Keynote Speech by Mr Samuel Tsien

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At The Association of Banks in Singapore's Roundtable Session on SGD Interest Rate Landscape Changes
9 September 2020, 11.15am to 12.30pm

1. Thank you, Ai Boon and Jacqueline. Good to see you all.

2. I would like to extend a warm welcome to over 1,500 participants joining this webinar. We have, joining us, our colleagues from the financial industry; our corporate, SME and retail customers; our legal and accounting partners; and our friends from the media.

3. Jacqueline has just shared MAS' perspectives on how we should plan and act to ensure that we will be successful in this benchmark transition. She has clearly laid out MAS' expectations.

4. As the Chair of the Steering Committee for the Transition of SOR to SORA, I would like to give you an update of the work we have done so far to prepare for Singapore's transition.

5. Significant progress has been made. I am optimistic that, with the combined efforts of banks, other market participants and customers, we will drive the transition in an orderly and transparent manner.

6. I am confident that we will see a successful transition, come Dec 2021, when LIBOR will no longer be quoted.

7. Since the start of the year, despite the unprecedented disruption brought on by the Covid-19 outbreak, the MAS, the Steering Committee, the 7 Technical Sub-groups and the banks have put in tremendous amount of time and effort to prepare and plan for the transition to SORA.

   - from conceptualising and scoping of SORA applications to the creation of SORA products;

   - from communication and education to documentation and transacting - we have delivered major milestones for the transition.

8. The Steering Committee was formed in August last year, and since then we have

- Established market conventions for derivatives,

- Established central clearing of the SORA derivatives by LCH

- Finalised the Fallback rate for SOR and determined its shelf life,
  and, we have also

- Stepped up communication within the industry, and with partners and customers through numerous workshops, webinars, training sessions and media engagement.

9. Most importantly, banks have made good inroads in building SORA products and liquidity in both the derivative and the cash markets:

- We have been growing the trading volume in SORA derivatives - with the first SORA OIS trade transacted between OCBC and Standard Chartered in November last year

- We have issued SORA floating rate notes – with the first SORA floating rate note (FRN) issued in May this year by DBS, followed by MAS's 6-month SORA-based floating rate note (FRN) in August

- We have also launched the first SORA customer loan - OCBC did the first SORA-based corporate loan with CapitaLand in June and also launched the first SORA-based home loan programme for the consumer market in July this year

- Last week, UOB issued the first dual tranche SORA-SOFR loan, also with CapitaLand; and DBS launched a SORA-pegged business property loan package for SMEs

10. To our banks who have launched the various SORA pilots, thank you. Let us work together to do more.

11. We encourage all banks to launch further SORA-based products to broaden the adoption of SORA by both the retail and commercial segments.

12. Even as much progress has been made, there remains much work to be done to complete the transition.

13. Let me first touch on the market conventions and infrastructure support that are necessary for banks to deepen the penetration of SORA products.

- On the derivatives side, we are looking into extending central clearing for SORA OIS and SORA-SOR basis swaps from 5Y to 10Y, and the adoption of SORA for Price Alignment Interest and discounting of derivatives.

- In the coming weeks, Market Conventions and Contractual Fallbacks across product classes will be finalised and by the 4th quarter this year, a SORA Market Compendium on market conventions and documentation protocols will be published to encourage standardisation of practices amongst market participants as much as we can

14. The Steering Committee is also working on publishing a SORA usage guide for Corporate and SME companies to enhance their understanding of use cases.

15. In addition, we are developing an end-user checklist to guide our customers on practical considerations as they prepare for the transition and to assess your readiness. We are looking to publish these in early Q4, to help our clients get ready.

16. To further help our corporate customers prepare for the transition, the Steering Committee has also engaged Key Consulting and Accounting firms to help drive preparation and systems readiness among their corporate clients.

17. This will help ensure that both the financial and corporate sectors can move in tandem to achieve a smooth transition.

18. We have recently announced the introduction of a Fallback Rate (for SOR) for SOR derivatives that mature after 2021.

19. That said, it is important to emphasize that there should not be extended use of or unnecessary reliance on the SOR Fallback Rate as a new interest rate benchmark beyond its intended purpose -- which is to solely act as a fallback rate for existing SOR contracts and nothing more.

20. Fallback Rate (for SOR) will be published by ABS for about three years from end 2021. It may end earlier depending on market development. After that, it will be discontinued.

21. The reason for having a limited shelf-life for the Fallback Rate is to avoid having to deal with a situation whereby both SORA and the Fallback Rate (for SOR) co-exist for a long time. So, the Fallback Rate for SOR is designed to only have a finite shelf life.

22. And, please allow me to remind all that banks or customers should avoid having a large book that is based Fallback Rate post-2021.

