Making sense of Sibor and Sora

The Singapore Interbank Offered Rate is set to transition to a new benchmark in three to four years

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There have been much talk about Sibor and Sora lately. Here is how they matter to you.

SIBOR

The Singapore Interbank Offered Rate (Sibor) is based on the interest rates reported by member banks in Singapore when lending unsecured funds denominated in Singapore dollars. It is a daily average rate that is administered by the ABS Benchmarks Administration Co (ABS Co) since July 2015. Currently, 20 member banks contribute to the calculation of Sibor.

They are the three local banks (DBS, OCBC and UOB); eight banks from the Asia-Pacific region (Australia and New Zealand Banking Group, The Bank of Tokyo-Mitsubishi UFJ, Bank of China, CIMB Bank, HSBC, Mizuho Bank, Malayan Banking and Sumitomo Mitsui Banking Corporation); and nine international banks (Barclays Bank, Credit Swiss, Citibank, Bank of America, BNP Paribas, Deutsche Bank, Standard Chartered Bank, JP Morgan Chase Bank and UBS).

If fewer than 12 banks submit their quotes, the Sibor rate will be unavailable for that day. After deleting the top and bottom quartiles, the remaining rates (which should come from at least 10 banks) are averaged to get the day's Sibor.

Sibor has been the benchmark interest rate not only for Singapore but also for other Asian economies. This is to a great extent due to Singapore's political stability and reliability as an Asian financial hub. Sibor has a term structure of one-month, three-month, six-month and 12-month. The one-month and three-month Sibor are the most popular benchmarks. The six-month and 12-month are less widely used and will be discontinued from end-2021 and end-2020 respectively.

Sibor commonly serves as the benchmark interest rate for debt instruments such as commercial loans, syndicated loans, mortgages, trade financing and working capital financing, and for currency and interest rate swaps in Asia. It is applied to debt instruments by adding a credit spread to the quoted rate, for example, three-month Sibor plus a spread of 25 basis points.

SORA

The Singapore Overnight Rate Average (Sora) is the rate for unsecured overnight interbank Singapore dollar transactions brokered in Singapore daily between 8am and 6.15pm. Sora has been published by the Monetary Authority of Singapore (MAS) since July 1, 2005.

On July 19, the Association of Banks in Singapore (ABS), ABS Co, SFEMC (Singapore Foreign Exchange Market Committee) and SC-STS (Steering Committee for SOR Transition to Sora) released a consultation paper proposing the phasing out of Sibor over the next three to four years in favour of Sora.

The financial industry has, till the end of next month, to provide its feedback before a final verdict on the fate of Sibor is passed.

On Aug 5, the MAS announced key initiatives to provide more clarity on the reporting of Sora which will be administered by the MAS.

WHY IS SORA IMPORTANT

The story began with the Libor (London Interbank Offered Rate) scandal uncovered in 2012. It exposed market manipulation of Libor by member banks that falsely inflated or deflated their rates so as to profit from trades.

The rigging of Libor resulted in billions of fraudulent interest payments. After the scandal, many countries sought a more robust benchmark interest rate. The Libor will likely cease after end-2021.

The search for a suitable replacement was arduous. Libor is deeply embedded in a range of financial contracts. In the United States alone, it serves as a reference rate for contracts worth over US$200 trillion (S$273 trillion), which is about three times the total market capitalisation of all stocks worldwide last year.

In Europe, the Sterling Overnight Index Average (Sonia) will replace Libor by next year. In Switzerland, the Swiss Average Rate Overnight (Saron) will be used.

Japan, Australia, Canada, Hong Kong and the US will use respectively the Tokyo Overnight Average Rate (Tonar), the Reserve Bank of Australia Interbank Overnight Cash Rate (Aonia), the Canadian Overnight Repo Rate Average (Corra), the Hong Kong Dollar Overnight Index Average (Honia) and the Secured Overnight Financing Rate (Sofr) in place of the Libor.

These alternative "risk-free" rates are based on real transactions, making them less vulnerable to coordinated price fixing.

The Sofr has been criticised for its excessive volatility, backward-looking nature and lack of term structure. Hence, many financial institutions are still hesitant about adopting Sofr in case of a liquidity crunch and financial instability.

Given that Sofr does not have a forward curve like Libor, the Chicago Mercantile Exchange started offering Sofr futures in 2018. By end-2019, there were about US$345 billion in outstanding Sofr swaps. But the size of Sofr derivatives is relatively small compared with Libor's.

There are similar issues with Sora introduced in 2005.

On Aug 5, the MAS announced that Sora will be based on the volume-weighted actual transacted rates of 24 reporting banks that are most active in the Sora market.

They include three local banks (DBS, OCBC and OUB); 10 Asia-Pacific banks (Australia and New Zealand Banking Group, Chang Hwa Commercial Bank, CIMB Bank, HL Bank, ICBC, Malayan Banking, Mizuho Bank, MUFG Bank, National Australia Bank and HSBC); and 11 international banks (ABN Amro Bank, Barclays Bank, BNP Paribas, Citibank, Commerzbank, Credit Agricole Corporate & Investment Bank, Deutsche Bank, ING Bank, KBC Bank, Natixis and Standard Chartered Bank).

This list is subject to periodic review by the MAS. Naturally, the shorter list of reporting banks from the Sora market will reduce Sora volatility, an important quality for a robust benchmark interest rate.

Second, the Sora for one-month, three-month and six-month tenors are compounded from past daily Sora. Hence, there is no corresponding forward-looking term spreads.

The financing cost of interest-rate-related products such as loans and mortgages under Sora will depend on the specific creditworthiness of the borrowers and the market conditions.

To have a more complete picture of the impact on the final financing cost, more data will be needed.

DBS and MAS have recently offered Sora-based Floating Rate Notes (FRN) to facilitate a deepening of the Sora market. The phasing out of Sibor over three to four years will provide ample time for the market to adjust and transit to Sora whereas other countries face a more urgent timeline, given that Libor will cease by next year-end.

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