South African Reserve Bank

Financial Markets Department

Record of proceedings of the Financial Markets Liaison Group meeting held at the South African Reserve Bank in Pretoria on 10 May 2017

1. Overview

1.1 The following key issues were discussed at the Financial Markets Liaison Group (FMLG) meeting:

1.1.1 Presentation by National Treasury (NT) on the impact of the credit rating downgrades for South Africa.

1.1.2 The Bank for International Settlements' (BIS) Global Code of Conduct for Foreign Exchange Markets (which was launched on 25 May 2017).

1.1.3 The Financial Markets Review Committee (FMRC).

1.1.4 Progress reports from the subcommittees and working groups of the Financial Markets Liaison Group (FMLG), tabled by respective chairpersons.

2. Summary of discussions

2.1 Impact of credit rating downgrades to sub-investment

2.1.1 A downgrade of South Africa's local currency rating to sub-investment grade could result in the following:

i. Significant portfolio outflow, as approximately 40% of local currency debt is owned by non-residents, some of which track indices from which South Africa would have to be removed as a consequence of the downgrade.

ii. Increases in bond yields which could lead to increased government funding costs, while currency depreciation could lead to an increase in the stock of government debt (when government foreign currency is converted at a weaker rand exchange rate).

iii. A possible downward revision of the gross domestic product (GDP) growth forecast when compared to estimates contained in the 2017 Budget.

iv. Potential inflationary pressure resulting from a sharp and extended depreciation of the domestic currency, possibly requiring policy tightening.

2.1.2 The SARB restated its policy of leaving the exchange rate to be determined by market forces, but confirmed that it will seek to protect the orderly functioning of financial markets and provide liquidity should the need arise in the wake of markets becoming dislocated.

2.1.3 Banks noted that the rating agency, Standard & Poor's Global (S&P Global), had not recalibrated South Africa's national rating scale following its downgrade of South Africa's sovereign rating in April 2017, which could result in investors breaching their mandates. In addition, this could lead to market distortions as investors may reduce their exposures to banks' debt instruments while they renegotiate their mandates. Commercial banks and the Association for Savings and Investment South Africa (ASISA) would jointly approach S&P Global to request an urgent recalibration of the national rating scale.

2.1.4 The local market has discounted the risk of a possible one-notch downgrade to Baa3 by the rating agency Moody's Investors Service (Moody's). A two-notch downgrade to sub-investment grade, although seen as unlikely, might have a severe negative impact on the market.

2.2 **Global foreign exchange code (the Global Code)**

2.2.1 The Global Code sets out principles of good practice in the wholesale foreign exchange market and provides a common set of guiding principles to the market, with the intention to promote a robust, fair, liquid, open and transparent market.

The Global Code has been drafted in a sufficiently flexible manner with guiding principles that could be adapted to the scale of operations of affected institutions.

2.2.2 The SARB had an opportunity to contribute to the development of the Global Code by a way of providing comments, and South Africa was invited to become a member of the Global Foreign Exchange Committee that will assume the role of administrator for the Global Code going forward. The Global Foreign Exchange Committee would comprise one representative from the central bank and one from the private sector from member foreign exchange committees.

2.2.3 Following earlier consultations with its foreign exchange subcommittee, the FMLG endorsed the Global Code and the joint statement to be issued by a number of major foreign exchange jurisdictions (attached as Annexure A hereto).

2.2.4 The FMLG agreed that the structure of the South African foreign exchange committee needs revisiting in light of South Africa becoming a member of the Global Foreign Exchange Committee.

2.3 **Financial Markets Review Committee**

2.3.1 Building on the review of foreign exchange operations of local authorised dealers conducted in 2015, the SARB, Financial Services Board (FSB) and NT established the Financial Markets Review Committee (FMRC) to propose recommendations to reinforce conduct standards in the wholesale financial markets. The review will look at the standards and practices in South Africa’s wholesale financial markets, both regulated and unregulated, in terms of governance, accountability and incentives, and will ultimately develop recommendations for overall conduct standards to enhance the integrity of South Africa’s financial markets. Mr. James Cross was appointed as the Chairperson of the FMRC, and the SARB, FSB and NT will each nominate two senior staff members to participate in the activities of the FMRC on a part-time basis.

2.3.2 The FMRC officially commenced with its duties on 15 May 2017 and the review process, which will include consultations with a wide range of market participants, is envisaged to take up to 18 months to complete.

2.4 Feedback from the Money Market Subcommittee (MMS) and Reference Rate Working Group (RRWG)

2.4.1 The Money Market Subcommittee held meetings on 28 November 2016 and 3 April 2017.

2.4.2 Consultation paper on reference rate reform:

i. At its meeting on 17 October 2016, the FMLG resolved that the SARB would draft a consultation paper on the reform of domestic benchmark and reference rates for publication towards the end of March 2017. During consultations with banks, asset managers and hedge funds it became clear that the project is more complex than what was initially envisaged. It is now envisaged that the consultation paper will be released in early 2018.

