## From JIBAR to ZARONIA: An overview of the LMA SA Rate Switch Agreement

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> LMA Loan Market Associat

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## Context | Transition from JIBAR to ZARONIA

JIBAR = Johannesburg Interbank Average Rate (existing primary reference rate) ZARONIA = South African Rand Overnight Index Average (new reference rate replacing JIBAR)

#### ZARONIA will replace JIBAR

This is a **significant** change for the South African financial market

The transition is part of a global benchmark reform that will bring South Africa in line with international standards

#### **CORE OBJECTIVES**



Improve integrity & transparency of the market



Reduce potential manipulation risks associated with interbank offered rates like JIBAR



Build greater confidence in financial instruments referencing the new rate

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Image: Practition public and private sector body which manages the process of adoption and transition       SOUTH AFRICAN RESERVE BANK       LOAN MARKET ASSOCIATION         A joint public and private sector body which manages the process of adoption and transition       Formed the MPG and administers ZARONIA.       Involved in risk-free rate transitions globally and currently assisting the SA loan market move from JIBAR	Key Players		
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## Timeline: MPG Transition Approach (Pillars)



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## Key Differences | JIBAR vs ZARONIA

FEATURE		JIBAR		ZARONIA
RATE TYPE		Interbank Offered Rate (IBOR)	%	Overnight Index Average
PERIOD	${\mathfrak O}$	Forward-Looking (Term Rate)	Ċ	Backward-Looking (Overnight Rate)
RISK PROFILE	<b>*</b> 373 4741 4741	Includes credit & term premium		Near Risk-Free Rate (minimal credit / liquidity risk)

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## MPG Loan Conventions for Compounded Rate Loans

01	Lookback without observation shift
02	Non-cumulative compounded rate methodology (NCCR)
03	Margin quoted as simple rate and added after the compounded rate calculation – not compounded itself
04	ZARONIA rounded to 3 decimal places (set out in the definition of daily rate in schedule 12 (Compounded Rate Terms)
05	Accrual day count convention – actual/365
06	Final accrued interest amount recommended to be rounded to 2 decimal places
07	Zero floors







## Where does the LMA SA rate switch fit into this?

Amendment approach (agree to agree)	Amendment approach + fixed negotiation date + agreed key terms	Rate switch mechanism (fully hardwired approach)
SA Replacement of Screen Rate Clause	SA Replacement of Screen Rate Clause plus RFR Terms	Rate Switch Agreement
Not a fallback. Designed to facilitate a future amendment process.	Not a fallback. Designed to facilitate a future amendment process.	Hardwired fallback.



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#### LMA SA Rate Switch Agreement

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# What is the LMA SA Rate Switch Agreement?

A documentary framework to handle the switch from JIBAR to compounded ZARONIA for ZAR loans.

- Published on 9 May 2024 by the LMA
- Reflects recommendations by the MPG formed by the SARB



**Purpose:** Help market participants understand issues in structuring loans with a rate switch.





Main Benefit: Allows for proactive planning rather than reactive amendments.





### Rate Switch Triggers

Clause 8A1 > Compounded Reference Rate will replace JIBAR



Clause 8A2 > Current loans continue on the existing rates until the end of the interest period



- Objectively determinable
- Apply in relation to the Screen Rate for any Quoted Tenor

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• Mechanism for determining the actual date on which the change of the reference rate occurs

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## Calculation of interest: Term Rate Loans vs Compounded Rate Loans

#### **TERM RATE LOANS**

provides that calculation of interest is based on the applicable margin and JIBAR for an interest period

#### COMPOUNDED RATE LOANS

(which is based on the MPG ZARONIA loan conventions) provides that calculation of interest for any day during an interest period is the percentage per annum based on the applicable margin and the compounded reference rate

#### **MPG recommendation**

The relevant rate is compounded rather than the balance- more aligned to the behaviour of the deposits that underpin the rate



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## Compounded Reference Rate

#### COMPOUNDED REFERENCE RATE CONSTITUTES TWO ELEMENTS





#### THE FORMULATION OF THE COMPOUNDED RATE

based on the MPG ZARONIA Loan Conventions recommended by the MPG Cash Market Workstream; and

#### THE CREDIT ADJUSTMENT SPREAD

Specified in Schedule 12 (Compounded Rate Terms)





# Daily Non-Cumulative Compounded RFR Rate (NCCR) and notification of interest



Agent/ finance party that agrees to perform that role determines the percentage rate per annum applicable to any day in the interest period for a Compounded Rate Loan

Daily Rate Determination

Clause 8.5 outlines that the Agent will notify the parties of:

- Amounts of accrued interest that will become payable;
- provide an accompanying breakdown of each individual daily rate of interest applicable to that compounded rate loan used in the calculation of the accrued interest;

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• provide details of any market disruption rate to the extent relevant

Agreed Methodology (Schedule/ Supplement)

The agent will make one single notification per interest period





## Lookback without Observation Shift

In contrast to JIBAR which is fixed in advance for a set period, Compounding in arrears involves aggregating the overnight ZARONIA rates over a period

