Financial Markets Committee (FMC) Meeting
23 July and 3 August 2021
Bank Negara Malaysia

Summary of Discussion

The meeting discussed recent developments and outlook in the financial market amid a resurgence of Covid-19 cases, progress on financial market development initiatives and strategies to further deepen the onshore market.

1. Outlook for the economy and financial markets in 2021

1.1 The meeting noted that global market sentiment continues to be supported by recovery optimism with accelerating but uneven progress of inoculations globally. Meanwhile, the recent inflation spike is largely regarded as transitionary and expected to ease, as supply catches up with pent-up demand. On the domestic front, while the market remains cautious of the pace of economic recovery given the extended lockdown measures, members view that the onshore financial market remains resilient in withstanding periods of market volatility, underpinned by ample domestic liquidity conditions. Activities in the government bond and FX market remain healthy with YTD 2021 daily average trading volume of RM4.3 billion and USD11.5 billion respectively.

1.2 The meeting deliberated on various efforts that could mitigate adverse impact to the domestic market arising from the spread of Covid-19, including potential measures to minimise disruption to the supply chain and manufacturing output in various sectors, the need for continuous partnerships between banks and corporations, and ongoing efforts to facilitate foreign direct investment ("FDI") into the country via greater flexibilities on the Foreign Exchange Policy ("FEP").

2. Progress of market initiatives in 2021

2.1 Development of an Alternative Reference Rate ("ARR"), strategic direction for Kuala Lumpur Interbank Offered Rate ("KLIBOR") and Islamic reference rates

2.1.1 As the steering committee and consultative platform, FMC was presented with the results of the public consultation on ARR, KLIBOR and Kuala Lumpur Islamic Reference Rate ("KLIRR") which concluded on 18th June 2021.

2.1.2 In ensuring the robustness of the consultation process, all relevant responses were taken into consideration and benchmarked to best market practices.

2.1.3 Responses to the public consultation were generally in agreement with the proposed design and key features of the ARR (details in Appendix). To address alternative viewpoints and suggestions, the meeting deliberated further on the following features of the ARR:

i. On the proposed eligible transactions for the calculation of ARR, two options were deliberated:

a. interbank transactions including Bank Negara Malaysia ("BNM") overnight monetary operations ("OMO", excluding Standing Facilities)

b. interbank transactions excluding BNM OMO.

The meeting noted that a minority of respondents (18%) preferred to exclude the BNM OMO on the basis that it does not reflect the true borrowing cost in the market and is one-sided in nature. However, BNM OMO is based on a transparent market auction and participation is not mandatory. Therefore, the meeting decided that inclusion of BNM OMO would result in a more robust and reflective benchmark as it fulfils the criteria of a quality benchmark rate based on size, liquidity and data sufficiency. Furthermore, the daily squaring of surplus positions with BNM is a key part of banks' Asset and Liability Management (ALM) strategy.

ii. On contingency arrangements, the meeting agreed to adopt an improved methodology to reflect Overnight Policy Rate ("OPR") changes by referencing the OPR with a 3-day historical spread between the ARR and OPR, instead of a 3-day simple average ARR.

iii. The meeting acknowledged requests for earlier error reporting and republication cut-off times to facilitate orderly payment and settlement for any potential re-fixing of ARR. The meeting discussed and agreed on error reporting by 12 p.m., notification on potential republication by 1 p.m. and republication by 2 p.m. In the absence of a notification, participants could proceed with trade confirmation or settlement after 1 p.m.

2.1.4 The meeting noted that while a strong majority of respondents supported the discontinuation of the least referenced 2-month (89%) and 12-month (85%) KLIBOR tenors, respondents preferred to maintain the 6-month tenor for hedging and product pricing. For the 2 and 12-month tenors, the affected institutions confirmed that they are able to resolve outstanding exposures by 1st January 2023. As such, the meeting agreed to announce the discontinuation of the 2 and 12-month KLIBOR tenors in September 2021 with an effective date of 1st January 2023. In

addition, to cater for the unlikely event that there may be residual exposures to these tenors, the meeting also agreed for the 2M and 12M KLIBOR to incorporate generic fallback provisions. As BNM does not intend to nominate a fallback rate for the 2M and 12M KLIBOR, the fallbacks will effectively be determined either through mutual agreement between the parties or by the calculation agent.

2.1.5 On KLIBOR derivatives fallbacks for the remaining active tenors (i.e. the 1, 3 and 6 months), the meeting agreed with the proposed adoption of the ISDA[1] methodology, engagement with Bloomberg on the publication of fallback rates and the inclusion of KLIBOR in a new ISDA IBOR Fallbacks Protocol, supported by unanimous interest of respondents to adhere to the new Protocol as well as a positive review of the methodology by the Malaysia Competition Commission ("MyCC"). Given that the ISDA IBOR Fallbacks Protocol will only apply to conventional derivatives transacted under the existing ISDA Master Agreement, the meeting decided to maintain the current scope on conventional derivatives and focus efforts on ensuring KLIBOR's timely inclusion in the new Protocol tentatively by end-2021 (subject to negotiations with ISDA). The meeting also recommended for financial institutions to continue engaging clients to improve market awareness and understanding of these fallbacks.

