Consultation on Adjustment Spreads for the Conversion of Legacy SIBOR Loans to SORA

15 March 2023

Steering Committee for SOR & SIBOR Transition to SORA (SC-STS)

PREFACE

This consultation paper seeks feedback on recommendations for the setting of adjustment spreads for the conversion of legacy Singapore Interbank Offered Rate ("**SIBOR**") loans to a Singapore Overnight Rate Average ("**SORA**") reference rate.

No representation or warranty is given by the SC-STS as to the accuracy or completeness of the contents of this consultation, or to its suitability for any particular product and/or transaction. The SC-STS shall not be liable for any loss suffered by any person as a result of any transaction entered into on the basis of the contents of this report or which may arise from the presence of any error or omission in this report and no proceedings shall be taken by any person in relation to such losses.

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1. Background and Aim

1.1 **Since 2014, national authorities and industry bodies globally have been working to encourage and support the transition away from the London Interbank Offered Rate ("LIBOR") and other Interbank Offered Rate ("IBOR") benchmarks, to more robust overnight interest rate benchmarks.** This followed from the recommendations of the Financial Stability Board ("**FSB**")[1] that year to strengthen confidence in the reliability and robustness of interest rate benchmarks, and identify alternative near risk-free reference rates.

1.2 **In Singapore, the Steering Committee for SOR Transition to SORA was set-up in August 2019 to oversee an industry-wide interest rate benchmark transition to the Singapore Overnight Rate Average ("SORA"), a near risk-free overnight interest rate benchmark.** SC-STS' initial focus was on the transition from the Swap Offer Rate ("**SOR**") to SORA, given its reliance on USD LIBOR[2], which would be discontinued immediately after 30 June 2023. This mandate was later expanded in December 2020 – following a public consultation on the future landscape of SGD interest rate benchmarks[3] – to include the transition from the Singapore Interbank Offered Rate ("**SIBOR**") to SORA, and the committee was accordingly renamed as the Steering Committee for SOR & SIBOR Transition to SORA ("**SC-STS**"). The convergence from legacy SOR and SIBOR markets towards a unified SORA market was to allow for improved market liquidity, more transparent market pricing for borrowers, and more effective interest rate risk management for lenders.

1.3 **The SC-STS also finalised in December 2020 that SIBOR would be discontinued after 31 December 2024, 18 months after the discontinuation of SOR after 30 June 2023**. The later date of SIBOR discontinuation would allow time for more SIBOR legacy contracts to exit contractual lock-in periods or mature, alongside guidelines for all financial institutions and their customers to cease usage of SIBOR in new contracts after end-September 2021.

1.4 **Since then, coupled with progress in the transition from SOR, SORA has become the de facto interest rate benchmark for use in SGD financial products**.

(i) In derivatives, the outstanding stock increased to over S$2.2 trillion in December 2022, while new SORA originations remained healthy at approximately S$350 billion in 4Q

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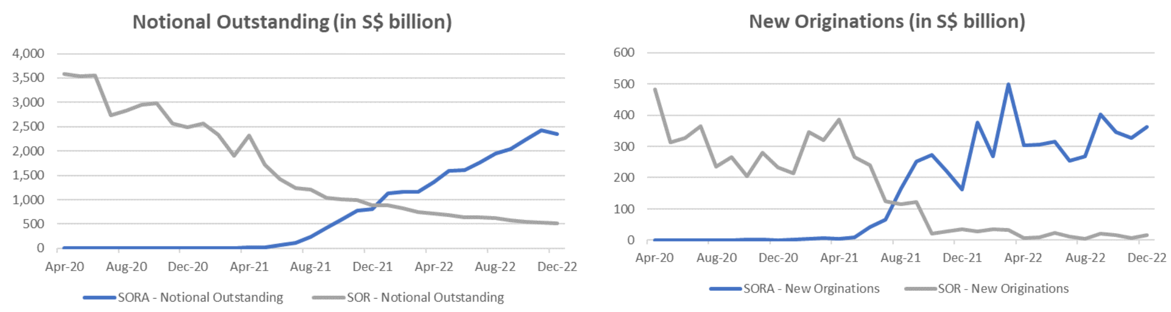
[1] The FSB is an international body with responsibility for promoting global financial stability by coordinating the development of regulatory, supervisory and other financial sector policies, and conducting outreach to non-member countries.

