

**Alternative Reference Rate for
Hong Kong Interbank Offered Rate (HIBOR) - Consultation with
Industry Stakeholders**

Treasury Markets Association

April 2019

About this document

1. This paper is published by the Treasury Markets Association (“TMA”) and seeks to consult industry stakeholders on issues relating to the alternative reference rate (“ARR”) for Hong Kong Interbank Offered Rate (HIBOR).
2. The TMA is requesting informed feedback to this consultation. Comments should be submitted in writing to the TMA no later than **30 April 2019** by *any one* of the following channels –

(1) By mail

TMA

Unit 1603, 16/F, Fu Fai Commercial Centre

27 Hillier Street, Sheung Wan

Hong Kong

(2) By fax

+852 2815 9931

(3) By email

tma@tma.org.hk

3. After considering the consultation feedback, the TMA will issue a consultation conclusions paper.

4. Any persons submitting comments on behalf of any organisation are requested to provide details of the organisation they represent.
5. Please note that the names of respondents and their affiliations may be published or reproduced by the TMA. If you do not wish the TMA to disclose your/your organization's identity, please state this clearly in your response. TMA may also freely reproduce and publish contents of the feedback, in whole or in part, in any form; and may use, adapt or develop any proposal put forward without seeking permission from or providing acknowledgement to the party providing the feedback.
6. Any personal data received by the TMA through consultation feedback will only be used for purposes directly related to this consultation. Such data may be transferred to other parties for the same purposes only. For access to or correction of personal data contained in your feedback please contact the TMA by email.

BACKGROUND

1. Financial benchmarks, especially benchmark interbank offered rates (“IBORs”), play an important role in the global financial system. There is no reliable statistics on the use of IBORs but there is no doubt that IBORs are referenced in a large volume of financial contracts that worth trillions of dollars and a wide array of financial instruments ranging from residential mortgage loans to interest rate derivatives. In terms of users, the population is also huge and diverse, covering banks, corporates, insurers, asset managers as well as retail customers.
2. Nonetheless, the uncovering of cases of attempted market manipulation and false reporting of IBORs in 2012, together with the post-crisis decline in liquidity in interbank unsecured funding markets, have undermined confidence in the reliability and robustness of existing IBORs.
3. Since 2013, the Financial Stability Board (“FSB”) has, through its Official Sector Steering Group (“OSSG”), been working with national authorities to promote global benchmark reforms with a view to enhancing the robustness and reliability of interest rate benchmarks. Hong Kong is a member of the FSB as well as OSSG.

4. The FSB published its recommendations on interest rate benchmarks in July 2014. The recommendations included measures to:
 - (a) Strengthen IBORs in particular by anchoring them to a greater number of transactions, where possible;
 - (b) Improve the processes and controls around IBOR submissions; and
 - (c) Identify nearly risk-free rates as alternative reference rates (“ARRs”).

LATEST DEVELOPMENTS

***Development of ARR*s**

5. Based upon the FSB recommendations, the five LIBOR currency areas (i.e. the US, Euro Area, Japan, the UK and Switzerland) have taken steps to identify ARR for the five LIBOR currencies.
6. As recommended by the FSB, these currency areas have chosen nearly risk-free overnight interest rates as their ARR. For example, for USD LIBOR, the Alternative Reference Rate Committee in the US has identified the secured overnight financing

rate (“SOFR”) as the ARR. SOFR is a broad Treasuries repo financing rate published by the Federal Reserve Bank of New York (“FRBNY”) since April 2018. A table showing ARRs for the five LIBOR currencies is appended below : -

Table 1: Alternative Reference Rates for Major Currencies

Currency	Nearly risk-free rate	Tenor	Nature	Administrator
USD	Secured Overnight Financing Rate (SOFR)	Overnight	Secured	FRBNY
EUR	Euro Short-Term Rate (ESTER)*	Overnight	Unsecured	European Central Bank
JPY	Tokyo Overnight Average (TONA)	Overnight	Unsecured	Bank of Japan
GBP	Sterling Overnight Index Average (SONIA)	Overnight	Unsecured	Bank of England
CHF	Swiss Average Overnight (SARON)	Overnight	Secured	EUREX

**ESTER is to be launched in October 2019.*

- There are three major differences between ARRs and IBORs. Firstly, ARRs are nearly risk-free, while IBORs generally reflect the perceived credit risk of large banks. Secondly, ARRs are overnight rates, while the tenors of IBORs can span from overnight to 12 months. Thirdly, ARRs are derived solely from transaction data, whereas IBORs are based on submissions by a number of selected contributing banks. As recommended by the FSB, reform measures have been implemented to anchor IBOR submissions to transaction data as far as practical, but contributing banks are generally allowed to exercise expert judgement to make submissions when there is a lack of transactions.

*Adoption of ARR*s

8. In the LIBOR currency areas, preparations are being made for a transition from LIBOR to ARR as the UK Financial Conduct Authority has indicated repeatedly that it will stop using its legal power to compel banks to make submissions for LIBOR after the end of 2021. If a significant number of existing contributing banks refuse to make submissions after end-2021, LIBOR will become unsustainable by then.
9. Despite the risk of LIBOR cessation, some market participants are reluctant to adopt the overnight ARR as they prefer using forward-looking term rates to determine interest payments in advance. Currently, most financial contracts use term IBORs as reference rates. For example, mortgage loans are usually linked to 1-month IBOR, while the majority of interest rate swaps make reference to either 3-month or 6-month IBOR.
10. In order to encourage the adoption of ARR, efforts have been made to derive term rates from the overnight ARR by introducing derivative instruments such as futures and overnight indexed swaps (“OIS”). For example, CME has launched 1-month and 3-month SOFR futures, and LCH has been providing central counterparty clearing services for OIS swaps linked to SOFR, TONA, SONIA and SARON.

