Update on the Jibar transition plan

prepared by

The Market Practitioners Group's
Transition Planning and Coordination
Workstream

South African Reserve Bank

ABBREVIATIONS

ARR	alternative reference rate
CMW	Cash Market Workstream
FSB	Financial Stability Board
FSCA	Financial Sector Conduct Authority
IBOR	interbank offered rates
ISDA	International Swaps and Derivatives Association
Jibar	Johannesburg Interbank Average Rate
Libor	London Interbank Offered Rate
MPG	Market Practitioners Group
OIS	overnight indexed swap
ONRR	overnight reference rate
TPCW	Transition Planning and Coordination Workstream
SARB	South African Reserve Bank
ZAR	South African rand
ZARONIA	South African Rand Overnight Index Average

1. EXECUTIVE SUMMARY

The transition plan defines the trajectory of the transition away from the Johannesburg Interbank Average Rate (Jibar), having considered the best practice recommendations that have emerged through similar offshore transitions and taking into account the structure of the South African financial markets. The transition plan comprises three pillars that encapsulate the critical milestones that market participants would need to meet along the transition path, with input from the Market Practitioners Group (MPG) and industry.

In preparing the transition plan, the Transition Planning and Coordination Workstream (TPCW) relied heavily on the best practices developed through the recently completed transition away from the London Interbank Offered Rate (Libor). The transition timeline, although ambitious, is achievable. Market participants need to engage actively with transition efforts underway and ventilate issues requiring further consideration expeditiously.

2. BACKGROUND

The highly publicised irregularities relating to the production of interbank offered rates (IBORs) in 2012 prompted a global regulatory response to reform major interest rate benchmarks. The use of IBORs within financial markets has subsequently reduced substantially in favour of more robust alternative reference rates (ARRs), namely overnight reference rates (ONRRs) that are near risk-free. The global financial market has recently successfully completed the transition away from Libor, with 31 Libor settings having now ceased permanently.

South Africa has also embarked on a transition journey with the release of a consultative paper prepared by the South African Reserve Bank (SARB), detailing its initial proposal to reform domestic benchmark and reference rates.[1] The SARB subsequently formed the MPG in 2019 to manage the process of adoption and transition to a new overnight interest rate, the South African Rand Overnight Index Average (ZARONIA). The MPG is a joint public and private sector body, comprising representatives from the SARB, the Financial Sector Conduct Authority (FSCA) and

[1] More information around the relevant papers may be accessed at: https://www.resbank.co.za/en/home/what-we-do/financial-markets/financial-markets-market-practitioners-group

senior professionals from a variety of market interest groups active in the domestic capital and loan markets.

Through its various publications and statements to the market, the SARB has expressed that the discontinuation of Jibar is a certainty and that market participants should take appropriate action to transition away from Jibar[2]. ZARONIA, the MPG's preferred successor rate to replace Jibar, reflects the interest rate at which rand-denominated overnight wholesale funds are obtained by commercial banks. It is based on actual transactions and calculated as a trimmed, volume-weighted mean of interest rates paid on eligible unsecured overnight deposits. ZARONIA is published by the SARB on every South African business day.[3]

Given that Jibar is deeply embedded in the domestic financial system, the Jibar transition is bound to be complex and to require co-ordinated effort across all market players. As such, the MPG mandated the TPCW to examine options for transitioning from legacy reference interest rates to designated successor rates, identify key transition risks and mitigants, and provide final recommendations to the MPG on the steps and timelines of the transition.

It is important that market participants have clarity on the transition roadmap and their responsibility towards making it a success. The TPCW has prepared this document to provide market participants with the information they may need to adequately prepare for Jibar's cessation. Recognising the importance of widespread agreement on the transition path, the TPCW consulted extensively through industry engagement and considered best practices that emerged through similar offshore transitions to formulate the Jibar transition plan[4].

This document is provided for informational purposes only and does not constitute legal, accounting or financial advice and is not exhaustive. Given the potential impact of the Jibar cessation across the South African (and potentially other) financial markets,

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[2] Please note that this publication does not constitute a termination announcement for purposes of contractual fallbacks (refer to notes on milestone 7 of the transition timeline on page 14).

