FCA has stated that the use of forward looking term rates, such as Term SONIA, is meant to be limited.

Permitted Use

In relation to derivatives, the FMSB Standard on use of Term SONIA reference rates requires that there must be robust rationales for the use of Term SONIA. The main circumstances identified in the FMSB Standard where there may be a robust rationale for using Term SONIA include:

- “End-user facing derivatives used to hedge cash products which reference Term SONIA or end –user derivatives used to manage such hedges”; and
- “End-user facing derivatives used to hedge tough legacy products which reference synthetic LIBOR or end user derivatives used to manage such hedges”

Standards for Use of Term SOFR

The Alternative Reference Rates Committee (ARRC) is a group of private-market participants convened by the Federal Reserve Board and the New York Fed to help ensure a successful transition from U.S. dollar (USD) LIBOR to a more robust reference rate, its recommended alternative, the Secured Overnight Financing Rate (SOFR).

The ARRC has issued [Best Practice Recommendations](#) and related Scope of Use [FAQ](#) with respect to the use of the term SOFR rate (the “ARRC Recommendations”). The scope of use recommendations are in line with [guidance](#) issued by the Financial Stability Board.

The ARRC Recommendations are intended to be in line with the principles set out by the ARRC, that use of the term SOFR rate should be in proportion to the depth of transactions in the underlying derivatives market and should not materially detract from volumes in the underlying SOFR-linked derivatives transactions that are relied upon to construct the term SOFR rate itself over time and as the market evolves.

Permitted Use

Although the ARRC supports the use of the term SOFR rate for certain business loan activity and related securitizations, the ARRC **does not support the use of the term SOFR rate for the vast majority of the derivatives markets**. The ARRC recommends that any use of term SOFR derivatives **be limited to end-user facing derivatives intended to hedge cash products that reference the term SOFR rate**. The definition of an end user can be found in Q14 of the [ARRC FAQ](#) (General RFR FAQ from the ARRC not to be confused with the Scope of Use FAQ noted above).

In the ARRC FAQ, the ARRC recognized that some lending institutions are not structured to make markets or warehouse the risk of offering derivatives products to end users but may wish to enter in to term SOFR derivatives as part of their services to help a borrower hedge a term SOFR rate business loan. In this instance, provided that the institution does not make two-way prices in interest rate derivatives and is not a market maker in the interdealer market for such derivatives in the regular course of its business, the ARRC considers that the use of offsetting derivatives matching the derivatives exposure that the institution has would be consistent with the ARRC Recommendations.

Expectations and Representations for Future Transactions

It is BNP Paribas’s intention that any transaction that it enters into is fully compliant with the FMSB Standard and the ARRC Recommendations. Accordingly, we require that you only approach us for transactions that fulfil the criteria set out above (a “permitted use”).

While we reserve the right to raise queries with you on the compliance of transaction requests with these principles, in general, following your acceptance of this communication, we will treat any request from you to execute with us a derivative transaction on a term Sonia or term SOFR rate as incorporating an implied representation that the proposed transaction is for a permitted use. If you object to this approach please let us know as soon as possible and certainly before concluding any derivate transaction with us on a term SONIA or term SOFR rate.

Should you have any questions, please do not hesitate to contact your BNP Paribas representative.

Yours faithfully,

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