Adjustment Spreads for the Conversion of SIBOR Loans to SORA

Response to Consultation Feedback and Final Recommendations

30 June 2023

Steering Committee for SOR & SIBOR Transition to SORA

(SC-STS)

PREFACE

This paper sets out the SC-STS' response to feedback that was received on the consultation paper, *Consultation on Adjustment Spreads for the Conversion of Legacy SIBOR Loans to SORA*, published on 15 March 2023. Taking into account the broad support for SC-STS' recommendations, this paper sets out the finalised approach for the setting of adjustment spreads for the conversion of Singapore Interbank Offered Rate ("**SIBOR**") corporate and retail loans to a Singapore Overnight Rate Average ("**SORA**") reference rate.

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1 Background

1.1 **On 15 March 2023, the Steering Committee for SOR & SIBOR Transition to SORA ("SC-STS") issued a consultation paper titled "*Consultation on Adjustment Spreads for the Conversion of Legacy SIBOR Loans to SORA*"** (**"the Consultation"**) to seek feedback on proposals for setting adjustment spreads for the conversion of SIBOR loans to a SORA reference rate.

1.2 **The Consultation covered both corporate (including small and medium-sized enterprises ("SME") loans, bilateral corporate loans and syndicated loans) and retail loans**:

- **<u>Corporate loans (including SME loans, bilateral corporate loans and syndicate loans):</u>** The SC-STS recommended for the adjustment spreads to be based on the 5-year historical median spreads between SIBOR and compounded SORA.

- **<u>Retail loans:</u>** The SC-STS recommended the transition to take place in two phases:

  - First, **an active transition phase** during which customers may choose to take up either the SIBOR–SORA Conversion Package ("**SIBOR-SCP**") or any of their bank's prevailing packages. The SIBOR-SCP will be structured as: 3-month compounded-in-advance SORA + customer's existing SIBOR margin + Adjustment Spread (Retail). The Adjustment Spread (Retail) during the active transition phase will be determined via a spot-spread approach, which is calculated as the average difference between SIBOR and compounded-in-advance SORA over the preceding three-month period.[1]

  - Second, **an automatic conversion** will take place for customers who did not participate in the active transition phase. The banks will automatically convert any remaining SIBOR retail loans to the SIBOR-SCP by applying an adjustment spread based on the 5-year historical median spreads between SIBOR and

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

compounded-in-advance SORA. The 5-year historical median will be set in conjunction with the publication of the response to the consultation.

1.3 Feedback was received from a total of 45 respondents, comprising 35 banks and 10 non-banks. Of the 45 respondents, 20 respondents highlighted that they had no comments or objections to the approach as they had no SIBOR exposures. The subsequent sections will focus on the feedback by the 25 respondents.

1.4 This paper summarises the SC-STS' response to the feedback and the finalised recommendations.

2. Feedback on Transition Approach for SIBOR Corporate Loans and Finalised Approach

2.1 24 out of the 25 respondents provided feedback on the transition approach for SIBOR corporate loans. Of the 24 respondents, 23 were supportive of the proposed approach for the adjustment spreads to be based on the 5-year historical median spreads between SIBOR and compounded SORA.

Feedback: 5-Year Historical Median Spreads

2.2 **1 respondent preferred using a longer averaging period to determine the historical median spreads between SIBOR and compounded SORA, as the 5-year lookback includes the "ultra-low interest rate environment during the Covid-19 pandemic".** The respondent provided the same feedback for the transition of SIBOR retail loans in relation to the 5-year historical median spreads applied at automatic conversion.

Response

2.3 **The 5-year period is deemed to have sufficient coverage through different parts of the interest rate cycle.** This includes the low interest rate environment during the Covid-19 pandemic, and also the recent past one year where the spreads between SIBOR and compounded SORA have been wider than historical averages, due to the interest rate tightening cycle by central banks globally.

2.4 **Further, the setting of the historical median spreads using a 5-year lookback period is aligned to international convention adopted for the transition of London Interbank Offered Rate ("LIBOR") and other interest rate benchmarks as well as the transition of**

Singapore Dollar Swap Offer Rate ("SOR") wholesale contracts[2]. This methodology thus has the added benefit of familiarity to market participants that have transitioned their contracts that referenced LIBOR, SOR and other interest rate benchmarks.

