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Financial Markets Department

Minutes of the meeting of the Market Practitioners Group on Interest Rate Benchmark Reforms (MPG) held via MS Teams on Tuesday, 4 June 2024 at 13:00

Minutes No. 02/2024

Present:

R Cassim	Chairperson – Deputy Governor of the SARB
P Mjandana	SARB – DG Cassim's Office
J Mol	Association of Corporate Treasurers of Southern Africa (ACTSA)
G Raine	Association for Savings and Investment South Africa (ASISA)
G Haylett	Banking Association of South Africa
R Roux	SARB: Chair – Data Collection and Infrastructure Workstream
Z Parker	SARB: Chair – Communications Workstream
A Du Toit	Chair - Risk-free and Term Reference Rates Workstream
R Klotnick	Chair – Derivatives Workstream
E Hamman	Chair - Governance and Regulatory Issues Workstream
P Burgoyne	Chair – Transition Workstream
M Phungo	Secretariat – SARB Financial Markets Department

In attendance:

B Maronoti	SARB Financial Markets Department
Z Gininda	SARB Financial Markets Department
N Hoosenmia	SARB Financial Markets Department

By invitation:

A Bhowan	Derivatives Workstream member
P Gokaldas	Former chair – Derivatives Workstream
K Makoko	SARB Prudential Authority

Apologies:

M Shongwe	SARB: Chair – Legal Workstream
P Mananga	SARB Prudential Authority
O Makhubela	Financial Sector Conduct Authority (FSCA)

1. **Welcome**

1.1 The Chairperson welcomed members to the second meeting of the Market Practitioners Group on Interest Rate Benchmark Reforms (MPG or Committee) in 2024.

1.2 There being a quorum present, the meeting was duly constituted.

2. **Adoption of the agenda**

2.1 The agenda was adopted as proposed, with no amendment.

3. **Confirmation of the Anti-Competitive Statement**

3.1 The Anti-Competitive Statement was noted and accepted by all members and attendees present.

4. **Approval of Minutes No. 1/2024 of the meeting held on 8 February 2024**

4.1 The minutes of the meeting held on 8 February 2024 were accepted as a true reflection of the deliberations and were approved for signature by the Chairperson.

4.2 The signed minutes would be published on the MPG page on the SARB website.

5. **Matters arising**

5.1 **Updated Jibar transition plan**

5.1.1 Mr Hoosenmia reported that the updated Jibar transition plan document had been published on the MPG webpage as a consultation paper on 6 May 2024. Market participants were given the period until 31 May 2024 to provide their comments. It was stressed that the detailed transition plan was not intended to serve as an announcement of Jibar cessation. The SARB would determine the appropriate cessation date for Jibar publication which would be preceded by official announcement of the event in December 2025.

5.1.2 Mr Burgoyne proposed that the Cash Market Workstream's deliverable on the development of a forward-looking term rate be moved from November 2024 to the second quarter of 2025. This adjustment would align with the strategy to enable the derivatives market to adopt

ZARONIA First, allowing for sufficient time for liquidity build up in the derivative market, which will underpin the term rate.

5.2 **Tax and Accounting Workstream**

5.2.1 Mr Gininda indicated that the SARB had contacted all the Accounting and Tax Workstream members to determine their availability to continue with the work. The workstream had largely been dormant to allow for the completion of certain foundational phase initiative. The workstream needed to be re-activated to consider accounting and tax issues that could hinder a smooth and orderly transition towards ZARONIA and make recommendations on measures to address them. Most members had expressed interest to continue with workstream. There were some members that also indicated their availability to act as the chairperson of the workstream. It was envisaged that the workstream would be reconstituted in the following weeks and that the selected chairperson would be invited to join the next MPG meeting.

5.3 **Benchmark regulation and SAFEX O/N**

5.3.1 Ms Hamman reported that the Financial Sector Conduct Authority (FSCA) had not concluded the finalisation of the draft Benchmark Regulation and Conduct Standard. The FSCA had consulted the public further regarding some of the benchmarks that were widely used in South Africa.