23. Covid-19 has created a new normal in the way we live, work and play. The new interest rate regime - without SOR by the end of 2021, and possibly without SIBOR by 2024, and with SORA becoming the only Singapore dollar benchmark interest rate - is likewise the next normal.

24. It changes the way pricing is quoted for our loans, investment and derivative products, and the way we hedge in the SGD financial market.

25. Given that SORA is the next normal in the financial market, it is most important that SORA is clearly understood -- not just by banks and the derivative market players, but it must be clearly understood and accepted by our commercial and retail customers.

26. That is why the Steering Committee has been focusing on ensuring that the engagement and communication by the industry and the banks with their customers are timely, adequate and effective – it is one of the key pillars in our transition roadmap.

27. SORA is fundamentally and economically different from IBOR or interbank offer rates, such as LIBOR and SIBOR. It is a backward-looking rate.

28. SORA is an overnight rate used in the inter-bank market on cash placements for one day only.

29. It is a lending rate that is almost risk-free. It therefore carries almost nil credit risk premium and no term premium.

30. In contrast, SIBOR and SOR are forward looking term rates charged between banks for 1-month, 3-month, or 6-month placements and borrowings.

31. SIBOR and SOR term rates have included both a term risk premium and a credit risk premium, reflecting the two risks embedded in the interbank transaction.

32. Therefore, as can be seen from the data published since 2005, there has always been a spread between SOR or SIBOR, which are higher, and SORA, which is lower.

33. To illustrate, in the last 3 years, the average difference between 3-month SOR and compounded SORA is about 37 basis points. Between 3-month SIBOR and compounded SORA, the average difference is about 48 basis points.

34. What does this mean? It means that when SORA is used for customer loan pricing, the spread quoted over SORA would have to be higher than the original spread over SOR or SIBOR to take the additional risk premiums into account.

35. The higher customer spread is to reflect the risk premiums associated with (i) the term risk and (ii) the credit risk, which are components not embedded in the SORA rates. It does not mean that the spread earnings by the banks have increased.

36. After taking into account the two risk premiums, the final absolute amount of interest payments on the loans, whether they were referencing SOR, SIBOR or SORA, should work out to be about the same over the lifetime of the loan, everything else (such as market conditions) being the same.

37. This is a very important difference that our customers need to understand.

38. The best way to understand how this works is to start exploring SORA products now and not wait to react only when SOR and SIBOR are phased out.

39. By exploring with SORA, customers will better understand how this new benchmark rate is used and how it is applied.

40. By or before the end of next year, banks will no longer be able to offer new SOR based products because USD LIBOR used in the computation of SOR will no longer be available.

41. As Jacqueline mentioned, the Steering Committee is planning to recommend an appropriate timeline to stop the usage of SOR in new loans and issuances before December 2021.

42. We are studying this issue carefully and will issue market guidance on this in October, so that all market participants have enough advance notice to prepare.

43. The SORA-centred approach is aligned to the development that Risk-free Rates are being used across the global markets as new benchmark rates for financial markets.

44. As more institutions start to use SORA-based pricing, the broadened use of SORA will facilitate the development of hedging instruments, price discovery and other cash and derivative products.

45. This will, in turn, allow retail and corporate customers to benefit from a deeper and more efficient market with greater transparency.

46. SORA is independently administered by MAS. The rates are transparent as they are published daily on the MAS website.

47. Since August, MAS has also started to publish the 1-month, 3-month and 6-month compounded SORA rates, which OCBC has adopted as a reference rate in our retail home loan offering.

48. SORA is also more robust as it is derived from the large daily cash placements made by banks, running into the billions.

49. As I said, all other major financial markets globally are moving toward a more transparent risk-free rate centred approach. Singapore as a leading financial centre is doing the same, and needs to do the same.

50. We have made good progress and gained good momentum over the past year. The Steering Committee will build on this foundation to continue with the transition plan.

51. We urge all financial institutions, corporates and retail customers to continue with your preparation. If you have not yet started, please get started.

52. Remember, we are only 5 quarters away from the end of LIBOR and SOR. There is no extension for LIBOR as has been repeatedly said by the FCA and the Bank of England. And, as I have mentioned earlier, without LIBOR, SOR cannot be quoted.

53. Finally, let me conclude on a lighter note.

54. While it remains unclear when a Covid-19 vaccine will be available, it is definitely clear that SOR will end, the latest by 31 December 2021.

55. The good news is that SOR has a vaccine, which is SORA. We have been testing it with promising results and will expand its usage to bring it to maturity.

56. The Steering Committee's hope is that all banks will be ready to dish out the SORA vaccine by early next year.

57. If more and more of us adopt SORA sooner, the ending of LIBOR and SOR by end-2021 shall be a non-event.

58. Thank you. And now, I will pass it back to Ai Boon.

Samuel Tsien
Chair
Steering Committee for SOR Transition to SORA