[3] For more detail on ZARONIA and the relevant technical specifications, visit the SARB website at https://www.resbank.co.za/en/home/what-we-do/financial-markets/south-african-overnight-index-average

[4] The TPCW leaned heavily on the work completed to date by the Financial Stability Board (FSB) and the various official offshore transition working groups, as well as on the approaches adopted by the Sterling Working Group on Risk Free Reference Rates.

this document is intended to be a 'living document' that may need to be amended as novel risks or transition impacts present themselves.

3. JIBAR TRANSITION APPROACH

The Jibar transition path is largely informed by several strategic decisions taken by the MPG, including that the preferred route for the South African market entailed strengthening Jibar to ensure that it remained a credible benchmark while the market developed an alternative rate. Consequently, the period for the 'parallel run' between the legacy and new/replacement rate will afford the South African market the opportunity to gradually adopt ZARONIA where feasible, while still having the option of relying on Jibar.

Further, in line with international practice, the MPG intends to catalyse the broad adoption of ZARONIA in the South African market and not wait for a viable forward-looking term rate to be developed based on this overnight rate. Although it remains a possibility that these term rates may be developed at a later stage, the absence of a forward-looking term rate should not be seen as an impediment to the adoption of ZARONIA.[5]

The formulation of the transition path considered the report of the FSB (2014), which dealt with both the reform of existing benchmarks and approaches to the adoption of new benchmarks[6]. In relation to the adoption process, the FSB report recommended some key actions, including an initial focus on derivatives markets and encouraging a substantial portion of new contracts to be written in the new rate, thereby increasing liquidity and reducing transaction costs. The initial focus on derivatives markets was considered appropriate as derivatives securities tend to be better suited to reference rates that are credit risk-free or nearly risk-free.[7] The relative ease of transition in this market could then serve to assist the transition in other markets. Once a critical mass

[5] All jurisdictions that have transitioned away from legacy rates have selected overnight rates as replacements for existing legacy term rates. There has been much debate and discussion about the need for term rates based on these overnight successor rates going forward, based on the fundamental structural differences between term and overnight rates (interest payments for financial products typically occur at less frequent intervals and term benchmarks allow payment certainty as cash flows are known in advance). Both the United States and United Kingdom have recognised the need for a forward-looking term rate based on the overnight rate and subsequently endorsed such rates; however, both regulators consider that the use of these term rates should be exceptional.

[6]Reforming Major Interest Rate Benchmarks, available at https://www.fsb.org/wp-content/uploads/r_140722.pdf

[7] According to the FSB Report, "…[this] may reflect, in part, an expectation of continued greater reliance on secured funding as well as ongoing structural changes in derivatives markets requiring greater use of collateral and shifts to central clearing." See page 10, note 1.

of contracts using the new rate has been achieved, the FSB report recommends that the focus is shifted to incentivising the conversion of legacy contracts to the new rate.