11. At the same time, some debt issuers have tested investors' demand for floating rate notes ("FRNs") referencing overnight ARR. It is reported that about USD40 billion of SOFR-linked FRNs have been issued in the US since mid-2018. The interest payments of these FRNs are usually determined on a compounding in arrears basis. In other words, each interest payment is calculated by re-fixing and compounding the reference rate (i.e. SOFR plus a certain spread) on a daily basis until the next payment date. As such, the actual amount of each interest payment will only be known on the payment date.
12. In light of these market-driven promotion efforts, it is expected that the use of ARRs will gradually increase in the LIBOR currency areas toward the end of 2021.
13. While LIBOR will likely cease to exist after end-2021, the FSB recognises the need for continued existence of other IBORs if they are still supported by sufficiently active funding markets and continues to be considered reliable by both relevant authorities and market participants in the relevant jurisdictions. In fact, many jurisdictions have decided to adopt a multiple-rate approach whereby they would continue to maintain their existing IBORs while developing an ARR. In the case of Hong Kong, HIBOR is a benchmark widely recognised by market participants, and we see it desirable and necessary for HIBOR to remain.

ARR for Hong Kong

14. In order to fulfil Hong Kong's obligation as a FSB member, the TMA has set up a Working Group on Alternative Reference Rates ("WGARR") to engage relevant stakeholders in identifying an appropriate ARR for HIBOR.
15. As noted above, the LIBOR currency areas have already chosen nearly risk-free overnight funding rates as their ARRs. In Hong Kong, the TMA currently compiles the HKD Overnight Index Average ("HONIA"), which is also a nearly risk-free overnight interbank funding rate based solely on transaction data (please refer to Annex 1 for the specification of HONIA). It is obvious that HONIA is similar to the ARRs chosen by the LIBOR currency areas.
16. After reviewing the characteristics of the ARRs for the LIBOR currencies and taking into account the FSB's guiding principles, the WGARR has identified HONIA as the ARR for HIBOR. The WGARR has also proposed some technical refinements to HONIA with a view to enhancing its robustness and representativeness. The TMA is inviting feedback on the proposed refinements.

REFINEMENTS TO HONIA

17. Same as all major benchmarks which require continuous refinements to enhance their robustness and representativeness, the WGARR has also proposed some technical refinements for HONIA as set out below :

(a) Data source: Currently, HONIA captures overnight interbank funding transactions routed through a number of money brokers. Following similar practices adopted by other major currency areas for their ARRAs, transaction data for HONIA may be directly collected from the primary source (i.e. the banks).

(b) Reporting window: Under the current methodology for HONIA, all eligible transactions between 09:00 and 16:00 on every Hong Kong business day should be reported. To better reflect the local market conditions, the WGARR suggests extending the reporting window to 08:00 – 17:00 on each Hong Kong business day.

(c) Publication time: HONIA is currently published on a same-day basis. In light of its proposed extension of the reporting window as per (b) above, the WGARR proposes changing the publication time of HONIA to the following business day so as to allow more time for compilation. This proposed change is

in line with international practice. For example, SOFR and SONIA are also published on the following business day.

FEEDBACK SOUGHT

18. TMA would like to invite industry stakeholders' feedback to the WGARR's proposed refinements to HONIA as set out in paragraph 17 above. Any other general comments with regard to the latest developments as set out in the paper are also welcome. The TMA plans to issue a paper in due course to summarize the feedback received.

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Annex 1: Specifications of HKD Overnight Index Average (HONIA)

Description	HONIA is the effective overnight (i.e. where repayment is made on the following Hong Kong business day) reference rate of HKD unsecured lending transactions in the Hong Kong interbank market, executed through the panel of contributing brokers.
Benchmark Owner and Administrator	TMA
Calculation Agent	Thomson Reuters
Eligible Transactions	HKD unsecured overnight deal(s) in Hong Kong interbank market, transacted through a contributing broker between 9:00 am and 4:00 pm Hong Kong time on the relevant business day.
Calculation Methodology	Volume-weighted mean of Eligible Transactions
Contributing Brokers	Please refer to Table 1 below
Publication Date	Every Hong Kong business day from Monday to Friday except public holidays. Users should also be aware of the Special Weather Arrangements for the benchmark.
Publication Time	Around 5:00 pm Hong Kong time on every Publication Date
No. of Decimal Points	Rounded to five decimal places
Dissemination	The computed HONIA shall be published on Reuters page <HONIX> and <HONIZ> respectively at around 5:00 pm Hong Kong time. The HONIA Rate is also available on the TMA website on a delay basis .
Special Arrangements	In case of no Eligible Transactions within the transaction window, there will not be a published rate. Users of the benchmarks should include robust contingency arrangements they consider appropriate in their transaction documents, e.g. those promulgated by the International Swaps and Derivatives Association, for situations such as but

	<p>not limited to (i) non-publication of HONIA on a Publication Date; (ii) possible material changes to, or cessation of, HONIA.</p> <p>Users should be aware of the possibility that various factors, including external factors beyond the control of the Administrator, might necessitate material changes to HONIA.</p>
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Table 1: List of Contributing Brokers (*in alphabetical order*)

1. BGC Capital Markets (Hong Kong) Limited
2. ICAP (Hong Kong) Limited
3. Nittan Capital Asia Limited
4. Tradition (Asia) Limited
5. Tullet Prebon (Hong Kong) Limited

Last revised: 15 December 2016