[2] USD LIBOR is a short-term USD interest rate benchmark administered by ICE Benchmark Administration. The UK Financial Conduct Authority has confirmed that all remaining USD LIBOR settings will either cease to be provided by any administrator or be no longer representative immediately after 30 June 2023.

[3] Link to Response to Consultation Paper on SIBOR Reform and the Future Landscape for SGD Interest Rate Benchmarks (11 December 2020)

2022, at levels consistent or above those seen previously in the SOR derivatives market, which SORA derivatives have replaced (see Diagram 1).

<u>Diagram 1: SOR and SORA Derivatives – Notional Outstanding and New Originations</u>



(ii) In <u>corporate loans</u> *(including bilateral corporate loans, syndicated loans, and SME loans)*, the outstanding stock of corporate lending reached S$128 billion in December 2022, steadily replacing SOR as the predominant industry benchmark for corporate loans.

(iii) In <u>retail loans</u>, outstanding SORA lending reached S$43 billion with around 69,000 retail loans as of December 2022, far exceeding the stock of SOR retail loans before the active transition period, and steadily catching up to the stock of SIBOR retail loans of S$37 billion with around 87,000 retail loans as of December 2022.

(iv) In <u>bonds</u>, issuers have transitioned to the use of SORA as a reference, with 23 SORA-OIS linked bonds issued as of December 2022 and catching up to the outstanding stock of SOR-IRS linked bonds.

1.5 **As the transition from SOR to SORA[4] nears completion, the industry will shift its focus towards the SIBOR transition in 2023 and 2024, where the determination of an appropriate adjustment spread to be applied is a key aspect.** Such adjustment spreads seek to account for inherent differences between legacy IBOR benchmarks, which incorporate term and credit risk premium, and the near risk-free overnight interest rate benchmarks such as SORA, that would replace them. In preparation for this next phase of transition work, the following sections sets out the SC-STS' recommendations for the setting of the adjustment spreads for the conversion of legacy SIBOR loans to a SORA reference rate.

[4] The retail SOR transition was completed following the automatic conversion to SORA in October 2022, and the institutional SOR transition is on track for successful completion by June 2023.

2. Transition Approach for Corporate Loans

Background of SOR Corporate Loan Transition

2.1 **Under the SOR transition for corporate loans (including SMEs loans, bilateral corporate loans and syndicated loans), the SC-STS has recommended for the adjustment spreads in the MAS Recommended Rate ("MRR Adjustment Spreads"), which will apply after 31 December 2024, to be determined by a 5-year historical median of the spread between SOR and compounded-in-arrears SORA.**[5] This is in line with the transition approach adopted for transition of LIBOR and other interest rate benchmarks.

(i) In the ISDA Documentation[6] and the SC-STS recommended fallbacks for corporate loans, Fallback Rate (SOR) is the fallback that will first apply when SOR is discontinued after 30 June 2023. The MRR will serve as the contractual fallback rate after Fallback Rate (SOR) is discontinued after 31 December 2024, for residual contracts that have not transitioned to SORA.

(ii) To support the industry's active transition from SOR, the SC-STS has also published supplementary guidance for adjustment spreads until 31 December 2024. These adjustment spreads are based on a linear interpolation between a reference spread based on a recent and shorter historical median of the SOR-SORA Spread and the MRR Adjustment Spreads that would apply after 31 December 2024.

Proposed Transition Approach for SIBOR Corporate Loan Transition

2.2 **The SC-STS has considered the following factors to guide the determination of adjustment spreads for the SIBOR corporate loan transition, in order of priority:**

(i) **Fair rate to apply over the lifetime of the loan** – The adjustment spread applied should be a fair rate through the lifetime of the loan, accounting for the inherent differences between SIBOR and compounded SORA, as SIBOR incorporates term and credit risk premium, while SORA is an overnight near risk-free rate.

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[5] Prior to the determination of the MRR Adjustment Spreads, transition of SOR corporate loans was via reference to SOR-SORA basis swap market:

(i) Unlike in the SIBOR market, there was an active SOR derivatives market in the period prior to the transition in 2022, including an active SOR-SORA basis swap market in the period from 1H 2021 to 1H 2022, as derivatives market participants looked to transition from SOR IRS to SORA OIS contracts.

