

SABR Model: Theory and Applications

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1 Key Fundamentals

The SABR (Stochastic Alpha, Beta, Rho) model, developed by Hagan et al. in 2002, is a **stochastic volatility model** specifically designed for modeling the dynamics of forward rates and their implied volatilities. Unlike the Heston model which was developed primarily for equity markets, SABR was created with interest rate derivatives in mind, though it has since found applications across multiple asset classes. The model’s key innovation is its ability to produce closed-form approximations for implied volatilities while capturing market-observed volatility smiles and skews.

1.1 Core Mathematical Structure

The SABR model is defined by two coupled stochastic differential equations (SDEs) describing the evolution of a forward rate and its volatility:

Forward Rate Process:

$$dF_t = \alpha_t F_t^\beta dW_t^F \quad (1)$$

This equation describes how the forward rate F_t (such as a forward LIBOR rate, FX forward, or commodity forward) evolves over time. Unlike traditional models, SABR includes no drift term—it’s designed for modeling forwards under their natural probability measure where they are martingales. The exponent β controls the backbone or “shape” of the volatility smile, determining how volatility scales with the level of the forward rate.

Volatility Process:

$$d\alpha_t = \nu \alpha_t dW_t^\alpha \quad (2)$$

This remarkably simple equation governs the evolution of volatility α_t . The volatility follows a **geometric Brownian motion**—it has no mean reversion (unlike Heston’s CIR process). The parameter ν represents the “volatility of volatility” (vol-of-vol), controlling how much the volatility itself fluctuates. The geometric structure ensures that α_t remains positive for all time.

Correlation Structure:

$$dW_t^F dW_t^\alpha = \rho dt \quad (3)$$

The two Brownian motions are correlated with coefficient ρ . This correlation captures the relationship between movements in the forward rate and changes in its volatility.

Parameter Definitions:

- F_t = forward rate at time t (forward LIBOR, FX forward, commodity forward, etc.)
- α_t = stochastic volatility at time t (instantaneous volatility level)
- α_0 = initial volatility (typically calibrated to at-the-money volatility). Typical range: 0.10 to 0.50
- β = CEV (Constant Elasticity of Variance) exponent (controls backbone curve). Range: 0 to 1
 - $\beta = 0$: Normal/absolute volatility model (volatility independent of rate level)
 - $\beta = 0.5$: Common choice for interest rates and FX
 - $\beta = 1$: Lognormal model (volatility proportional to rate level)
- ν = volatility of volatility (vol-of-vol; controls smile/skew curvature). Typical range: 0.1 to 1.0

- ρ = correlation between forward and volatility (-1 to +1)
 - $\rho < 0$: Typical for interest rates (rates down \rightarrow volatility up)
 - $\rho > 0$: Sometimes observed in commodities
 - $\rho \approx 0$: Symmetric smile
- W^F and W^α = correlated Wiener processes with correlation ρ

1.2 The CEV (Constant Elasticity of Variance) Backbone

The parameter β is central to SABR's flexibility. It determines the **backbone** relationship between the forward rate level and its volatility:

$$\text{Local Volatility} \propto F^\beta \quad (4)$$

This creates different volatility structures:

- $\beta = 0$ (**Normal SABR**): Volatility is independent of the forward rate level. This is appropriate when rates can go negative (as in modern European interest rate markets post-2008). The model produces an approximately symmetric volatility smile.
- $\beta = 0.5$: A middle-ground choice popular for interest rate modeling. It produces realistic smile shapes while maintaining numerical stability even for low or negative rates. This is the most common choice for LIBOR derivatives.
- $\beta = 1$ (**Lognormal SABR**): Volatility scales linearly with the forward rate (equivalent to percentage or relative volatility). This is the traditional Black model assumption. It's appropriate when rates are strictly positive and when market participants think in terms of percentage moves rather than absolute moves.
- $0 < \beta < 1$: Intermediate cases interpolate between these extremes, allowing fine-tuning to match market dynamics.

The choice of β is often made based on market conventions, historical calibration studies, or regulatory requirements. Some practitioners fix β (typically at 0.5 or 1) and calibrate only the other three parameters, while others allow β to be calibrated from market data.

1.3 Hagan's Approximation Formula

The key practical innovation of SABR is the **closed-form asymptotic approximation** for implied Black volatility developed by Hagan et al. This formula allows extremely fast pricing without Monte Carlo simulation or numerical PDE solutions.

