



SOUTH AFRICAN RESERVE BANK

2023 Market Practitioners Group Conference

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MPG Term Reference Rate Workstream

Discussion Points

1. Term Reference Rate Mandate
2. Forward-looking term reference rate (TRR)
3. Extension of TRR WS Mandate to include Cash Market
4. Cash Market White Papers
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Term Reference Rate Mandate

Extract from 'Terms of Reference for the Term Reference Rates Workstream of the Market Practitioners Group' (Section 5)

'In line with the stated functions of the MPG, the TRRWS will be responsible for the following:

5.2.1. Term reference interest rates

5.2.1.1. Recommend the key principles for a forward-looking term-rate ("term rate") based on the new suite of reference rates. This includes (and not limited to):

5.2.1.1.1. Identifying factors in determining whether a term rate is necessary and appropriate for certain instruments and client types,

5.2.1.1.2. Determining the criteria to ensure that the term rate is sufficiently robust to be considered as a reference rate,

5.2.1.1.3. Determine market indicators in underlying derivative markets that support the determination of the term rate.

5.2.1.2. Make final recommendations on the best practice related to the scope of use of the term rates such that it does not impede the market's adoption of the overnight rate.

5.2.1.3. Make final recommendations on the preferred methodology to be carried out by the calculating agent for the term rates.

5.3. Additional work streams or sub-working groups may be established if the need arises.'

Forward-looking term reference rate (TRR)

- A Forward-looking term reference rate (TRR) relies on the derivative market where there is no deep and liquid term deposit market, or the term deposit market doesn't conform to the IOSCO principles.
- **TRRs are subject to limitations as they are viewed as adding risk to the financial system** and hence their introduction in the U.S., U.K. and E.U. markets have been controlled by some mitigating principles.

- **Term SOFR** conditions published by the Alternative Reference Rates Committee (ARRC)

(source: https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/ARRC_Infographic_Term_SOFR.pdf)

- *Supports the use of SOFR Term Rates for business loan activity, where adapting to an overnight rate could be more difficult;*
- *Does not support the use of SOFR Term Rates for derivatives markets, except for end users to hedge cash products using the SOFR Term Rates; and*
- *Continues to recommend using forms of overnight and averages of SOFR where possible.*

- **Term SONIA** conditions published by FICC Markets Standard Board (FMSB)

(source: https://fmsb.com/wp-content/uploads/2021/07/Standard-on-use-of-Term-SONIA-reference-rates_FINAL.pdf)

- *Robust rationale when deciding to use Term SONIA in all markets*
- *Trade and working capital products which require a forward-looking interest rate for discounting*
- *End-user-facing derivatives used to hedge cash products or tough legacy products*
- Robust underlying derivative market activity and a limited scope of use of TRRs over time are important conditions to help **ensure that a recommended TRR does not reintroduce the vulnerabilities** that first prompted the transition away from IBOR-type rates (i.e., lack of transactional volume).

Extension of TRR WS Mandate to include Cash Market

- To overcome the barriers to the cash market from using ZARONIA in for the following target product set:
 - Money Market Securities
 - Capital/Perpetual Securities
 - Corporate loans
 - Intra Company Loans (using benchmarks to do valuations)
 - Securitisations
 - Trade Finance
 - Structured Notes (DMTN) programs
- Understand current market conventions and methodologies to inform target product set conventions in line with market standards.
- Highlight the operational and implementation requirements to adopt an RFR.
- Determine target product set conventions with which to meet client needs post transition
- Obtain clarification on possible regulatory, valuation, tax & accounting treatment for all new products.

Cash Market White Papers

Conventions have been looked at in terms of backward-looking rates for these papers.