(ii) SOR-SORA basis swap spreads, which reflect market prices for receiving SORA over a given period in exchange for SOR, were a suitable reference for the price that a SOR borrower transitioning to SORA should pay over the SORA benchmark rate, and was recommended by SC-STS for use as a reference for active transition of institutional contracts, including corporate loans. This would remain useful for as long as the SOR-SORA basis swap market remained liquid, until 1H 2022 when the liquidity declined as earlier envisaged.

[6] The ISDA Documentation refers to the ISDA IBOR 2020 Fallbacks Protocol, Supplement number 70 to the 2006 ISDA Definitions and the 2021 ISDA Interest Rate Derivatives Definitions.

(ii) **Consistency with SOR corporate loan transition and alignment to international practices –** Consistency with the SOR and LIBOR transition would encourage adoption, given market participants' greater familiarity with the approach, particularly for large corporates who operate across jurisdictions and have experienced the transitioning of their SOR and LIBOR loans.

2.3 **The SC-STS recommends applying the 5-year historical median spread between SIBOR and compounded SORA as the applicable adjustment spread for the conversion of SIBOR corporate loans.**

(i) **The 5-year historical median reflects a fair spread over the lifetime of the loan**. For instance, in response to SC-STS' May 2022 SC-STS consultation on adjustment spreads for the conversion of legacy SOR contracts to SORA[7], most respondents supported the view that a 5-year period is sufficiently long to smooth out the effects of idiosyncratic market events over past years, and reasonably estimates where spreads could converge towards in the long run.

(ii) The 5-year historical median is similar in approach for the setting of the MRR Adjustment Spreads used in the transition of SOR corporate loans, and in-line with the standard adopted globally for the setting of the contractual fallback for LIBOR in the ISDA documentation.

2.4 **The actual 5-year historical median spread to be applied will be calculated and published by SC-STS in 3Q 2023 so as to provide certainty to market participants and facilitate the transition of SIBOR corporate loans.** This adjustment spread will not change once finalised in 3Q 2023. SC-STS recommends market participants to actively transition early, ahead of the discontinuation of SIBOR.

3. Transition Approach for Retail Loans

Background of SOR Retail Loan Transition

3.1 **The SOR retail loan transition, which took place from September 2021 till October 2022, comprised two key phases:**

(i) <u>Active transition phase</u>: From September 2021 to August 2022, customers were able to voluntarily opt to transition out of their SOR retail loan, either via

[7] Link to Response to Consultation Feedback on Adjustment Spreads for the Conversion of Legacy SOR Contracts to SORA (18 July 2022)

the SORA Conversion Package ("**SOR-SCP**") or to the banks' prevailing packages.

(ii) Automatic conversion phase: For the remaining customers that did not switch out of their SOR retail loan by the deadline of 31 August 2022, a bank-facilitated conversion of all outstanding SOR retail loans was carried out in October 2022. This was necessary to prevent any loan disruption to the customer (e.g. interest payments on SOR cannot be computed after SOR is discontinued).

3.2 **An industry-wide SOR-SCP was introduced to give customers the option to switch their existing SOR loan to a comparable SORA loan.** An adjustment spread ("**Adjustment Spread (Retail)**") was applied in the conversion of SOR retail loans to a SORA reference, to account for the term and credit risk premium present in SOR but not in SORA. The Adjustment Spread (Retail) was floored at zero. The key features of the SOR-SCP were as follows:

(i) **The SOR-SCP was structured as: 3-month SORA compounded-in-advance[8] + customer's existing SOR margin[9] + Adjustment Spread (Retail).**

(ii) **The Adjustment Spread (Retail) was designed to minimise impact on customer's all-in loan payment at the point of conversion of the loan (see Diagram 2).** As the adjustment spread was computed using the average difference between SOR and compounded-in-advance SORA over the preceding three-month period (termed as "**spot-spread approach**"), customers would find the all-in rate and, consequently their loan payment, on the SOR-SCP to be broadly comparable to their original SOR loan at the point of conversion.

