SOR Transition to SORA Masterclass:
A Corporate and SME Guide to SORA Transition

01 December 2020, 09:30am to 11:00am

Programme

09:30 AM **Opening Remarks**
Ong-Ang Ai Boon
Director
The Association of Banks in Singapore

09:35 AM **Briefing on Corporate Guide**
Yura Mahindroo
Partner, Financial Services Assurance
PricewaterhouseCoopers LLP

10:00 AM **Panel Q&A**

Moderated by: *PricewaterhouseCoopers LLP*

Panellists: *Chairs/Members of the Steering Committee for SOR Transition to SORA Sub-Groups on Derivatives, Bonds/Perpetual Securities, Business/Syndicated Loans and Legal*

10:55AM **Closing Remarks**
Ong-Ang Ai Boon
Director
The Association of Banks in Singapore

Briefing on Corporate Guide

Yura Mahindroo
Partner, Financial Services Assurance
PricewaterhouseCoopers LLP

What is this Guide and who is it for?

- **Targeted at Corporates and SMEs**
- Provides **background to the interest rate benchmark** changes in Singapore
- Looks in depth at **key concepts** involved in the transition and how it impacts you
- Sets out key changes to SGD denominated **products**
- **Recommends actions** for you to mitigate disruption risk to your business

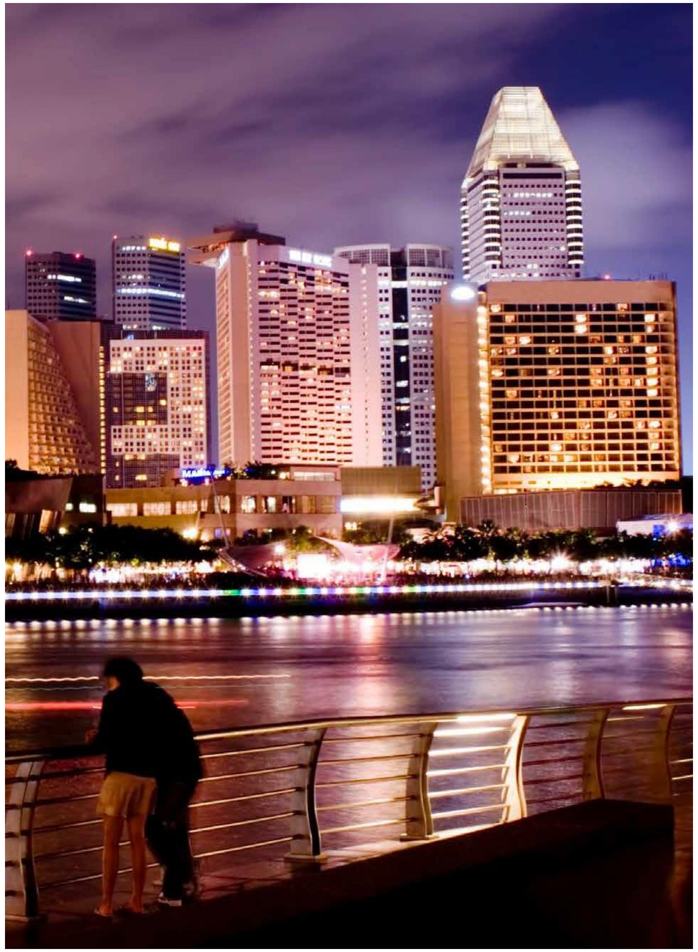
Guidance available in Singapore

The Association of Banks in Singapore

https://abs.org.sg/benchmark-rates/about-sc-sts

Resources provided by the SC-STS:

- **Overview on the Usage of SORA in Loans**, which explains why and how SORA is appropriate for use in loans.
- **SORA Market Compendium**, which provides details of technical guidance of SORA derivative, loan and bond products
- **SC-STS End-user Checklist on Benchmark Transition** which provide guidance on practical considerations for you as the corporate user in managing the transition away from SOR, and
- **SC-STS transition roadmap**
- **SORA – a Guide for Corporates and SMEs**