5.3.2 Mr Gininda highlighted that it would be beneficial to understand the outcome of the FSCA's determination on whether SAFEX Overnight Rate would be regarded as critical benchmark in terms of the draft Benchmark Regulation and Conduct Standard and be required to comply with the IOSCO Principles of Financial Benchmarks. This clarity was crucial as it could eliminate the need for the MPG to encourage the market to transition away from SAFEX Overnight Rate. Instead, the MPG would rely on regulation to prohibit its use of the rate and enable the rapid adoption of ZARONIA discounting. In the absence of clarity on this matter, the MPG would draft a position paper in this regard and use its powers of persuasion.

6. Jibar transition: readiness of the market to adopt ZARONIA

6.1 Dear CEO letter and supervisory plan

6.1.1 Mr Govender indicated that, the Prudential Authority (PA) and FSCA had announced that the Jibar transition would be included on their scope of work. It was highlighted that the first item placed on the agenda of the Financial Market Implementation Committee (FMIC) was the drafting of “Dear CEO” letters, which would be discussed at its meeting in June 2024. It was envisaged that the “Dear CEO” letters would be distributed to banks and insurance companies in the third quarter of 2024, following the review process conducted by several governance structured at the PA and FSCA.

6.1.2 Additionally, the PA would take a proactive approach to ensure that supervised financial institutions have well conceptualised the governance transition programs. The PA had established an internal working group that had begun constructing and designing a supervisory examination agenda. It was likely that supervisory examinations would commence in the fourth quarter of 2024. This process would allow the PA to monitor each affected institution’s progress on its transition program.

6.1.3 It was queried whether the supervisory plan would cover all financial institutions. It was indicated that where a particular regulation would be impacted, the PA would seek to understand the consequential impact and determine how to engage institutions that do not fall directly within the scope of the PA’s supervisory examination. Furthermore, joint work between the PA and FSCA would address how to manage such situations.

6.2 **Market infrastructure readiness**

6.2.1 Mr Roux reiterated that the London Clearing House (LCH) had confirmed that it would include ZARONIA OIS clearing capability on its SwapClear platform as part of its main release of upgraded product functionality in July 2024. However, the release would be subject to internal and external approvals and last round of ZARONIA-based test trades.

6.2.2 It was also highlighted that the Data and Collection Infrastructure Workstream (DCI) had engaged clearing brokers through local banks to gauge their readiness, with mixed responses indicating varying levels of readiness. Notably, Deutsche Bank and the Bank of America had confirmed their readiness for clearing. Furthermore, local banks had commenced streaming indicative prices, while international banks were waiting for pricing commitment and trading activity from local banks. The workstream aimed to continue engaging international banks to expedite this process.

6.2.3 Furthermore, on the infrastructure readiness for the cash market, the workstream would adopt a similar approach as the derivative market. Subsequently, a key focus area was reviewing results that would be derived from the impact assessment conducted by the cash market to gauge overall impact of the transition away from Jibar.

6.3 **ZARONIA First initiative for derivatives**

6.3.1 Mr Bhowan presented on the inaugural ZARONIA First initiative, which involved a regulatory push to encourage institutions to prioritise trading of overnight risk-free instruments over Jibar instruments. A comparison of data sourced from LCH pre and post the Secured Overnight Financing Rate (SOFR) First initiative suggested the initiative had driven the increase in SOFR volumes, contrary to the decrease observed in Libor volumes. Consequently, the Derivatives Workstream (DWS) aimed to achieve similar results with its proposed ZARONIA First initiative. The workstream had established a working group to develop recommendations to the MPG and the SARB regarding a ZARONIA First initiative for derivatives.

6.3.2 A critical aspect of this effort involved addressing certain market structure issues, such as the significant offshore volumes that may require regulators to coordinate with their offshore counterparties to encourage the offshore market to trade ZARONIA First. Furthermore, building liquidity in the market and considering key players would be crucial.