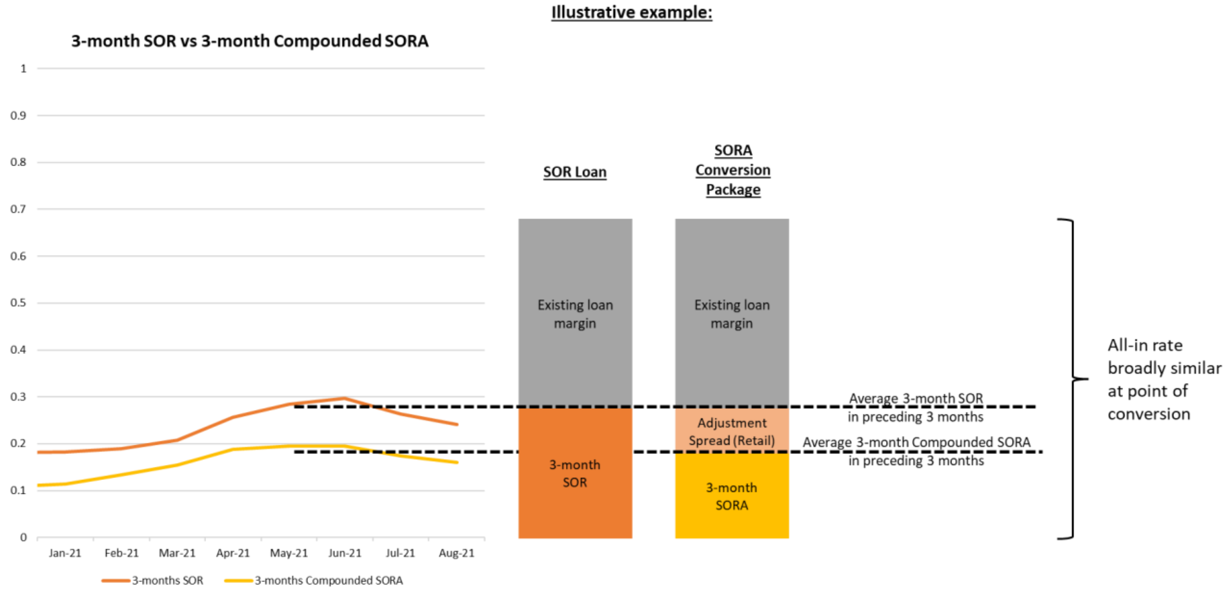
(iii) **To facilitate transparency, customer communication and understanding, the Adjustment Spread (Retail) was published monthly on the SC-STS website.** The adjustment spread published at the start of each month would apply to all customers who switched to the SOR-SCP in that particular month. The Adjustment Spread (Retail) applied would remain fixed for the remaining tenor of the loan.

(iv) **No additional lock-in period applied when customers took up the SOR-SCP.**

[8] 3-month compounded SORA is calculated, administered and published by MAS at https://eservices.mas.gov.sg/statistics/dir/DomesticInterestRates.aspx.

[9] Customer's existing SOR margin: Banks will carry over a customer's existing SOR margin (as a component of the all-in interest rate) in the SORA Conversion Package, so as to switch the customer's existing SOR loan to a comparable SORA loan.

Diagram 2: Illustrative example on how Adjustment Spread (Retail) is computed under SOR-SCP



3.3 **As customers have different financial needs and preferences, an important aspect of the SOR retail loan transition was public education, and helping customers make informed choices on the transition of their SOR loans.** Aside from the SOR-SCP, customers had the choice to switch to any of the prevailing loan packages (e.g. fixed rate, board rate, and other floating rate packages) offered by their bank.[10]

3.4 **To further facilitate customer transition, the following measures were also put in place:**

(i) **A one-time fee-free switch for all SOR customers to switch out of their SOR loans, i.e. waiver of administrative fees.** SOR customers could utilise the one-time fee-free switch during the active transition period and up till 30 June 2023. This meant that for all SOR customers whose loan was automatically converted to the SOR-SCP in October 2022, the one-time fee-free switch was available up till 30 June 2023 where they could choose to switch from the SOR-SCP to any prevailing package offered by their bank.

(ii) **Regulatory exemptions.** As the need to replace the SOR-based loan with an alternative loan package was driven by the discontinuation of SOR, MAS did not require financial institutions to re-compute the Total Debt Servicing Ratio (“**TDSR**”),

[10] Banks may subject customers to the prevailing terms and conditions, such as a lock-in period, similar to the existing refinancing practices.

Loan-To-Value (“**LTV**") and Mortgage Servicing Ratio (“**MSR**”) for affected customers making the switch within the same financial institution.

3.5 **The SOR retail loan transition has been completed smoothly.** All outstanding SOR retail loans have been transitioned to either the SOR-SCP or to the banks’ prevailing packages. Slightly more than half of the SOR customers had transitioned during the active transition phase from September 2021 to August 2022, while the remaining SOR loans were automatically converted by the banks in October 2022.