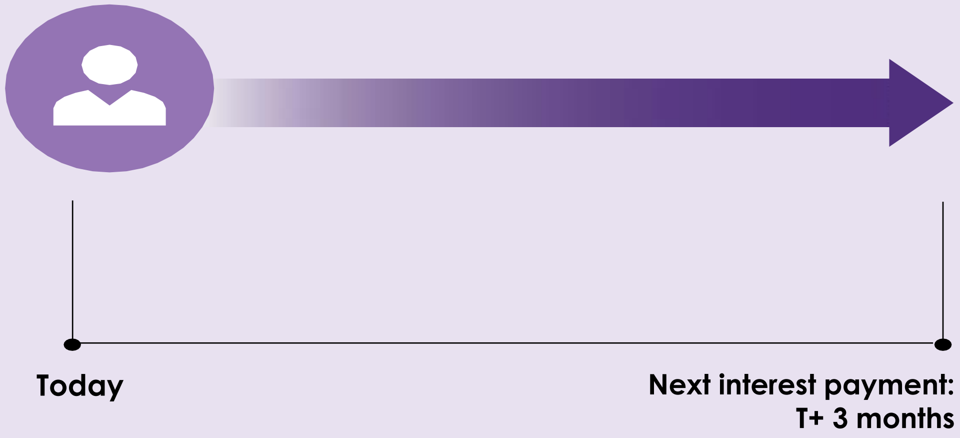


Benchmark reform in Singapore

	SOR	SORA
What is it	Effective rate of borrowing SGD for typically **1,3 or 6 months** by **‘synthetically’ borrowing USD** and swapping into SGD	Average rate of **overnight SGD cash market** transactions
How is it calculated	Volume-weighted average rate of USD to SGD FX swap transactions, with USD LIBOR input	Volume-weighted average of unsecured overnight interbank borrowings in the SGD cash market
Administrator	ABS Benchmarks Administration Co Pte Ltd	Monetary Authority of Singapore (MAS)
What is the tenor	Rate published for overnight, one month, three months and six months. **This is the rate at which banks borrow to pay back 1,3 or 6 months later.**	Overnight rate. **This is the rate at which banks borrow to pay back the next day.**
Does the rate include credit risk	**Lending to another party for 1,3 or 6 months carries a risk that they will not pay back.** As such, a ‘credit spread’ or premium is included in the interbank lending rate to compensate for this risk.	**Lending to a party that is “alive and well” today means it is very likely they will be “alive and well” tomorrow to pay you back.** Generally viewed as nearly free of credit risk (aka “near risk-free”) – the short tenor (overnight) has minimal credit risk and therefore ‘credit spread’.

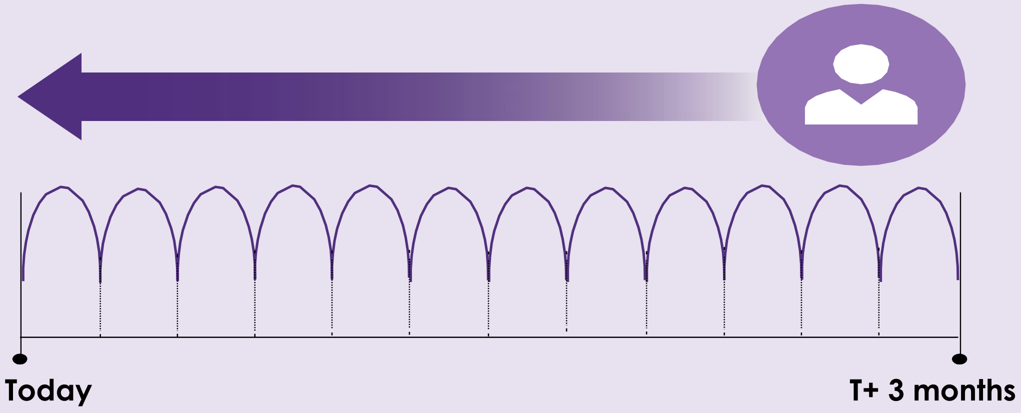
Key Concepts – “Forward” and “Backward” looking rates

‘Forward looking’ (in advance)



Interest amount ‘fixed’ or pre-determined for 3 months and known today

‘Backward looking’ (in arrears)



