South African Reserve Bank

National Payment System Department

Position paper confirming the South African Reserve Bank's support for the Principles for Financial Market Infrastructures published by the Committee on Payment and Settlement Systems and the Technical Committee of the International Organisation of Securities Commissions

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Abbreviations

BIS	Bank for International Settlements
CCP	central counterparty
CPSIPS	Core Principles for Systemically Important Payment Systems
CPSS	Committee on Payment and Settlement Systems
CSD	Central Securities Depository
FMI	financial market infrastructure
FSB	Financial Services Board
IOSCO	International Organisation of Securities Commissions
NPS	National Payment System
NPSD	National Payment System Department
NT	National Treasury
PFMIs	Principles for Financial Market Infrastructures
SSS	Securities Settlement System
TR	trade repository

Glossary

implementation document	“Implementing a Twin Peaks Model of Financial Regulation in South Africa, 2013”
the Bank	South African Reserve Bank

1. Background

1.1 In April 2012 the Committee on Payment and Settlement Systems (CPSS), under the auspices of the Bank for International Settlements (BIS), and the Technical Committee of the International Organisation of Securities Commissions (IOSCO) published the "Principles for Financial Market Infrastructures (PFMIs)" report.[1]

1.2 The PFMIs report is an expansion of the BIS "Core Principles for Systemically Important Payment Systems" (CPSIPS) published in January 2001, which provided ten principles for the safe and efficient design and operation of systemically important payment systems (PSs), and the four responsibilities required of central banks, and which the National Payment System Department (NPSD) of the South African Reserve Bank (the Bank) supported and implemented within the payments environment.

1.3 As defined by the BIS and IOSCO, "financial market infrastructure" (FMI) is "a multilateral system among participating institutions, including the operator of the system, that is used for the purposes of clearing, settling or recording payments, securities, derivatives or other financial transactions".

1.4 The standards set out in the PFMIs report update, harmonise and, where appropriate, strengthen the international risk management and associated standards applicable to systemically important PSs, central securities depositories (CSDs), securities settlement systems (SSSs), central counterparties (CCPs) and trade repositories (TRs). The PFMI report also sets out the responsibilities for FMIs of central banks, market regulators and other authorities involved.

1.5 The South African National Treasury (NT) has initiated a shift to a Twin Peaks model for financial regulation as part of broader financial regulatory

[1] The report is available on both the BIS website (http://www.bis.org/publ/cpss101.htm) and the IOSCO website (http://www.iosco.org/library/pubdocs/pdf/IOSCOPD350.pdf).

reform in South Africa. This approach entails appointing the Bank as prudential regulator and transforming the Financial Services Board (FSB) into a dedicated market conduct regulator.

1.6 In initiating the shift to the Twin Peaks model, the NT, the Bank and FSB jointly, as the Financial Regulatory Reform Steering Committee (FRRSC), issued two policy documents entitled (i) "A Safer Financial Sector to Serve South Africa Better, 2011"[2] and (ii) "Implementing a Twin Peaks Model of Financial Regulation in South Africa, 2013" (implementation document).[3]

1.7 The implementation document stipulates that the Bank's financial stability mandate will include responsibility for overseeing systemic risks that may arise from key FMIs.[4] Furthermore, the Bank will be responsible for the following:[5]

1.7.1 Overseeing the regulation of the CCP and TR, and the systemic risks posed by these infrastructures

1.7.2 Ensuring that exchanges and CCPs adhere to specific regulatory requirements linked to emergency liquidity facilities

1.7.3 Approving rules for systemically important clearing and settlement members.

1.8 The implementation document further outlines the joint responsibility of the Bank and the market conduct regulator for the following:[6]

1.8.1 Licensing FMIs

1.8.2 Licensing and supervising exchanges

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2 www.treasury.gov.za

3 www.treasury.gov.za

4 Financial Regulatory Reform Steering Committee, "Implementing a Twin Peaks Model of Financial Regulation in South Africa" (Pretoria: National Treasury, 2013), p. 36.

5 Ibid, p. 39.

6 Ibid, p. 39.

1.8.3 Establishing rules and awarding licences for clearing houses

1.8.4 Overseeing the relationship between the PS operator, the CCP and their respective members.

1.9 The legal framework that would give effect to the policy commitments for the above-mentioned Twin Peaks model is currently being drafted and will provide the Bank with the basis for implementing the PFMIs.

1.10 The objective of this position paper is to confirm that the Bank supports the PFMIs, is committed to the implementation of the PFMIs once the legal framework for the Twin Peaks model has been completed, and delegates to the NPSD the mandate to implement and oversee the interim arrangements until the Twin Peaks legal framework has been finalised.

2. The Principles for Financial Market Infrastructures

2.1 Principle 1: Legal basis

An FMI should have a well-founded, clearly transparent and enforceable legal basis for each material aspect of its activities in all relevant jurisdictions.

2.2 Principle 2: Governance

An FMI should have governance arrangements that are clear and transparent, promote the safety and efficiency of the FMI, and support the stability of the broader financial system, other relevant public interest considerations and the objectives of stakeholders.