For an option with strike K and maturity T on a forward rate F , the implied Black volatility is approximately:

$$\sigma_B(K, T) \approx \frac{\alpha}{(FK)^{(1-\beta)/2} \left[1 + \frac{(1-\beta)^2}{24} \log^2 \frac{F}{K} + \frac{(1-\beta)^4}{1920} \log^4 \frac{F}{K} \right]} \times \frac{z}{x(z)} \quad (5)$$

where:

$$z = \frac{\nu}{\alpha} (FK)^{(1-\beta)/2} \log \frac{F}{K} \quad (6)$$

$$x(z) = \log \left[\frac{\sqrt{1 - 2\rho z + z^2} + z - \rho}{1 - \rho} \right] \quad (7)$$

with a time adjustment factor:

$$\sigma_B \times \left[1 + \left(\frac{(1-\beta)^2 \alpha^2}{24(FK)^{1-\beta}} + \frac{\rho\beta\nu\alpha}{4(FK)^{(1-\beta)/2}} + \frac{2-3\rho^2}{24} \nu^2 \right) T \right] \quad (8)$$

At-the-Money Simplification:

When $K = F$ (at-the-money options), the formula simplifies dramatically:

$$\sigma_{ATM} = \frac{\alpha}{F^{1-\beta}} \left[1 + \left(\frac{(1-\beta)^2 \alpha^2}{24F^{2(1-\beta)}} + \frac{\rho\beta\nu\alpha}{4F^{1-\beta}} + \frac{2-3\rho^2}{24} \nu^2 \right) T \right] \quad (9)$$

This formula is remarkably accurate for typical market conditions and can be evaluated in microseconds, making it ideal for real-time trading applications.

2 What It Models

2.1 Interest Rate Volatility Smiles

SABR was specifically designed to model the **volatility smiles** observed in interest rate options markets—particularly caps/floors (options on LIBOR) and swaptions (options on swap rates). Before SABR, practitioners used the Black model with constant volatility, which couldn't explain why out-of-the-money options traded at different implied volatilities than at-the-money options.

The SABR model captures three key features of interest rate volatility smiles:

- **Smile asymmetry/skew:** Implied volatility is not symmetric around the at-the-money level
- **Smile curvature:** The smile has convexity (second derivative effects)
- **Term structure:** The smile shape changes with option maturity

The parameters ρ and ν primarily control these features: ρ determines the skew (tilt), while ν controls the curvature (smile depth).

2.2 Forward Rate Dynamics Under Natural Measure

Unlike many equity models, SABR is formulated under the **forward measure**—the natural probability measure for forward rates. In this measure, the forward rate F_t is a martingale (has no drift term), which is mathematically convenient and aligns with how interest rate derivatives are typically valued.

This no-arbitrage framework ensures that the model is internally consistent for pricing multiple derivatives on the same underlying. The absence of drift simplifies both the mathematics and the calibration process.

2.3 Stochastic Volatility Without Mean Reversion

Unlike Heston (which uses mean-reverting CIR volatility), SABR models volatility as a **geometric Brownian motion** without mean reversion:

$$d\alpha_t = \nu\alpha_t dW_t^\alpha \quad (10)$$

This has important implications:

- Volatility can drift away from its initial level indefinitely
- Volatility is log-normally distributed: $\alpha_t = \alpha_0 \exp(\nu W_t^\alpha - \frac{1}{2}\nu^2 t)$
- There's no “long-term mean” volatility level
- The process is stationary in log-space but not in level-space

This structure is particularly appropriate for short-to-medium dated options (up to 2-3 years) where mean reversion is less critical. For very long-dated options, the lack of mean reversion can lead to unrealistically wide volatility distributions, though in practice this limitation is manageable through parameter adjustments or model extensions.

2.4 Correlation Between Rates and Volatility

The correlation parameter ρ captures the empirical relationship between rate movements and volatility changes:

- **Negative correlation** ($\rho < 0$): When rates fall, volatility rises (and vice versa). This is typical for interest rate markets, especially in low-rate environments where central banks' policy options become constrained as rates approach zero. Market participants become more uncertain about future rate paths, increasing volatility. Typical values: $\rho \in [-0.5, -0.9]$
- **Positive correlation** ($\rho > 0$): When rates (or prices) rise, volatility rises. This can occur in commodity markets where supply disruptions simultaneously increase prices and uncertainty. Less common but observed in some emerging market currencies and commodities. Typical values: $\rho \in [0.2, 0.6]$
- **Zero correlation** ($\rho = 0$): Forward movements and volatility changes are independent, producing a symmetric volatility smile centered at the current forward rate. Rare in practice but useful as a reference case.

