

Hong Kong Moves Closer to Interest Rate Benchmark Reform

The TMA is now consulting on technical refinements to the HONIA, the proposed alternative reference rate to the HIBOR.

Key Points:

- In July 2014, the FSB issued recommendations on reforming interest rate benchmarks, following cases of market manipulation and other misconduct that damaged confidence in the integrity of IBORs, the interest rates at which banks lend to and borrow from one another.
- The FSB recommended its members strengthen IBORs and identify near risk-free rates as ARRs to IBORs.
- The TMA is now consulting on technical refinements to the HONIA, the reference rate that has been chosen as the ARR to the HIBOR.

Overview

Hong Kong's plans for interest rate benchmark reform are continuing to take shape — with the Hong Kong Treasury Markets Association (TMA) identifying the Hong Kong Dollar Overnight Index Average (HONIA) as a new alternative reference (ARR) to the Hong Kong Interbank Offered Rate (HIBOR).

On April 1, 2019, the TMA issued a [consultation paper](#) to solicit feedback on its proposals for technical amendments to HONIA to enhance its “robustness and representativeness.” Unlike HIBOR, HONIA is an overnight interbank interest rate based on actual transaction data and is substantively similar to the ARRs that have been identified for US dollar (USD) London Interbank Offered Rate (LIBOR) and British pound sterling (GBP) LIBOR.

The move toward interest rate benchmark reform reflects recommendations issued by the Financial Stability Board (FSB) in July 2014, following cases of market manipulation and other misconduct that damaged confidence in the integrity of interbank offered rates (IBORs) — the interest rates at which banks lend to and borrow from one another. Specifically, the FSB recommended that its members strengthen IBORs and identify near risk-free rates as ARRs to IBORs.

The Hong Kong Monetary Authority (HKMA) has stated that, while there are currently no plans to discontinue HIBOR, Hong Kong is obliged as an FSB member to follow the international body's recommendation to identify an ARR to HIBOR, which is a widely recognized benchmark by industry stakeholders.

Proposed Technical Modifications to HONIA

The TMA's Working Group on Alternative Reference Rates (Working Group) has proposed technical refinements to HONIA after taking into account the FSB's guiding principles and reviewing the characteristics of the ARR for the LIBOR currencies (USD, EUR, JPY, GBP, and CHF). Specifically, the Working Group has recommended modifying the following processes.

- **Data source:** Currently, HONIA captures overnight interbank funding transactions routed through a number of money brokers. The Working Group has proposed that transaction data for HONIA may be directly collected from the primary source (*i.e.*, the banks), in accordance with similar practices adopted by other major currency areas for their ARRs.
- **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 Working Group suggests extending the reporting window by two hours so that it is open between 08:00 and 17:00 on each Hong Kong business day.
- **Publication time:** HONIA is currently published on a same-day basis. In light of the proposed extension of the reporting window from 08:00 to 17:00 on each Hong Kong business day, the Working Group proposes changing the publication time of HONIA to the following business day so as to allow more time for compilation. This proposed change is consistent with international practice.

The consultation is open for comments until April 30, 2019.

The TMA consultation paper was foreshadowed by a March 5, 2019 [circular](#) issued by the HKMA, in which the HKMA instructed Hong Kong banks to begin preparing for the transition to ARRs.

The HKMA noted that the UK's Financial Conduct Authority has indicated that the LIBOR may discontinue after 2021, and has taken action accordingly to prepare banks. Specifically, the Financial Conduct Authority and the Prudential Regulation Authority have written to banks to remind them to pay attention to the risks associated with transitioning to ARRs.

Implications

Both LIBOR and HIBOR are used extensively in the Hong Kong banking industry. The HKMA estimates that, as of December 2018, HK\$3.8 trillion of Hong Kong-licensed banks' US dollar assets referenced LIBOR while HK\$3.4 trillion of HK dollar assets referenced HIBOR — representing about 36% of Hong Kong-licensed banks' total assets denominated in the two currencies. As such, the ongoing interest rate benchmark reform will have significant implications for banks' businesses, risk management, and operational processes.

In its circular, the HKMA states that banks' preparatory work should cover the following elements:

- Regularly quantifying and monitoring affected exposures
- Identifying and evaluating key risks arising from the reform under different scenarios (including a LIBOR discontinuation scenario)
- Formulating an action plan to manage the risks identified prudently

- Closely monitoring developments related to benchmark reform (both in Hong Kong and internationally), and updating scenarios and action plans as appropriate

Banks' boards of directors should oversee the process and remain informed of the status of preparatory work. As reform efforts further develop, the HKMA may approach banks again to understand their progress and readiness for the transition.

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

Simon Hawkins

simon.hawkins@lw.com
+852.2912.2733
Hong Kong

Kenneth Y.F. Hui

kenneth.hui@lw.com
+852.2912.2711
Hong Kong

You Might Also Be Interested In

[Recent SFC Enforcement Action: 5 Key Takeaways for Hong Kong IPO Sponsors](#)

[Global Developments on Best Execution](#)

[Hong Kong's SFC Issues Significant Announcements on the Regulation of Virtual Assets](#)

Client Alert is published by Latham & Watkins as a news reporting service to clients and other friends. The information contained in this publication should not be construed as legal advice. Should further analysis or explanation of the subject matter be required, please contact the lawyer with whom you normally consult. The invitation to contact is not a solicitation for legal work under the laws of any jurisdiction in which Latham lawyers are not authorized to practice. A complete list of Latham's *Client Alerts* can be found at www.lw.com. If you wish to update your contact details or customize the information you receive from Latham & Watkins, visit <https://www.sites.lwcommunicate.com/5/178/forms-english/subscribe.asp> to subscribe to the firm's global client mailings program.