Interest payable only known at T + 3 months

Key Concepts – Compounding in arrears vs in advance

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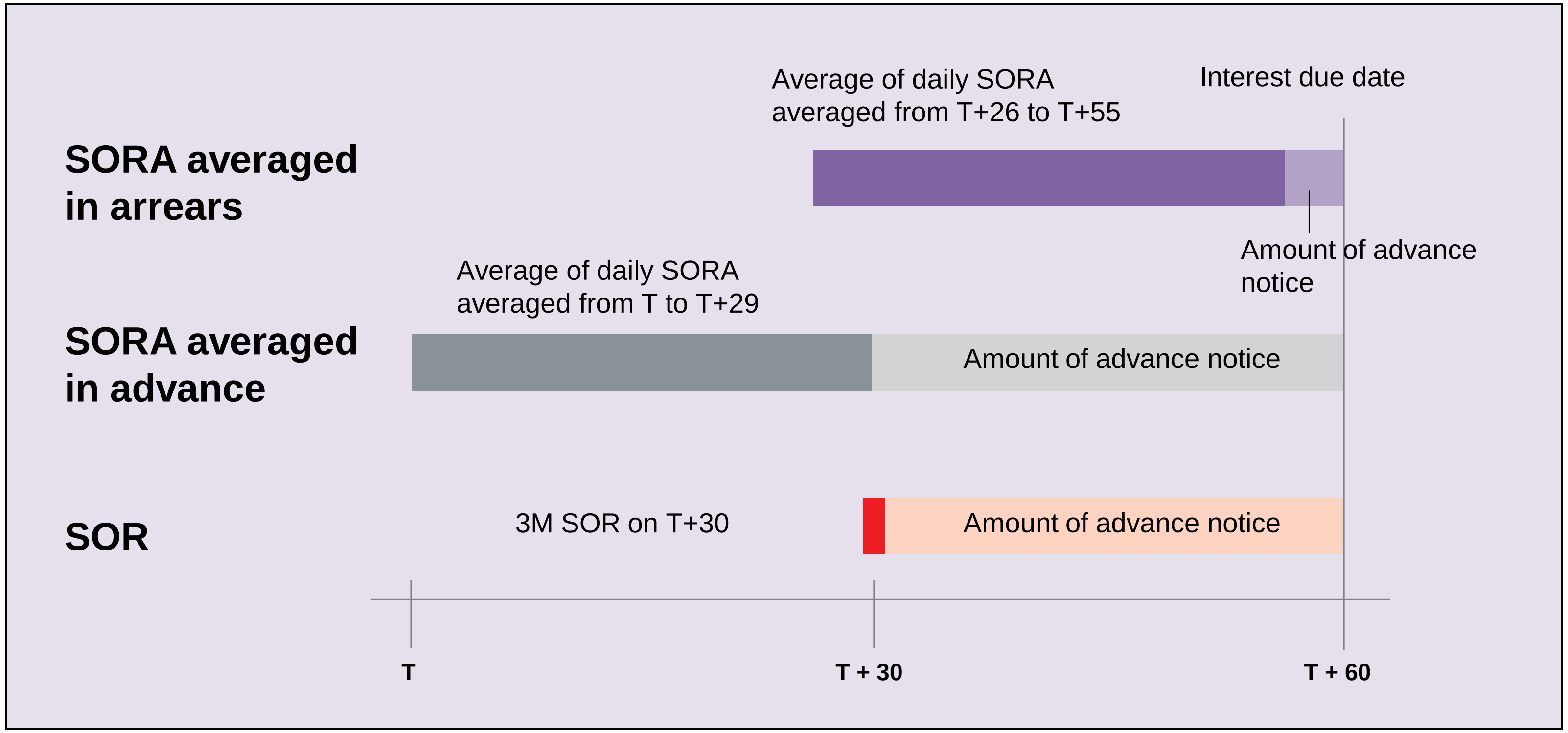

Compounding in arrears is expected to be used by medium-to-larger institutions that transact in interest rate derivatives, large corporate loans and syndicated loans

For SMEs, compounded in arrears is also recommended. However, for simplicity or payment certainty and when hedging is not required, **compounding in advance** is an option.

The published 1 month, 3 month and 6 month Compounded SORA and SORA Index 6 means that most corporates will not have to calculate compounded SORA averages themselves.

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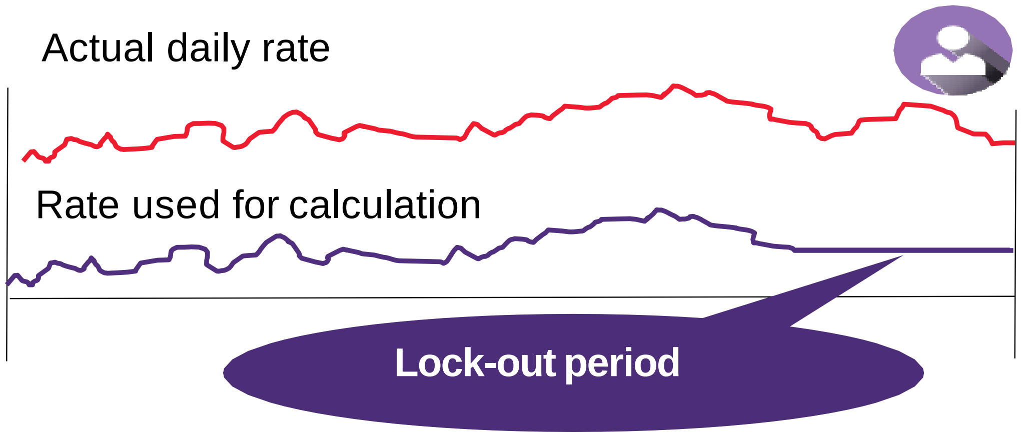
Key Concepts – payment conventions (1/2)

