Deloitte.

The end of JIBAR is nearing

Time to take action

Since the 1990s the Johannesburg Interbank Average Rate (JIBAR) has been the most prominent benchmark interest rate in the South African institutional financial markets. Nearly every interest rate bearing product or derivative has some reference or exposure to JIBAR. Soon that will no longer be the case as momentum is gathering to transition away from JIBAR to a new benchmark interest rate, in line with global best practice. The implications of this transition span across operations, legal, risk management, reporting and finance.

This article provides treasurers with guidance to steer their organisations through this transition, while minimising disruptions to the management of the derivative and debt portfolios.

The implications of this transition span across operations, legal, risk management, reporting and finance.

Buildup to the current landscape

In July 2017, Andrew Bailey, Chief Executive of the Financial Conduct Authority (FCA) in the United Kingdom (UK), announced the transition away from the London Interbank Offered Rate (LIBOR or more generally IBOR) during a speech at Bloomberg London.[1] IBORs at the time, were the key interest rate indexes used in calculating the interest rate for loans, bonds, derivatives and other financial contracts. This move came after it was found that IBORs were susceptible to manipulation, as they are not based on actual interbank transactions, but rather on indicative rates that panel banks were willing to pay for funding.

In South Africa, the South African Reserve Bank (SARB) commenced the local reform journey in 2018, issuing the *Consultation paper on selected interest rate benchmarks in South Africa*.[2] The SARB also established a joint public and private sector body, namely the Market Practitioners Group (MPG). This body has been tasked with forging the way forward for the local interest rate benchmark reforms, including a replacement rate for JIBAR, by developing a local transition plan for the industry. Key considerations of the transition plan would include the legal, operational, valuation, accounting and tax implications of the move to a new interest rate benchmark.

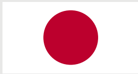
In September 2022, the SARB started the publication of the South African Overnight Index Average (ZARONIA),[3] the proposed replacement rate for JIBAR, for industry observation. The transition from observation to adoption is expected to occur later this year, which may also coincide with the announcement of a cessation date for JIBAR and the endorsement of ZARONIA.

Recent changes and the impact of new reference rates

Globally, IBOR underpinned approximately US$350 trillion in financial products and was one of the most significant reference rates used by financial market participants[4]. Since 2021, the cessation of major IBORs commenced. For example, the cessation of USD-LIBOR concluded at the end of June 2023[5]. Figure 1 outlines the reference rates and rate economics adopted by a selection of regions, as well as South Africa.

Like South Africa, other smaller economies such as Poland are also on the journey to review, strengthen, and in some instances, replace their current IBOR-style reference rates with a more robust alternative.

Figure 1. Key alternative risk-free rates replacing IBORs by region

Region	Reference rate	Rate economics	Administrator
	Sterling Overnight Index Average (SONIA)	Unsecured borrowing	Bank of England (BoE)
	Secured Overnight Financing Rate (SOFR)	Secured borrowing	Federal Reserve Bank of New York
	Euro Short-Term Rate (€STR)	Unsecured borrowing	European Central Bank (ECB)
	Swiss Average Rate Overnight (SARON)	Secured borrowing	SIX Swiss Exchange
	Tokyo Overnight Average Rate (TONA)	Unsecured borrowing	Bank of Japan (BoJ)
	South African Overnight Index Average (ZARONIA)	Unsecured borrowing	South African Reserve Bank (SARB)

Sources: Deloitte LLP, LIBOR transition – Setting your firm up for success, 2018; Deloitte Africa research, 2022