2.3 Principle 3: Framework for the comprehensive management of risks

An FMI should have a sound risk management framework for comprehensively managing legal, credit, liquidity, operational and other risk.

2.4 Principle 4: Credit risk

An FMI should effectively measure, monitor and manage its credit exposure to participants, and the exposure arising from its payment, clearing and settlement processes. An FMI should maintain sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence.

2.5 Principle 5: Collateral

An FMI that requires collateral to manage its or its participants' credit exposure should accept collateral with low credit, liquidity and market risk. An FMI should also set and enforce appropriate haircuts and concentration limits.

2.6 Principle 6: Margin

A CCP should cover its credit exposure to its participants for all products through an effective margin system that is risk-based and reviewed regularly.

2.7 Principle 7: Liquidity risk

An FMI should effectively measure, monitor and manage its liquidity risk. An FMI should maintain sufficient liquid resources in all relevant currencies to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wider range of potential stress scenarios. These scenarios should include, but not be limited to, default of the participant and its affiliates that would generate the largest aggregate liquidity obligation for the FMI in extreme plausible market conditions.

2.8 Principle 8: Settlement finality

An FMI should provide clear and certain final settlement, at a minimum, by the end of the value date. Where necessary or preferable, an FMI should provide final settlement intraday or in real time.

2.9 Principle 9: Money settlements

An FMI should conduct its money settlements in central bank money where practical and available. If central bank money is not used, an FMI should minimise and strictly control the credit and liquidity risk arising from the use of commercial bank money.

2.10 Principle 10: Physical deliveries

An FMI should clearly state its obligations with respect to the delivery of physical instruments or commodities, and should identify, monitor and manage the risks associated with the physical deliveries.

2.11 Principle 11: Central securities depositories

A CSD should have appropriate rules and procedures to help ensure the integrity of securities issues, and minimise and manage the risks associated with the safekeeping and transfer of securities. A CSD should maintain securities in an immobilised or dematerialised form for their transfer by book entry.

2.12 Principle 12: Exchange-of-value settlement systems

If an FMI settles transactions that involve the settlement of two linked obligations (e.g., securities or foreign-exchange transactions) it should eliminate principal risk by conditioning the final settlement of one obligation upon the final settlement of the other.

2.13 Principle 13: Participant default rules and procedures

An FMI should have effective and clearly defined rules and procedures to manage a participant default. These rules and procedures should be designed to ensure that the FMI can take timely action to contain losses and liquidity pressures, and continue to meet its obligations.

2.14 Principle 14: Segregation and portability

A CCP should have rules and procedures that enable the segregation and portability of positions of a participant's customers and collateral provided to the CCP in respect of these positions.

2.15 Principle 15: General business risk

An FMI should identify, monitor and manage its general business risk, and hold sufficient liquid net assets funded by equity to cover potential general losses so that it can continue operations and services as a going concern should these losses materialise. Furthermore, liquid net assets should at all times be sufficient to ensure a recovery or orderly wind-down of critical operations and services.

2.16 Principle 16: Custody and investment risk

An FMI should safeguard its own and its participants' assets, and minimise the risk of loss of, and delay in access to, these assets. An FMI's investment should be in instruments with minimal credit, market and liquidity risk.

2.17 Principle 17: Operational risk

An FMI should identify the plausible sources of operational risk, both internal and external, and mitigate their impact through the use of appropriate systems, policies, procedures and controls. Systems should be designed to ensure a high degree of security and operations reliability, and should have adequate, scalable capacity. Business continuity management should be aimed at timely recovery of operations and fulfilment of the FMIs obligations, including in the event of a wider-scale or major disruption.

2.18 Principle 18: Access and participation requirements

An FMI should have objective, risk-based and publicly disclosed criteria for participation, which permit fair and open access.

2.19 Principle 19: Tiered participation arrangements

An FMI should identify, monitor and manage the material risks to the FMI arising from tiered participation arrangements.

2.20 Principle 20: FMI links

An FMI that establishes a link with one or more FMIs should identify, monitor and manage link-related risks.

2.21 Principle 21: Efficiency and effectiveness

An FMI should be efficient and effective in meeting the requirements of its participants and the market it serves.

2.22 Principle 22: Communication procedures and standards

An FMI should use or, at a minimum, accommodate relevant internationally accepted communication procedures and standards in order to facilitate efficient payment, clearing, settlement and recording.

2.23 Principle 23: Disclosure of rules, key procedures and market data

An FMI should have clear and comprehensive rules and procedures in place, and should provide sufficient information to enable participants to have an accurate understanding of risks, fees and other material costs they incur by participating in the FMI. All relevant rules and key procedures should be disclosed publicly.

2.24 Principle 24: Disclosure of market data by trade repositories.

A TR should provide timely and accurate data to authorities involved and the public in line with their respective needs.

3. Queries and contact details

Any enquiries (e.g., requests for clarification) concerning this paper may be addressed to: npsdirectives@resbank.co.za.