- Cross section of market participants are involved
- The White Papers have been split for the Cash Market to cater for listed and unlisted instruments as well as different nuances are different between the three markets
- What to expect
 - Detailed White Paper
 - A Layperson's Guide
 - Excel Workbook Example
- When to expect the White Papers:

Topic	Kick off meeting	Conventions Timeline	Review by TRR Workstream	Consultation Estimate
Market conventions for ZARONIA-based Cash Market Instruments (Bond Market)	15 February 2023	4 months (Completion estimate mid-June 2023)	1 month (Completion estimate mid-July 2023)	1 month (Completion estimate mid-August 2023)
Market conventions for ZARONIA-based Cash Market Instruments (Loan Market)	15 February 2023	4 months (Completion estimate mid-June 2023)	1 month (Completion estimate mid-July 2023)	1 month (Completion estimate mid-August 2023)
Market conventions for ZARONIA-based Cash Market Instruments (Money Market)	25 May 2023	2 months (Completion estimate mid-July 2023)	1 month (Completion estimate mid-August 2023)	1 month (Completion estimate mid-September 2023)

Cash Market Design Principles

Topic	Reasons
Price transmission	<ul style="list-style-type: none">• Reflect relevant interest rate conditions for respective interest periods.• Avoid non-representative samples.• Accurately reflect the time value of money.
Market functioning	<ul style="list-style-type: none">• Align with established market practice where possible, daycount, payment days, ... (local, including nuances, and international).• Ensure that the requirements of major exchanges and associations are observed and accommodated, where possible (e.g., settlement requirements).• Enable comparison in transactions through standardization, particularly margins are like for like.• Aid in the functioning of primary and secondary markets, particularly, known settlements.
Operational	<ul style="list-style-type: none">• Alleviate administrative burdens.• Enable sufficient time for confirmations and payment instructions.• Ensure payment periods do not begin on non-business day.• Accommodate users over different time-zones.
Alignment	<ul style="list-style-type: none">• Avoid unnecessary fragmentation.• Economic benefits should be consistent with deposits/repo/derivative markets.• Align hedges in the derivative markets, to avoid potential basis risk and hedging costs.• Hedge effectiveness could be impacted if not closely coupled.

Cash Market Considerations

- Credit Adjustment Spread – ensure that it is simple and understandable (there have been challenges in other markets)
- Borrowers will delay transition waiting for the possibility of term rates.
- Shorter lookback periods are difficult operationally for many counterparties, specifically in the loan market, to accommodate.
- Feedback from market participants indicates that a simple daily rate is preferable in certain circumstances.
- Cash flow forecasting in the absence of a forward index/curve.
- Managing interest rate risk
 - Hedging
- Operational challenges
 - Systems and settlement processes do not accommodate payments known with certainty *at the end of interest* accrual periods.
- Economic Considerations
 - Financial risk or liquidity/cashflow management issues
 - No appetite for fluctuations in interest rates over a short period
- Legal Considerations
 - Regulations require some amendments to accommodate the rate
 - Large number of agreements that need to be remediated, some being standardized using the LMA templates and others bespoke.
- Accounting Considerations
 - Hedge effectiveness
 - Disclosure

DRAFT Assessment of the strength of demand for TRRs across different products

Use Case	Operational Impact	Legal Impact	Accounting Impact	Economic Impact	Strength of Demand	Tenors
Floating Rate Notes	Low	Medium	Low	Low	Weak	
Money Markets	Medium	Medium	Low	Low	Weak	
Capital/Perpetual Securities	Low	Medium	Low	Low	Weak	
Securitizations	Low	Medium	Low	Low	Weak	
Structured Products	Low	Medium	Low	Low	Weak	
Leases	Low	High	Low	Low	Weak	
Corporate Lending (incl. syndications)	Medium	High	Low	Medium	Medium/High	1 month 3 month 6 month
Development Finance Institutional Lending	Medium	High	Low	Medium	Medium	3 month
Consumer Loans	Low	High	Low	Low	Very Weak	
Secured Financing Transactions	Low	Medium	Low	Low	Very Weak	
SMME Loans	High	High	Low	Medium	Medium	3 month
Receivables Discounting/Trade Finance	High	High	Low	Medium	Medium/High	1 month 3 month 6 month

Questions