National Treasury makes strides on devising new risk-free bank rate

By Khurshid Fazel

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The speed of National Treasury's progress in the very complex issue of establishing a new reference rate to replace the Johannesburg Interbank Average Rate (Jibar) has been commendable.

Source: Pexels

This represents a fundamental shift in the market, which will require an industry-wide adjustment to systems and processes and will have a far-reaching impact on secondary markets.

The global shift away from traditional benchmarks like the London Interbank Offered Rate (Libor) began after the 2007/08 crisis, when there were allegations that Libor had been manipulated by participants for several preceding years. Fines were imposed by the regulators, and financial markets lost confidence in the reliability of Libor.

Although South Africa was less affected by reference rate manipulation, it has also been seeking a more reliable rate. The main problems with Jibar are that it is not representative of the cost of funding for banks, as deposits now constitute the largest source of wholesale funding; Jibar is not transaction-based; there is a mismatch between the underlying universe for Jibar and the total book of financial assets and liabilities that reset against the rate; and Jibar may also be prone to manipulation.

In August 2018, the South African Reserve Bank published the *Consultation paper on selected interest rate benchmarks in South Africa*. The paper made key recommendations, including establishing a Market Practitioners Group (MPG).

Since then, the MPG committee has been analysing options for moving from Jibar, which is the overnight wholesale rate for rand transactions at which banks lend to each other, to a different “risk free or near risk free rate”. While Jibar, Libor and other rates were based on discussions between leading banks on what they expected to charge each other for interbank lending (that is that these were forward-looking rates), the new risk-free rate (RFR) will be based on actual transactions, so it will be backward-looking, and therefore more objective.

The MPG committee has collected five years of data from South Africa’s top four commercial banks and the JSE. It has devised a RFR which it considers to be robust and will meet international standards and has now invited industry stakeholders, including legal firms, to attend its meetings so they can be apprised of progress.

South African Rand Overnight Index Average

The proposed overnight RFR is called Zaronia (South African Rand Overnight Index Average). It will respond to policy rate changes and is expected to be more resilient than Jibar, partly because of the depth and liquidity of the markets that underpin it.

Treasury’s timeline for introducing Zaronia is to publish it this year, start adopting it in 2023, and gradually phase out Jibar from end-2023. The transition will take about three years, which is faster progress than other international RFRs have achieved.

Some of the issues around introducing the new RFR are how existing agreements and very long-dated loans based on Jibar will have to be amended. South African banks have known for several years that Libor and Jibar were going to be phased out and have already begun building new rates into loan agreements.

However, it will be necessary for South Africa’s financial services industry to agree on a standard wording for agreements. Unless there is standardisation, it will be very difficult to syndicate loans, transfer debt or include several lenders in a complex loan agreement.

A good way to approach the problem would be to approach industry bodies in the UK to learn from their experience. This work needs to begin very soon, given the MPG’s commitment to introduce Zaronia next year.

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