The ρ parameter is the primary driver of volatility **skew** (asymmetry): negative ρ creates higher implied volatility for low-strike options (puts) and lower implied volatility for high-strike options (calls), and vice versa for positive ρ .

2.5 Flexible Smile Shapes via CEV Structure

The β parameter allows SABR to accommodate different market conventions and rate regimes:

Pre-2008 (positive rate environment): $\beta = 1$ (lognormal) was standard, as rates were strictly positive and market participants thought in terms of percentage changes (“rates moved 20%” not “rates moved 50 basis points”).

Post-2008 (zero/negative rate environment): $\beta = 0$ (normal) became necessary for European markets where rates went negative. A lognormal model ($\beta = 1$) breaks down when rates approach zero (volatility explodes to infinity).

Modern practice: $\beta \in [0, 0.5]$ is most common for developed market interest rates, providing numerical stability while maintaining realistic smile shapes. The choice is often influenced by:

- Market conventions (some currency markets standardize on specific β values)
- Regulatory requirements (e.g., ISDA protocols)
- Historical calibration performance
- Whether rates can go negative in the relevant market

3 What It Ignores

3.1 Mean Reversion in Volatility

SABR's geometric Brownian motion volatility process has **no mean reversion**. Real market volatility tends to exhibit mean-reverting behavior: high volatility episodes (like the 2008 crisis or COVID-19 pandemic) eventually subside, and volatility returns toward more typical levels.

The lack of mean reversion means:

- Volatility can theoretically become arbitrarily large or small over long time horizons
- The model is less accurate for long-dated options (5+ years)
- It doesn't capture volatility clustering as naturally as mean-reverting models
- Calibrated parameters may need frequent updating as market conditions change

For short-to-medium dated options (the primary use case), this limitation is generally acceptable. For longer maturities, practitioners sometimes use:

- **Term structure of parameters:** Different SABR parameters for different expiries
- **Hybrid models:** Combine SABR for short end with mean-reverting models for long end
- **SABR-LMM:** Integrate SABR into a LIBOR Market Model framework

3.2 Jumps in Rates or Volatility

Like Heston, SABR assumes **continuous diffusion processes**—no jumps or discrete shocks. It doesn't capture:

- Central bank surprise announcements (Fed suddenly raises rates 75bp)
- Geopolitical events causing rate spikes (Brexit, war, sovereign debt crisis)
- Flash crashes in interest rate markets
- Discontinuous volatility jumps during major news events

Interest rate markets are generally less prone to jumps than equity markets, but they do occur. The 2008 Lehman Brothers bankruptcy, the 2010 European sovereign debt crisis, and the 2020 COVID-19 outbreak all created jump-like behavior in rates and volatility that SABR's smooth diffusions cannot capture.

Extensions incorporating jump processes (similar to Bates for equities) exist but sacrifice the analytical tractability that makes SABR attractive.

3.3 Stochastic Interest Rates for Discounting

SABR models the forward rate itself but typically assumes a **deterministic discount curve** for pricing. The model doesn't account for:

- Uncertainty in the discount factors used to price derivatives
- Correlation between forward rates at different maturities
- Term structure dynamics (how the entire yield curve evolves)

For single-period options (like a caplet on 3-month LIBOR), this is usually acceptable. For multi-period derivatives (like an interest rate swap or a Bermudan swaption), more sophisticated frameworks are needed:

- **SABR-LIBOR Market Model (SABR-LMM)**: Combines SABR dynamics with a full term structure model
- **Multi-factor models**: Explicitly model multiple forward rates jointly
- **HJM-SABR**: Integrates SABR into a Heath-Jarrow-Morton framework

3.4 Multiple Risk Factors

SABR is a **two-factor model** (one for the forward rate, one for volatility). It doesn't capture:

- Multiple volatility regimes (short-term vs. long-term volatility components)
- Separate factors for different sources of uncertainty (credit risk, liquidity risk)
- Cross-asset correlations (FX rates affecting interest rate volatility)
- Smile dynamics (how the volatility smile itself evolves over time)

Empirical studies show that volatility surfaces exhibit complex dynamics that a single volatility factor cannot fully explain. The smile doesn't just shift up and down—it twists, flattens, and steepens in ways that require additional factors to model accurately.