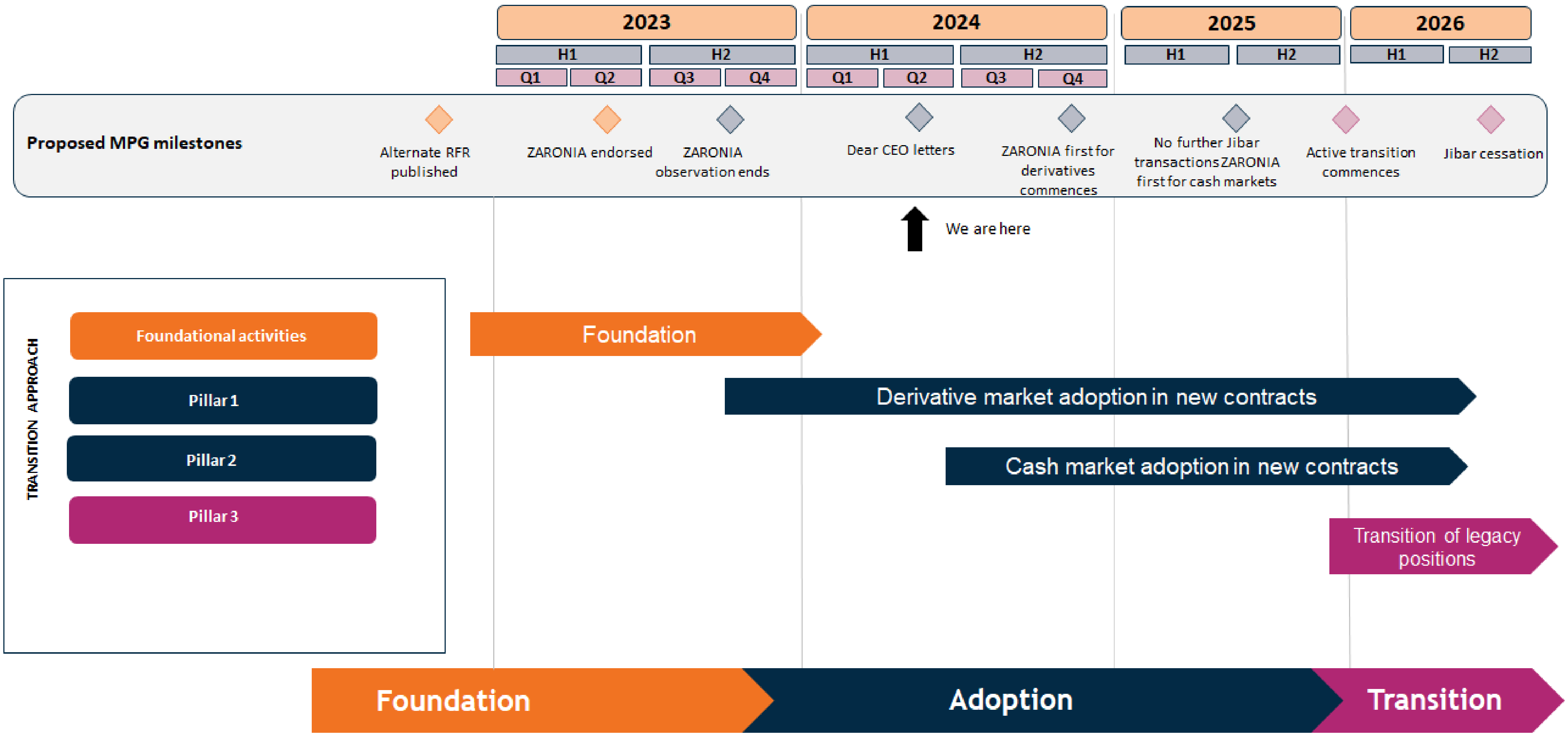
As such, a high-level transition path for the South African market was defined along three key pillars as follows:

- Pillar 1: Adoption in derivatives markets (new contracts/positions);
- Pillar 2: Adoption in cash markets (new contracts/positions); and
- Pillar 3: Transition of legacy positions.

We have included a graphical representation of the three pillars on the next page.[8]

[8] This representation was shared with the market at the inaugural MPG Conference held in April 2023.

MPG Transition Approach (Pillars)



3.1 PILLAR 1 – ADOPTION IN DERIVATIVES MARKETS

The first key activity under Pillar 1 will be the establishment of a South African rand (ZAR) overnight indexed swap (OIS) market. This will require that the existing ZAR interest rate swap market transition to an OIS market.

The Derivatives Workstream of the MPG has been mandated with making recommendations on the development of ZARONIA derivatives markets and to consider strategies for market adoption. To this end, the Derivatives Workstream consulted on and recommended market conventions for ZARONIA-based derivatives (on-the-run overnight indexed swap) in its September 2023 white paper.[9] The aim of these conventions is to support the initiation of a voluntary ZARONIA derivatives market through the recommendation of conventions that may be adopted by the market. This white paper is a valuable resource for market participants to consider when using ZARONIA in the specification of derivatives contracts.

A further catalyst to the adoption of ZARONIA in new derivatives contracts is the inclusion of ZARONIA into the 2021 Interest Rate Derivatives Definitions and related Floating Rate Matrix published by the International Swaps and Derivatives Association (ISDA). This means that ZARONIA is available as a floating rate option in new derivatives contracts incorporating these definitions.

The publication of the derivatives white paper, the amendment of the 2021 Interest Rate Derivatives Definitions and the end of the ZARONIA observation period on 3 November 2023, are all critical steps for Pillar 1 and will support the establishment of a liquid ZARONIA derivatives market, which is an important foundation for a successful transition.