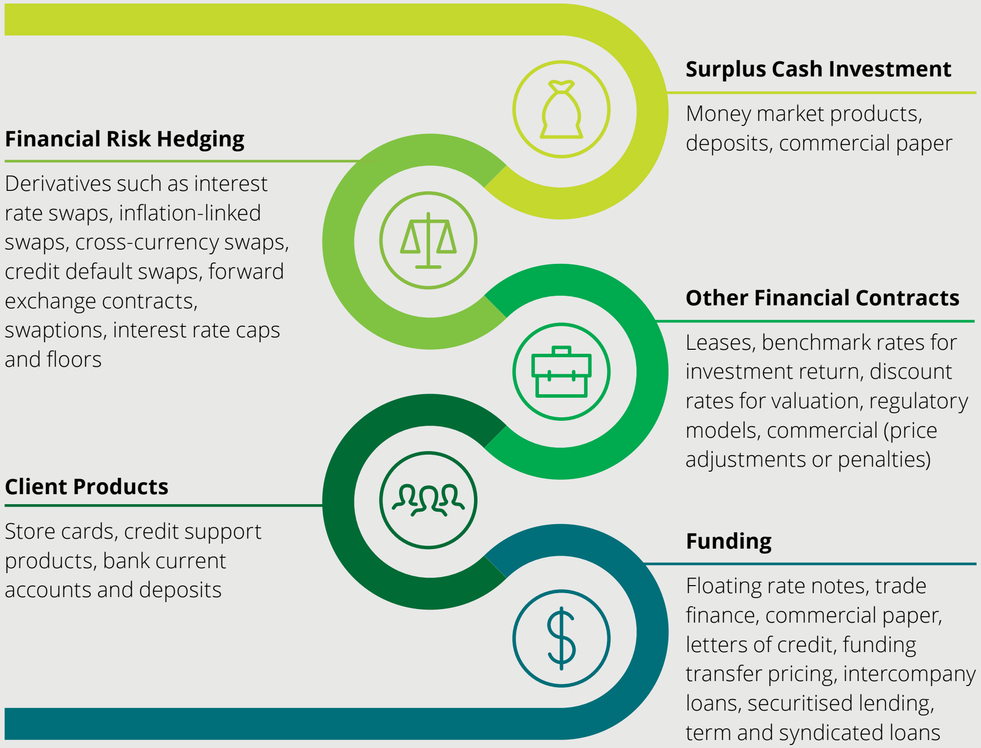
> "The SARB would prefer a relatively short JIBAR transition period. Therefore, market participants are encouraged to actively transition as soon as possible to avoid what was witnessed during the Libor transition."
>
> **Dr Rashad Cassim, Deputy Governor of the SARB, Market Practitioners Group Conference, 2023**

1 The future of Libor, Speech by Andrew Bailey, Chief Executive of the FCA, at Bloomberg London, 27 July 2017.
2 South African Reserve Bank, 2018. Consultation paper on selected interest rate benchmarks in South Africa, 28 August 2018.
3 Available on the SARB website (resbank.co.za) – https://www.resbank.co.za/en/home/what-we-do/financial-markets/south-african-overnight-index-average.
4 Report, ICE Benchmark Administration, March 2016.
5 Financial Conduct Authority, March 2021. FCA announcement on future cessation and loss of representativeness of the LIBOR benchmarks

Within South Africa, the pricing of many financial instruments is tied to JIBAR. Therefore, the replacement of JIBAR with ZARONIA will impact a range of derivatives, debt and investment instruments, as well as other contracts (see Figure 2).

It is important to appreciate that where JIBAR is a polled rate and forward-looking in nature, ZARONIA is based on actual overnight deposit rates and therefore backward-looking in nature. This feature of ZARONIA is fundamentally different from how JIBAR is used in interest calculations. These changes will have significant implications for corporates' operations and risk management. For example, the ability to know and plan for cash movements well in advance where they are based on JIBAR will no longer be possible. Also, where payments are based on ZARONIA the exact amount will only be known mere days before a cashflow falls due.

Figure 2. Different instrument types impacted by the introduction of a new benchmark rate



Source: Deloitte research

Preparing for transition

During the MPG conference held on 19 April 2023, SARB Deputy Governor Dr Rashad Cassim indicated that the observation period of ZARONIA is due to end on 31 October 2023, which will be followed by a period of adoption, signalling the early stages of transition away from JIBAR. In his speech, Dr Cassim stated that the SARB would prefer a short transition period, encouraging market participants to actively transition as soon as possible.[6]

To ready organisations for this transition will require establishing a comprehensive organisational transition plan that considers the key activities within legal, operational, financial and risk management processes and reporting. An overview of the key activities for such a transition is outlined below.

1. Measuring reference rate exposure

Undertake an impact assessment of the current exposure to JIBAR to identify the exposure quantum, raise awareness of the transition impact and prioritise practical next steps.

- Include all external and internal borrowing and funding commitments, derivatives, cash pooling, leases and other contracts or models that reference JIBAR, assessing the spreads and maturities.
- Assess proposals presented by banks and other counterparties for amendments to contractual interest rates (e.g., from JIBAR to ZARONIA plus a spread) to ascertain that these are fair and do not result in losses due to the inclusion of other factors in the spread.