3.5 Negative Forward Rates

While Normal SABR ($\beta = 0$) can handle negative rates mathematically, standard SABR with $\beta > 0$ has issues when F_t approaches zero or becomes negative:

$$dF_t = \alpha_t F_t^\beta dW_t^F \quad (11)$$

When $\beta > 0$ and $F_t < 0$, the term F_t^β is undefined for non-integer β . This created significant challenges for SABR after 2008 when European rates went negative.

Solutions include:

- **Free boundary SABR:** Modifies the dynamics to allow negative rates
- **Shifted SABR:** Applies SABR to $F_t + s$ for some positive shift s
- **Normal SABR:** Simply use $\beta = 0$ (most common modern approach)

The shift approach is particularly popular: by modeling $(F_t + 100bp)$ instead of F_t , you ensure the argument to F^β is always positive even if the actual rate is negative. The shift amount is typically chosen based on historical rate minimums or expected future scenarios.

3.6 Approximation Errors

Hagan’s formula is an **asymptotic approximation**, not an exact solution. It assumes:

- Small volatility of volatility (ν not too large)
- Not too far from at-the-money ($|K - F|$ moderate)
- Not too long time to maturity (T not too large)

The approximation breaks down when:

- **Deep out-of-the-money options:** When $K \ll F$ or $K \gg F$, errors increase
- **High vol-of-vol:** When $\nu > 1$, approximation accuracy deteriorates
- **Long maturities:** For $T > 5$ years, errors can become significant
- **Extreme correlations:** When $|\rho| \approx 1$, numerical issues can arise

For these cases, practitioners may use:

- **Monte Carlo simulation:** Directly simulate the SABR SDEs
- **PDE methods:** Solve the Kolmogorov forward/backward equations numerically
- **Higher-order approximations:** Extended formulas with better accuracy (at cost of complexity)

In typical market conditions with liquid vanilla options, Hagan’s approximation is remarkably accurate (errors $< 0.1\%$ in implied vol), but edge cases require care.

4 Why People Use It

4.1 Designed for Interest Rate Markets

SABR was purpose-built for interest rate derivatives, particularly:

- **Caps/Floors:** Options on LIBOR or other reference rates
- **Swaptions:** Options to enter interest rate swaps
- **CMS products:** Constant Maturity Swap derivatives
- **Exotic IR derivatives:** Range accruals, digitals, barriers

The model’s structure naturally aligns with how interest rate markets work—forward rates are martingales under their forward measures, and market participants quote volatilities in the Black framework that SABR directly produces.

4.2 Closed-Form Volatility Approximation

Hagan’s approximation formula provides **extremely fast pricing**—a few microseconds per option. This is critical for:

- **Real-time quoting:** Market makers need instant prices for thousands of strikes/expiries
- **Calibration:** Fitting the model to market data requires evaluating prices thousands of times
- **Risk management:** Revaluing large portfolios under multiple scenarios
- **High-frequency trading:** Algorithmic strategies requiring rapid price updates

The speed advantage over Monte Carlo or PDE methods is typically 100x-1000x, making SABR practical for applications that would be computationally infeasible with simulation-based models.

4.3 Market Standard for Volatility Surfaces

SABR is the **industry standard** for representing interest rate volatility surfaces. The ISDA (International Swaps and Derivatives Association) protocols for interest rate derivatives often reference SABR conventions. This standardization means:

- Counterparties can communicate volatility surfaces via just 4 parameters per expiry/tenor
- Regulatory reporting and risk calculations have common frameworks
- Trading systems and risk platforms universally support SABR
- Historical data and research use SABR as a common language

Even if a firm uses a different model internally for pricing, they often translate to/from SABR for external communication.

4.4 Parsimonious Parameterization

With only **4 free parameters** (α , β , ν , ρ) per volatility surface slice, SABR achieves a strong balance between:

- **Flexibility:** Can fit complex smile shapes
- **Stability:** Not prone to overfitting or calibration instabilities
- **Interpretability:** Each parameter has clear economic meaning
- **Parsimony:** Few enough parameters to estimate reliably from limited data

Compare this to local volatility models (which require a full 2D function) or complex multi-factor models (with dozens of parameters). SABR’s simplicity is a major practical advantage.