Convention		Considerations
Lockout period Within the interest period, the rate for the last few days is 'frozen' (the "**Lockout Period**") at the last observed daily rate.	 	For users that hedge, there may be a short mis-match for interest rate movements during the lock-out period unless the derivative matches this.
Lookback without observation shift The day's interest rate is replaced by the rate a few business days ago. As such, the 3 month interest (in this example) is known a few days before the end of the interest period.	 	While recommended for SORA loan products, this mechanism is not supported by the published SORA index or SORA compounded rates.

Key Concepts – payment conventions (2/2)

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Convention		Considerations
Lookback with observation shift As above, except the entire interest period is also shifted to align with the interest observation period.		Recommended for SORA loan products. Hedging using derivatives under this option would require less customisation. Compatible with the published SORA compounded index.
Payment delay Interest payments are delayed by an agreed number of business days after the end of the interest period.		Could lead to a mismatch of cash flows and may be difficult to handle operationally.

Key Concepts – adjustment spread

Key

- Risk free / near risk free
- Term and credit spread adjustment
- Original customer spread

Dealing with legacy SOR contracts

Contract 'Fallbacks'

- 'Back up' clause that is intended to cover instances when SOR is **temporarily unavailable**.
- In Singapore, a common fallback rate for loan contracts is the lending bank's 'Cost of Funds'.
- As SOR is expected to **permanently discontinue** from end-2021, existing fallback in your contracts may not be appropriate because:
  - the fallback rate may not be economically equivalent to SOR, and
  - the fallback rate may not be easily hedged.

The SC-STS has set out suggested fallback guidance in the **SORA Market Compendium**

Fallback Rate (SOR)

- For SOR **derivatives** and **loans**, 'Fallback Rate (SOR)' is the primary fall back rate.
- Like SOR, Fallback Rate (SOR) is derived from the USD and SGD forward exchange rates – but with USD LIBOR replaced by Fallback Rate (SOFR).
- Unlike SOR, which is calculated **in advance,** Fallback Rate (SOR) will be published **in arrears.** Corporates should take note of the need to prepare systems and operational changes for this change.
- Fallback Rate (SOR) is intended solely as an **interim fallback arrangement** (with a limited shelf-life of about 3 years starting from when SOR is discontinued), and not intended for use in new contracts.

(!) **We recommend that you re-paper contracts to SORA where possible to avoid having a large number of contracts referencing SOR, or Fallback Rate (SOR) in the near future. Where possible, it is easier to transition from SOR to SORA now, than from SOR to Fallback Rate (SOR) and then to SORA later.**

Product Overview: Derivatives

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Which products are impacted?	• SOR interest rate swaps, SOR-USD LIBOR cross currency basis swaps, and other SOR derivatives, including forward starting contracts and options.
New contracts referencing SORA	• Reference SORA instead of SOR with interest calculated **compounded in arrears.** • Whilst SORA derivatives can be written today, new SORA derivatives from 25 January 2021 under an ISDA Master Agreement will incorporate the updated 2006 ISDA Definitions (including the ISDA supplement) that define the way that SORA is calculated • In practice, corporate users can use the **MAS published SORA index** for this calculation. • The SORA market compendium has **template confirmations** for products such as overnight interest rate SORA swap, USD floating SOFR to SORA swap and SOR-to-SORA basis swap.
Expected SORA Payment Convention (new contracts)	• **Payment Delay of 2 Singapore Business Days**.
What about existing SOR derivatives?	• ISDA has published the **ISDA 2020 IBOR Fallbacks Protocol** to facilitate the amendments of existing derivative transaction fallbacks to Fallback Rate (SOR). • For SOR derivatives entered after 25 January 2021 under the ISDA IBOR Fallbacks Supplement, the fallback is Fallback Rate (SOR). • The fallback for SOR will be **triggered** if USD LIBOR is no longer published, or if the Financial Conduct Authority in the UK (FCA) decides that USD LIBOR is no **longer representative.**

Product Overview: Capital Market Products (Bonds)

