HONG KONG MONETARY AUTHORITY
香港金融管理局

Our Ref.: B1/15C

5 March 2019

The Chief Executive
All Authorized Institutions

Dear Sir/Madam,

Reform of Interest Rate Benchmarks

I am writing to request authorized institutions (AIs) to make preparations for the transition associated with the interest rate benchmark reform being pursued under the auspices of the Financial Stability Board (FSB).

In the past years, the FSB has been working with authorities and standard-setting bodies to develop reform proposals with a view to enhancing the reliability and robustness of interest rate benchmarks. In the UK, the Financial Conduct Authority has indicated that the London Interbank Offered Rate (LIBOR) may discontinue after the end of 2021 and has, together with the Prudential Regulation Authority, written to banks to remind them to pay attention to the risks associated with the transition to alternative reference rates (ARRs).

As an FSB member, Hong Kong is obliged to follow the FSB's recommendation to identify an ARR to the Hong Kong Interbank Offered Rate (HIBOR), which is a widely recognized benchmark by industry stakeholders. The ARR should be nearly risk-free and should serve as a fall-back for HIBOR. In this connection, the Treasury Market Association (TMA) has proposed to adopt the Hong Kong Dollar Overnight Index Average (HONIA) as the ARR and plans to consult industry stakeholders later in the year.

Both LIBOR and HIBOR are used extensively in the Hong Kong banking industry. It is estimated that, as of December 2018, HK$3.8 trillion of AIs' US dollar assets referenced LIBOR while HK$3.4 trillion of HK dollar assets referenced HIBOR, representing about 36% of AIs' total assets denominated in the two currencies. As such, the ongoing interest rate benchmark reform will have significant implications on AIs' businesses, risk management and operational processes, and the corresponding preparatory work can be substantial and complicated.

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The Hong Kong Monetary Authority (HKMA) considers it important that AIs should start to make preparation for the transition to ARRs in case the need to fall back on such ARRs arises. The preparatory work should cover the following elements:

(i) quantification and monitoring of affected exposures regularly;
(ii) identification and evaluation of key risks arising from the reform under different scenarios (including but not limited to a LIBOR discontinuation scenario);
(iii) formulating an action plan to prudently manage the risks identified; and
(iv) monitoring closely the developments of the benchmark reform both in Hong Kong and internationally and updating the scenarios and action plan as appropriate.

The boards of directors of locally incorporated AIs and the head/regional offices of AIs incorporated overseas should provide oversight of the process and be kept informed of the progress of the preparatory work.

As the reform develops, the HKMA may approach AIs again to understand their progress and readiness for the transition. Should you have any questions about this letter, please contact Mr Peter Cheung on 2878-8537 or Mr Ronald Lam on 2878-8879.

Yours faithfully,

Raymond Chan
Executive Director (Banking Supervision)