4.5 Natural Smile Dynamics

When market conditions change, the SABR parameters evolve in economically intuitive ways:

- α responds to overall volatility level shifts (market becomes calmer or more volatile)
- ρ captures changes in skew (shifts in rate-volatility correlation)
- ν adjusts to changes in smile curvature (uncertainty about future volatility)
- β typically remains fixed (represents structural market conventions)

This interpretability aids risk management: traders can identify which aspect of the volatility surface is changing and understand the economic driver.

4.6 Handles Negative Rates

Normal SABR ($\beta = 0$) naturally accommodates **negative interest rates**, which became essential after 2008 when European and Japanese rates went below zero. Unlike lognormal models (which break down at zero), normal SABR:

- Has well-defined dynamics for any rate level (positive, zero, or negative)
- Maintains consistent implied volatilities across the zero boundary
- Aligns with market practice of quoting normal (basis point) volatilities for negative rate products

This flexibility was crucial for continuing to use a unified model framework across different rate regimes without having to switch models based on whether rates are above or below zero.

4.7 Flexible Backbone via β

The CEV exponent β provides **model flexibility** to match different market conventions:

- $\beta = 0$: Normal volatility (basis points of vol), appropriate for negative rate environments
- $\beta = 0.5$: Square-root model, popular for positive interest rates
- $\beta = 1$: Lognormal volatility (percentage vol), traditional for high-rate environments

This allows the same model framework to be applied across different markets (EUR vs. USD vs. emerging markets) with different quoting conventions, simply by adjusting β . Institutions can standardize on SABR while accommodating regional differences.

4.8 Extensions and Integrations

SABR serves as a building block for more sophisticated models:

- **SABR-LMM (LIBOR Market Model)**: Full term structure model using SABR for each forward rate
- **Markov Functional SABR**: Combines SABR with arbitrage-free evolution
- **Multi-currency SABR**: Models FX rates and multiple interest rate curves jointly
- **SABR with jumps**: Adds discontinuous moves for event risk

The model's tractability makes it an ideal component in larger modeling frameworks.

4.9 Calibration Efficiency

The closed-form formula enables extremely fast calibration to market data. Given quoted implied volatilities for caps/swaptions at various strikes, the four SABR parameters can be fitted via:

- **Least-squares optimization:** Minimize squared differences between model and market vols
- **Gradient-based methods:** Fast convergence using analytic derivatives of Hagan's formula
- **Global optimization:** Find robust parameters even with noisy data

Typical calibration time is milliseconds for a single expiry/tenor, enabling real-time recalibration as market quotes update throughout the trading day.

5 Practical Considerations

5.1 When to Use SABR

- **Interest rate derivatives:** Caps, floors, swaptions, CMS products (primary use case)
- **FX options:** Volatility smiles in currency markets, particularly for short-to-medium maturities
- **Commodity options:** Some commodity markets quote volatilities in ways that fit SABR naturally
- **Short-to-medium term:** Options with maturity ≤ 2 -5 years where lack of mean reversion is acceptable
- **Liquid vanilla markets:** Where calibration data (multiple strikes) is available
- **When speed matters:** Real-time pricing, high-frequency strategies, large portfolio valuation

5.2 When to Consider Alternatives

- **Heston:** Better for equity options, incorporates mean-reverting volatility
- **Local volatility (Dupire):** Perfect fit to vanilla options but poor extrapolation to exotics
- **LIBOR Market Model:** Multi-period interest rate derivatives requiring consistent term structure
- **Stochastic-Local Vol:** Combines local vol and stochastic vol for better exotic pricing
- **Long-dated options:** Models with mean reversion for maturities > 5 years
- **Jump-diffusion:** When discrete rate shocks are important (central bank surprises)

5.3 Calibration Best Practices

Parameter Constraints:

- Keep $\nu < 1$ to ensure approximation accuracy
- Restrict $|\rho| < 0.95$ to avoid numerical instabilities
- Set β based on market conventions (often fixed, not calibrated)
- Ensure α_0 is consistent with ATM volatility

Calibration Strategy:

- Use liquid strikes (typically 25-delta to 75-delta options) to avoid noisy data
- Weight ATM options more heavily (most liquid and important for hedging)
- Calibrate daily or intraday as market conditions change
- Validate calibrated parameters are economically reasonable
- Check approximation quality by comparing to Monte Carlo for a subset of strikes