Proposed Transition Approach for SIBOR Retail Loan Transition

3.6 **For SIBOR retail loan transition, the SC-STS considered the following factors in developing its recommendations:**

(i) **Retain key features of SOR retail transition as much as possible, in view of the successful conversion and familiarity of processes for both banks and customers –** This includes (i) structuring the SIBOR retail transition into two phases (active transition and automatic conversion), (ii) developing the SIBOR–SORA Conversion Package (“**SIBOR-SCP**”) as an additional option, and (ii) helping customers make informed choices between the conversion options available and putting in place measures to facilitate conversion.

(ii) **SIBOR retail transition approach should be robust to uncertain macroeconomic conditions in the period ahead –** Given the more uncertain macroeconomic conditions in 2023 and 2024, the transition approach for SIBOR retail loans should take into consideration the elevated possibility of interest rate movements deviating away from historical norms during the transition period. For example, spot-spreads (i.e. average difference between SIBOR and compounded-in-advance SORA) could widen (or narrow) significantly under some scenarios, such as an economic recession, a financial crisis, an escalation in geopolitical tensions, a second round of runaway inflation (or any combination of these).

(iii) **Safeguard against tail-risk scenarios, anchored by the view that the historical median is a fair rate** – Under SOR retail transition, banks’ prevailing packages were an attractive option for most customers when Adjustment Spreads (Retail) were high. The prevailing packages effectively acted as a cap on the adjustment spreads, as customers could choose to switch to banks' prevailing packages[11]. The SIBOR retail transition should provide an alternative option for customers should the Adjustment Spread (Retail) under the spot-spread approach experience unexpected and volatile surges.

3.7 **The SC-STS recommends a SIBOR retail transition timeline that is similar in structure and duration to the SOR retail transition, comprising two key phases:**

(i) Active transition phase (August 2023 – April 2024): During this period, customers may choose to take up either the SIBOR-SCP or banks' prevailing packages. The active transition period will provide sufficient time for customers to decide which package would best suit their financial needs and preferences.

(ii) Automatic conversion (June 2024): A bank-facilitated automatic conversion will be carried out to convert all outstanding SIBOR loans for remaining customers who have not switched out of their SIBOR loans by April 2024, to prevent loan disruption as interest payments based on SIBOR cannot be computed after SIBOR is discontinued. The automatic conversion will take place about six months before the discontinuation of SIBOR on 31 December 2024, which will provide sufficient time for remediation and resolution of post-conversion issues, if any.

Further details on the above transition approach are in Annex A below.

3.8 **The key features of the SIBOR-SCP are proposed as follows:**

(i) **The SIBOR-SCP will be structured as: 3-month SORA compounded-in-advance[12] + customer's existing SIBOR margin[13] + Adjustment Spread (Retail)[14].**

(ii) **The Adjustment Spread (Retail) rates will be published each month**, namely the (i) 1-month SIBOR to 3-month compounded SORA and (ii) 3-month SIBOR to 3-month compounded SORA spreads. The Adjustment Spread (Retail) published at

[11] For example, assuming a customer has a SOR loan margin of 0.65%, and was paying an all-in rate of 3-month SOR + 0.65% on its original loan, the customer could choose to switch to a prevailing SORA package of 3-month compounded SORA + 1.00%. As such, the "effective adjustment spread" when the customer takes up the prevailing package would be 0.35% (i.e. 1.00% - 0.65% = 0.35%)

[12] The 3-month compounded SORA is the only tenor used in the SIBOR-SCP as it has been assessed to be more stable than the 1-month compounded SORA and less lagged than the 6-month compounded SORA. It is also the most common tenor setting in SORA loan packages offered by banks in Singapore.

[13] Banks will carry over the customer's existing SIBOR margin (as a component of the all-in interest rate) in the SIBOR-SCP.

[14] The Adjustment Spread (Retail) will be floored at zero.

the start of each month will apply to all customers who switched to the SIBOR-SCP in that particular month, and will remain fixed for the remaining tenor of the loan.

(iii) No additional lock-in period applied when customers take up the SIBOR-SCP.[15]

3.9 **The SC-STS recommends for the SIBOR-SCP to apply the spot-spread approach (floored at zero) during the period of active transition, and the 5-year historical median (floored at zero) at automatic conversion.** The 5-year historical median will be set from a specified date in 3Q 2023, in conjunction with the publication of the response to this consultation. This approach has the following benefits:

(i) **Provides customers with choice during active transition** – to switch to either spot-spreads, allowing customers to lock in the favorable spreads over the lifetime of the loan (should spot-spreads be low), or to banks' prevailing packages[16], or to do nothing and be converted in June 2024 at the 5-year historical median spread.