3.2 PILLAR 2 – ADOPTION IN CASH MARKETS

As the demand for derivatives stems in part from the hedging of underlying instruments, Pillar 2 focuses on catalysing the potential use of ZARONIA in a broader set of instruments, outside of the derivatives markets (often referred to under the nebulous term ‘cash market’). In general, due to the nuances associated with this market, the

[9] The final conventions, including a practical guide and worked examples, may be accessed on the SARB website: https://www.resbank.co.za/en/home/publications/publication-detail-pages/media-releases/2023/Market-conventions-for-ZARONIA-based-derivatives0

cash market adoption of successor rates has lagged derivatives market adoption in most offshore transitions.

In line with the recommendations that non-derivatives markets require specific consideration, a dedicated Cash Market Workstream (CMW) has been constituted and mandated to make recommendations on the adoption of ZARONIA in cash market products, including developing appropriate market conventions and overcoming transition barriers. To reflect South African market realities, this workstream has established subgroups to focus on the different needs of the loan, bond and money markets respectively.

For cash markets to function efficiently, market participants need a standard set of conventions for the use of ZARONIA, given that it is a daily backward-looking, overnight near risk-free rate, whereas Jibar is a forward-looking term rate with various tenors and includes a credit and liquidity premium. The CMW embarked upon a process to formulate a set of recommended conventions for these markets and has published market conventions for ZARONIA-linked loan market instruments, ZARONIA-linked money market instruments and ZARONIA-linked bond market instruments.[10]

The recommendations set out in the relevant papers are intended to serve as the basis for new cash market instruments that reference ZARONIA and that can be incorporated into legal agreements. These working papers are a valuable resource for cash market participants to consider when using ZARONIA in the respective products.

3.3 PILLAR 3 – TRANSITION OF LEGACY POSITIONS

Since Jibar is set to cease indefinitely after a defined transition period, there will be a need to migrate legacy contracts away from Jibar, where these contracts are set to continue post Jibar's determined cessation date. Pillar 3 focuses on the transition of legacy contracts and an investigation of the feasibility of converting existing Jibar-linked products to ZARONIA.

[10] All relevant papers are published on the SARB website and may be accessed here: https://www.resbank.co.za/en/home/what-we-do/financial-markets/financial-markets-market-practitioners-group/Market_Practitioners_Group_Publications

The transition of legacy contracts received significant focus through the course of offshore transitions, given the cliff-edge effects that may result from a disorderly transition.

This would include breach of contract where appropriate fallback clauses were not included in legacy contracts.

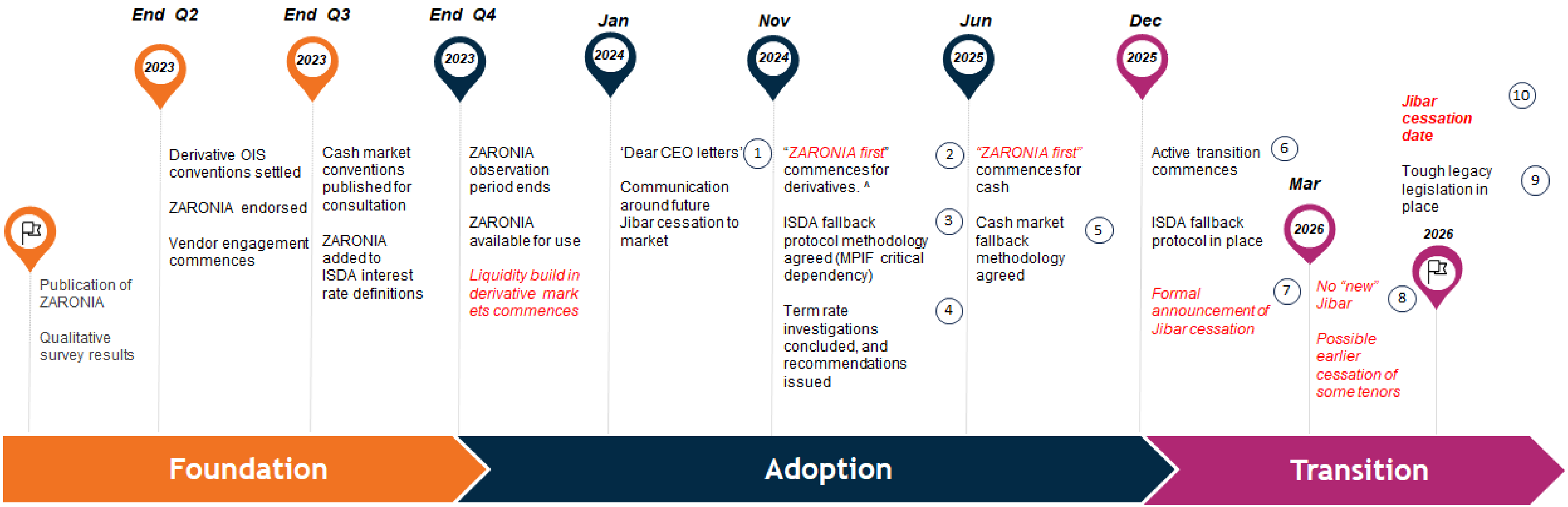
It is important to emphasise that while these three pillars do represent defined phases along the transition path, it is not the intention that they run consecutively. Instead, relevant investigations may be running in parallel. For example, while derivatives liquidity is a necessary precondition for a successful transition, this has not precluded the CMW from defining its conventions. In a similar vein, while the transition of legacy positions is the final transition phase, important work has already commenced at the MPG to ensure that due consideration is given to the steps that may be necessary to facilitate the conversion of legacy positions, including:

- an analysis of potential legislative 'safe harbours' that may be required to ensure contractual continuity where legacy contracts have not been amended prior to Jibar's cessation;
- engagement around 'spreads' that may need to be added when a legacy Jibar-referencing product is converted to a ZARONIA-referencing product (intended to account for the structural differences between these rates);
- recommendation of fallback language that may be proactively included into contracts, prepared by the Legal Workstream of the MPG; and
- analysis of governance and regulatory issues that may arise through transition.

Essentially the three pillars unpack the building blocks that will facilitate the creation of new products and markets in the successor rate and the conversion of existing Jibar exposures, both of which are essential to phasing out Jibar. Furthermore, they assist in identifying the key intermediate steps and milestones that are necessary under each pillar, and hence, they formed the basis for the Jibar transition timeline.

4. JIBAR TRANSITION TIMELINE

The Jibar transition timeline is shown below in Figure 2. Every effort has been made to produce and reflect realistic transition milestones based on the information available. Importantly, the Jibar transition timeline indicates that it would be appropriate that a formal announcement of the cessation of Jibar be made during 2025 and the production of the benchmark should be discontinued before the end of 2026. The SARB, as the administrator for Jibar, will determine the exact dates for the Jibar cessation announcement and the actual cessation of the benchmark.



^ May be dependent on a clearable ZARONIA product offering

*Term rate endorsed and available, pending confirmation

We appreciate that not all market participants may have had an opportunity to engage with the transition plan in detail prior to this publication, nor may have had prior experience with the language associated with the transition of reference rates. We have set out below a high-level summary of upcoming milestones:

1. '**Dear CEO letters**' – refers to letters to be sent by the SARB to the CEOs of financial services firms (banks, insurers, asset managers) setting out the SARBs expectations of firms in managing the Jibar cessation and possibly requesting feedback from firms detailing the preparations that they are undertaking to manage the transition. This letter will confirm the intention that Jibar will cease permanently after a defined period.
2. '**ZARONIA first**' – refers to a phased initiative for switching trading conventions from Jibar to ZARONIA, designed to support market participants decrease their reliance on Jibar over time. As with offshore transitions, this is likely to commence in derivatives markets first. The Derivatives Workstream is tasked with recommending the appropriate phasing of this initiative in the derivatives markets (for example, starting with linear derivatives and then moving on to non-linear derivatives over time).
3. '**ISDA fallback protocol methodology agreed**' – ISDA has consulted widely in developing the IBOR Fallbacks Supplement and the IBOR Fallbacks Protocol to support market participants in their transition away from relevant IBOR rates in legacy contracts/positions. ISDA has also developed a methodology to fallback to an adjusted risk-free rate for each currency to reflect the fact that the relevant IBOR is a term rate and to factor in the bank credit risk premiums and other factors embedded into the rate. It is necessary that the MPG investigates and confirms that this methodology is appropriate for the South African market. If not, alternative recommendations will need to be made.
4. '**Term rate investigations concluded and recommendations made**' – at this stage, the intention of the MPG is to catalyse a broad-based adoption of ZARONIA across South African financial markets. To this end, market participants are encouraged to transition to the overnight ZARONIA as recommended in the relevant published market conventions and not to wait for the possible development of a ZARONIA term rate. The CMW is tasked with investigating whether there is a need for a ZARONIA term rate and making recommendations around the scope of usage and potential limitations. Should