6.3.3 Mr Gininda inquired about the level of market activity that would satisfy the MPG that the market had matured enough to successfully execute the ZARONIA Fist initiative. While no specific volume was provided, it was suggested that monitoring activity in both local and offshore market would be necessary to gain confidence for initiating ZARONIA First. Furthermore, it was noted that for SOFR transition, significant volumes were not observed until the SOFR initiative was launched.

6.3.4 There was concern raised about the delay from local banks in making a market given that LCH would be ready for ZARONIA clearing in July. It was indicated that there was no risk appetite to display prices on screens due to fears of being unable to obtain pricing. Furthermore, banks were waiting for LCH to initiate clearing with the hope that liquidity would increase once LCH was operational. LCH’s involvement was expected to remove bottlenecks for domestic banks and provide access to data to measure ZARONIA versus Jibar activity. It was therefore crucial for the MPG and DWS to maintain close communication with LCH during this period and use its influence to encourage participation from international banks.

6.3.5 Furthermore, a key concern was raised about the link between the derivatives and cash market, given the initial phase solely focused on derivative trading between banks. It was questioned whether evolving it into a banking book was considered. It was noted that the DWS had not included the cash market in their plan. However, the initiative for local banks to trade ZARONIA-based derivatives did not rely on the presence of a cash market. A market for ZARONIA derivatives would allow local banks to convert fixed issuance back to ZARONIA. Nonetheless, the workstream would consider the cash market in their planning.

6.4 **Term rate development**

6.4.1 Mr Du Toit reported that the Cash Market Workstream had drafted a final proposed framework for ZARONIA-linked forward looking term rates, which the committee had adopted. The investigation into the viability of term rates would commence when trading begins in the derivative market in November 2024. The framework would be published for consultation, with an observation period expected to end in April 2025. Furthermore, the workstream had reviewed both local and international literature on the subject but required independent assistance to explore calculation methodologies, which would be finalised by end of July. The workstream also noted their intentions to collaborate with the DWS to identify a calculation agent for term rates if adopted.

7. **Jibar-related exposure survey results**

7.1 Mr Hoosenmia provided feedback on the latest Jibar-related quantitative exposure survey. The survey was disseminated to local and foreign banks and insurers through the SARB Prudential Authority (PA), requesting data on all assets, liabilities and derivatives that reference Jibar (as at 30 December 2023). Key results suggested that commercial banks had a gross outstanding exposure of R42.2 trillion, which reflected a marked decrease since the prior survey date (c.R46.8 trillion as at 30 June 2023). As expected, derivatives exposures made up the largest contribution to the total exposure, i.e., c.93% of all exposures (=R39 trillion). Interest rate swaps were highlighted as the predominant derivatives product.

7.2 Furthermore, following concerns raised at the MPG meeting held in December 2023 regarding the growth in total exposures which warranted investigation on whether there was a potential data quality issue. Latest survey results indicated recurrence of high exposures. It was noted that with the commencement of ZARONIA-based derivatives in November 2024, a shift in these derivatives' exposure was expected, likely leading to a decrease in Jibar exposure.

8. **Safe harbour provisions for tough legacy contracts**

8.1 Ms Hamman presented on the regulatory implications of the cessation of Jibar and transition to ZARONIA.

8.2 The FSCA had issued an information request in the form of a questionnaire to the industry in July 2023 to drill further on the issues that were identified in the analysis of the results of the first survey that the Governance Workstream administered. The questionnaire was disseminated to industry participants, requesting inputs on all the legislation that would be impacted by the reference rate reforms and how to deal with tough legacy contracts.

8.3 The questionnaire response suggested several focus areas that required attention, including; the grandfathering protection of existing securitisation; model change assessment related to prudential regulations and internal model standards; and implications for banks capital buffers, market risk and valuation standards. Therefore, solutions to addressing these issues would require adequate consultation with the various impacted parties. The Governance and Regulatory Issues Workstream's (GRIW) would request relevant MPG workstreams to address the issues that are most suited to their expertise.