2.4.3 New monetary policy implementation framework:

i. Good progress has been made with the review of the SARB's policy implementation framework. Several internal workshops were held. Once the proposals have been endorsed by the SARB's executive, the Financial Markets Department will engage with the relevant external stakeholders prior to any changes being implemented.

ii. The purpose of the review is to improve transparency in the money market, enhance the ability of the SARB to influence market rates (especially short-term rates) and to better monitor the effectiveness of the monetary policy transmission mechanism. The existence of credible reference rates will be a prerequisite for the transition to any new framework.

2.4.4 Committed liquidity facility:

i. The planning cycle for the 2018 committed liquidity facility (CLF) will start in June/July 2017. For this purpose, the CLF Implementation Committee (CLFIC) was established in the SARB. Issues regarding the CLF and the related Guidance Notes should be forwarded to the CLFIC.

2.4.5 End-of-day square-off:

i. The supplementary facility is now being used more regularly by the commercial banks in the end-of-day square-off. Banks nevertheless again raised concerns that when the market is short, some banks with surplus positions do not provide liquidity in the interbank market. It was emphasised that this inefficiency in the interbank market was the main reason why the development of a secured interbank market was urgent. Some banks, once again, proposed that the standing facility deposit rate should be lowered to zero in order to dissuade some commercial banks from leaving excess funds in their South African Multiple Option Settlement (SAMOS) accounts. It was also mentioned, however, that even if the rate was lowered to zero, some funds would be, nonetheless, deposited into the facility due to the structural set-up of some commercial banks.

2.4.6 Strate collateral management proposal:

i. Strate organised a workshop to discuss progress and challenges with the development of the secured interbank market, the shortage of collateral in the money market, and proposals to broaden the range of eligible collateral for the liquidity coverage ratio (LCR). The workshop also deliberated on proposals on how the Strate tri-party collateral management system could possibly be used as a platform to calculate a secured overnight benchmark rate, in particular general collateral (GC) repurchase (repo) rates.

2.4.7 Extension of the pool of eligible collateral for the weekly repo rate:

i. Commercial banks reported that they are working on a proposal for the SARB's consideration to expand the pool of eligible collateral for its refinancing operations. These proposals will be made in the context of the increased demand for high-quality liquid assets (HQLA) by banks to comply with Basel III liquidity ratios.

2.4.8 Money market yield curve:

i. ASISA had again raised the issue that, despite the resolution that the JSE Limited (JSE) would harvest rates longer than 12 months from the commercial banks' negotiable certificate of deposit (NCD) screens to calculate a money market curve with a maturity of three years, it appears that this was still not happening.

ii There seems to be different interpretations between the JSE and commercial banks with regard to how firm longer-term NCD rates posted on the banks' screens are for trading. An annexure to the Johannesburg Interbank Average Rate (Jibar) Code would be drafted to formalise the process of constructing a long-term money market curve.

2.4.9 Enhancing liquidity in the secondary market for Treasury bills:

i. A working group had been established, comprising representatives from the JSE, Strate and the five major commercial banks to formalise proposals for promoting liquidity in the secondary market for Treasury bills (TBs). A more liquid secondary market in TBs will enable the calculation of a risk-free money market curve. The NT will lead the process.

2.4.10 Electronic Trading Platform (ETP) repo facility:

i. The consultation process regarding the ETP settlement assurance model had been completed. The SARB approved the provision of cash to ETP members in the event of settlement failure through a ETP repo facility. The SARB will use the General Collateral repo rate in providing liquidity to the performing ETP member in the event of settlement failure due to a credit event. NT was still awaiting internal approvals.

2.4.11 Master Repurchase Agreements:

i The SARB is in the process of finalising the alignment of the Master Repurchase Agreement for both its refinancing operations and the Corporation for Public Deposit's (CPD) buy/sell-backs with the 2011 version of the Global Master Repurchase Agreement.

2.4.12 Changes to the Jibar code:

i. In formalising the governance process of Jibar, it had been decided that the revised Jibar Code should be referred to the Financial Stability Committee (FSC) of the SARB for approval of changes to the Jibar Code proposed by the Reference Rate Overnight Committee (RROC). The updated Jibar Code will be published on the SARB’s website.

2.4.13 Republication of Jibar:

i The RRWG’s proposal for a Jibar correction mechanism was endorsed by the FMLG. It was approved that the Jibar can be republished within 30 minutes of the initial publication when the magnitude of the error is at least 3 basis points. Once approved by RROC, the Jibar Code will be adjusted to reflect this error correction mechanism pertaining to the republication of Jibar.

2.5 **Feedback from Fixed Income and Derivatives Subcommittee (FI&DS)**

2.5.1 The Fixed Income and Derivatives Subcommittee (FI&DS) met on 29 March 2017.

2.5.2 Finalisation of overnight reference rates in conjunction with the Money Market Subcommittee (MMS):

i. The FI&DS, in conjunction with the MMS, concluded that the South African Futures Exchange (SAFEX) rate was not an appropriate reference rate as commercial banks are not able to achieve a SAFEX return on overnight collateral. However, the process of reference rate reform, which includes the establishment of a risk-free benchmark rate suitable for derivatives that will replace SAFEX, proved challenging and slow.