2.1.6 The meeting noted that an overwhelming majority (95%) of respondents supported the discontinuation of KLIRR, citing limited interests for KLIRR-based financial contracts. The meeting agreed with the joint AIBIM-FMAM[2] Islamic Market Technical and Development Committee ("IMTDC")'s recommendation for the replacement of KLIRR with a new Islamic benchmark rate, which will be announced in September 2021. The effective date will be confirmed by the IMTDC upon finalisation of the Islamic benchmark rate's design and requirements[3] prior to the announcement.

2.1.7 The meeting discussed the overall roadmap and communications strategy for KLIBOR transition and development of an Islamic benchmark rate. The meeting agreed to an end-September announcement covering the launch of the new ARR (Malaysia Overnight Rate – MYOR), 2 and 12-month KLIBOR discontinuation and their

[1] International Swaps and Derivatives Association
[2] AIBIM = Association of Islamic Banking and Financial Institutions Malaysia
FMAM = Financial Markets Association Malaysia
[3] Includes eligible transactions, calculation methodology, Shariah permissibility, data sources and other operational requirements

fallbacks, and the replacement of KLIRR with the new Islamic benchmark rate.

2.1.8 The meeting noted that FMAM has sought its legal counsel's opinion on Collateralised Commodity Murabahah ("CCM") and Sell and Buy Back Agreement ("SBBA") to address concerns on their enforceability and close-out netting status, among others. The legal opinion is expected to be issued in Q3 2021, and the meeting agreed for BNM's feedback to be sought prior to the issuance.

2.2 Dual currency investment ("DCI") products for retail investors

2.2.1 The meeting was apprised of findings from a recent market survey which indicated the popularity of DCI products among resident individual investors.

2.2.2 Members deliberated on FEP refinement options that could support the growth and development of products offerings in the onshore wealth management market, as well as the potential compliance costs across the refinement options.

3. Enhancing and further deepening the onshore financial market

3.1 Progress update on liberalisation of interest rate swap ("IRS") market

3.1.1 The meeting noted that onshore IRS activity continues to gain traction following the introduction of flexibility to transact ringgit-denominated IRS without underlying on 15 March 2021, with a notional volume of RM49.5 billion transacted between onshore banks and non-residents year-to-date as at May 2021.

3.1.2 Members noted that recent trading and hedging interests have been primarily driven by developments in the global and domestic bond market and viewed the improving liquidity in the onshore IRS market as a positive and timely development which facilitate risk management activities in this period of heightened volatility in bond yields.

3.2 Clarification on regulatory treatment for cleared transactions with a Central Counterparty ("CCP")

3.2.1 Members highlighted that the Bank's requirements on the Single Counterparty Customer Limit (SCEL) and the capital framework for clearing derivatives transactions via clearing members constrained the banks' ability to facilitate onshore derivatives transactions.

3.2.2 FMAM will provide its proposals in relation to derivatives exposure of banks as part of the Bank's ongoing implementation of the various components of the Basel III framework.

3.3 Growth opportunities in sustainable financing

3.3.1 Members shared that sustainable investing has gained significant traction globally in recent years with a widened investor base in the sustainable fixed income market.

3.3.2 Members collectively expressed strong demand for local currency Sustainability bond and sukuk by the government and private sectors, as well as the further development of domestic sustainability rating agencies and review providers.

3.4 Progress on trade repository

3.4.1 Securities Commission Malaysia ("SC") provided an update on the status of trade repository infrastructure and noted that extended timeline was needed to evaluate the proposals to cater for all types of products including Islamic derivatives. SC targets to finalise the proposal by end Q32021.

3.4.2 Members noted the current progress and FMAM further recommended for a consolidated reporting infrastructure to relevant regulators to enhance efficiency.

Appendix

Key features and design of ARR

No.	Type	Details
1	Name	Malaysia Overnight Rate (MYOR)
2	Administrator and Calculator	BNM
3	Calculation Methodology	Volume-weighted average rate of unsecured overnight MYR interbank transactions comprising: i) Wholesale unsecured deposits between interbank institutions (includes both brokered and direct/bilateral) ii) BNM's overnight monetary operations, excluding Standing Facilities
4	Rounding Precision	Rounded to two decimal places
5	Data Sources	Real-time Electronic Transfer of Funds and Securities System (RENTAS)
6	Data Collection Window	All eligible transactions done throughout the entire business day (i.e. until RENTAS closes at 6 p.m.)
7	Publication	10 a.m. Kuala Lumpur time on the next business day on BNM's website
8	Erroneous data and republication	Republication if erroneous rate is more than 2 basis points away from the correct rate and erroneous data is identified or reported by 12 p.m. on publication day. A notification on potential republication due to erroneous data will be available by 1 p.m., with republication (if any) by 2 p.m. on the same day.
9	Contingency Arrangements	Short-term disruption: OPR + historical 3-day spread between ARR and OPR Prolonged disruption/exceptional circumstances: BNM to determine the appropriate contingency rate