2. Re-papering or re-contracting

Review documentation to identify any fallback provisions or any contractual terms that may enable transition without the need for renegotiation of contracts after JIBAR ceases.

- Engage early in understanding the potential impact on contracts and plan changes to existing contracts accordingly. Any intercompany arrangements should also be included in this assessment.
- Future-proof new contracts by considering the wording and prepare fallback provisions in all new contracts referencing JIBAR.

6 Remarks by Dr Rashad Cassim, Deputy Governor of the SARB, at the Market Practitioners Group Conference, The Galleria, Sandton on 19 April 2023.

3. Economics

Understand the impact that ZARONIA will have on the contract terms and thus the contractual cash flows, and the impact this may have on hedging instruments, as well as key reporting metrics.

- Consider whether the change to ZARONIA requires a change in the funding or hedging instruments. For example, if hedging a floating rate loan that will reference ZARONIA in future, the corresponding interest rate swap should change to ZARONIA at the same time to avoid the introduction of basis risk and hedging ineffectiveness.
- The new benchmark rate may not be consistently adopted across all types of financial contracts and therefore an economic mismatch could arise between a derivative and the underlying hedged exposure.
- Special attention should be given to potential basis risk that will arise from contracts with different currency reference rates, such as cross-currency swaps. Many of these contracts are already subjected to deviations as IBORs have already been phased out, while the ZAR legs will still reference JIBAR, and may already have basis risk management strategies in place, which will need to be revisited.

4. Financial reporting

The reference rate reform introduces several direct and indirect financial reporting implications that require careful assessment.

The International Accounting Standards Board (IASB) identified two groups of accounting issues related to the reference rate reform that could impact financial reporting:

- Pre-replacement issues – these are issues affecting the accounting in the period before the terms of financial instruments are modified and specifically affect entities that apply hedge accounting.
- Replacement issues – these are issues that might affect the accounting when an existing interest rate benchmark is either reformed or replaced.

Specific amendments to the accounting standards were introduced to deal with the two groups of issues. The amendments are aimed at helping entities to provide investors with useful information about the effects of the reform on those entities financial statements.

As a result, once an entity has identified the scope of reference rate exposure, it is important to consider the application of the relevant accounting amendments and the related effects on reported financial results. This understanding will support the decisions made in the transition process and ensure adequate preparation to adopt the relevant accounting requirements.

5. Systems, processes and controls

The transition may necessitate changes to internal systems, processes and controls.

- Identify all processes, systems and controls impacted by the change. For example, systems may need to be updated with ZARONIA curves for trade execution, capture, settlement, valuation and hedge accounting. This will have implications for the associated processes and controls and may introduce new risks.
- Systems, pricing modules and processes will also need to be adapted to cater for the new rate conventions associated with an overnight rate, compared to the term version of JIBAR rates. Special attention should be given to the rate convention prevalent for each market, as it is being published. (The MPG published a white paper on the market conventions for ZARONIA-based derivative instruments in January 2023.[7])
- Any valuation models that use JIBAR as an assumption will also need to be updated for the replacement rate (including related calculation changes required when moving from a term rate (JIBAR) to an overnight rate (ZARONIA).
- System capability needs to be established for managing legacy pre-transition positions in parallel to new reference rate positions.

How can the treasurer best initiate this process?

The time to act is now to ensure that organisations are ready for this transition.

It is of key importance to build awareness and educate all impacted stakeholders across the organisation to pre-empt potential roadblocks in the transition plan early on.

The transition also requires early engagement with banks and/or counterparties to reach agreement on the legal terms for new contracts, but also to ensure the necessary fallback language is in place for legacy contracts.

One of the lessons learned from the global IBOR reforms is that the changes to systems, process and controls are one of the most intensive elements of the transition journey and require a well-coordinated approach to ensure enough time for system improvements and upgrades, testing and validation.

7 The Market Practitioners Group's Derivatives Workstream, 2023. Market conventions for ZARONIA-based derivatives (Working draft), SARB, 19 January 2023

Authors

Cristina Dos Santos
Senior Manager: Financial Services Advisory
Deloitte Africa
cdossantos@deloitte.co.za

Susan Meyer
Senior Manager: Financial Services Advisory
Deloitte Africa
sukruger@deloitte.co.za