8.4 Regarding legacy contracts, it was suggested that to mitigate against the risk of loss of contract continuity and potential contract frustrations when Jibar ceases, provisions needed to be made to allow a set time for the legacy contracts to mature, which would minimise the impact of legal fees. Also, fallback options needed to be agreed upon and built into the International Swaps and Derivatives Association (ISDA) definition.

8.5 Furthermore, three safe harbour provisions needed to be included in the legislation to facilitate the transition to synthetic Jibar. These included (1) the provision of synthetic Jibar as a continuation of the current Jibar, which would ensure that the use of synthetic Jibar would prevent arguments that the basis of the contract had changed so materially that the entire agreement was no longer enforceable, (2) legislative protection from liability for those who would use synthetic Jibar, ensuring that parties relying on synthetic Jibar were safeguarded against legal repercussions, and (3) legislative protection from liability for the administrator mandated to publish synthetic Jibar, ensuring that those responsible for its publication were protected from legal liability.

8.6 It was also noted that the Office of General Counsel (OGC) of the FSCA expressed the view that the nature of the amendments required safe harbour requirements to be in primary legislation. Concerns were raised regarding the timelines as the inclusion of safe harbour requirements in primary legislation would be a lengthy process that would impact the transition timelines. However, it was indicated that given that the FSCA was currently working on amending the regulatory framework for benchmarks as a result of the Conduct of Financial Institutions (COFI) bill, addressing safe harbour requirements within these amendments could be beneficial.

9. **Annual MPG conference**

9.1 Mr Parker provided an update on the annual MPG conference which was scheduled to take place at The Maslow Hotel in Sandton on 21 August 2024. The conference would be recorded and posted on YouTube in due course as the format of the conference would only allow for in-person attendance. The conference agenda entailed a keynote address by the Chairperson, followed by panel discussions with selected MPG members. The content that would be discussed at the conference would include, among others, the updated MPG's Jibar transition plan, managing tough legacy contracts, the development of a ZARONIA-based term rate and modernising market infrastructure. Furthermore, it was noted that the South African Institute of Financial Market would be hosting a conference concurrently with the MPG conference. However, this would not impact the planned MPG conference as the date and venue were confirmed.

10. **Updates from MPG workstreams**

10.1 The DWS had conducted ZARONIA-based test trades with commercial banks and buyside firms, which would assist the DWS to assess infrastructure and operational readiness. In addition, the workstream had completed a draft version of the white paper on nonlinear market conventions for ZARONIA-based derivatives.

10.2 The Transition Workstream would collaborate with the CMW and the DWS on the determination of an appropriate credit spread adjustment methodology. It was noted that there would be a need for a public consultation, considering the impact that the Monetary Policy Implementation Framework (MPIF) and the Gold and Foreign Exchange Contingency Reserve Account (GFECRA) would have on the spreads. The workstream had formed a sub-working group, which had a planned kick-off meeting in June 2024. Given the urgency of the matter, the sub-working group would explore ways to expedite the work to shorten the proposed timeline, which was shown to extend into 2025.

10.3 The Cash Market Workstream had engagements with Strate Pty Ltd to discuss system readiness for the bond and money markets. It was envisaged that trading in each of these markets would commence in the first quarter of 2025. On the loan market, the Loan Market Association was planning a more inclusive conference on 24 July 2024. This followed a training session that took place on 29 February 2024, primarily aimed at junior lawyers and bankers active in the syndicated loan market.

11. **Date of the next meeting – 6 August 2024, 09:00 AM**

12. **Closure**

12.1 The Chairperson thanked everyone in attendance for their contributions, and there being no further matters for discussion, the meeting was closed.

Signed by:Rashad Cassim
Signed at:2024-09-11 13:30:06 +02:00
Reason:Witnessing Rashad Cassim

Rashad Cassim 11/09/24

DG R Cassim **Date**

Chairperson:

Market Practitioners Group on the Interest Rate Benchmark Reforms