Feedback: Applicability of the Transition Approach to SIBOR bonds

2.5 **1 respondent asked if the corporate transition approach would be applicable for the transition of bonds.** The respondent suggested that the SC-STS' proposed approach, to apply 5-year historical median spreads between SIBOR and compounded SORA as the adjustment spread for the transition of corporate loans, could similarly be used for the transition of bonds referencing SIBOR to SORA.

<u>Response</u>

2.6 **The consultation was not scoped to cover SIBOR bonds, as there are no known outstanding SIBOR bonds in the market at this juncture.** Nevertheless, the SC-STS' recommendation to use the 5-year historical median spreads for the transition of corporate loans can serve as a useful reference point for the transition of SIBOR bonds. Issuers with outstanding SIBOR bonds, if any, may wish to consider amending the contractual terms of the SIBOR bonds to incorporate fallback provisions to prevent any disruption to the bond or redeeming outstanding SIBOR bonds before the discontinuation of SIBOR after 31 December 2024.

Feedback: Applicability of the Transition Approach to Benchmarks used by Funds which Reference SIBOR

2.7 **1 respondent asked if the corporate transition approach would be applicable to funds that are benchmarked to SIBOR** (e.g. where the mandate of the fund is to achieve returns of SIBOR + x%).

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[2] The 5-year historical median spreads have been used in the setting of contractual fallbacks for LIBOR, as well as the setting of the MAS Recommended Rate ("**MRR**"), which applies in ISDA Documentation (ISDA IBOR 2020 Fallbacks Protocol, Supplement number 70 to the 2006 ISDA Definitions and the 2021 ISDA Interest Rate Derivatives Documentation) and in ST-STS' July 2022 guidance on adjustment spreads for the conversion of legacy SOR loans to SORA.

Response

2.8 **For funds which are benchmarked to SIBOR, fund managers may consult relevant stakeholders on adopting suitable replacement benchmarks or alternative reference rates and transition before the discontinuation of SIBOR, which could include SORA with an adjustment spread applied.** This will prevent any disruption to the benchmarking of fund returns.

Finalised Approach for SIBOR Corporate Loans

2.9 **For the transition of SIBOR corporate loans (including SME loans, bilateral corporate loans and syndicate loans) to SORA, the SC-STS recommends applying the 5-year historical median spreads between SIBOR and compounded SORA as the adjustment spread.** 23 out of 24 respondents agreed with this, with several noting that a 5-year historical median would reflect a fair spread for both lenders and borrowers and that a 5-year period was sufficiently long to smooth out extreme market volatilities. In addition, the setting and publication of the 5-year historical median spreads will provide certainty to market participants and encourage active transition.

2.10 **The 5-year historical median spreads to convert existing SIBOR loans to a similar tenor reference are provided in Table 1 below.**

Table 1[3]: For SIBOR corporate loans: 5-year historical median[4]

	1-month SIBOR to 1-month compounded SORA	3-month SIBOR to 3-month compounded SORA
5-Year Median Period Start Date	30 June 2018	
5-Year Median Period End Date	30 June 2023	
Adjustment Spread (4 decimal places)	0.2059%	0.3571%

[3] The 5-year historical median is computed based on the SIBOR and compounded SORA data published on Singapore business days.

[4] For alignment with the computations for the transition of SIBOR retail loans to SORA, all computations for the 5-year historical median will be based on the spreads between SIBOR and Compounded-in-advance SORA (as opposed to Compounded-in-arrears SORA), regardless of whether the SIBOR corporate loan would be transitioned to Compounded-in-advance SORA or Compounded-in-arrears SORA. Differences between the spreads are minimal given the long historical period used.