(ii) **Provides customers with certainty on automatic conversion outcome** – As the 5-year historical median will be set and fixed upfront, customers would be made aware early of the adjustment spread that would apply should they do nothing and be converted automatically on the industry timeline in June 2024. On a month-to-month basis, they would be able to compare among (i) the current month's spot-spread that would apply during the active transition period, (ii) banks' prevailing packages, and (iii) the 5-year historical median that will apply at automatic conversion, which will help inform their decision as to whether to actively transition in that month.

3.10 **The SC-STS recognises the implementation challenges faced by banks given the larger number of SIBOR retail customers and that proactive communications will be key to help customers understand the proposed transition approach.** The following will be undertaken, in preparation for SIBOR retail loan transition:

(i) **Early-preparation by key banks with large pool of customers with SIBOR loans:** Banks are expected to ensure systems are ready for the large number of customers undergoing transition, including potentially a concentrated number through

[15] (i) For customers who are within the lock-in period on their SIBOR loan – the existing lock-in period will be ported over to the SIBOR-SCP. i.e. customers will have to serve out their current lock-in period.
(ii) For customers who are out of the lock-in period on their SIBOR loan – there will be no lock-in period on the SIBOR-SCP.

[16] Other than the SIBOR-SCP, customers could choose to switch to any of the prevailing loan packages (e.g. fixed rate, board rate, and other floating rate packages) offered by their banks, subject to the prevailing terms and conditions of the loan (e.g. lock-in period).

automatic conversion. SC-STS will work with banks to develop the necessary collateral and FAQs to be shared with the customers to facilitate understanding.

(ii) **Proactive and transparent communications:** A public education campaign will be carried out by SC-STS and ABS in 2H 2023. Information will also be made available on the SC-STS website. This will be supplemented by the banks' direct outreach (e.g. customer letters).

3.11 **Similar to that applied for SOR transition, measures will be put in place to facilitate customers switching out of their SIBOR loans.** As announced in the accompanying media release on 15 March 2023[17], these measures will support customers who wish to switch out of their SIBOR loans early, ahead of the finalisation of the SIBOR-SCP.

(i) **Fee waivers:** A one-time fee-free switch would be availed to SIBOR retail loans customers up till 31 December 2024, where customers could choose to switch to either the SIBOR-SCP or to the banks' prevailing packages.

(ii) **Regulatory exemptions:** As the need to replace the SIBOR-based loan with an alternative loan package was driven by the discontinuation of SIBOR, the taking up of the SIBOR-SCP and prevailing packages offered by their banks to customers with existing SIBOR loans will not be regarded as a refinancing of property loans under MAS' property loan rules[18]. As such, MAS will not require financial institutions to re-compute the TDSR, LTV and MSR for affected customers making the switch within the same financial institution.

3.12 **The SC-STS has considered other approaches for the SIBOR-SCP but felt that these approaches would not satisfactorily meet the key considerations that should underpin the transition.**

(i) **The SC-STS considered applying only the historical median approach for both the active transition period and the automatic conversion**, given that this represents a fair rate over the lifetime of the loan. The historical median would also mitigate against the macroeconomic uncertainties as it would be fixed at a point in time. However, this approach would not provide customers with the choice to transition

[17] Link to media release on SIBOR to SORA Transition Commences (15 March 2023)

[18] Property loan rules under MAS Notice 632 and MAS Notice 645 will not apply. In addition, where existing SIBOR retail loans are repriced to the SIBOR-SCP, the Property Loan Factsheet treatment specified in MAS Notice 632A for banks (and its equivalent for other financial institutions) need not apply. Instead, financial institutions can provide a generic Property Loan Factsheet (using the format in MAS Notice 632A) or an abridged version to disclose key features of the loan (including applicable fees and charges) to borrowers. For good measure and to meet the same disclosure objective, if the borrower chooses to reprice to other loan packages that the bank may have on offer, the Property Loan Factsheet as specified in MAS Notice 632A will apply.

at spot-spreads which could be beneficial to customers in a scenario where spot-spreads are low.