- Schedule 12 (Compounded Rate Terms)
- Reflects the MPG's recommendation of a **5 business day lookback**
- Impact of "Without Observation Shift"





## Credit Adjustment Spread (CAS)

#### **PURPOSE**

is to address the issue of potential transfer of economic value from one party to another as a result of the switch from JIBAR to ZARONIA

- **separate component** of the interest calculation for compounded rate loans
- no change in margin
- rate/methodology function of commercial agreement (note that the MPG has published a recommendation for fallbacks)
- The LMA SA Rate Switch Agreement allows for credit adjustment spread as either:
  - a methodology or formula which will produce a percentage rate per annum; or
  - a specified percentage rate per annum



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## Compounding Methodology Supplement

The daily non-cumulative compounded RFR rate also refers to the rate calculation methodology set out in a compounded methodology supplement

#### **REASON:**

Market practice for the use of ZARONIA is evolving and this allows parties to amend documentation to allow for subsequent amendments to the calculation methodology

- Supersedes anything relating to the daily non-cumulative compounded rate or the cumulative compounded rate in schedule 13 all 14 and any earlier compounded methodology supplement
- Intended to operate alongside and as an alternative to an amendment process

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#### Break Costs

Break costs for term rate loans designed to protect the commercial interest of lenders on the assumption that lenders have funded a loan by match funding arrangements i.e. borrowing an amount equal to the amount of the loan for a period equal to the interest period

A lender is protected against any potential loss if a loan is prepaid prior to the last day of its interest period but the lender continues to be required to pay interest on such match funding until the end of the interest period The borrower is required to compensate the lender to the extent of the amount of interest that it would have received had the prepayment not taken place minus the amount it would be able to recoup by redepositing the sum



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#### ZARONIA Fallbacks

#### HISTORIC RFR RATE

- The Historic RFR- the most recently available ZARONIA
- Historic ZARONIA applied if there is no ZARONIA prior to the application of a Central Bank Rate plus an appropriate credit adjustment spread

#### CENTRAL BANK RATE

- Consistent with fallbacks adopted for other RFRs in LMA documentation (and comes from the in-built fallbacks to RFRs themselves)
- Historic ZARONIA applied if there is no ZARONIA prior to the application of a Central Bank Rate plus an appropriate credit adjustment spread

#### COST OF FUNDS (OPTIONAL)

- Practical issues with cost of funds fallback
- Some institutions may have policy reasons not to include this option
- In LMA SA Rate Switch Agreement this is only ever an option as an ultimate fallback to ZARONIA after the Central Bank Rate

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## ZARONIA Fallbacks – Central Bank Rate



#### CENTRAL BANK RATE AND CENTRAL BANK RATE ADJUSTMENT

Repurchase rate of the SARB suggested, but parties to consider appropriate rate Key fallback to ZARONIA if historic ZARONIA is not available If the Central Bank Rate for the relevant RFR banking day is not available, a historic Central Bank Rate may be used

Parties should consider whether a spread is required to take into account the potential difference between ZARONIA and the specified Central Bank Rate





#### Changes to reference rate clause

Changes to Reference Rate



- Clause 34.3 (Changes to Reference Rates) but has been expanded to extend to ZARONIA as well as JIBAR
- Optional
- This clause is NOT a fallback it is designed to facilitate amendments
- Note: The compounding methodology supplement is intended to allow for more streamlined changes to the calculation of the daily non-cumulative compounded RFR rate

### ZARONIA: Market Disruption

# Market disruption in Term Rate (i.e. JIBAR) Loans:

Can be triggered by a specified proportion of lenders if the interest rate benchmark understates the cost of funding their participation in a loan.



- Relevance for Compounded Rate Loans given ZARONIA is a RFR?
- Market Disruption Rate is optional and defined for ZARONIA as:
  - cumulative compounded RFR (CCR) for the relevant interest period; plus
  - relevant credit adjustment spread



#### Key Takeaways



The groundwork has been laid – ZARONIA and the conventions for ZARONIA-linked loans have been set.



LMA SA Rate Switch Agreement provides a **framework** for transitioning ZAR loans from JIBAR to compounded ZARONIA.



Leverages existing LMA South African documents and rate switch mechanics and applies them to ZARONIA.



Familiarise yourself with **key conventions**, such as Lookback without Observation Shift and Non-Cumulative Compounding.



**Practical/operational aspects** need careful consideration & potential adaptation.



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Formal cessation date is likely to be announced end-2025 for end-2026. **Time to prepare is getting shorter** 

We are in this together – share your experiences. Education and communication is key.





## Resources

**SARB Website** 

MPG publications: market conventions, practical guides, examples, discussion documents LMA website: LMA SA Rate Switch Agreement and Commentary, RFR elearning, IBOR microsite

Industry associations: coordinating efforts and providing educational sessions

Communication between market participants

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## Audience Q&A

Questions can be submitted via Slido





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