3. Feedback on Transition Approach for SIBOR Retail Loans and Finalised Approach

3.1 21 out of the 25 respondents provided feedback on the transition approach for retail loans. Of the 21 respondents, 20 were supportive of the proposed approach for retail loans to apply the (i) spot-spread during the period of active transition, and (ii) historical median at automatic conversion.[5]

Feedback: Clarifications on Implementation Details

(i) Fee-free switch

3.2 **1 respondent asked if the one-time fee-free switch would be applicable to customers whose loans were automatically converted to the SIBOR-SCP in June 2024.**

Response

3.3 **Customers whose SIBOR loans were converted to the SIBOR-SCP, either during the active transition phase or automatically in June 2024, would be eligible up until 31 December 2024 to request a one-time fee-free switch to the banks' prevailing packages.**

(ii) Residential Property Loans Fact Sheet

3.4 **1 respondent proposed for the industry to have a common Residential Property Loans Fact Sheet for the SIBOR-SCP** to ensure consistency in implementation and better customer communication across the industry.

Response

3.5 **The SC-STS will develop common templates for the abridged Property Loan Factsheet.**

[5] 1 respondent had suggested for a longer averaging period in the determination of the historical median spreads applied at automatic conversion, which has been addressed in paragraphs 2.3 and 2.4 of this paper.

- For customers who take up the SIBOR-SCP: The Property Loan Factsheet requirements specified in Monetary Authority of Singapore ("**MAS**") Notice 632A[6] for banks (and its equivalent for other financial institutions[7]) need not apply. However, financial institutions will minimally need to provide an abridged Factsheet to disclose key features of the loan (including applicable fees and charges) to customers, which requires no signature from customers.
- For customers who take up the bank's prevailing packages: If the borrower chooses to reprice to the bank's prevailing packages, the Residential Property Loans Factsheet as specified in MAS Notice 632A will need to be issued.

Finalised Approach for SIBOR Retail Loans

3.6 **For the transition of SIBOR retail loans to SORA, the SC-STS recommends the transition to take place in two phases**:

- First, **an active transition phase** from 1 September 2023 to 30 April 2024 during which customers may choose to take up either the SIBOR-SCP or any of their bank's prevailing packages. The SIBOR-SCP will be structured as: 3-month compounded-in-advance SORA + customer's existing SIBOR margin + Adjustment Spread (Retail). The Adjustment Spread (Retail) during the active transition phase will be determined via a spot-spread approach, which is calculated as the average difference between SIBOR and compounded-in-advance SORA over the preceding three-month period.[8] The Adjustment Spread (Retail) will be published on the first business day each month, and will apply for customers transitioning to the SIBOR-SCP in the particular month. E.g. the spot-spread published on 1 December 2023 will be applied to customers who actively transition to the SIBOR-SCP in December 2023.

- Second, **an automatic conversion** will take place in June 2024 for customers[9] who did not participate in the active transition phase. The banks will automatically convert any

[6] See MAS Notice 632A: https://www.mas.gov.sg/-/media/mas/regulations-and-financial-stability/regulations-guidance-and-licensing/commercial-banks/regulations-guidance-and-licensing/notices/mas-632a-2023_04.pdf

[7] MAS Notice 115A (applicable to direct insurers), MAS Notice 825A (applicable to finance companies) and MAS Notice 1106A (applicable to merchant banks)

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

[9] This refers to customers who continued to service their loan via their existing or other payment methods, and did not switch out of their SIBOR loan by the end of the active transition phase (i.e. by 30 April 2024).

remaining SIBOR retail loans to the SIBOR-SCP by applying an adjustment spread based on the 5-year historical median spreads between SIBOR and compounded-in-advance SORA over the period 30 June 2018 to 30 June 2023, as specified in Table 2 below.

3.7 **20 out of 21 respondents were supportive of the proposal for the transition approach for SIBOR retail loans to apply the (i) spot-spread during the period of active transition, and (ii) historical median at automatic conversion.** Reasons cited in support of the proposal included:

- Customers are provided with the option to either (i) convert their SIBOR retail loans during active transition period or (ii) do nothing and wait for automatic conversion. To inform customers' decisions, there is certainty on the adjustment spreads that would be applied at automatic conversion.

    - During active transition, customers could choose to take up the SIBOR-SCP at the spot-spread, or to switch to the banks' prevailing packages.
    - As the 5-year historical median is determined upfront, customers would be made aware of the adjustment spread that would apply should they do nothing and be converted automatically in June 2024.
    - During the active transition period, customers can compare between (i) the bank's prevailing packages, (ii) the spot spreads published each month, and (iii) the historical median spreads which will apply at automatic conversion, to decide whether to convert their loan in that particular month.