(ii) **The SC-STS also considered applying a spot-spread approach for both the active transition period and the automatic conversion (i.e. similar to SOR retail transition)**. However, this would not meet the SC-STS' intention of the proposed approach to be resilient against uncertain macroeconomic scenarios.

(iii) **On balance**, the SC-STS was of the view that applying the spot-spread during the active transition period and the 5-year historical median at automatic conversion best satisfy the factors set out in paragraph 3.6.

4. Invitation to Provide Feedback

4.1 **With regard to the proposed approaches for setting the adjustment spreads for the conversion of legacy SIBOR loans to SORA, the SC-STS welcomes interested parties to provide feedback on the following:**

Q1 Do you agree with the SC-STS' recommendation to apply the 5-year historical median spreads between SIBOR and compounded SORA for SIBOR corporate loans (including SMEs loans, bilateral corporate loans and syndicated loans)? Please elaborate with reasons for your views. Q2 Do you agree with the SC-STS' recommendation to enhance the successful retail transition approach under SOR by applying (a) the spot-spread during the period of active transition and (b) the 5-year historical median spreads between SIBOR and compounded SORA at automatic conversion for SIBOR retail loans? Please elaborate with reasons for your views.

4.2 Please submit your feedback **by 28 April 2023**. Electronic submissions via the online feedback form are encouraged and written feedback may be submitted to:

The Association of Banks in Singapore
#12-08, MAS Building
10 Shenton Way, Singapore 079117
Fax: 6224 1785
Email: sibor@abs.org.sg

4.3 Please note that all submissions received may be published and attributed to the respective respondents unless they expressly request the SC-STS not to do so. As such, if respondents would like

(i) their whole submission or part of it (but not their identity), or

(ii) their identity along with their whole submission,

to be kept confidential, please state so explicitly in the submission to the SC-STS.

Further information on SIBOR Retail Loan Transition Approach

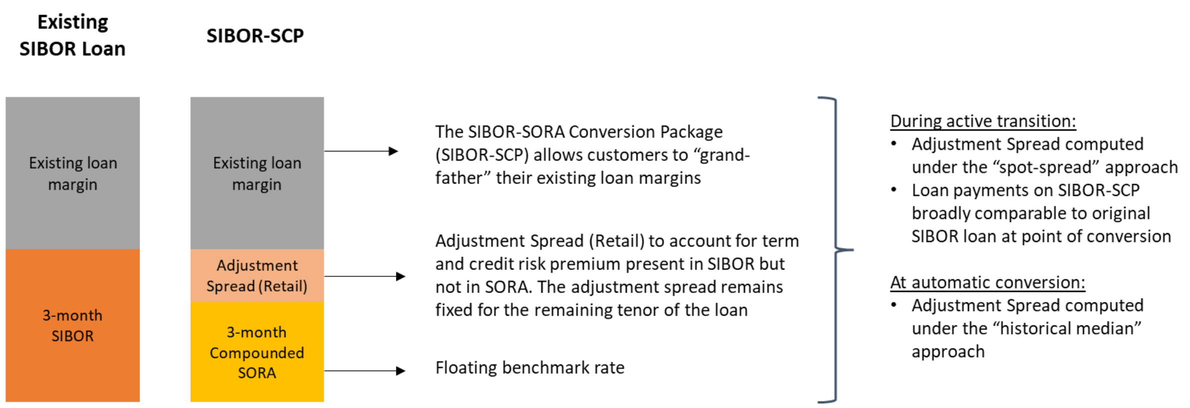
I. Active transition phase

The SIBOR-SCP package will retain the spot-spread approach during the period of active transition. The Adjustment Spread (Retail) computed under the spot-spread approach will be the average difference between SIBOR and compounded-in-advance SORA over the preceding three months. This accounts for the prevailing difference when a customer takes up the SIBOR-SCP (see Diagram 3). The spot-spread will be computed and published each month on the SC-STS website, and will apply for conversion of SIBOR loans to the SIBOR-SCP in that particular month. The spot-spread approach (during active transition) will:

(i) **Ensure the all-in loan payment on the SIBOR-SCP and the SIBOR loan at the point of transition would be broadly similar.** This helps customers to minimise changes in loan payments at the point of conversion of the SIBOR loan to the SIBOR-SCP.

(ii) **Allows customers to lock in the spreads over the lifetime of the loan.** As the Adjustment Spread (Retail) applied in the month of conversion of the loan will remain fixed for the remaining tenor of the loan, customers would be able to lock in low spreads (when spot-spread is low).