2.5.3 The impact of a net stable funding requirement (NSFR) on derivative markets and consequent impact on the real economy:

i. As a result of the NSFR, commercial banks need to align the funding profile of derivative instruments with their maturity profile instead of relying on short-dated funding. Given that the yield curve is upward sloping, institutions will incur higher funding costs on derivative instruments which they will pass on to end users such as corporates, state-owned enterprises (SOEs) and asset managers. The FI&DS will estimate the actual increase in the hedging cost and possibly lobby for leniency in the implementation of the NSFR.

2.5.4 Single period swaps:

i The FI&DS is in the process of arranging discussions with the London Clearing House in order to align South Africa's forward rate agreement market to single period swaps. Thereafter, the subcommittee will engage with other market participants in order to determine a way forward.

2.6 **Feedback from the Foreign Exchange (FX) Subcommittee**

2.6.1 The Foreign Exchange (FX) Subcommittee met on 4 April 2017.

2.6.2 Members of the FX Subcommittee highlighted concerns on the current process of risk mitigation for the closing out of currency future positions prior to expiry, which allowed direct contact between authorised dealers. There was concern that direct contact between authorised dealers could be perceived as collusive behaviour in light of the over-the-counter (OTC) FX code of conduct. The JSE agreed to facilitate the closing out of the currency futures position prior to expiry by conducting auctions. The JSE has successfully implemented the auction process for the close out of currency futures positions.

2.7 **Feedback on progress in implementing the ETP project for the South African government bond market**

2.7.1 Draft documents on the ETP for the government bond market have been circulated and finalisation is required on the settlement assurance model, the calculation of margins and the settlement model.

2.7.2 The implementation of the ETP is scheduled for September/October 2017.

2.8 **Additional item**

2.8.1 The possible settlement of US dollar through SAMOS would be investigated.

Enquiries:

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Secretariat of the FMLG

Attendance of the FMLG meeting on 10 May 2017

Members who attended	**Apologies from members**
Daniel Mminele (Chairperson), **SARB** Edwin Makgopa, (Secretariat of the FMLG), **SARB** Taalya Phekun, **SARB** Callie Hugo, **SARB** Zafar Parker, **SARB** Linda Motsumi**, SARB** Edward Leach**, SARB** Garth Klintworth, **Absa Capital** Deon Raju, **Absa Capital** Yeshveer Koobair, **Absa Capital** Andries du Toit, **FirstRand/RMB** Theo Thomas, **FirstRand/RMB** Brett Landman, **IBA** Lourens van Rensburg, **Investec** David Gracey, **Investec** Johan Redelinghuys, **NT** Mampho Modise**, NT** Vukile Davidson, **NT** James Glover, **Nedbank** George Kerby, **Nedbank** David Kinsey, **Standard Bank** Paul Burgoyne, **Standard Bank**	Leon Myburgh, **SARB** Tim Masela, **SARB** Muneer Ismail, **IBA** Clive Sindelman, **Investec** Anthony Julies**, NT** Roy Havemann, **NT** Andrew Hall, **Standard Bank**

Joint Statement on the Publication of the FX Global Code: May 2017

May 25, 2017

The central bank-sponsored Foreign Exchange Committees from major financial centres signed below welcome and support the publication of the Global Code, which provides a single set of global principles of good practice for the wholesale foreign exchange market (the "FX Market"). The Global Code was approved and endorsed at the Global Foreign Exchange Committee meeting held in London on 24 May 2017. This publication represents the culmination of two years of work, facilitated by the Foreign Exchange Working Group (FXWG) and in partnership with a broad and diverse set of market participants, including the Market Participants Group (MPG) and the Foreign Exchange Committees listed below.

These principles, while not rules or regulation, are important to promoting the integrity and effective functioning of the FX Market. As such, the members of the below Foreign Exchange Committees are continuing to evolve their own institutions' FX practices to be consistent with the principles in the Global Code and will also seek to promote these principles across the industry. Further, we look forward to our continued involvement in the development and adoption of such good practices in the FX Market on a global basis, through our participation in the Global Foreign Exchange Committee, which will be responsible for the ongoing maintenance and evolution of the Global Code.

The Committees listed below collaborated in the drafting of the Global Code and this statement.

Australian Foreign Exchange Committee

Brazil Foreign Exchange Committee [Comitê Consultivo do Mercado de Câmbio do Brasil]

Canadian Foreign Exchange Committee

China Foreign Exchange Committee

ECB's Foreign Exchange Contact Group

Hong Kong Treasury Markets Association

London Foreign Exchange Joint Standing Committee

Mexican Foreign Exchange Committee

New York Foreign Exchange Committee

Seoul Foreign Exchange Market Committee

Singapore Foreign Exchange Market Committee

South Africa's Financial Markets Liaison Group's Foreign Exchange Sub-committee

Tokyo Foreign Exchange Market Committee