Which products are impacted?	Floating rate securities, resettable fixed rate securities, such as perpetual / hybrid securities; and Capital instruments issued by banks, such as Tier 2 or Additional Tier 1 securities.
New contracts referencing SORA	• **Forward looking Term SORA**, if available, would be the preferred benchmark rate. **In the absence of Term SORA**, **SORA compounded in arrears** is the recommended benchmark. • Credit and term adjustment spreads are to be individually determined.
Expected SORA Payment Convention (new contracts)	**Lookback with observation shift and lookback without observation shift**

What about existing SOR contracts?	• The fallback hierarchy when SOR is no longer deemed to be representative is:
	    • Term SORA (if available), otherwise
	    • Compounded SORA, otherwise
	    • Other alternative rates.
	• This is a different fallback hierarchy than for derivative products.
	• Issuers who hedge may want to amend bond fallbacks to match the derivative fallbacks
	• Issuers should consult professional advisors when an adjustment spread is required

Product Overview: Loans

Which products are impacted?	• Floating rate bilateral loans and Syndicated loans
New contracts referencing SORA	• Reference **compounded in arrears** SORA. • For SMEs, for simplicity or payment certainty when hedging is not required, alternatives such as **compounded SORA in advance** or bank-administered rates can be considered.
Expected SORA Payment Convention	5 Business Day 'Lookback with Observation Shift' or 5 Business Day 'Lookback without Observation Shift'

What about existing SOR contracts?	• Contracts for bilateral and syndicated loans are less standardised than derivative contracts.
	• For SOR bilateral loans, the **recommended fallback** would be in the following hierarchy:
	  • Fallback Rate (SOR), otherwise
	  • Recommended fallback rate by MAS, otherwise
	  • A replacement rate that is agreed between the Lender and the Borrower plus the Benchmark Replacement Adjustment.
	• Primarily for syndicated loans, the Replacement of Screen Rate Clause ("RSR Clause"), published by the Loan Market Association and endorsed by the Asia Pacific Loan Market Association, aids the transition to SORA by **lowering the thresholds for borrower consent required** to make such transition.

Corporate user checklists

Workstream	What you should do
Governance	• Appoint a project lead and establish reporting to Board / Senior Management
Quantify SOR exposures	• Establish an inventory of SOR-linked exposures • Define a strategy to reduce reliance on SOR for new transactions

Contract inventory and analysis	• Establish inventory of SOR contracts maturing post 2021, identify contract fallbacks
	• Begin a dialogue with internal and external counterparties to:
	    • renegotiate or repaper existing contracts; and
	    • transition to SORA on new contracts

Assess operational and system impacts	• Assess adequacy of systems and operational processes (such as settlement) to move to ‘backward looking’ rates with different conventions (payment delay, observation shift, etc) • Begin a dialogue with external vendors to implement changes • Consider frequency and use of published Compounded SORA Rate and SORA Index • Consider downstream impact to control and process documentation
Assess tax, disclosure and accounting	• Assess accounting relief provided by IASB, and SC-STS guidance. • Engage auditors and tax advisors early. • Consider disclosure to customers and investors, eg. in bond issuances/annual report
Assess treasury risks	• Consider treasury “mis-match” risks in assessing choices for loan and derivative conventions • Assess impact to valuation and pricing models.

Key takeaways / recommendations

For **borrowers**:

- Understand and assess the published **Compounded SORA and the SORA Index** to determine future contract interest payable/receivable on SORA
- Minimise the number of contracts referencing SOR or Fallback Rate (SOR) in the near future, for example by **re-papering contracts to SORA** where possible.
- Discuss existing loans with maturities beyond 2021 with lenders early.
- **Leverage the user checklists** to prepare for the wider business impacts.

For **issuers** of floating rate products:

- Discuss early with professional advisors legacy fallback language to determine if terms should be amended to reflect the original intention of the contracts.
- Consider disclosure obligations to investors in new prospectus documents.

For **corporates using hedging** products:

- Engage your bankers or professional advisors to decide **whether or not to sign up to the ISDA 2020 IBOR Fallbacks Protocol** to update existing SOR contracts.
- Assess the **'mismatch risks'** from hedging with new rates, which should inform the discussion with banks on the conventions for loan (or bond) and derivative products.

Panel Q&A

Moderated by:

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Thank You!

- Today's session can be accessed on demand at: https://abs.org.sg/benchmark-rates/events

- Feedback survey form on today's session can be found on: https://pigeonhole.at/
  Passcode: SORA1201

- For further queries relating to this subject matter, please write to: SORTransition@abs.org.sg