Diagram 3: SIBOR-SCP during active transition period (where spot-spread is applied)



II. Automatic conversion phase

At the automatic conversion in June 2024, SIBOR retail loans will be converted with an adjustment spread based on the 5-year historical median spread (instead of spot-spread) between SIBOR and compounded-in-advance SORA. The application of the 5-year historical median spread at automatic conversion is anchored by the SC-STS' view that this represents a fair rate to both banks and customers. This is also consistent with the setting of the MRR Adjustment Spreads in the SOR corporate transition and LIBOR transition approaches. As uncertainties in macroeconomic conditions for 2023 and 2024 are rising, amidst slowing growth and still-high inflation, and there could be large and unpredictable changes in the short-term spreads between SIBOR and compounded SORA (i.e. spot-spreads during active transition could rise or fall), the application of the historical median spread for the bank-facilitated conversion would help mitigate against this elevated uncertainty. Customers will have the option among transitioning to the SIBOR-SCP (at spot-spread) or banks' prevailing packages during active transition, or doing nothing and undergoing automatic conversion (at historical median) (see Box A below).

Box A: Stylised example of options available to customers

(i) When the spot-spread is <u>lower</u> than historical median

Assuming the market rates are as follows:

- Spot-spread (applying to SIBOR-SCP in a particular month during active transition) = 0.20%
- Historical median spread (applying at automatic conversion in June 2024) = 0.35%
- 3-month SIBOR = 4.2%
- 3-month compounded SORA = 4.0%

Assuming the customer's current SIBOR loan package is as follows:

- Customer's loan margin = 0.40%
- All-in interest rate on SIBOR package = 3-month SIBOR + loan margin = 4.2% + 0.4% = **<u>4.6%</u>**

<u>If customer takes up the SIBOR-SCP at spot-spread (During active transition):</u> All-in interest rate on SIBOR SCP = 3-month compounded SORA + loan margin + Adjustment Spread (spot-spread) = 4.0% + 0.4% + 0.2% = **<u>4.6%</u>** Note: The all-in rate of the SIBOR-SCP would be *broadly comparable* (but may not exactly equal) to the all-in rate of the SIBOR loan at the point of conversion.	<u>If customer waits until automatic conversion (where historical median will apply):</u> All-in rate on SIBOR SCP at automatic conversion = 3-month compounded SORA + loan margin + Adjustment Spread (historical median) = 4.0% + 0.4% + 0.35% = **<u>4.75%</u>**

This example illustrates customers are able to benefit from the lower spot-spreads during the active transition period. As the spot-spread is below the historical median, customers may wish to consider active transition to the SIBOR-SCP to lock in the adjustment spread for the remaining tenor of the loan. Apart from the SIBOR-SCP, customers could also choose from the banks' prevailing packages.

(ii) When the spot-spread is higher than historical median

Assuming the market rates are as follows:

- Spot-spread = 0.45%
- Historical median = 0.35%
- 3-month SIBOR = 4.4%
- 3-month compounded SORA = 4.0%

Assuming the customer's current SIBOR loan package is as follows:

- Customer's loan margin = 0.40%
- All-in interest rate on SIBOR package = 3-month SIBOR + loan margin = 4.4% + 0.4% = **4.8%**

If customer takes up the SIBOR-SCP at spot-spread (During active transition):	If customer waits until automatic conversion (where historical median spread will apply):
All-in interest rate on SIBOR-SCP = 3-month compounded SORA + loan margin + Adjustment Spread (spot-spread) = 4.0% + 0.4% + 0.45% = **4.85%** Note: The all-in rate of the SIBOR-SCP would be *broadly comparable* (but may not exactly equal) to the all-in rate of the SIBOR loan at the point of conversion.	All-in rate on SIBOR SCP at automatic conversion = 3-month compounded SORA + loan margin + Adjustment Spread (historical median) = 4.0% + 0.4% + 0.35% = **4.75%**

This example illustrates how customers could benefit from having the choice to wait for automatic conversion when the spot-spread is higher during the active transition period. As the spot-spread is higher than the historical median, customers may wish to wait for the spot-spread to fall, or to wait for automatic conversion to be converted at the historical median spread of 0.35%. Apart from the SIBOR-SCP, customers could also choose from the banks' prevailing packages.