- The application of the spot-spread (which is determined as the average difference between SIBOR and compounded SORA over the preceding three months) during the period of active transition is a reasonable rate for banks as it appropriately reflects prevailing market conditions.

- The application of the 5-year historical median rate at automatic conversion also serves as a safeguard against extreme scenarios where spot-spreads may experience unexpected and volatile surges. This benefits both banks and customers.

3.8 **The 3-month compounded SORA will be 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.

3.9 **The 5-year historical median spreads that will apply at automatic conversion are provided in Table 2 below.**

Table 2[10]: For SIBOR retail loans: 5-year historical median applied at automatic conversion in June 2024

	1-month SIBOR to 3-month compounded SORA	3-month SIBOR to 3-month compounded SORA
5-Year Median Period Start Date	30 June 2018	
5-Year Median Period End Date	30 June 2023	
Adjustment Spread (4 decimal places)	0.2426%	0.3571%

3.10 **In addition, as outlined in the 15 March 2023 consultation paper, the following measures will be implemented to support retail transition:**

- **Public education and communications:** The SC-STS will work with banks to develop the necessary materials and FAQs to be shared with the large number of customers with SIBOR retail loans to facilitate understanding of the transition approach. Information will also be made available on the SC-STS website. This will be further supplemented by the banks' direct outreach (e.g. customer letters).

- **Measures to facilitate customers switching out of their SIBOR retail loans:** As set out in the media release on 15 March 2023[11], several measures have been put in place to support customers who wish to switch out of their SIBOR retail loans.

    - **Fee-waivers:** A one-time fee-free switch has been made available to customers with SIBOR retail loans until 31 December 2024, where customers could choose to switch to either the SIBOR-SCP (after 1 September 2023) or to the banks' prevailing packages without any administrative fees being charged. Customers whose SIBOR retail loans were converted to the SIBOR-SCP, either automatically in June 2024 or earlier during the active transition phase, would also be eligible up until 31 December 2024 to request a one-time fee-free switch to the banks' prevailing packages.

[10] The 5-year historical median is computed based on the SIBOR and compounded SORA data published on Singapore business days.

[11] See SC-STS Media Release on SIBOR to SORA Transition Commences (15 March 2023)

- **Regulatory exemptions:** The taking up the SIBOR-SCP and prevailing packages offered by their banks to customers with existing SIBOR retail loans will not be regarded as a refinancing of property loans under MAS' property loan rules. As such, the property loan rules to re-compute the Total Debt Servicing Ratio ("**TDSR**"), Loan-To-Value ("**LTV**") and Mortgage Servicing Ratio ("**MSR**") will not apply for affected customers making the switch within the same financial institution.

4. Implementation Timeline

4.1 Taking into consideration feedback from market participants, particularly the launch of the active transition period for SIBOR retail loans, the SC-STS recommends the following implementation timeline:

<u>Corporate loan transition</u>

- <u>1 September 2023:</u> All banks to be ready to offer to customer the transition of SIBOR loans to SORA at the 5-year historical median spreads.
- <u>30 June 2024:</u> All financial institutions to have substantially transitioned or remediated the stock of SIBOR corporate loans.

<u>Retail loan transition</u>

- <u>1 July – 31 August 2023:</u> All banks and finance companies with SIBOR retail loan exposures to prepare their systems and processes to be ready to commence the Active Transition Phase
- <u>1 September 2023 – 30 April 2024:</u> Active Transition Phase
- <u>Between 1 June 2024 – 30 June 2024:</u> Automatic Conversion of all outstanding SIBOR loans for customers who have not switched out of their SIBOR loans by 30 April 2024.

5. Conclusion

5.1 **The SC-STS thanks all respondents for the feedback and strongly encourages market participants with SIBOR exposures to adopt this guidance to convert to SORA.** Customers with SIBOR retail loans are also encouraged to consider their options early, and to utilise the one-time fee-free switch provided by their bank to convert their existing SIBOR loans to the SC-STS' recommended SIBOR-SCP or any prevailing package offered by their bank.