Stability Checks:

- Monitor parameter stability over time—large jumps indicate calibration issues
- Ensure smooth term structure of parameters across expiries
- Validate that calibrated surface produces no-arbitrage prices (no calendar or strike arbitrage)
- Test sensitivity to input data noise (small changes in quotes shouldn't cause large parameter shifts)

5.4 Common Pitfalls

- **Over-reliance on approximation:** Don't use Hagan's formula beyond its accuracy range
- **Ignoring approximation errors:** Validate against exact methods for exotic derivatives
- **Unstable β calibration:** Often better to fix β than calibrate it from data
- **Extrapolating too far:** The model is less reliable for deep OTM or very long-dated options
- **Neglecting no-arbitrage constraints:** Calibrated parameters can sometimes violate arbitrage bounds
- **Wrong β choice:** Using $\beta = 1$ when rates can go negative causes explosions

5.5 Regulatory and Operational Considerations

- **Model validation:** Requires documentation of approximation accuracy and limitations
- **Back-testing:** Regularly compare model prices to realized values
- **Stress testing:** Evaluate model performance under extreme scenarios
- **Model risk management:** Understand when approximations break down
- **ISDA conventions:** Follow market standards for parameter quoting and day-count conventions

6 SABR vs. Heston Comparison

6.1 Similarities

- Both are two-factor stochastic volatility models
- Both capture volatility smiles/skews naturally
- Both include correlation between underlying and volatility
- Both are industry-standard models in their respective domains
- Both allow semi-analytical pricing (though via different methods)

6.2 Key Differences

Feature	SABR	Heston
Primary Market	Interest rates, FX	Equity options
Underlying Process	Forward rate (martingale, no drift)	Asset price (with drift μ)
Volatility Process	Geometric Brownian motion (no mean reversion)	CIR process (mean-reverting)
Backbone	CEV with exponent β (flexible)	Square-root (fixed)
Pricing Method	Asymptotic approximation (Hagan formula)	Fourier inversion (characteristic function)
Speed	Extremely fast (microseconds)	Fast (milliseconds)
Accuracy	Approximate (excellent for typical cases)	Exact (up to numerical integration error)
Long-term behavior	Volatility can drift indefinitely	Volatility mean-reverts to θ
Negative values	Handles negative rates (if $\beta = 0$)	Cannot handle negative prices
Parameters	4 (α, β, ν, ρ)	5 ($\kappa, \theta, \sigma, \rho, v_0$)
Positivity condition	Automatic (α always positive)	Feller condition required

6.3 When to Choose Which

Use SABR when:

- Modeling interest rate derivatives (caps, swaptions)
- FX options with short-to-medium maturity
- Need extremely fast pricing (microsecond scale)
- Working with negative rates (using $\beta = 0$)

- Following market conventions (SABR is the standard)

Use Heston when:

- Modeling equity options
- Long-dated options where mean reversion matters
- Need exact (not approximate) pricing
- Volatility trading strategies requiring precise vol dynamics
- Want to capture persistent volatility regimes

7 Conclusion

The SABR model occupies a central position in modern derivatives pricing, particularly for interest rate and FX markets. Its key strengths—analytical tractability via Hagan’s approximation, flexibility via the CEV backbone parameter β , and parsimonious parameterization with just four parameters—make it the de facto standard for volatility surface modeling in these markets.

While SABR makes simplifying assumptions (no mean reversion in volatility, no jumps, approximation errors), its practical performance has proven robust over more than two decades of market stress tests. The model’s ability to handle negative interest rates through Normal SABR ($\beta = 0$) ensured its continued relevance in the post-2008 zero-rate environment, demonstrating remarkable adaptability.

Understanding SABR is essential for any practitioner in interest rate derivatives, FX options, or quantitative risk management. Its combination of theoretical elegance, computational efficiency, and market acceptance has established it as a cornerstone of modern financial engineering. Whether you’re pricing a simple cap/floor or constructing a complex multi-currency derivatives portfolio, SABR provides the foundational framework for consistent, market-aligned valuation.

The model’s continued evolution—through extensions like SABR-LMM for term structure modeling, free-boundary SABR for extreme scenarios, and higher-order approximations for improved accuracy—ensures that it remains at the forefront of derivatives modeling for years to come.

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