such a rate be recommended, then work will commence around the methodology to calculate it. If not, then a term rate will not be developed at this stage (if at all).

5. '**Cash market fallback methodology agreed**' – similar to the ISDA fallbacks referenced above but denoting the agreement around the appropriate methodology to transition legacy Jibar referencing cash market contracts/positions. Since cash markets tend to lag derivatives markets, some time is allocated post settling of the derivatives markets fallback methodologies for these cash market fallbacks.
6. '**Active transition commences**' – denotes proactively transitioning legacy Jibar positions to reference ZARONIA prior to Jibar's cessation, either with immediate effect or at a specified date. This is intended to help firms to reduce resource constraints at the cessation date and to ensure their preparedness for the cessation of Jibar. This may be considered more robust than a passive transition approach through the inclusion of contractual fallback language that is triggered on cessation date and may help to mitigate operational risk that may arise from transitioning a large volume of exposures on a single day.
7. '**Formal announcement of Jibar cessation**' – while market participants are aware of the SARB's intention of ceasing Jibar at some point in the future, this public announcement will provide an exact cessation date to the market. This statement will engage certain contractual triggers for the calculation and future application of fallbacks that are activated by pre-cessation or cessation announcements (as included in the ISDA IBOR Fallbacks Supplement and the IBOR Fallbacks Protocol). The date of this announcement will be a 'Spread Adjustment Fixing Date'.[11] Furthermore, there will be a range of further financial accounting and disclosure, tax and other legal considerations for firms to consider following a formal cessation announcement.
8. **'No 'new' Jibar'** – denotes a directive from the SARB that no new Jibar referencing contracts may be written from this date. The intention is to ensure that firms are not adding to the Jibar exposure that will have to be transitioned at cessation date, thereby aggravating possible cliff-edge effects.

[11] On the assumption that the ISDA IBOR Fallbacks Supplement and the IBOR Fallbacks Protocol are applied/adopted in their current form to the Jibar transition.

9. '**Tough legacy legislation in place**' – refers to relevant legislative safe harbours or savings provisions that will need to be enacted by the cessation date to reduce any disruption to contracts that have not been successfully transitioned by this date. There may be various legitimate reasons for market participants to fail to amend contracts in time and it will be necessary to ensure contractual continuity in these circumstances.
10. '**Jibar cessation date**' – refers to the date at which Jibar ceases to be made available to the market. No further publication of Jibar will occur post cessation date.

5. QUALITATIVE SURVEY

The TPCW appreciates that for any transition to succeed, the market should reach broad consensus, with an understanding on how to achieve our aims as transition progresses. It is also essential that any specific issues highlighted by market participants are adequately addressed. To this end, the TPCW conducted a market-wide survey with the aim of understanding and ventilating market participants' concerns as well as to understand the support for a transition plan that hinges on these three pillars. The responses from the detailed qualitative survey were considered in defining the transition trajectory as outlined in this document.

6. CONCLUSION

The transition plan maps out a clear and achievable strategy for creating robust demand for trading ZARONIA derivatives and ultimately catalysing the broader adoption of ZARONIA. However, as already noted, the plan can only be successfully implemented if South African market participants recognise their own interest in voluntarily helping to establish markets for ZARONIA instruments and building a critical mass of liquidity in them. As witnessed through the course of the recently completed Libor transition, transitioning away from Jibar will pose many challenges. However, it should be possible to transition in a way that minimises serious market disruptions if market participants work diligently and cooperatively to avoid them.

The timeline provided in this paper depicts a high-level overview of the many steps involved in transitioning away from Jibar. Each milestone will take considerable work to implement and requires commitment from all market participants.