GUIDANCE ON SPREAD ADJUSTMENTS FOR THE TRANSITION OF LEGACY FIXED RATE DEBT SECURITIES REFERENCING SOR IRS

13 June 2023

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

PREFACE

This document sets out the guidance in formulating an adjustment spread for the transition of fixed rate debt securities referencing SOR interest rate swaps ("**IRS**") to instead reference SORA overnight index swaps ("**OIS**").

SOR IRS shall have the same meaning ascribed to it in [Chapter 3 (Capital Markets) of the SORA Market Compendium: Transition from SOR to SORA], meaning the fixed leg of SOR interest rate swap rates commonly obtained from screen rates such as Page TPIS on the monitor of Bloomberg Agency under the caption "*Tullett Prebon – Rates – Interest Rate Swaps – Asia Pac – SGD*". It is an implied interest rate for tenors of more than 1 year commonly used by market participants to price fixed rate securities (using the "Ask" side).

SORA OIS shall mean the fixed leg of SORA overnight indexed swaps commonly obtained from screen rates such as the OTC SGD OIS page on the monitor of Bloomberg Agency under the "BGN" panel and the column headed "Ask". It is an implied interest rate for tenors of more than 1 year which is now commonly used by market participants to price fixed rate securities (using the "Ask" side).

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Background

On 18 July 2022, the Steering Committee for SOR & SIBOR Transition to SORA ("**SC-STS**") published its Response to Consultation Feedback: Adjustment Spreads for the Conversion of Legacy SOR Contracts to SORA (the "**Report**"). The Report finalised the broad approach for:

- Setting of the MAS Recommended Rate ("**MRR**"), which is the contractual fallback rate for Fallback Rate (SOR) as set out in the relevant ISDA documentation[1] as well as SC-STS' recommended fallback template for bilateral and syndicated corporate loans[2], which will apply when Fallback Rate (SOR) is discontinued after 31 December 2024. The Report determined that:
    - The MRR for the respective tenors for Fallback Rate (SOR) (Overnight, 1-month, 3-month, and 6-month) would be computed as the sum of Compounded-in-arrears SORA and an MRR Adjustment Spread for the respective tenor.
    - The applicable MRR Adjustment Spread would be determined using the historical median of the spread between SOR and Compounded-in-arrears SORA for the respective tenor, using a 5-year lookback period ending around 18 July 2022.[3]
- Supplementary Guidance for the active transition of unhedged loans[4]. The Report determined that:
    - Adjustment spreads for the active transition of unhedged loans before 31 December 2024 would be computed using a linear interpolation between the Reference Spot Spread ("**RSS**") and the MRR Adjustment Spread of the relevant SOR tenor.
    - The RSS would be determined by the historical median of the spread between SOR and Compounded-in-arrears SORA for the respective tenor, using a 6-month lookback period ending around 18 July 2022.

On 14 December 2022, the SC-STS published the Implementation of Supplementary Guidance on Adjustment Spreads for the Conversion of Legacy SOR Loans to SORA ("**Supplementary Guidance**") which provides further details on the computation of the MRR Adjustment Spreads and the RSS, and the formula for interpolation between the RSS and MRR Adjustment Spreads, for use in the active transition of unhedged loans from SOR to SORA.

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[1] Specifically, the ISDA 2020 IBOR Fallbacks Protocol, Supplement number 70 to the 2006 ISDA Definitions and the 2021 ISDA Interest Rate Derivatives Definitions. For avoidance of doubt, for the purpose of the ISDA Documentation, the MAS Recommended Rate referred to here is the rate (inclusive of any spreads or adjustments) recommended as the replacement for Fallback Rate (SOR) by the Monetary Authority of Singapore or by a committee officially endorsed or convened by the Monetary Authority of Singapore.

[2] Fallback template for bilateral and syndicated corporate loans are in the SC-STS publication "Update to the SORA Market Compendium: Transition from SOR to SORA" (17 November 2021). In addition to fallbacks for SOR-linked corporate loans, the fallback provisions in some SOR-linked bonds also reference a "spread, formula or methodology which… is formally recommended in relation to the replacement of the Original Reference Rate with the applicable Benchmark Replacement by any Relevant Nominating Body".

[3] Specific dates, after taking into account weekend/holiday calendars, day count conventions, and other such technical considerations, were set out in SC-STS' 14 December 2022 publication on the Implementation of Supplementary Guidance on Adjustment Spreads for the Conversion of Legacy SOR Loans to SORA.

[4] For unhedged loans, the recommended spreads should be applied directly without need for further negotiation. For bilateral derivatives and hedged loans, the recommended spreads would be a starting point for counterparty discussions. See further details in Paragraph 3.2.5 of SC-STS' *Response to Consultation Feedback* (18 July 2022).

Floating Rate Securities and Resettable Fixed Rate Securities

In this guidance, the SC-STS differentiates between two different types of debt securities:

- Floating rate securities that reference the corresponding tenors of SOR and which typically have a fixed maturity date; and
- Resettable fixed rate securities that reference SOR IRS which have a fixed maturity date or are perpetual in nature, and have a callable and resettable feature.

For the transition of floating rate securities, the SC-STS recommends that the Supplementary Guidance for active transition of unhedged loans be applied directly.

For the transition of resettable fixed rate securities, the SC-STS recommends to replace the SOR IRS reference rate with the sum of the SORA OIS of the same tenor and the 6-month MRR Adjustment Spread which has been determined at 0.3112%[5]. The MRR Adjustment Spread for 6-month tenor is chosen as this is the typical fixing frequency used for the floating leg of SOR IRS. Furthermore, no additional adjustments for differences in day count fractions and payment frequencies are necessary as all legs of SOR IRS and SORA OIS use the same day count convention (Actual/365) and payment frequencies (semi-annual payments).

The recommendation simplifies the SOR-SORA transition for resettable fixed rate securities, taking into account their features, while minimising the difference in outcome with the approach set out in the Supplementary Guidance:

- Using a single spread for the transition of resettable fixed rate securities simplifies the transition, especially for securities with no fixed maturity date which constitute the majority of resettable fixed rate securities with a coupon reset before 2025. Unlike most loans or derivative contracts where a single adjustment spread can be computed from the Supplementary Guidance, resettable fixed rate securities with no fixed maturity date may require multiple coupon reset, and hence potentially multiple adjustment spreads to be computed. If the Supplementary Guidance for the active transition of unhedged loans were directly applied to resettable fixed rate securities, this would require the adjustment spread for any reset date before 2025 to follow the interpolation methodology in the Supplementary Guidance, while the adjustment spread for any reset date in and after 2025 will be the MRR Adjustment Spread.

- The use of the MRR Adjustment Spread yields an outcome that is substantially similar to that for the adjustment spreads under the Supplementary Guidance for long-dated tenors. Considering the typical 5-year, 7-year, or 10-year tenors which the SOR IRS references, the difference between the adjustment spreads calculated using the Supplementary Guidance for such tenors and the MRR Adjustment Spread has narrowed significantly, and will decrease to zero as we get closer to end-2024.

- Using the MRR Adjustment Spread instead of the adjustment spread under the Supplementary Guidance at the point of transition also grants the benefit of standardising the adjustment spread for all resettable fixed rate securities going forward.

Queries regarding the above guidance may be directed to SORTransition@abs.org.sg.

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[5] The computation of the MRR Adjustment Spreads can be found at this link: https://abs.org.sg/docs/library/sc-sts-computation-of-the-mas-recommended-rate-adjustment-spreads-and-the-reference-spot-spreads.xlsx